CHAPTER 2
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COMPARATIVE STUDY OF ECONOMIC REFORMS IN INDIA AND GULF COOPERATION COUNCIL (G.C.C.) COUNTRIES

The preceding chapter was devoted to prepare the framework of the study. It included the introductory background of the study and extensive review of literature on the subject matter based on the review of literature; a research gap was identified to streamline the scope and objectives of the study. The hypotheses was evolved to corroborate with the objectives of the study. In order to examine the problems of the study, an appropriate research methodology has been adopted.

The present chapter deals with the policy studies with regard to foreign trade before and after the introduction of economic reforms in India as well as Gulf cooperation council (G.C.C.) countries. Here our concern will be the Indian economic reforms and G.C.C. economic reforms, because trade reform is a part of economic reform and other reforms is bound to affect the trade policy of the country. One of the most significant developments in the world economy since the 1980s has been structural adjustments and macro-economic reforms introduced by a member of developing countries. India has not been an exception. Trends towards liberalization in the Indian economy were well apparent during 1980s, but took concrete shape in mid 1991 when the economic conditions of the country, especially in the external sector, turned unmanageable. The Indian
government had no option but to resort to full-fledged macro-economic reforms and structural adjustment in order to bring the economy back on rails. Economic reforms initiated in India during mid 1991 were broad-based and comprehensive. They embraced vital sectors of the economy and consequently, the industrial, fiscal, monetary, financial and trade policies underwent sea change. The reforms in different sectors are interlinked, though the way they are related may not always be direct and proximate.

2.1: India before the reforms:

India's development strategy launched in 1950s, soon after independence aimed mainly at strengthening the industrial base of the country especially in basic goods and heavy machine building, and adopted the major substitution model to achieve self reliance. The development experience over the years was a mix of the good, the bad and the indifferent. Given the complexities, it would be idle to pretend that the everything the government did was right and also naïve to suggest that the every thing the government did was wrong. There were both successes and failures. The achievements in the long run were, step up in savings, investment and growth combined with the development of a diversified industrial sector and a sustained expansion in agricultural output, which ensured food security. The shortcomings were the neglect of human resources, agrarian reform and exports, declining productivity of the investment and lack of international competitiveness, which required a reformulation of policies and a restructuring of the economy. The key strategy adopted for growth and progress in India after independence was a heavy reliance on planned
economy with an emphasis on public sector participation in economic
development. Jawaharlal Nehru set up the planning commission as the top
centralized planning body of the country. And then came into being the five
year plans of which the second plan mainly emphasized heavy industrial
growth. But inspite of their plans the economy was marked by slow growth,
low income and existence of a majority of the population below the poverty
line. After forty years the country was faced with a major economic crisis,
mainly because we continued to cling to policies and institutions long after
they had served their purpose.

The policy of import substitution was established to protect infant and
strategic industries. Import substitution has indeed been an important phase
in the industrialization and development process, but impact was gross
misallocation of resources to industry and enterprises, which provided no
inherent advantages and could not survive competition internationally. The
government also gave tremendous support to small industries, by reserving
hundreds of products for them. Small industry also enjoyed subsidies by way
of excise duty concessions, preferential import allocations, cheaper credit
and sales tax concessions. Thus small industries preferred to stay small for
all the benefits their smallness brought, contributing continuously burden on
the already burdened economy.

In order to protect workers from exploitation, wages in the organized
sector became a fixed rather than a variable cost. Wages were completely
unrelated to productivity. And under aggressive union leadership labour
became completely detached from the market fundamentals. Labour
legislation also gave unrestricted freedom to trade union activity, which
ultimately had a corrosive effect. This prevented the emergence of a stable system of industrial relations, which in turn had a negative effect on the growth rate of productivity. Also it induced the managers in industries and agriculture to substitute capital for labour wherever they could, thereby retarding the growth of employment, which is the most effective instrument of poverty alleviation.

If we consider the subsidy provided to the agricultural sector in the fertilizer, power, and irrigation, these subsidies hardly reach the targeted section and results in less than optimum allocation of the scarce resources. Policies especially those pertaining to foreign trade, continued to be rigid. When international trade was expanding rapidly, India preferred to be insulated and followed an inward looking policy of self-sufficiency. As a consequence India was bypassed by the trade boom, which had started in the fifties and lasted till the early seventies. India did not avail the opportunities to use foreign capital when the rates of interest were low. Indian participation in world trade was quite insignificant; it was 2 percent in 1950, which steadily fell to 0.7 percent in 2004.\(^2\)

It was during the latter half of the fifties when the second five year plan was underway with its emphasis on heavy industry largely in the public sector that it began to be realized that India needed to export to be able to finance at least part of maintenance and development imports. The foreign exchange crisis that was looming large by mid 1957 reinforced the importance of export growth as a part of planned development. The pessimistic view about the potential for export earnings gave way to a more positive approach in the third plan (1961-66) with the introduction of export
promotion measures without deflecting from the thrust of imports substitution and industrialization.\textsuperscript{3}

Renewed emphasis on export was laid in the fourth plan (1969-74) which envisaged progressive elimination of dependence on foreign aid while the fifth plan (1974-79) identified certain sectors, such as engineering goods, garments, leather manufacture and marine products for achieving increase in exports.\textsuperscript{4} Which brought some relief but at the end of the fifth plan, second oil shock in 1979 widened the trade deficit further.

As pre-requisite for export promotion, the Cash Compensatory Support (CCS) and the Duly Drawback and Import Entitlement Schemes were introduced in the late 1960s. This was followed by the formulation for the first time of an export policy resolution (1970), which sought sustained, exports growth through productive efficiency and cost effectiveness to qualify for international competitiveness. The appointment of a number of committee relating to import liberalization (headed by Dr. P.C. Alexander 1978) control and subsidies (headed by Late Mr. Vadilal Dagli 1979) and export promotion (headed by Mr. Prakash Tandon 1980). These committees came up with suggestions for rationalization in the structure of subsidies, promotion of export of services and investment in export sector with dynamic comparative advantage.

At the beginning of the eighties, India embarked on the sixth five year plan (1980-85) which coincided with the huge current account deficit due to oil price hike in 1979. There was the greater recognition of the weakness bred by inward looking industrialization of the earlier decades. India had to
seek an IMF extended fund facilities of over five billion dollars in 1981 in the wake of the international oil price increase.

Foreign trade policy issues came to the force in the early eighties and the view gained ground that India must avail the benefit of international division of labour by greater reliance on tariffs than import restriction and liberalization of imports of capital goods and technology. With external environment becoming increasingly important for India’s steady progress, the government decided in mid 1980s to appoint a committee on trade policies headed by Dr. Abid Hussain, the then commerce Secretary and subsequently member of Planning Commission, and a committee headed by Mr. M. Narshimham to examine issues related to a “Possible Shift from fiscal to financial control”.

The Abid Hussain committee report was a path breaking exercise which emphasized that trade can not be separated from the national economy as exports are a means of transforming domestic resources into foreign resources, which are necessary to finance the process of development. It focused export as an engine of growth, though it did not recommend an export growth strategy.

