5.1 Introduction

5.2 India’s Trade Policy: An Overview

5.3 Phase wise Analysis of Trade Policy & Performance

5.4 Summary

5.1. INTRODUCTION

It is observed that most of the third world countries had a colonial past and their economies were exploited by colonial powers. The colonial powers used foreign trade as an instrument of exploitation in these countries. Development Economists of 1940s and 1950s like Raul Prebisch, Hans Singer, Gunnar Myrdal, Ragnar Nurkse, and many others pointed out that the colonial powers were the consumers of primary goods and producers of manufactured goods, while the colonies (the underdeveloped countries) were mainly consumers of manufactured goods and producers of primary goods. As the prices of primary goods were declining and that of manufactured goods were increasing, there was a deterioration in the terms of trade over time of underdeveloped countries. Therefore, many underdeveloped countries which became independent after the Second World War viewed foreign trade and investment with suspicion. Hence, they focused their attention towards domestic markets. Many of them adopted a programme of industrialization on a large scale to build up their industrial sector and reduce their dependence for manufactured goods from developed countries. Thus, these countries mainly followed ‘inward oriented policy’ and had a pessimistic view with regard to exports.
However, during and after 1960s many developing countries adopted programmes of import liberalization and export promotion and achieved remarkable success. As a result economists as well as international agencies like IMF and the World Bank started advocating import liberalization and export promotion as a solution for many economic problems of the developing countries.

5.1.1 Trade Policy

On analytical grounds, trade policy can be broadly divided into two groups – (a) Inward oriented and (b) Outward oriented.

(a) Inward – oriented policy: - An inward oriented strategy is the one in which trade and industrial incentives are biased in favour of production for domestic market over the export market. Thus, an inward oriented policy is often designated as the import substitution strategy.

(b) Outward – oriented policy : - On the contrary, an outward oriented strategy is the one in which trade and industrial policies do not discriminate between production for domestic goods and foreign goods. Thus, an outward oriented strategy is often designated as the export promotion strategy.

As remarked by World Bank in its World Development Report (1987) – “Inward – oriented regimes are generally characterized by high levels of protection for manufacturing, direct controls on imports and investments, and overvalued exchange rates. By contrast, outward orientation links the domestic economy to the world economy.”

The solution to the problem of BOP for a country depends on the trade policy / export – import policy of the country. Hence, a systematic study of BOP of a country should take into account the changes in the trade policy of a country over a period of time.
5.2 INDIA’S TRADE POLICY: AN OVERVIEW

In a broader sense, after independence for almost forty years or so India adopted inward oriented strategy. The basic rationale behind it was that it would help rapid industrialization through import substitution and at the same time save valuable foreign exchange. This strategy covers the period from First Five Year Plan (1951 – 56) to the Seventh Five Year Plan.(1985 – 90). This period is considered as the period of “Licence – Quota Raj” wherein there was a controlled and restrictive environment.

However, the decade of 1990 is marked with a near U turn as India adopted gradually a path of economic liberalization. It followed the policy of Liberalization, Privatization and Globalization (LPG) to solve its BOP and related problems. A series of economic reforms were introduced in various sectors to tackle the BOP and other problems. Hence, the Indian economy which was a closed economy for almost forty years now became relatively more open posing challenges for macroeconomic management. Thus, from 1990 onwards India adopted an outward oriented strategy which can be considered as a significant turnaround from the earlier period. The adoption of outward oriented strategy was a major departure from the relatively protectionist trade policies pursued in earlier years.

5.2.1 Phases of India’s Trade Policy

There is no doubt that in the broader sense of the term India followed an inward - oriented trade policy after independence till 1990. However, an in depth analysis of India’s trade policy shows that there were certain shifts in policy stance from time to time. Taking this into account trade policy of India can be broadly divided into the following phases (1) Phase I – Import Restriction and Import Substitution (From
1950’s to 1970s), (2) Phase II – Export Promotion & Import Liberalisation (From 1970s to 1990s), and (3) Phase III – Outward Orientation – (From 1990 onwards).

5.3. PHASE – WISE ANALYSIS OF TRADE POLICY & PERFORMANCE *

5.3.1 Phase I – Import Restriction and Import Substitution (From 1950s to 1970s)

At the time of independence, the Indian economy was a predominantly agricultural economy using primitive production techniques and was completely shattered by centuries of colonial plunder. There was a need for planned economic development with the state playing a leading role.

At that time there was also a debate among the economists as well as policy makers with reference to the choice between either import substitution or export promotion strategy needed for planned economic development. Moreover, in the early fifties, neither there was any empirical evidence of the relative advantage of one or the other strategy, nor the experience of developed countries in the pre-war period could provide any appropriate guidelines for the choice of the policies. As a result, the Indian planners had to shoulder the special responsibility taking their own independent decisions on development and trade strategies. Under such circumstances, it was the pragmatism, initiative and even the urge for socio-economic transformation of the leaders and the policy makers played an effective role in the choice of the strategies. Hence, for the purpose of economic development India adopted Economic Planning supported by Nehru’s vision.

As the country adopted Economic Planning for the purpose of economic development, trade and industrialization policy were subject to plan priorities. Phase

In general, during the post – independence period and up to the end of First Five Year Plan ( 1951 – 52 to 1955 – 56 ) , the import policy was liberal so as to meet the pent up demand released after the Second World War as there was availability of sufficient sterling balances. The strategy of long term planned development was spelt out in the Second Five Year Plan(1956/57 -1960/61) which gave a high priority to industrialization. As the draft outline of this Plan was prepared by P. C. Mahalanobis, it is also referred to as Mahalanobis strategy of development.

