CHAPTER - I

Foreign Trade Historical Perspective

This chapter discusses foreign trade with a historical perspective.

1. Foreign Trade Before Independence

Indian foreign trade was largely determined by the strategic needs of the British colonial powers prior to its independence in 1947. Like other colonies, India too was supplier of raw materials and agricultural commodities to Britain and other industrial countries and it used to import the manufactured goods from Britain. The dependence of colonial India on Britain for manufactured goods hindered the process of industrialization and obliterated the indigenous handicraft and cottage industries.

As a part of the British strategy, India had to export more than its imports prior to World War II, so as to meet the unilateral transfer of payments to Britain by way of the salaries and pensions of the British officers, both military and civil, dividends on British capital invested in India, and Interest on sterling loans. This helped India to achieve a favourable trade balance of Rs. 17.33 billion, ever after paying of the sterling debt. However, the share of raw materials in
India's exports declined from 45 percent in 1938-39 to 31 percent in 1947-48 whereas the share of manufactured goods increased from 30 percent in 1938-39 to 49 percent in 1947-48.

The country's past serves as a reminder that India today, with its overcrowding and scramble for material gain, its poverty and outstanding intellectual accomplishments, is a society in constant change. Human beings, mostly humble folk, have within a period of 200 generations turned the wildness into one of the most complicated societies in the world. The process began in the northwest in the third millennium B.C. with the Indus Valley, or Harappan, civilization, when an agriculture economy gave rise to extensive urbanization and long-distance trade. The second stage occurred during the first millennium B.C. when the Ganga-Yamuna river basin and several southern river deltas experienced extensive agriculture expansion and population growth, leading to the rebirth of cities, a sophisticated urban culture, and trade.

By the seventh century A.D. a dozen core regions based on access to irrigation-supported kingdoms became tied to a pan-Indian cultural tradition and participated in increasing cross-cultural ties with other parts of Asia and the Middle East. India's inclusion within a global trading economy after the thirteen the century culminated in
the arrival of Portuguese explorers, traders, and missionaries. Vasco-de-Gama landed at Calicut, sailing via the Cape of Good Hope in 1498. This marked the beginning of the European-Indian trade era in Indian history. The lucrative trade in spices of Malabar - in modern Kerala- had tamped the Portuguese and inspired the search for a sea route to the India's. The Portuguese were able to establish their colony in Goa by the first decade of the 16th Century but their territorial and commercial hold in India remained rather limited.

In 1962 the French with an eye on trade established their foothold in Pondicherry, an enclave on the east coast of the Indian peninsula, which they held even after the British, had left India. In 1600, Queen Elizabeth I had granted a charter to a London trading company giving them a monopoly on British trade with India. In 1612 the British established a trading post at Surat that was the harbinger of over 300 years of British colonial rule. British trading posts were established in Madras in 1640, at Bombay in 1668, in Calcutta in 1690.

When British first reached India they did not find a backwater country a report on Indian Industrial Commission published in 1919 said that the industrial development of India was at any rate not inferior to that of the most advanced European nations. India was not only a great agricultural country but also a great manufacture country.
It has prosperous textile industry, whose cotton, silk, and woolen products were marked in Europe and Asia. It had remarkable and remarkably ancient, skills in iron working. It had its own shipbuilding industry in Calcutta, Daman, Surat, Bombay and Peru. In 1802 skilled Indian worker were building British warships at Bombay. According to a historian of Indian shipping the teak wood vessels of Bombay were greatly superior to the oaken wall of Old England. Benares was famous all over India for its brass, copper and bell metal wares. Other important industries included the enameled jewellery and stone carving of Rajputana town as well as filigree work in gold and silver ivory, glass tannery, perfumery and papermaking. All this altered under the British leading to the de-industrialization of India its forcible transformation from a country of combined agriculture, manufacture and trade into an agriculture colony of British capacities British annihilated Indian textile industry because a competitor existed and it had to be destroyed so that their traders could prosper.