The problem of Indian economy which assumed crisis proportions in 1991 did not develop suddenly. They had accumulated over several years. In fact, the origin of the crisis is directly attributable to the cavalier macro management of the economy during the 1980s which led to large and persistent macro-economic imbalances. The widening gap between the revenue and expenditure of the government resulted in growing fiscal deficits which had to be met by borrowing at home. Further the steadily
growing difference between the income and expenditure of the economy as a whole resulted in large current account deficit in the balance of payment (BOP) which were financed by borrowing from abroad.\(^7\)

However, the Gulf crisis in the later 1990 sharply accentuated macro-economic problems. This along with other developments together eroded international confidence in the Indian Economy and as a result countries credit rating in International capital market declined steeply. However, it has to be recognized that this problem of the economy did not assume crisis proportions abruptly. These problems in fact, were very much for years destroying the capacity of the economy to cope with any internal or external shocks. In the 1970s, the Indian economy was strong enough to bear much larger and more sustained oil shocks. But by 1990s, the situation had changed so much that the minor oil shock made disproportionately large impact on the economy and a macro-economic crisis erupted in the form of unsustainable fiscal and current account deficit accelerating inflation.\(^8\)

The fiscal crisis in 1990 was not an accident or coincidence. The fiscal situation had deteriorated throughout the 1980s due to the growing burden of non-developmental expenditure. The gross fiscal deficit of the central government was 8.2\% of GDP during the late 1980s as compared to 6.3\% during the early 1980s. To fill the gap successive government, indulged in excessive borrowing from internal and external sources leading to mounting internal debt from 35\% of GDP in 1980-81 to 53\% in 1990-91. This made the burden of servicing the debt onerous. Interest payments, which increased, from 2\% of GDP and 10\% of the center’s expenditure in
1980-81 increased to 4% and 19% in 1990-91 respectively, had eaten up 37% of total revenue collection of the centre.\(^9\)

The balance of payment crisis too was neither sudden nor unexpected. The policies followed in 1970’s and 1980’s created incentives for import-intensive industrialization and production while export performance was at best modest. Consequently, the current account deficit doubled from an annual average of $2.3 billion or 1.3% of GDP during the early 1980’s to an annual average of $5.5 billion or 2.2% of GDP during the late 1980’s. These persistent deficits were financed by borrowing from abroad leading to increase in external debt from $23.8 billion or 14.3% of GDP in 1980-81 to $ 62.3 billion or 22.8% in 1990-91. Consequently debt service burden also rose from 7.9% of current account receipts and 14.9% of export earnings in 1980-81 to 21.7% and 29.8% respectively in 1990-91. As a result, foreign exchange revenues dropped to levels, which were not enough to finance essential imports even for a fortnight during the Gulf crisis.\(^{10}\)

Instead of taking corrective measures to manage balance of payment, short-term debt was incurred to finance imports of petroleum and fertilizers while borrowing from international market were used to sustain imports. The rapid pile up of external debts and increased burden of debt servicing eroded international confidence in India’s capacity for repayment. Thus the overall picture of Indian economy was not very comfortable during the pre-reform period and especially at the time of launching of the reforms. However, a massive structural reform was taken up to bring Indian economy back on the rail. In the preceding section a discussion about the reforms which were started in mid 1991 is taken up.
2.2: Economic Reforms in India:

The challenge of consolidation is based on the premise that liberalisation, stabilization and privatization and poverty relief are intrinsic to transition. Well known formulas from reform are reiterated: market supporting institutions, a skilled and adoptable labour, integration into the global economy, good institutions, including good laws and effective information mechanism and strong financial institutions. The obsessions with small government which can support and complement “rather than stifle” private enterprises are seen as essential. Undoubtedly there is universal agreement that it is essential to build a strong human capital base by reforming education and health systems. Finally openness to trade and foreign investment is seen as major force behind strong economic performance across countries. Therefore there is need to take into account the historical context of declining terms of trade which faces many developing countries. In spite of this, deeper integration into the institution of the global economy is recommended. Such thrust can not be envisaged without fundamental reform.11

During 1980’s India had a fairly good economic performance. But towards the last years of the decade, and further in 1990-91, Indian economy entered an unprecedented liquidity crisis. As a result, India found it difficult to raise funds in the international markets. India was on the verge of default
on external payment liabilities. Under these circumstances, it was felt that there was no alternative but to undertake drastic economic reforms.\textsuperscript{12}

In the midst of the grave balance of payments (BOP) crisis of 1990-91, the decision was taken in 1991 by the government of Narsimha Rao to give up the old economic policies decided to initiate far-reaching reforms that would transform India from a controlled closed economy into a fairly open economy in which not only would the private sector have much enhanced role, but the market would be given the prime role in the allocation of resources. Further, there would be a gradual opening up of the economy so that the economy would become linked to the world economy.\textsuperscript{13}

**Fiscal reforms in India:**

The aim of fiscal reforms was to correct the fiscal imbalance like inflation, balance of payment (BOP) disequilibrium fiscal deficit in the 1990’s arising due to the Gulf war and subsequent rise in oil-prices. The major themes of the fiscal policy reforms were.

i) A systematic effort to simplify tax structure and tax laws.

ii) A deliberate move to a regime of reasonable direct tax rate and better administration and enforcement.

iii) Creation of stable and predictable tax policy environment.

iv) Reliance on non-discretionary fiscal and financial instrument in managing the economy.

v) Efforts to strengthen methods of controlling expenditure.

For achieving these targets the government aimed at collection of higher tax and non-tax revenues and to control public expenditure. However,
a committee under Raja J. Chelliah was appointed in 1991 to look into the taxation reforms. Acting on his recommendation, the Government of India in her reform drive restructured the personal income tax. Now there are lower rates, fewer slabs, a higher exemption limit and reduced number of concessions and exemptions. The high rates of customs duties have been reduced over the past years. The 2000-01 budget proposed to reduce the peak rate of protective customs duty from 40 per cent to 35 percent. The number of duty rates have also been brought down to four i.e. 35 percent, 25 percent, 15 percent and 5 percent. The excise tax system has also made a switch from numerous and varying duties with large exemptions to one based on advalorem, and fewer rates and exemptions. The number of duty rates has also been brought down to three, a central rate of 16 percent, a merit rate of 8 percent and a demerit rate of 24 percent.¹⁴

Tax reforms were reinforced by modification to tax proposals announced in January 2004 covering reduction in customs duties and excise duties on computer and aviation fuel. Modifications in direct taxes included phasing out of filing of income tax returns for employees drawing salary income upto Rs.1.5 lakh, exemption of pensioners from the preview of the one-by-six schemes and expanding computerization for tax administration.¹⁵

The union budget 2004-05 sought to expand tax reforms to encompass taxation of services and to facilitate the introduction of Value Added Tax (VAT). Two new taxes were proposed to be introduced, a transaction tax in equities and a tonnage tax for shipping companies. The service tax rate was proposed to be raised from 8% to 10% along with the addition of 13 new services under the tax net and removal of certain exemptions.¹⁶
Also Government is in process of eliminating subsidies on oil, fertilizers, LPG and Kerosene etc. To reduce the public expenditure, downsizing in various department and introducing compensatory pension schemes to bring down the non-plan expenditure.

**Financial Sector Reforms in India:**

The Indian financial system is in the process of rapid transformation. Since 1991, there has been substantial transformation and liberalization of the whole financial system. A crucial element of the financial sector reforms has been rationalization of the interest rate structure and permitting banks to freely fix rates for domestic deposits with a maturity of over two years. For deposits up to two years, there is a prescription of a single maximum deposit rate. Therefore considerable flexibility has been given to the Indian banks to determine the cost at which they wish to raise money and lend it out or make investment commitments keeping in view their objectives of viability and profitability. Instead of privatization, increase in capitalization has been done through diversification of ownership to private investors up to a limit of 49 percent, thereby keeping majority ownership and control with government. In order to infuse a greater element of competition the phased introduction of new private sector banks and expansion in the number of foreign bank branches are being permitted. Measures aimed at establishing regulation and supervision of non-banking financial companies (NBFcs), especially those involved in public deposit taking activities, have been brought under the regulation of RBI. Development financial institutions (DFIs), specialized term-lending institutions, NBFCs, urban cooperative bank and primary dealers have all been brought under the supervision of the
board for financial supervision. Another positive development in the financial sector is the opening up of the insurance sector to private investment. Reforms were not limited to the banking sector alone. They extended it to the capital market as well. The companies issuing securities were free to fix price and premium. The reforms went on to permit companies to approach international capital market through the issue of Euro-equities under the global depository receipt (GDR) mechanism. Also reforms have been carried out in the government securities debt market. Automatic monetisation of the government’s deficit have been phased out and the market borrowings of the central government are presently undertaken through a system of auctions at market determined rates. Foreign institutional investors (FIIs) were allowed to invest in government securities subject to certain limits and introduction of trading of government securities on stock exchanges for promoting retailing in such securities, permitting non-banks to participate in repo-market.17

