CHAPTER 6

The Implications of Ongoing Economic Reforms on Indo-EU Trade

6.1 Introduction

In the preceding chapters of our study, we have analysed the trends in India’s exports/imports in absolute figure and pattern of change to/from other regions in general and to/from the EU in particular. Now we are to explain the implications of ongoing reforms on India-EU trade. In this chapter, some of the important topics have been included. Such as; emerging scenario in the post-reform period, consequences and implication for India, India’s importance to the EU and challenge and opportunities for India.

6.2 Emerging Scenario in the Post-Reform Period

Since independence, India followed the policy of planned growth. In this regard, we followed conservative policies. The policies regarding external-sector were made very restrictive. Import of a few items such as capital equipment, machinery components spare parts, industrial raw material was allowed, while, the import of all inessential items was strictly checked. However, the consequences of that scenario originated the economic-reforms. For analysing post-reform era, we take some of important areas to discuss.

Foreign investment

Foreign investment had played a very limited role in India’s external sector prior to 1991. The restrictions on equity participation in Indian industries, the technology requirements and the then existing industrial licensing policy tended to discourage foreign direct investment (FDI) in India. New industrial policy and subsequent policy announcements liberalised the
existing industrial policy. This led to liberalisation of FDI and foreign technology agreements.

**Import Licensing**

India’s foreign trade policy was quite complex till the beginning of 1991s. There were various categories of import licenses and ways of importing. The process of liberalisation was given a push with the announcement of EXIM Policy in 1992. The policy allowed free trade of all items except a negative list of imports and exports. The EXIM policies of 1997-2002, 2000-2001 and 2004-2009 further pruned the list of restricted consumer goods by removing certain items. The number of import licenses has also been reduced.

**Quantitative Restrictions**

Quantitative Restrictions (QRs) were removed on 714 items in EXIM Policy of 2000-2001 and on remaining 715 items in EXIM Policy of 2001-02. Thus except defence goods, environmentally hazardous goods and some other sensitive goods, gates of domestic markets have been opened to all kinds of imported consumer goods. EXIM Policies of 1997-2002, 2002-07 and 2004-09 further pruned the list and now only very few sensitive items are subject to QRs.

**Export Subsidies**

Export subsidies were thought to be important to boost exports during the period 1980-81 to 1990-91. However, they involved considerable transaction costs, delays and corruption. Since 1991, the emphasis of the export incentive system has considerably changed and modified. The Cash Compensatory Scheme was abolished in July 1991. The EXIM Scrip scheme was abolished with the introduction of the dual exchange rate scheme. A new class of value-based duty exempt import license was introduced in which the exporter could
import materials of his choice, rather than pre-defined precise value of certain categories of import, up to the permitted foreign exchange value of the license. A special scheme known as Export Promotion Capital Goods (EPCG) scheme originally introduced in 1990 was liberalised in April 1992 to encourage imports of capital goods. Finally, export income has been exempted from income taxes. EPCG scheme has been further improved by providing additional benefits to the exporters in the EXIM Policy 2004-09.

Foreign Exchange Reserves

The foreign exchange reserves of India consist of foreign currency assets held by the Reserve Bank of India, gold holdings of the RBI and Special Drawing Rights (SDRs). Foreign exchange reserves have been steadily built up from the low level of US $1.1 billion in July 1991 to above US $141.5 billion in 2004-05 and further to US $180 billion in 2006-07.

From FERA to FEMA

Due to acute shortage of foreign exchange in the country, the Government of India had enacted the Foreign Exchange Regulation Act (FERA) in 1973. FERA remained a nightmare for 27 years for the Indian corporate world. It, instead of, facilitating external trade, discouraged it. As a result, Foreign Exchange Management Act (FEMA) was made. FEMA sets out its objective as “facilitating external trade and payment” and “promoting the orderly development and maintenance of foreign exchange market in India.”

Exchange Rate Stabilisation

The rupee was overvalued for most of the period prior to 1991 thus adversely affecting exports. The rupee was devalued twice in July, 1991 amounting to a cumulative devaluation of about 19 per cent.
The RBI used to control the foreign exchange in accordance with the Foreign Exchange Regulation Act, 1973, as amended periodically. With unification of exchange rates in March 1993, transactions on trade account were freed from foreign exchange controls. It was in 1994 that various types of current account transactions were liberalised from exchange control regulations with some indicative limits. Certain capital transactions were also freed from exchange controls. India is moving towards fuller capital account convertibility in a phased manner.

Other Measures

The Foreign Trade Policy 2004-09 has identified certain thrust areas, like agriculture, handlooms and handicrafts, gem and jewellery, leather and footwear etc. Special schemes have been started to promote their growth. For example, ‘Vishesh Krishi Upaj Yojana’ has been started to promote agricultural exports. Similarly, to accelerate growth in exports of services so as to create a unique ‘Served from India’ brand, the earlier Duty Free Export Credit (DFEC) scheme has been revamped and recast into the ‘Served from India’ scheme.