In 1769 the company prohibited Indians from trading in grain, salt, betel nuts and tobacco and discouraged handicraft. Company also prohibited the homework of the skill weavers and compelled them to work in its factories. Weavers who disobeyed were imprisoned, fined or flogged company's servants lined their own pockets by private
trading and bribery and extortion. Goods were seized at fraction of their price and resold to their owners at five times their price. In this whole process Indian trade suffered heavily.

The vacuum created by the contrived run of the Indian handicraft industries a process virtually completed by 1880, was filled with British manufactured goods British’s industrial revolution, with its explosive increase in productivity made it essential for British capitalists to find new markets, India turned from exporter of textile to its importer. British goods had to have virtually free entry while into Britain of India goods were met with prohibitive tariffs. Horace Hayman Wilson in 1845 in the history of British India from 1805 to 1835 said the foreign manufactured employed the arm of political injustice to keep down and ultimately strangle a competitor with whom he could not have contended on equal terms.

The Europeans primarily the English who arrived in force in the early seventeenth century and by the eighteenth century had made a profound impact on India. India was forced for the first time, into a subordinate role within a world trading system based on industrial production rather than agriculture. Many of the dynamic craft or cottage industries that had long attracted foreigners to India suffered extensively under competition with new modes of mass production
fostered by the British. Modern institutions such as universities and technologies such as railroads and mass communication broke with Indian intellectual traditions and served British, rather than Indian economic interest. A country that in the eighteenth century was a magnet for trade was, by the twentieth century, and underdeveloped and overpopulated land groaning under alien domination.

2. Foreign Trade After Independence

After independence Indian trade patterns began to change in view of its developmental needs. India, as a newly independent country, had to import equipment and machinery that could not be manufactured domestically, in order to create new production capacity and build infrastructure known as developmental imports. It also has to import intermediate goods and raw material so as to make full use of its production capacity, known as maintenance imports. Moreover, as newly developing country, it had to import consumer goods such as food grains that were in short supply domestically, in order to curb inflationary pressures. Such heavy dependence on imports adversely influence of trade.

Indian exports grew significantly from US$ 1.26 9 billion in 1950-51 to US$ 155.5 billion in 2007-08 whereas imports increased from
US$ 1.273 billion to US$ 235.9 billion during the same period (Annexure I). Exports have shown an increase of about 20 percent during the last four decades, in four phases, 1972-77, 1987-90, 1993-96, and 2000-04. However over the four decades after independence, India followed a planned development strategy based on extensive public ownership of commercial assets a complex industrial licensing system, substantial protection against imports (including some of the worlds heights tariffs on import of capital good and a ban on import of consumer goods.) restriction on exports virtual prohibition of foreign investment, and extensive regulation of financial intermediation. At some point in the 1970 and early 1980, these policies enable the government to control the most basic business decisions down to the firm level.

While the development strategy it adopted helped the country escape from the massive illiteracy, recurrent famines, fertility rates of about seven children per women and secular stagnation prevailing before independence, it also isolated India from the rest of the world with the result form 2 percent in the 1950s, India share of world trade declined to less than half of one per cent in the late 1980s. It forced Indian consumers to pay higher prices for goods of lower quality and deprived the country of the benefits of foreign direct investment and
modern technology. It discouraged production for exports created recurrent shortage of foreign exchange and made the balance of payments extremely vulnerable to internal circumstances. Most important of all, it held back the country's growth and thus the pace at which poverty could have been reduced.

3. Overview of Balance of Trade

The balance of trade includes only those transactions arising out of the exports and imports of only visible items (goods); it does not cover the exchange.

In this heading, we explain to import and export policy of the government of India. This is divided into two part: (1) the pre-reform period (period prior to 1991), and (2) the reform period (period after 1991). During the latter period, massive liberalization measures have been introduced in the industrial sector, the foreign trade, sector, and the financial sector.

According to Rajesh Mehta, such a break stems from the change in the perception for the trade policy mind-set in the country. "while the objectives of self-reliance and self-sufficiency influenced the trade policy formulation in the 1950s and 1960s, the factors like export led growth, improving efficiency and competitiveness of Indian industries
prevailed upon the trade policy-making during the late 1970s and the early 1980s. The current trade policy reforms, on the other hand, seem to have been guided mainly by the concerns over globalization of the Indian economy, improving competitiveness of its industry and adverse balance of payments situations."