**Foreign Exchange Reforms in India:**

The wave of liberalization and reforms has brought various changes in the foreign exchange regime. These changes were brought to support the liberalized trade policy and foreign direct investment. India follows a market determined floating exchange rate, calculated on the basis of the basket of currencies. The exchange rate reform has been facilitated by the adoption of convertibility of rupee for current account transaction with acceptance of Article of agreement of the International monetary fund (IMF). And defecto full capital account convertibility for non-residents. Further calibrated
liberalization of transactions undertaken for capital account purposes in the case of residents. The foreign exchange regulation act (FERA) 1973 has been replaced by the market friendly foreign exchange management act (FEMA) 1999. There has been increase in instruments in the foreign exchange market by the liberalization, such as, development of rupee-foreign currency swap market. Authorized dealers have been permitted to use innovative products like cross-currency options, interest rate, currency swaps and forward rate agreements (FRAs) in the international forex market. Authorized dealers have also been permitted to initiate trading positions, borrow and invest in overseas market subject to certain specifications and ratifications by respective bank’s boards. Banks have also been permitted to fix interest rates on non-resident deposits, subject to certain specifications, use derivative products for asset-liability management and fix over night open position limits and gap limits in the foreign exchange market, subject to ratification by RBI. Further permission to various participants in the foreign exchange market, including exporters, Indians investing abroad, financial institutional investors (FIIs) to avail forward cover and enter into swap transactions without any limit subject to genuine understanding exposure was granted also. FIIs and NRIs were permitted to trade in exchange-traded derivative contracts subject to certain conditions and foreign exchange earners permitted to maintain foreign currency accounts. Residents have been permitted to open such accounts within a general limit of US$ 25,000 per annum.
**Privatization in Indian Economy:**

The need of active private sector participation in Indian economy was being realized since the mid 1980s. Because the functioning of the various public sector undertakings (PSUs) incurred heavy losses and not performing the real role, which was expected from them. The thrust of the economic reforms initiated by the government of India on 3\textsuperscript{rd} July 1991 aimed at activating the forces of competition and efficiency. These reforms bring a dimensional change in the relative roles of the public and private sector. Now the private sector has been assigned a larger role in accelerating industrial development. Greater opportunities have been assigned to the private sector for infrastructure development of sophisticated industries like, Power, telecommunications, petrochemicals, and transport.

In the process of privatization, in 1991 only eighteen specified industries related to security and strategic areas hazardous chemical, items of elitist consumption, environmental concerns needed license. At present there are only six industries under compulsory industrial licensing. The assets limits of monopolies and restrictive trade practices (MRTP) has been removed. The MRTP act is now used for controlling and regulating monopolistic, restrictive, and unfair trade practices. With a view to raise resources and ensure wider participation of private sector, disinvestments in PSUs in favour of mutual funds, financial institutions, workers and general public. The list of industries reserved for public sector was 17. It has been brought down to 4. At present only four industries of strategic importance is reserved for the public sector. Apart from the central government, many state governments have initiated significant procedural and policy reforms to
encourage domestic private participation in the development of their respective states. These include development of industrial estates, removing artificial barriers within states, decentralization of decision making, time bound clearance of projects, investment subsidies, exemption of sales tax and power tariff concessions etc. All these exercises at the government level are related to the changing economic scenario, where privatization would certainly create an environment conducive for the induction of the latest technology and would unleash both entrepreneurship and innovation, which is expected to have a multiplier effect upon other industries.

**Change in Foreign Investment Regime in India:**

Whenever one talks about economic reform in India’s external sector discussion on foreign direct investment (FDI) is bound to crop up. FDI is now widely perceived as an important resource for expediting the industrial development of developing countries in view of the fact that it flows as a bundle of capital, technology, skills and sometimes even market access. Most of the developing countries therefore offer a welcoming attitude to multinational enterprises (MNEs) that are usually associated with FDI. After following somewhat restrictive policy towards FDI, India has liberalized her FDI policy regime considerably since 1991. The liberalization has been accompanied by changes in the sectoral composition, sources and entry modes of FDI. The new industrial policy (NIP) announced on 24 July 1991, marked a major departure with respect to FDI policy with the abolition of industrial licensing system except where it is required for strategic or environmental ground. It also created a system of automatic clearance of
FDI proposals. The new FDI policy has allowed an increase in the stake of foreign investors in Indian companies. By the amendment in Foreign Exchange Regulation Act (FERA) 1973, the new policy removed the 40 percent ceiling for foreign equity participation that was in pre-reform period and it raised to 51 percent in normal cases and even up to 100 percent in special cases. The new sectors have been thrown open for foreign equity participation such as mining, banking, insurance, telecommunication, construction and management of ports, harbours, roads and highways, air lines and defence equipment, to foreign owned companies subject to sectoral caps. Foreign ownership upto 100 percent is permitted in most manufacturing sectors, in some sectors even on automatic basis, except for defence equipment where it is limited to 26 percent. And for items reserved for production by small-scale industries where it is limited to 24 percent. The dividend balancing and the related export obligation conditions on foreign investors, which applied to 22 consumer goods industries, withdrawn in the year 2000.22 The FDI in the retail sectors is being permitted recently. India has been identified as the second most attractive retail destination globally among 30 emergent markets. With the contribution of 14 percent to the GDP and employing 7 percent of the total work force in the country, the retail industry is definitely one of the pillars of the Indian economy. In this industry permission of FDI will further improve the efficiency.23

**External Sector Reforms in India:**

Prior to mid 1991, foreign trade of India suffered from strict bureaucratic and discretionary controls. The period after 1991 has been
marked by a substantial liberalisation of the trade policy while some liberalisation measures were taken to make export competitive in the international market and some were undertaken in the pressure of the international agencies. Moreover with India joining the world trade organization (WTO) in 1995 as a founder member, it is under an obligation to strike down all quantitative restrictions on imports and reduce import tariffs in a phased manner so as to open up the economy to world trade.

Trade policy reforms in the recent past, with their focus on liberalisation, openness, transparency and globalization, have provided an export friendly environment with simplified procedures for trade facilitation. The main features of the new trade policy evolved over the year since 1991 are as follows.

**Improvements in Advance Licensing:**

A new value-added based advance licensing system has been introduced in which duty free imports of raw material and components are permitted upto a certain percentage of declared export value. Physical quantities and standards have not been determined for individual inputs. Self certified advance licensing facilities has been provided to export houses, commercial houses and superstar trading houses. The export time ceiling under this advance licensing scheme in Exim policy 1997-2002 was extended from 12 months to 18 months. Similarly the validity duration for advance licensing was also extended from 12 months to 18 months. And it still continues.
Rationalisation of Tariff Structure:

The custom tariff rate is regularly on the decline since 1991. The peak rate was brought down to 150 percent from 300 percent in July 1991. It was further reduced to 110 percent in 1992-93, 85% in 1993-94, 65% in 1994-95, 50% in 1995-96 budget and 40% in 1998-99 with a subject to 5% surcharge. But the budget proposals for 1999-2000 discontinued the surcharge; further the 2000-01 budget reduced the peak rate of basic custom duty rates to 35%, 25%, 15% and 5%. However a surcharge of 10% has been levied due to revenue consideration. Now in the 2005-06 budget custom duty structure has been brought closer to that of East Asian neighbouring countries. Peak rate for non-agricultural product reduced from 20% to 15%.

Removal of Quantitative Restrictions:

Quantitative restrictions (QRs) on imports maintained on Balance of payment (BOP) ground and to safeguard the domestic industries were notified to world trade organization (WTO) in 1997 for 2,714 tariff lines at the eight digit level. But according to the guideline of WTO these QRs have to be reduced in a phased manners. In the exim policy on March 31, 2000, the government removed QRs on imports of 714 products from 1st April 2000, and further removed the restrictions of the remaining 715 products from April 1, 2001.