6.3 Consequences and Implications for India

The economic reform process has completed almost two decades and available evidence indicates that the Indian industry has coped extremely well with the new competitive environment after having been sheltered in a protected economy for more than 40 years. From an average industrial growth rate of 8 per cent in the 1980s despite the slowdown in some few years we can see the beginning of the possibility of new sustained growth of over 10 percent. All the areas that were subjected to the fresh winds of the competition have indeed fared well. A great deal of re-engineering has taken place. New technologies have been imported at a rapid pace; quality is being upgraded all
around. The removal of licensing has sped up firms’ reactions, increased competition and has made growth the only protection against competition. The removal of import licensing and lowering of the tariffs have helped exporters compete internationally and facilitated value-added exports. There has been a considerable increase in the investment levels, foreign investment, and reduction in the formalities to be fulfilled after the onset of economic reforms in India.

(i). Companies, no longer, feel shy of restructuring, merging and acquisitions.
(ii). Many industries are now directing their efforts towards the world market.
(iii). An improvement in work culture has been noticed. The workers have become more quality and cost conscious.
(iv). Many entities have graduated from being labour intensive to capital intensive.
(v). Trade unions and workers have not responded in a much hostile manner to the economic reforms.
(vi). There has been much awareness and stress on quality and R&D.
(vii). There has been much awareness and acceptance of the role of scale economies, rapid technological growth and increased productivity.
(viii). Corporate are going in for aggressive brand building in an increasingly competitive market place.

To meet the challenge economic reforms were introduced in industrial, financial, external and fiscal areas. As a result of these reforms, many positive changes have taken place in India such as improved rate of growth, lesser prices, more efficiency and competition. But failure to have fiscal discipline, ad-hocism, slow financial reforms and not fully opening the economy still mar the progress of economic reforms.

6.4 Problems and Prospects

The year 1992 is an event which offers challenges as well as opportunities for India. A unified single market is expected to be an expanding one and not a
shrinking one. So there would be greater opportunities than before. At the same time, an increasingly competitive environment will be generated from within the market and also outside the market, this would mean greater challenges. India will have to bargain effectively for as much access to the EU market as possible. Moreover, India will have to enhance rapidly and clearly its own global competitive capacity.

6.5 Prospects of India’s Exports

The progress of India’s exports to the Union is of vital importance in the overall global context, if the trade deficit to be reduced and the external debt burden are to be contained. The task is challenging indeed as to reduce the trade deficit without reducing imports would imply that India’s exports must grow three times faster than imports. The exports to the EU will have to be increased and diversified.

Above 70 percent of India’s exports to the EU consists of consumer goods, such as cotton textiles and garments, handicraft, carpets, leather and leather products, gems and jewellery, marine products, tea, coffee, cashew, spices and other food items. The market for these items is expected to expand, as there would be higher economic growth and resultant increase in consumption. The impact of higher demand would mean increased and keener competition from rival suppliers from the developed as well as the developing world. India will have to give more importance to quality control, packaging and adherence to delivery schedules and at the same time fix competitive prices for its exportable.

Although, our exports to the EU on average basis registered 24.94 percent during period of study as a whole, where 27.97 percent per annum during pre-WTO period, and only 23.88 percent per annum during post-WTO period. The impact of 1992 has also reflected in the increased demand in the engineering and manufacturing sectors. Some of the requirements to strengthen the exports are:

1. Need to restructure Industry
2. Implement Buy-back Arrangement
3. Production Servicing Facilities in India
4. Development of Export Strategy
5. Need for Exchange of Information
6. Incentive to Exporters
7. Increasing Exports of Textiles and Clothing
8. Unified VAT and Excise Duty
9. Need to Improve Technical Standards
10. Potential for Electronics telecommunication and Information Engineering Exports
11. Expand Engineering Exports
12. Use of Counter Trade to boost Exports

The Indian government’s medium-term export strategy for 2002–07, announced on 30 January 2002, observed that: ‘A compositional change has been witnessed in the export basket of India with the opening up of the economy. During the last 10 years there has been a significant shift in the composition of the export basket. The share of manufactured goods in total export of India has increased from 76 % in 1991–92 to 83 % in 2000–01.’ This process continues. The MTES puts strong emphasis on the need to have a comprehensive strategy towards trade expansion between India and its important trading partners.