**Import Policy in the Pre-reform Period**

The import policy of the government of India in the pre-reform period had two important constituents: (1) import restrictions and (2) import substitution. It was formulated keeping in view the limited foreign exchange reserves of the country, shortages of essential consumer goods in the economy, requirements of capital goods, machinery, spare-parts and components for the building up of heavy, basic industries, and the role and scope of import substitution in the country. The period of 1980s was characterized by massive import liberalization- the desire being to enhance the export competitiveness of large sections of Indian industry.

**Restrictions on Import**: under this strategy of development the government had to import capital equipment, machinery, components, industrial raw materials, intermediate goods, technical know-how etc. in large quantities and this led to a substantial increase in foreign
exchange expenditure. The government also had to resort to import of foodgrains from time to time to overcome the shortage of food grains.

The trade policy can significantly affect the fortunes of firms. For example, a restrictive trade policy, or a policy of protecting the home industries, may greatly help the import competing industries, while a liberalization of the import policy may create difficulties for such industries.

Trade policy is often, integrated with the industrial policy. As part of the economic liberalization and WTO compliance, India has very substantially liberalized imports, domestic firms now increasing competitions from imports. In other words, they face a growing international competition on the domestic turf. This implies that in many cases Indian firms which do not come up to the international standards- in quality, cost, marketing, after-sales services, etc.- will not be able to survive. And a firm which effectively fights foreign competition in the home market may be provoked to think ‘why not compete with foreign firms in the foreign markets’. Liberalizations of imports facilitates global sourcing and this could help many Indian firms to become more competitive.
Foreign Exchange Policy

Exchange rate policy and the policy in respect of cross-border movement of capital are important for business. For example, the abolition/liberalization of exchange controls all around the world since the late 1970s has encouraged cross-border movement of capital.

Foreign Investment and Technology Policy: Until the late 1980s, when the worldwide trend towards liberalization set in, foreign capital and technology were under severe restrictions in many developing and socialist/communist countries.

Restrictions on foreign capital and technology constrain not only the foreign firms but also the domestic firms because it may come in their way of acquiring the technology of their choice from the best source. Restrictions on foreign capital may effect the growth plans of firms, including establishment of joint ventures. India has restrictions on foreign investment by Indian companies.

Huge investments in infrastructural and other vital sectors can significantly improve the environment for industrial development, as in the case of China.

Fiscal Policy: government’s strategy in respect of public expenditure and revenue can have significant impact on the business. The pattern of public expenditure may affect the development of various regions,
sectors and/or industries differently. Such is the case with the taxation policy. Governments often use tax incentives or disincentives to encourage or discourage certain activities. For example, when an industry suffers from recession, a reduction of taxes like personal income tax and corporate tax may help increase, because of the resultant increase in the disposable income, the spending in the economy leading to an increase in demand governments, central as well as provincial, of many countries offer different fiscal incentives to woo industries.

**Monetary Policy**: It refers to an increase in the nation’s money supply and leads to a reduction in the nation’s interest rates, which stimulates investments. A policy based on the nation’s monetary authorities changing the nation’s money supply and the effect these changes have an domestic interest rates.

On the other hand, expenditure-reducing (i.e. restrictive fiscal and monetary) policies to curb inflationary pressures in the economy increase a surplus.

### 4. Balance of Payments Position

A balance of payments statements statement is helpful in double- entry system of record of all economic transactions between
the 'residents' of a country and the rest of the world carried out in a specific period of time.

It can classified record of all receipts on account of goods exported, services rendered and capital transferred to 'non-residents' or foreigners. Thus, balance of trade. Whereas the latter refers only to merchandise imports and exports, the former refers to all economic transactions with the outside world.

The balance of payments statement is divided into two major accounts viz., current account and capital account.