Decanalization:

A large number of exports and imports used to be canalized through the public sector agencies in India. The supplementary trade policy
announced on August 13, 1991 review these canalized items and decanalised 16 export and 20 import items. The 1992-97 Exim policy decanalised a number of items including news print, non-ferrous metals, natural rubber, intermediate goods and raw materials.

**Special Import Licensing:**

It is an incentive given to exporters to import goods which are otherwise restricted, subject to a payment of normal customs duties. The central government in accordance with the commitment made to WTO, announced relaxations in imports of a number of goods and Special Import Licensing (SIL) has been abolished on 31 March 2001, and goods from SIL list were shifted to Open General Licence (OGL), from April 1, 2001.

**Export houses, trading houses and star trading houses:**

To increase the marketable efficiency of exporters, the government introduced the concept of export houses, trading houses and star trading houses. These units are provided some special facilities and benefits by the government under the 1992-97 trade policy, export houses were provided the benefits of self certification under the advance licence system which permits duty free imports for exports. On March 31, 2002, 1832 export houses, 372 trade houses and 60 super star trading houses and star trading houses working in the country.
EOU/EPZ/EHTP/STP:

The units undertaking export of their products may be set up at Export Processing Zone (EPZ), Electronic Hardware Technology Park (EHTP), Software Technology Park (STP) and Export Oriented Units (EOUs). EPZs are special enclaves separated from the Domestic Tariff Area (DTA) by fiscal barriers and are intended to provide an internationally competitive duty free environment for export promotion at low cost. The government has liberalised the scheme for export oriented units and export processing zones. Agriculture, horticulture, poultry, fisheries and dairying have been included in EOUs. EPZ have also been allowed to export through trading and star trading houses and can have equipment on lease. These units have been allowed cent percent participation in foreign equities.

Setting up of Special Economic Zones:

In the export and import policy on 31 March, 2000, government announced a new scheme for setting up special economic zone (SEZ) in the country to promote exports. The policy provided for setting up of SEZs in the public, private, joint sector or by state government. It was also announced that some of the existing EPZs would be converted into SEZs. The government has offered more concessions for SEZ to bolster exports and foreign exchange inflows. All services rendered to a developer on a unit within SEZ would be exempted from service tax. This means that a service provider of any of the 51 odd taxable services including telephone brokerage and insurance will not be levied service tax within the zone.
Export Promotion Industrial Park (EPIP):

A centrally sponsored export promotion industrial park (EPIP) scheme has been introduced in August 1994 with a view to involving the state governments in the creation of infrastructural facilities for export-oriented production. It provides for 75 percent of the cost but with a limit of Rs.10 crore grant to state government towards creation of such facilities.

Liberalisation of Export Promotion Capital Goods (EPCG) Scheme:

It is an export promotion scheme under which exporters are permitted to import capital goods on concessional import duty. Under EXIM policy 1997-2002, exporters of goods and services can import capital goods by paying only 10% import duty. It further liberalised in 2002-07 Exim Policy that EPCG licences of Rs. 100 Crore or more to have 12 year export obligation (EO) period with 5 years moratorium period, EO fulfillment period extended from 8 years to 12 years in respect of unit in agri-export zones and in respect of companies under the revival plan of BIFR. And exim policy 2002-03 extended the EPCG scheme uniformaly to all sectors and to all capital goods without any threshold limit of payment of 5% of duty. It has also been extended to identified service sectors. No additional custom duty is required to be paid. In all cases, export obligation fulfillment period is being extended to 8 years.

Duty Entitlement Pass Book (DEPB) Scheme:

The object of DEPB is to neutralize the incidence of basic custom duty on the import content of export products. This neutralization is
provided by way of grant of duty credit against the export products at rates announced by the directorate general of foreign trade from time to time. As part of Indian commitment to phase out export incentive scheme government in his 2002-03 Exim Policy abolished DEPB Scheme. And by April 1, 2002 the DEPB Scheme subsumed into one drawback scheme. This Exim policy has also removed the threshold limit of Rs.20 crore for fixing new DEPB rates. This is expected to make the scheme more accessible to the exporters.

**Agricultural Export Zones (AEZ):**

The Exim Policy 2001 introduced the concept of Agricultural Export Zones to give primacy to promotion of agricultural exports. It would help in Internationalisation of our agriculture, and help in shifting the terms of trade in favour of agriculture. Till March 31, 2004, the Union government had sanctioned and notified 48 AEZ, which were being setup in 19, various states.

**2.3: India’s Foreign Trade Policy (2004-09):**

On August 31, 2004 a new foreign trade policy for the period 2004-09, replaced the prevalent Exim Policy by the name of Foreign Trade Policy (FTP). The new trade policy highlights the view, “Trade is not an end in itself, but a means to economic growth.” Exports are not only for foreign exchange generation but are an engine of growth that can create international economic activity in the country. For establishing this view point into reality, new foreign trade policy has set a broader objective of doubling
India’s share from 0.7% in 2003 to 1.5% in 2009 in global merchandise trade.24

The salient features of new trade policy are:

- An express thrust of policy is on the exports of farm produce while exporters of specified farm goods would benefit from a new duty free credit entitlement upto 5% of the FOB value of exports, for all other agriculture products exporters would be allowed to import capital goods free of duty under EPCG scheme.

- Policy comprises ‘special focus initiatives’ for employment intensive sectors like gems and Jewellery, handlooms, handicrafts, leather and footwear.

- The threshold for becoming a status holding exporter has been brought down from Rs.45 crore to Rs. 15 crore and export clusters of Rs.250 crore (As against Rs.1000 crore at present) have been qualified as ‘Town of export Excellence’.

- By liberalisation of import of capital goods and the additional flexibilities for the fulfillment of export obligation under EPCG scheme, small and medium exporters would be benefited.

- Three new export promotion schemes target plus gives incentives based on incremental export growth, ‘vishesh krishi upaj yojana’ to boost export of agricultural product and ‘Served for India’ to boost export of services started.

- This policy focuses on procedural simplification and in the long run it would reduce transaction cost for the exporters.
• The new policy aims to create warehousing infrastructure for both exports and imports in India and wants to increase competition with the Free Trade Zones (FTZs) set up by UAE.

• For giving a boost to foreign trade, policy proposes to set up Free Trade and Ware housing Zone (FTWZs) on the line of SEZs. These zones would be established in the areas proximate to sea-ports, airports or dry ports so as to offer easy access by rail and road.

• Policy makers room for setting up of bio-technology Parks across the country. The policy announcement on service tax exemption for all goods and services exported including those from the domestic tariff area (DTA) will be available on 161 tradeable services.

• Policy offers duty free import of labour intensive services such services are to be associated with labour intensive industries like gems and jewelry, handloom and handicraft, leather and footwear.

2.4: Future Prospects:

In the fifteenth years of economic reform, India is comfortably sitting on a mountain of foreign exchange reserves and a huge buffer stock of food grains. Macro economic management as revealed by low inflation rate, better money supply management, confidence in the external sector, stable rupee and so on, indicate that the report card of reform era is reasonably satisfactory. While admitting that the country has gained significantly from policy reforms, but this reform have still a long way to go. The reform process which was started in mid 1991 brings drastic changes in the Indian
economy, whether it is fiscal reforms, financial reforms, and external sector reforms.

After all these reforms India still lags behind most of the Asian nations in the competition of globalisation. Still there are various kinds of problems prevailing in the country, which have resulted in poor FDI inflow in the country, and it leads to infrastructural bottleneck, which further effects, the production capacity.

Therefore for attracting FDI, India need to have further reforms in the foreign investment regime and foreign exchange. From the point of view of external sector, India’s trade is only 0.7% of world total trade although this was one percent at the time of independence. The new foreign trade policy 2004-09 have set the target to double the share in world trade from 0.7% to 1.5% upto 2009. The G.C.C. countries represent an important target market for India in this context. The next section discusses reforms in G.C.C. countries.