Going into the third generation of reforms, India’s future economic prospects appear increasingly bright, particularly given Indian industrial eminence in key sectors, many of them high-tech. India is a world leader in information and communications technology (ICT), in particular in the field of outsourcing. A competitive resource base, efficient market linkages, a well-timed development in respect of global market trends and a highly supportive regulatory/policy environment have contributed to India’s impressive strides in ICT. Software is projected to become India’s largest industrial sector, contributing 28 % of GDP by 2020. By 2008, the sector is expected to grow to US $ 80 billion. This is one area that offers considerable opportunities for EU–India business partnerships.
There is enormous potential for growth in a number of other fields, such as:

- financial services—especially banking and insurance;
- power and energy-supply where economic and population growth creates growth in demand;
- telecommunications—both fixed and cellular lines and Internet usage;
- mechanical engineering, here there is important expansion and improvement of the infrastructure base and major projects in the pipeline;
- biotechnology—India being the world’s largest market for vaccines of all types;
- textiles and clothing—a traditional staple industry that, so long as certain conditions are met (such as modernisation, improved competitiveness and deregulation), could benefit significantly from the end of textile quotas in 2004.

Because the EU is India’s main trading partner, Indian economic growth is inevitably reflected in growth in trade with the EU. This is particularly evident because the EU is the most open market in the world and so the most accessible to Indian products.

A good example of this trend is trade in services between India and the EU, which has increased significantly in recent years—in both directions. In 2001, India exported € 2.5 billion (over INR 124 billion) worth of services to the EU, whilst EU service exports to India amounted to € 2.4 billion (over INR 119 billion). This is an economic area with rich potential for growth and, in particular, for future EU–India bilateral business, which would create tremendous prospects in terms of trade, job creation and economic progress.

Similarly, whilst being the leading foreign investor in India, the EU is also a major destination for Indian investors. About 40% of Indian overseas investment flows into Europe, compared to 20% to the USA. Indian firms now operating in the EU include India’s IT giants—Infosys, Tata Consultancy...
Services, HCL Technologies, Wipro and Birla Soft—but also a range of firms from various sectors like Bharat Forge, Thermax, Tata Tetley, Compact Disk India Ltd, Mastek and Bank of India.

As India’s leading trade and investment partner in both directions, the EU therefore shares the view that India’s reform process is working well and should continue—for instance, through a move to rebalance taxation away from import tariffs—and that, as a result, India has great potential for economic growth in the years ahead. The EU is committed to supporting this trend. This will require support for trade and economic development, partnership to supply the needs of India’s growing market-on which further economic development will depend—and inward investment.

With this in mind, the EU and India are working together to enhance the trading environment in general, to improve trade in specific products and reduce the various market irritants that inhibit trade flows between the two regions—for instance, by improving industrial infrastructure and clarifying policy signals with regard to foreign investment in India. This is reflected both in the range of commercial initiatives between the two partners, such as the 2000 ‘joint initiative to enhance trade and investment’ and the 1994 ‘memorandum of understanding’ on trade in textiles and in economic cooperation ventures and other initiatives such as:

- EU–India civil aviation agreement;
- EU–India maritime transport project;
- EU–India agreement on science and technological cooperation;
- EU–India trade and investment development programme (TIDP, which will get underway early in 2004);
- EU–India partenariat, which will fund cooperation projects in 2005.

These issues are discussed at summit meetings, between Indian ministers and their EU counterparts, in the regular meetings of the joint commission and by the round table. Crucially, it is discussed amongst business on both sides.
The EU-India business summit was launched by the Confederation of Indian Industry (CII) to coincide with the first EU-India political summit in 2000.

Since then a business summit organised by UNICE (Union of Industrial and Employers’ Confederations of Europe), CII (Confederation of Indian Industry), FICCI (Federation of Indian Chambers of Commerce and Industry) and the business organisation of the country holding the EU presidency has preceded every political summit. It brings together business leaders, policy makers, and political leaders. It is a powerful forum for tackling the barriers to greater trade and investment between the EU and India, and for networking.

Previous business summits have closely discussed, within the framework of the joint initiative for enhancing trade and investment, industry recommendations in sectors such as manufacturing & engineering; information & communication technologies; textiles and clothing; power/energy; telecommunications; biotechnology; food processing; financial services and insurance. Individual businesses have met to discuss business opportunities, and there have been sessions on policy developments and investment opportunities.

The fourth EU-India business summit will be held on 28 and 29 November 2003 in New Delhi, India. It is being jointly organised by the CII and FICCI in partnership with the Department of Industrial Policy and Promotion (DIPP), the Government of India, the European Employers’ Federation UNICE, Confindustria of Italy and the European Commission. It promises to continue in the tradition of providing relevant debate, pointing to solutions and raising opportunities.

Other sectors also hold major potential after a decade of growth, India moves into the third generation of reforms with increasingly bright economic prospects India is an ICT world leader: software is projected to be the largest economic sector by 2020.