**Current Account**

In this transactions relating to goods, services and income constitute the current account on the balance of payments, are functionally classified into two broad categories: merchandise and invisibles. However, due to data constraints the Indian authorities present imports on CIF (cost, insurance and freight) basis while the exports are presented on fob basis. The main categories of service transactions are travel and transportation, royalties, income on foreign investments refers to the interest & profit received on U.S. assets abroad and paid on foreign assets in the United status. Unilateral
transfers refer to gifts made by individuals and the government to foreigners and to gifts received from foreigners.

While those relating to claims and liabilities of a financial nature, which go to finance the deficit on current account, while those relating to claims and liabilities of a financial nature, which go to finance the deficit on current account.

**Capital Account**

It shows the change in the nation’s assets abroad & foreign assets in the nation other than official reserve assets. It includes direct investments (such as the building of a foreign plant), the purchase or sale of foreign securities (stock, bonds and treasury bills), and the change in the nation’s non-bank and bank claims on and liabilities to foreigners during the year. Increases in the nation’s assets abroad and reductions in foreign assets in the nation are capital out flows in the nation’s capital a/c because they lead to payments to foreigners.

5. **Trade Policy**

On August 31, 2004 the Government spelt out a bold vision to double India's share in world trade within five years, and to focus on the generation of additional employment in the process. The current trade figures indicate that India is not only on the right path but approaching the goal at an accelerated pace.
India to be a major gainer from Emerging Global Trends

In the fast changing international trading scenario, outsourcing of manufacturing activities in the skill intensive sectors has become an essential business strategy for the developed countries. India with its large skilled work force, growing domestic market, raw material availability and the emergence of a mature supply base is set to gain enormously from this trend since the Indian advantage goes well beyond the low wage rates. While there is no doubt that knowledge based industries such as information technology offer India a smooth route to world markets, great potential and opportunities exist in the manufacturing sector also.

FTP Strategy is on the Right Track

When the five year Foreign Trade Policy was announced on August 31, 2004, the Government took cognizance of the fact that a bold and clearly delineated approach was needed to tap such opportunities. The Foreign Trade Policy articulated two basic objectives that would enable India to achieve these goals.

The first objective was doubling our percentage share of global merchandise trade within five years. To achieve this, an average annual growth rate of about 16% was envisaged. The DGCI&S trade statistics show that the actual growth of the merchandise trade in the
very first year of the policy period has been of the order of 24%, which has far surpassed the target we set for ourselves. This growth has been unprecedented in India's economic history, and if we can maintain the momentum, the Government is confident that India will cross the 150 billion dollar milestone substantially earlier than the target date.

**FTP as a Generator of Employment**

The second objective of the FTP was providing thrust to employment generation particularly in semi-urban and rural areas. The FTP announced special focus initiatives in the employment intensive areas of agriculture, handicrafts, handlooms, gems & jewellery and leather & footwear sectors. The employment generation has been encouraging not only in these sectors, but in other sectors across the board.

**A Policy of Partnership**

The FTP provided a road map that could help Indian companies become globally competitive and simultaneously aimed at giving Indian consumers world class products and services. Specific sectoral initiatives have helped in creating more jobs, higher exports and an enhanced level of confidence for Indian products and services in the global economy.
I believe that it is the new equation of partnership and co-operation engendered by the FTP last year that has paid the rich dividends we are now encountering. Business and industry have responded remarkably.

Government is committed to resolving all outstanding problems and disputes pertaining to the past policy periods through the Grievance Redressal Committee set up last year, for condoning delays, regularizing breaches by exporters in bonafide cases, resolving disputes over entitlements, granting extensions for utilization of licenses etc. The atmosphere of partnership between Government and Business will be enhanced and taken forward.

**Changing International Trade Dynamics**

The dynamics of global trade and the opportunities provided by the multilateral trading platform necessitate a continuous realignment of our international trade strategies and priorities. While India's international trade will continue to function under the overall framework of the Foreign Trade Policy 2004-09 announced on 31st August 2004, some fine-tuning needs to be done to take into account the changing international trade dynamics. This Annual Supplement endeavors to incorporate additional policy initiatives and simplify
procedures, thereby facilitating and enhancing India's international trade.