2.5: Economic Reforms in Gulf Cooperation Council (G.C.C.) Countries:

Prior to the discovery of oil, the economic activities Gulf Cooperation Council (G.C.C.) countries were limited to the agricultural activities like production of dates, vegetable and fruits, fishing and exploitation of sea for pearls and other precious commodities. Sea-faring and boat building were also important economic activities, whereas the pearl diving was the main industry in Kuwait and some other G.C.C. countries. After the discovery of oil in 1930s the whole economic structure was changed but this change
gathered momentum in the oil boom period of 1970s. Which brought huge financial revenues. The G.C.C. countries with the exception of Bahrain, share one dominant common characteristics namely, oil. These economies are largely based on the extraction and export of a single commodity described as monoculture economies. This factor, the economic dependence of the G.C.C. countries on a single and depletable nature of oil resources means that each barrel of oil-extracted reduces the number of barrels to be produced in the future by an equivalent amount.

The countries whose economies are based on depletable resource must adopt policies in the long run, that will enable them to maintain their standards of living after the resources are exhausted. It requires that policies enhance the business climate should be embraced and distorting economic policies should be eliminated, and the process of diversification of the economic activity should be fastened. The post 1973 period has been characterized by the important issues pertaining to the long run future of the G.C.C. economies. Implying that non-oil sectors should be developed so that a permanent flow of income could be generated in the event of gradual depletion of oil resources and consequent decline in oil revenues.

The process of industrialization and diversification has greatly accelerated the economic activity throughout the G.C.C. economies as both individual entrepreneurs and government policy makers assumed that industry was key to a better life. In fact this drive symbolized a break with the past, a break with traditional, slow moving economies, with primitive technology and with the role of supplier of primary commodities and buyer of manufactured goods. In G.C.C. countries the industrialization is assigned
to create greater balance in the growth and structure of the G.C.C. economies by making them less dependent on the dominant hydrocarbon sector.\textsuperscript{26} Remarkable changes have been taking place in economic policies in the G.C.C. countries also. These changes reflect a switch to strategy that, instead of trying to protect economies from the rest of the world, seeks to take advantage of opportunities offered by participating in the global economy. And they are putting in place more realistic, forward looking economic policies. G.C.C. countries’ public sector have acted as the dominant players in their economies, investing directly in industrial capacity, financial institutions, and utilities. Today, the public sector still dominates the region’s economies, providing by far most of the infrastructure and utilities, and substantial percentages of industrial output. The fiscal constraints of the past few years, however along with the increasing globalization of trade and investment flows, have caused a profound shift towards greater reliance on private instruments. This shift will eventually lead the government to change their role from that of “player”, towards that of “referee” in competitive private markets. The shift from player to referee signals a change in the instruments of public policy from direct investment in goods and services towards regulation of the actions of private investors.\textsuperscript{27}

The pace of diversification since the 1980s has been very rapid within the Gulf Cooperation Council (G.C.C.) countries. In 1980, crude oil constituted 60 percent of GDP, its contribution fell to 30.5 percent in 1998.\textsuperscript{28} UAE is probably the most dynamic as well as diversified economy among the G.C.C. economies. Despite having the third biggest oil revenues, it has
managed to avoid the heavy dependence on a single commodity that is oil. Its diversification and economic liberalization is definitely her biggest strength. Not only UAE has been liberalizing her economy but also all G.C.C. countries has been under the wave of economic liberalization. It would be in the correct perspective of this study to discuss in short the liberalization and reforms undergoing in G.C.C. countries.

Fiscal Reforms in G.C.C. Countries:

In the 1970s oil revenues had far exceeded budgetary expenditures in the G.C.C. economies and substantial surpluses were accumulated over the years. However in the 1980s with the decline in the region’s oil revenues, the G.C.C. countries started operating under deficit budget. These economies witnessed a transition from surpluses in the balance of payment and government budget into corresponding deficits. An examination of revenue and expenditures for each of the G.C.C. economies, reveals that all the countries have experienced budgetary deficits at some point since 1983. The G.C.C. economies recorded an aggregate current account deficit of around $5.14 billion in 1984 and a deficit of $4.30 billion in 1985, a sharp decline from surpluses of more than $66.54 billion in 1981 and $13.29 billion in 1982.29

The main reasons for these deficits were high expenditure in the public services system, numerous direct and indirect subsidies and incentives provided by the G.C.C. economies to the consumers and heavy defence expenditures. Therefore G.C.C. economies were looking at ways to cut down on their unplanned expenditure and therefore budgetary deficit. In
this regard the main theme of the 1985-86 G.C.C. budget was rationalization of government expenditures, increasing non-oil sources of revenues and minimizing the draw down on foreign assets.  

To finance the budgetary deficit G.C.C. economies have been diversifying their revenue collection by introducing personal and corporate taxes. In this contest a new income tax law (2004) has been implemented in the Saudi Arabia. G.C.C. countries have undertaken measures to increase non-oil revenues. Prices of electricity, water and gasoline were raised, and telephone charges and domestic airfares were adjusted upwards. In Oman an excise tax targeting vehicles and certain luxury items was introduced and corporate taxes were increased to 12 percent in the budget of 1999-2000. As noted, resident permit fees for expatriates were raised in Saudi Arabia, which also increased electricity and gasoline prices and slashed subsidies, mainly for wheat production, by 80 percent in the last four years. Removing subsidies and simultaneously introducing an income allowance to those in the lower income brackets is a solution that can meet the legitimate interests of nationals but at the same time remove the economic distortions created by subsidies.  

The G.C.C. countries have also been raising users fees and increasing visa and work permit fees to levels where expatriat labour becomes appropriately priced. Estimates are that huge amount of the G.C.C. annual budget expenditure goes for defence and security, the Six G.C.C. countries allocated around $35 billion in 1998 for defence and other military related expenditures, with the highest per capita spending in Qatar at $2,033. But now these countries are cutting down their defence expenditures and the fall
of Sadam Husain government in Iraq facilitated the decline in G.C.C. defence expenditure particularly Kuwait. Also there is a large-scale privatization taking place in the G.C.C. countries. The privatization of certain public sector enterprises and greater private sector participation will help to reduce the financial burden on the governments. It would result in cutting the public sector wage bill and making public sector institutions more efficient and also help in the reduction of deficit in the budget by creating profits. Therefore G.C.C. economies are working in every possible way to reduce the budgetary deficit and the problem of exhausted natural resources. For example in Qatar, a proportion of the revenues surpluses are being chanelled into a stabilization fund set up in year 2000. In the past whenever there was a fluctuation in the oil prices, there was almost immediate impact on infrastructure spending. It was budgeting according to the oil price, which meant people suffered. By the establishment of the fund, if there is a drop in the oil price, the ministry of finance will be reimbursed. If there is an increase, there will be more money spent on infrastructure. The fund therefore provides a guarantee and allows long term planning.34

Financial Sector Reforms in G.C.C. Countries:

Since 1970s Gulf Cooperation Council (G.C.C.) countries have made significant progress in establishing a modern and well-established financial sector. They have introduced the economic and financial reforms, recognizing that economic growth and stability are often associated with the strong financial sector and quick adoption of the elements of globalization. Therefore in the G.C.C. countries financial and monetary authorities have
implemented financial sector liberalisation. These liberalisation programs have included deregulation, interest rates liberalisation, the gradual opening of the financial sector to foreign participation, increasing competition and privatization of banks and other financial institutions. Interest rates in the G.C.C. countries have been de-regularized and market forces now largely determine interest rate. The capital market in G.C.C. countries are relatively new and rapidly expanding as the role of the private sector is increasing and the demand for equity investment is rising. The emergence of bond markets is also related to the financial liberalisation. Until the late 1980s banking sector and its rate of interest and credit allocation was governed by control regime. But the recent reforms have transformed the financial environment in the G.C.C. region. In this regard under the financial services provisions of the WTO, UAE, Kuwait Qatar and Bahrain opened their financial markets to overseas banks in 2003. On the WTO advice Oman has permitted wholly owned foreign subsidiaries in banking insurance, brokerage and securities from January 2003. Banks in the G.C.C. economies are becoming innovative. Several banks have initiated successful Euro Medium Term Loan (EMTN) programmes, with the explicit aim of attracting European and other investors from outside the region. The G.C.C. financial market is open for competition. Riyadh granted licence to three international banks in May 2004. Several banks from other G.C.C. countries have recently been permitted to begin operations in the Kingdom. Kuwait passed a law in 2004 re-admitting foreign banks, while there is a talk in the UAE of ending a two decade hiatus on new international licence. Also the facility of online banking is being provided in the G.C.C. economies bank and some
international bank which were working in the G.C.C. countries, and brokers also provided the facility to trade on line.

New capital market law 2003 in Saudi Arabia promises a new era for banks and non-bank financial intermediaries. The new law will open up a number of business opportunities for Saudi banks. Bahrain offshore banking sector is working well, but facing huge challenge thrown by newly liberalised policies in G.C.C. banking. Bank Muscat aims at overseas expansions. It has acquired 26% stake in India’s centurion bank, and has focus on the G.C.C. countries with the immediate priorities being Saudi Arabia and the UAE. The bank Muscat is going head to head with its G.C.C. rivals, National Bank of Bahrain, Emirates Bank International and National Bank of Kuwait.36

The G.C.C. stock market is relatively new, the Saudi stock market, is the largest in the G.C.C. countries and the foreign investors are permitted to own shares in the Saudi market through mutual funds. To attract foreign capital in Bahrain stock exchange ownership structure is liberalised, and allows G.C.C. investors to own upto 100 percent of listed Bahraini companies, and non-G.C.C. investors to own upto 49 percent. The UAE second trading floor (The first being Dubai), the Abu Dhabi Securities market (ADSM) started formal trading in November 2000. Trading commenced with 12 firms listed on the market, none of which were listed on the Dubai financial market. Qatar stock market was also opened to the non-Qatari investors through mutual fund in 2001. Since liberalisation of financial markets, non G.C.C. investors are also permitted to invest in Kuwaiti equity. Foreigners are now allowed to acquire shares in companies listed on the Kuwait stock exchange and to participate in the establishment
of publicly listed companies through mutual funds managed by Kuwaiti financial institutions. The Muscat Securities Market (MSM) has been recognized as the most accessible of the G.C.C. stock markets, one of the region’s most progressive markets and the best regulated and transparent capital market in the region. Out of 139 companies listed of the MSM, 121 companies are open for foreign investors of which 39 are restricted for G.C.C. nationals.

The G.C.C. insurance market is one of the least developed sectors of the financial service industry. Now with the accession of free trade in services a norm of WTO required the G.C.C. countries to open up their markets to the activities of foreign insurance. Therefore the G.C.C. countries are increasing private sector involvement in the health and social insurance sector also. For example, UAE has approved the establishment of companies of foreign origin to provide pensions, health care and social insurance schemes for their people.

One important group of banking services that has experienced rapid growth in all G.C.C. countries is the Islamic financial services. Many G.C.C. commercial banks have added Islamic accounts and banking services side-by-side their regular banking operations. An increasing number of new Islamic investment institutions have been launched since the mid 1990s. They tend to be focused on financing and leasing operations and also manage wide-ranging portfolios of equities in companies and business activities of which are compatible with Islamic rules. The major policy challenge currently facing monetary authorities in the G.C.C. countries is
how to bring their Islamic financial institutions and activities under the same supervision and regulation as imposed on regular commercial banks.\textsuperscript{39}

**Foreign Exchange Policy of G.C.C. Countries:**

The G.C.C. countries are highly exchange-oriented economies. Where external sector is dominant and most of the Gross Domestic Product (GDP) comes from external sector. Which in turn is dominated by oil related exports whose prices are denominated in dollars. Further the income from foreign investment made by G.C.C. economies are also mostly dollar denominated. Therefore a small exchange rate fluctuation can cause huge damage to these economies. Hence the float exchange rate was not considered to be suitable for G.C.C. economies. Further the characteristics of G.C.C. economies like small in size, depending mostly on the extraction and exports of oil made these countries best suited to have their currencies pegged to the dollar. Therefore, all the G.C.C. countries have chosen fixed exchange rate regimes, whereby their currencies are pegged to the US dollars. Having a fixed exchange rate, it helps them to maintain investor's confidence in the currency, encourages savings and investment and discourages capital outflow.\textsuperscript{40}

In early seventies, Saudi Arabian Riyal was pegged to the US dollar but in 1975 Saudi Arabia shifted to International Monetary Funds (IMF) Special Drawing Rights (SDRs). But Saudi Arabia Monetary Agency (SAMA) gradually placed more weight on the dollar than the SDR while determining the exchange rate of the riyal. However, since June 1986, the riyal has effectively been pegged to the US dollar. Since 1986, the Omani
riyal has also been pegged to the dollar. Currencies of Bahrain, UAE and Qatar were formally linked to the IMF’s special drawing right but in practice currencies of these G.C.C. countries are linked to the dollar at fix rate. But Kuwait follows a different exchange rate policy, the Kuwaits dinar is freely convertible at an exchange rate calculated daily on the basis of a bucket of currencies weighted to reflect Kuwait’s trade and capital flows. In practice, the dinar has closely followed the exchange rate fluctuations of the US dollar. But as on 1st January 2003 Kuwait also pegged their dinar to the dollar officially. This move is according to the G.C.C. proposal in tune with aim of monetary unification. There are no restrictions on current or capital account transactions in Kuwait beyond a requirement that all foreign exchange purchases be made through a bank or licenced foreign exchange dealer. The G.C.C. countries are fulfilling one of the important criterias of successful monetary unification. Because all the currencies are directly or indirectly pegged to the dollar. They aim at achieving monetary union and also aim at attaining common currency by the year 2010.

**Privatizations in G.C.C. Countries:**

The G.C.C. countries are witnessing an economic transition from the public to the private sector. The privatization of the G.C.C. economies was started in the early 1980s as a result of the deterioration of development rate and mounting budgetary deficit in addition to the instability of the oil market, unstable economic policies, increased unemployment, inflation, external debts. Forced by such conditions, the G.C.C. countries launched active liberalisation and privatization drive. Here also most of the strategies
of the G.C.C. development plans confirmed the necessity of increasing the role of private sector in enhancing local productivity rates and the diversification of national income sources, through investing in industry, agriculture, mining and services. The new policy of liberalisation and privatization transforms from total reliance on government expenditure, as a basic locomotive of economic activities, to private sector initiatives and investments in the G.C.C. countries. And this privatization process has started to yield important results in the G.C.C. countries. It also contributed to the bringing out of the G.C.C. economies that is more homogenous and able to deal with the international economic changes.

Saudi Arabia’s five-year development plan (2001-05), asserted that the kingdom would focus on privatization as a basic economic option. A supreme economic council has been formed to broaden discussion of economic policy and advise the government on reforms and privatization. On the recommendation of Council, the government has privatized the collection of municipal fees as part of the kingdom’s drive to give the private sector bigger role in the economy. Meanwhile, major sectors such as power and telecoms have undergone a huge restructuring programme. And a private GSM operator, Ettihad Etisalat is given licence to operate in the kingdom, and it abolished the monopoly of Saudi telecom in May 2005. Concerning water and power sector privatization in Saudi Arabia, ‘Shouaiba’ Independent Water and Power Project (IWPP) and the Saline Water Conversion Corporation (SWCC) has been thrown open for the private sector. In addition Saudi Arabia mining company (Maaden) has
short listed three banks for the mandate to advice on its planned privatization.\textsuperscript{47}

Within the G.C.C., the UAE sees itself as a progressive force, in the economic sphere. The private sector is the corner stone of the future economy. The private sector has nearly doubled in size over the last 10 years in UAE. In 2003 the private sector contributed 44 percent of the total GDP. Under the UAE latest privatization plans, equity stakes in six-factories owned by the General Holding Company will be offered for sale. Moreover in April 2004, the federal government in effect threw open the Telecommunications sector by creating a regulatory body to end the monopoly of Emirates telecommunication Corporation (Etisalat).\textsuperscript{48} Abu Dhabi has built up a strong track record on the private power front. Taweelah B, is its fifth Independent Water and Power Plant (IWPP). Therefore Abu-Dhabi has been pursuing an innovative privatization programme in the utilities sector. The private sector has taken a prominent role in three high profile schemes in Abu Dhabi, the Saadiyat Island Development Project, the Dolphin Project and the Thuraya Setellite Telecommunications.\textsuperscript{49}

Kuwait has also followed a privatization programme since 1994 under the management of the Kuwait Investment Authority (KIA). Kuwaiti privatization process is motivated by the need to increase the pace of economic development, which suffered slow growth rate in the beginning of the 1990s. The draft privatization law in Kuwait provides for the setting up of the higher committee for privatization under the council of ministers. The duties of the higher committee was defined as the planning, management,
implementation and supervision of privatization programme and operations. KIA has announced plans to divest $2.7 billion worth of shares in 19 local companies as of the beginning of 2002 as a part of privatization policy. Also Kuwaiti parliament approved a draft law in 2001 that will allow foreigners including non-G.C.C. nationals to invest in the Kuwaiti stock exchange, and foreign residents could invest in the local shares through mutual funds.