6. Review of Literature

Various studies have been conducted by economist's in this field of foreign trade. We are reviewing them below.

S.K. Misra and V.K. Puri in their study "Economic Environment of Business" Himalayas publishing House, points out that the 'macro-economic inter-connections' between foreign trade sector and the overall process of planning for industrialization are crucial. According to them the solutions of the problems of national economy cannot be found through foreign trade sector or simple recipes associated with it. On the other hand, the problems of the foreign trade sector can be restored to a considerable extent, through an improved performance and a better management of the economy at home. "In other words, the tail cannot wag the dog".

Deepak Nayyar in his study entitled "The Foreign Trade Sector, Planning and Industrialization in India" Oxford University Press shows that in the euphoria and enthusiasm generated by the large-scale trade policy reforms one should not ignore the following three issues which are of fundamental importance for our trade: - the
relative importance of home market, the nature of the degree of state intervention and the acquisition or development of technology.

R.L. Varshney & B. Bhattacharyya in their study "International Marketing Management" have discussed the trends in India's Foreign Trade since liberalization. According to them because of the conscious policy reforms by the Government of India, exports have increased substantially. The various reasons for the increase in exports are-exemption of export profits from income tax, devaluation of the rupee, greater availability of export credit and lower interest rates, partial and later fuller convertibility of rupee on trade account, easier import of inputs for export industries at lower rated of duty, development of export culture, greater competition in the domestic market, etc.

As regards imports they have also shown a continuous rise due to liberalization of import policy and introduction of Export-promotion Capital Goods scheme, increased buoyancy in the industrial sector evidenced by a higher increase in non- POL imports, imports of mass consumption items to control the inflationary pressures, reduction in import duties & increase in domestic prices.

As far as composition is concerned according to the authors the position of India from an exporter of basically primary products and few industrial products, viz. textiles, has changed to an important
exported of fairly diversified basket of manufactured items. According to them U.K. is important trading partners of India in Western European Countries.

Francis Cherunilum in his study "Global Economy and Business Environment" points that the global trade liberalization will benefit India. According to him if it is assumed that India's share in world exports improves to one percents, and that she is able to take advantage of the opportunities that are created, the trade gains may consequently be placed at $ 2.7 billion exports per year. More generous estimates range from $ 3.5 to 7 billion worth of extra exports. However, India's gain will be much less than china and newly industrialized economies.

K. Aswathappa in his study "International Business" is of the view that the coming into force of the WTO could help India in the long run. The author is of the opinion that Indian exports could increase to the Developed Nations especially US & Europe because of the likely reduction in tariffs and non-tariff barriers in these countries, reduction in subsidies to agriculture and phasing out of MFA by 2005. But he also warns that till now WTO seems not to be sensitive enough to the development of non-tariff barriers to imports from the developing nations, such as anti-dumping duties. He is also of the
opinion that the reform process under WTO is fast the in the areas that benefit rich countries and where the benefits of free trade accrue primarily to the developing countries, progress has been slow and halting.

**Amitendu Patil** in his study entitled *"Looking Back at India's Trade Policy"* points out that the span of nine years (1987-88 to 1995-96) was arguably the best period for India's external sector in the last 20 years. However, the part of 1990s was not as food for India's external sector as the earlier years. According to him in the 1990s, there was realignment within manufactured products towards export of new non-traditional items.

**K. Aswathappa** in his book *"Essentials of Business Environment"* has highlighted the fact that exports have become very important for India after the liberalisation process of nineties. He is of the opinion that there is an urgent need to step up our export drastically. According to him the need for increased export earnings stems from several reasons like imports will increase & to finance them, we need higher export earning's; it is not advisable to depend on external assistance to finance imports; and debt-servicing burden is ever mounting, necessitating increased export earnings.
P.R. Bhatt in his study entitled "Second Generation Reforms: Some Issues" opines that there is a good scope for increasing India's share of world market for software products and services. According to him India's software exports which have increased from $ 128 million in 1990-91 to $ 2900 million in 1998-99 are estimated to touch $ 50,000 million by 2008.