Private sector participation has been increasing day by day in Qatar also. The first attempt at privatization in Qatar took place in 1990 when the Qatar Electricity and Water Joint Stock Company was created to take over to manage the country's utility complexes including power generation and water desalination. It was 60 percent privately owned and 40 percent government owned but the take over did not materialize. Qatar commissioned, Germany's Fichtner in 2003 to undertake a study on privatization of power transmission and distribution. And bids for Qatar second Independent Water and Power Project went in on 11 July 2004. In the field of telecommunication Qatar Telecom (Q-Tel) has monopoly in Qatar and ventured outside of the home market for the first time in 2004, when it entered Oman.

Bahrain is the most diversified economy among the G.C.C. economies. Therefore the process of privatization is also rapid. In January 1994, the Bahrain government sold its 20 percent stake in the general trading and food processing company. Bahrain privatization process passed several milestones in 2004. The kingdom's first Independent Power Project (IPP) Al-Ezzal, was successfully tendered and awarded. The kingdom became the
first fully liberalised telecom market in the G.C.C., after licences for the last untouched parts of the sector went on offer. Four leading international operators have been shortlisted to run Mina Salman and the new Hidd ports under a 25 year concession agreement. More private sector involvement is also being brought into waste water services and health sectors.56

For Oman, the sixth economic plan (2001-06) emphasises at the privatization to make it a cornerstone of the economic development. Privatization of state owned industries is in progress in Oman also. Sohar Independent Water and Power Project will be 100 percent owned by developer consortium. It is expected to start functioning in 2006. Before Sohar comes on stream, about half of Oman’s Power is already privately generated.57 Oman is the latest G.C.C. telecom market to open its doors to private competition. The award of the sultanate’s second GSM licence, due within some time, will take the first chip out of the monopoly enjoyed by Oman Telecommunications Company (Oman tel).58 Furthermore, the government is considering privatization of Seeb and Salalah airports. Therefore the privatization in all G.C.C. countries is taking its deep root and playing major role in the economic diversification and liberalisation.

**Reforms in Foreign Direct Investments in G.C.C. Countries:**

In the era of liberalisation, the Foreign Direct Investment (FDI) has proved to be a leading factor in improving the macro-economic structure of the economies world over. With the capital input, FDI also brings advance technologies and managerial expertise, which cuts cost of production and boost the efficiency. For attracting FDI country should have conducive
economic environment. In this context the G.C.C. countries have the advantage of offering their economic stability and high credit worthiness. They enjoy one of the highest per capita income in the world and have huge foreign assets. External debt is either very low or non-existent. Further the G.C.C. countries have been following active economic liberalisation and diversification which is also contributing to attract FDI. The free convertability of regional currencies, the freedom to repatriate profits and fees, and relative simplicity of the tax system also help to attract FDI. Despite this, the economic condition of the G.C.C. countries is not comparable to the developed industrial countries and investment flows are very low and growing slowly. The political and legislative hindrances are still there which is contributing in slow rise of FDI in the G.C.C. countries. There is another aspect to the slow growth of FDI in G.C.C. countries, which is its financial abundance. The G.C.C. countries are working hard to globalize their economies they are trying to reduce the obstacles day-by-day in the reforms and liberalisation process. Reforms are accelerating but from a low speed and with multiple obstacles in its path.

The Saudi Arabian General Investment Authority (SAGIA) is targeting core-strategic investors. FDI amounted to be a mere 12.1 percent of GDP in 2003 and it was 17.5 percent of GDP in 1995. Therefore SAGIA is working to create a positive investment environment by removing all barriers obstructing the capital inflow and ensuring investment here save and secure. Saudi Arabia now follows highly liberal FDI laws that allow majority foreign ownership in most sectors, including power generation, water desalination and petrochemicals. The negative list which was banned
for FDI on strategic grounds, was shortened from 23 to 16. The upstream
gas, printing, mobile phone, insurance and healthcare sectors are now
accessible to Non-Saudis.\textsuperscript{59} Saudi Arabia has approved new income tax law
in January 2004, reduced the tax on foreign investors to 20 percent in most
sectors, excluding natural gas and hydrocarbons. In October 2004, SAGIA
unveiled its new five-year strategy to create a pro-business environment,
provide comprehensive services to investors and foster investment
opportunities in energy, transportation and knowledge based industries. The
new mining law approved in September 2004, opens up the vast non-oil
mining sector to foreign and private investors.\textsuperscript{60}

United Arab Emirates is the second most diversified economy in the
G.C.C. after Bahrain. UAE is seen as the 17\textsuperscript{th} most attractive country in the
world to invest in by foreigners. In the World investment report, United
Nation Conference On Trade and Development (UNETAD) says that UAE
attracted $480 million FDI in 2003. But still FDI amounted to a mere 4.4
percent of GDP in UAE.\textsuperscript{61} Therefore the reforms process has continued to
increase FDI. In this respect the long awaited new company law will be
issued in the second half of the 2005. It will allow foreign companies to own
majority interests in local companies and make important changes to capital
market regulations. The present company law allows foreign investors to
own a maximum 49 percent in a company not registered in a dedicated free
zone authority, where 100 percent ownership is allowed. The cabinet has
also approved the creation of an independent insurance regulator aimed at
meeting, international standards, World Trade Organization (WTO)
requirements and encouraging foreign insurance companies to enter the
market. Abu Dhabi is also attracting some of the biggest foreign players to diversify its industrial base.\textsuperscript{62}

Kuwait’s investment climate is not as friendly as UAE’s. The FDI inflow in Kuwait is only 1.2 percent of her GDP.\textsuperscript{63} In order to attract FDI, in 1997, the Kuwaiti government drafted new foreign investment law which proposes to allow foreign investors to fully own companies they set up in this country. This law would allow any non-Kuwaiti concern for the first time to hold 100 percent of a company through a licence granted by the Ministry of Commerce and Industry.\textsuperscript{64}

Qatar is keen to attract foreign investment which will enable it to exploit its natural resources and diversify its economy, in such a way as to protect it from market fluctuations. In this respect 100 percent foreign ownership in certain local projects is allowed. Also Qatar permits foreigners to take lease of Qatari land for up to 50 years. This reform aims to attract foreign investment and technology to the non-oil sector, allowing fully owned project in the infrastructure development, health, tourism and small and medium scale industries sectors. Qatar second Independent Water and Power Project (IWPP) bids opened on 11 July 2004.\textsuperscript{65} Speed of Qatar’s gas-led growth created a relatively wider opening for FDI which contributed about 16 percent of GDP in 2003.

In order to meet WTO requirement Oman has been liberalising its foreign investment regime to facilitate entry of FDI. Tax rate is 12 percent which is same for foreign and local firms and new investors are offered a five-year tax holiday, frequently extended to a decade. Oman’s door to foreign investor is wide open, 100 percent ownership has been allowed
which was only 49 percent in 1994 capital investment law.\textsuperscript{66} FDI in Oman amounted to 12.6 percent of GDP in 2003.