B. Bhattacharaya in his paper "India's External Trade: Issues before WTO" has discussed certain issues of India's concern with respect to development regarding WTO. According to him the major areas of Indian concern are - maintainability of Quantitative Restrictions on imports and Exports; opening of agriculture & Service sectors; Intellectual Property Rights; Anti-Dumping and Subsidy measures; New forms of non-tariff barriers in guise of environment and social clauses; and Special & Differential Treatment.

Ashok Gulati & Sudha Narayanan in their study on "Indian Agriculture in the Global Economy" have specified that Indian should demand -One, complete wiping out of export subsidies by the developed countries, particularly the European Union (the dairy sector in particular) & Eastern Europe and Second, Indian should press for line-by-line reduction commitment on export subsidies. At present,
the chief drawback of the rules on export subsidy is that commitments are defined over commodity aggregates rather than individual lines.

I.J. Ahluwalia in his study "Industrial Growth in India; stagnation since the mid-sixties", Oxford University Press: The export performance of the Indian economy has not been good. Despite policies of import substitution, the demand for imports has risen faster than exports and there has been a perennial balance of trade deficit. In fact, in only one year, 1972 on the eve of the first oil shock was there a positive balance of trade. It is often argued that the policy of import substitution, rather than just nurturing "infant industries" also protected "elderly incompetents", shielding them from international competition. The resulting high cost industrial structure prevented industries in which India had competitive advantage from realizing that on world markets.

K.N. Prasad in his study "Indian Economy since independence - Volume II", has expressed that the reforms have benefited Indian export. The author is of the opinion that Indian exports responded positively to the various changes introduced in the trade policy and the exchange rate regime. India thus emerged as a major player, with lot of potential, in the world economy and entered the export market in a big way.
I.G. Patel in his study entitled "Limits of the current consensus on Development" opines that the reforms have benefited us. He is also of the opinion that changes should be made in the policy on the basis of experience. He finally says that we must guard against the danger of expecting too much from the current wave of economic reforms. As such expectations can lead to inadequate and ill sustained support that can abort even programmers that are eventually on right course.

K. Padmanabhan in "Political Economy of reforms and Liberalization" observed that the response evoked by reforms in European Countries, America and Japan has been overwhelming and has helped to establish a number of agreements between India and these countries.

Bimal Jalan in his study on "India's Economic Policy" has expressed that the export pessimism of fifties and sixties costed dearly India and now India cannot afford to make the same mistake again. According to him exports could increase if we pay attention on the following- further reduction of tariffs; high domestic interest and inflation rates pose problems for exporters; infra-structural problems; qualitative aggressive intervention for promotion of exports; export policies for agriculture commodities continues to be restrictive; and
that seventies and eighties periods of high growth in manufacturing sector were also periods of high growth in exports.

Annual Reports-2001-2002 (Supplement to RBI Bulletin, September 2002) observed that India's external sector posted significant gains during 2001-2002 despite the deepening of the global slowdown and uncertainties owing to September 11, 2001 terrorist attacks. For the sixth year in succession, the balance of payments (Bop) recorded an overall surplus. According to report it is necessary for India to device strategies based on product specific and market specific basis. Over the year, trade policy has undergone fundamental shifts to the earlier anti-export bias through the withdrawal of QRs, reduction and rationalization of tariffs, Liberalisation in the trade and payments regime and improved access to export incentives, besides a realistic and market based exchange rate.

Rakesh Mohan Joshi in his study on “International Business” expressed that India’s foreign trade was largely determined by the strategic needs of the British colonial powers prior to its independence in the 1947. The dependence of colonial India on Britain for manufactured goods hindered the process of industrialization and obliterated the indigenous handicraft and cottage industries.
P.K. Khurana in his study on “Export Management” expressed his view that growth in exports is vital to the economic development of India. The study of the trends in exports over the years has revealed that the share of the export of traditional products, that is, agricultural and allied products has declined over the years and that of manufactured goods has shown a steady growth.

Summary

This chapter analyses foreign trade with a historical perspective before independence and after independence, this also overview of balance of payment position of India.