Bahrain is the most diversified economy among G.C.C. countries. The investment climate in Bahrain has always been conducive to foreign investors. Bahrain allows 100 percent foreign owned companies to invest in all sectors, on condition that they locate their regional headquarters in Bahrain. This way Bahrain has succeeded to attract world-class companies and huge amount of FDI. In 2003 Bahrain has about 72.4 percent FDI to its GDP. This data clearly reflects the economic environment of Bahrain for FDI.\textsuperscript{67}

**Foreign Trade Reforms in G.C.C. Countries:**

The dependence of G.C.C. countries on foreign trade had been very high. In G.C.C. Countries exports constituted 72 percent of the total GDP in 1981, and imports constituted 37 percent. This data indicates the strong dependency of G.C.C. countries on foreign trade. The trading relations of the G.C.C. countries were mostly with the non-G.C.C. countries, because these economies were basically very similar. They depend upon extraction and exportation of their oil and gas. And also depend upon imports significantly.\textsuperscript{68} In the wake of liberalisation and diversification of G.C.C. countries this scenario is changing very fast. They have begun to produce many diversified products with the help of private as well as foreign investments. But still dependency on foreign trade of G.C.C. countries is high. Therefore the G.C.C. economies are reforming their trade related policies, like custom tariffs, quantitative restrictions etc. All the G.C.C.
countries are the members of World Trade Organization (WTO) and they have to follow the norms of the WTO, to open up their economies for global competition and shed up their undue restrictions on the trade.

In her drive to achieve faster growth in trade and investment, Bahrain signed a Free Trade Agreement (FTA) with United State (US) in September 2004. It is the first G.C.C. country to seek such an arrangement. But Saudi Arabia shows its disapproval at this FTA of Bahrain with the US. Saudi’s have complained that the deal by an individual G.C.C. country will be counter to G.C.C. economic cooperation accords. This view is not shared by other G.C.C. countries, all of whom are in various stages of FTA negotiations with Washington. The immediate importance of FTA for Bahrain is less for her exports to the US than the potential impact on foreign direct investment. It is hoped that multinational companies will setup their bases in Bahrain to benefit from duty free access to the vast American Market.

There are also indications that Abu Dhabi and Dubai are getting grips with World Trade Organization (WTO) requirement forcing liberalisation and competition prior to 2006. On 26 July 2004, UAE announced it would start implementing the WTO Agreement on Custom Valuation (ACV) after complying with all of the legal and technical requirements. In connection with the joining of WTO Saudi Arabia has already concluded bilateral WTO agreements with 33 countries and approved more than 12 trade related laws. A bilateral trade agreement with the US is also in progress.

Further in the process of foreign trade reforms G.C.C. countries have launched the long awaited customs union as on 1st January 2003. Imposing a
blanket 5 percent duty on most imports from non-member states, with the exemption of basic food-stuffs. Current duties had ranged from 4-12 percent.\textsuperscript{72} The custom union delayed because the UAE had insisted on lower tariffs to preserve its status as a commercial hub, while Saudi Arabia attempted to protect its industrial sector from foreign competition which led it to push for high tariffs. Saudi Arabia and Bahrain had been expected to be hurt by the 5\% tariff, as they impose higher duties although some economist suggest that the two countries will benefit because the lower tariffs will be offset by increased local sales of imported products due to lower prices. The custom union will streamline $46 billion in annual trade between G.C.C. members and is expected to be beneficial by giving them access to markets on better terms than if they were to negotiate bilaterally. It will enable the G.C.C. to take advantage of the economies of scale and to negotiate better deals with other trading powers. All goods produced in the G.C.C. countries would be considered `national products' and would not be subject to tariffs when they are moved from one country to another within the G.C.C.. The custom union would create a climate for healthy competition that would improve the quality of products, lower prices and open up investment opportunities in the region. The unified trading block will strengthen the G.C.C. countries collective position in international negotiations with the WTO. The custom union is significant because it is a key step to the G.C.C. securing a trade deal with the European Union (EU), which would bring about the elimination of tariffs on aluminum which attracts a 6 percent duty and petrochemical imports from G.C.C. countries.\textsuperscript{73} It is hoped that the
union will foster specialization, given that many G.C.C. member compete with each other due to the similar nature of their exports.

2.6: Future Prospects:

The reforms, which was started in 1980s in the G.C.C. countries are still continuing with the same vigour. In a few G.C.C. countries reforms have quick impact and are changing the economic scenario very fast. But in some countries of G.C.C. process of reforms is slow. The reforms have brought sweeping changes in the economies of the G.C.C. countries. A modern infrastructure and public utilities, which already existed is being transformed to be in consonance with the requirements of a market economy. Economic growth has substantially raised the level of income and considerably improved living conditions. Economic activities have been diversified with the noticeable development in the industrial and service sectors. External sector have also been liberalised. Now FDI is permitted in most of the industries. But still the FDI inflow in G.C.C. countries are low due to some unwanted restriction still continuing in these economies. Therefore, the restrictive laws of FDI will have to be gradually abolished in order to increase the FDI inflow. Custom union has come into existence but it still lacks some of the characters required to make it an ideal custom union. To come to the level of European Union the G.C.C. countries have to go a long way in reforms and regional cooperation. The G.C.C. countries also plan to adopt a common currency to improve its position in the international arena as a strong trading bloc. Although the economies of the G.C.C. have been diversified but yet a large part of the GDP in G.C.C. countries comes from the oil export. Hence the speed of diversification and
private sector participation should be increased to reduce the dependence on
the exhaustable natural resources. Therefore the process of reforms is bound
to continue in the G.C.C. countries to liberalise their economies under the
WTO framework.

2.7: Comparison Between India and G.C.C. Reforms:

The reforms process in the Gulf Cooperation Council (G.C.C.)
countries was started in the 1980s. The oil boom of 1970s brought in huge
financial resources. But with the fall in the oil prices in 1980s various kinds
of problems cropped up. To counter these problems due to fall in the oil
prices these economies planned to diversify their economic bases, to save
their economies from oil price fluctuations. Therefore in the process of
diversification of their economies they started process of reforms. But its
momentum has been increased in the 1990s and still it continues. But in
India the economic liberalisation and reforms was mainly started in the mid
1991 to correct its fiscal deficit. At this time India’s condition on credit
rating was very low before the international financial institutions. Therefore,
it sought international monetary fund’s help to correct the balance of
payment problem. The IMF supported with their usual conditionalities to
reform her economy and open it to the world. These reforms process was
started under pressure but now it has become inevitable to stop the reforms
process due to globalisation wave in the world and its accompanying
benefits.

The G.C.C. economies reforms and diversification was started much
earlier than India’s. Now India is ahead in the front of liberalisation and
reforms than some of the G.C.C. countries. G.C.C. economies were open since long because their economies were dependent on the external sector that is export of oil and gases and massive imports for all kinds. In the process of FDI inflow some of the G.C.C. countries are doing very well through liberalisation of their FDI laws and exchange rate stability. India has also liberalised their FDI laws and now most of the economic sectors are accessible by the foreigners. The external sector has also become very open and all the quantitative restrictions have been abolished and tariff rate has been brought down to open the external sector with the aim of achieving free export and imports. The privatization is in very advance stage in India where nearly every field is being opened for the private participation. And the public sector undertakings are being privatized. But in the G.C.C. countries like Kuwait private participation is very low and public sector is providing the main support to the economy. But in some countries in G.C.C. like Bahrain, Oman and UAE private participation is very high. Also other countries of the G.C.C. are in process to increase the private participation to diversify their economies. However, what is certain that both India and member countries of the Gulf Cooperation Council (G.C.C.) have committed to regulate their economies on the framework of free market mechanism. And the process of liberalisation and reforms in India as well as G.C.C. countries is an irreversible exercise. Which would facilitate India and G.C.C. countries to enhance their biletateral trade cooperation.
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