The Second Plan emphasized the strategic importance of the manufacturing and the capital goods sector. Since India was in its early stages of development, it had to rely heavily on import of capital goods, so the emphasis was on replacing these capital goods with domestic import substitution production. There were two options for production strategies : one to substitute the imports of consumer goods by domestic production of consumer goods, and allocate a large part of the investment to the production of consumer goods. The second strategy was to restrict the availability of luxury consumer goods to the minimum, either through domestic production or through import, and expand the base for capital goods through import substitution so that the capability of the economy to produce both consumer goods and capital goods at a future date could be very high. It was the vision of Jawaharlal Nehru, the then Prime Minister of India, that India adopted the later strategy on the ground that it would give India a sound foundation for development, though it implied considerable sacrifices on the part of the Indian people in the early stages of development. After accepting the strategy of import substitution there were two alternative approaches to the implementation of the import substitution : one was
based upon the use of fiscal and monetary policies such as tariffs, taxes, interest rate policies, etc. which could provide adequate protection to the domestic industry for encouraging competitive production for import substitution. The other was adoption of physical interventionist policies such as licensing, quotas, banning of imports, etc of imports and also adopting some tariff and non – tariff measures for providing protection. It was possibly, the severe foreign exchange crisis of 1956 – 57 and the urgency for adopting strict measures for import control that necessitated the policies which were heavily loaded with interventionist character.

In this context, Sen (1982) remarks – “At a policy level, attempts to induce industrialization in India during the Second Five Year Plan (1956 – 1961), incorporated a scenario where both capital goods (including intermediate products) and consumer goods production could potentially substitute for imports. In the absence of cost – reducing techniques, additional production was only feasible with only protection, which was readily provided by the government through tariff and non – tariff restrictions on imports.” ²

The policy of import restriction and import substitution was formulated by keeping in view the limited foreign exchange reserves of the country, shortage of essential consumer goods, requirements of capital goods, machinery, spare parts and components for the building up of heavy and basic industries, and the role and scope of import substitution in the country. Moreover, the country had to import food grains to overcome shortages of food grains. All this led to substantial increase in foreign exchange expenditure. The export earnings continued to be stagnant. Hence, the government had no option but to severely curtail import expenditure. Therefore, the history of severe import restrictions in India starts from the year 1956 – 57 onwards. Given the acute shortage of foreign exchange most of the time,
policymakers opted for direct allocation of foreign exchange among different users and uses through import licences.

In general, the adoption of import substitution strategy was based on four premises:

- it was believed that only after industrialization had proceeded some way that increased production would be reflected in larger export earnings;
- that given the large domestic market, exports need not be an engine of growth.
- growth in external demand for India’s products was likely to be inelastic because of the traditional nature of our exports; and
- the Prebisch –Singer argument that primary commodity exports face a secular deterioration in terms of trade.

As Rangarajan (1994) noted - “As we embarked on a period of planning, during the fifties, import substitution came to constitute a major element of India’s trade and industrial policies. Planners more or less chose to ignore the option of foreign trade as an engine of India’s economic growth. This was primarily due to the pessimistic view taken on the potential for export earnings. A further impetus to the inward orientation was provided by the existence of a vast domestic market.”

Thus, import substitution was considered as a correct and inevitable strategy for a continental economy such as India. The Government supported and adopted ‘import substitution’ or inward oriented strategy throughout our earlier decades of economic planning. This import substitution strategy was supported by use of monetary and fiscal policies, tariffs, taxes, and interest rate policies and physical interventionist policies such as licensing, quota, tariff and non – tariff barriers of import restrictions. In other words, export pessimism permeated the policy stance throughout the early decades of our planning.
The approach of licensing, quotas, etc. intensified in the late fifties and early sixties and led to the creation of a number of institutions such as Chief Controller of Imports & Exports Office, the regional offices, agencies issuing essential certificates, indigenous clearance certificates, etc.

In a nutshell, the two broad objectives of the import substitution policy were:

- to save foreign exchange for the import of more important goods, and
- to achieve self-reliance in the production of as many goods as possible.

The Third Five Year Plan (1961/62 to 1965/66) explored the possibility of supplementing export earnings with external assistance. During and after the Third Five Year Plan, export targets were set in various Plan documents and export promotion policies were introduced. However, the goals set for both import substitution and export promotion, continued to influence the policy decisions till about the mid-sixties. In this context, Panchamukhi (1987) observed – “The period from 1962 to 1966 could be identified as a period of induction of export orientation along with heavy import substitution orientation strategies.”

One of the important decisions taken in June 1966 was the devaluation of rupee by 36.5 percent. It was accompanied by the elimination of export subsidies, some increase in export duties, and a reduction in tariffs, which reduced the effectiveness of devaluation. It is argued that the devaluation was seen as having been imposed by external pressures. During this period, there was a concerted effort by the United States, the World Bank and the IMF to use external assistance as an instrument to induce India (a) to adopt a new agricultural strategy and (b) to liberalize its network of industrial and trade controls and to devalue the rupee.

The trade liberalization measures of 1966 appeared to be extensive, but their effective coverage was more limited. Import liberalization was offered to 59 priority
industries consisting of export industries, capital building industries, and industries catering to the needs of the common people like – sugar and cotton textiles.

The year 1966 also saw the initiation of the new agricultural strategy as the need to achieve domestic self-sufficiency in food grain production became a paramount policy aim. The government had to resort to large scale import of fertilizers, agrochemicals, seeds, pesticides, and insecticides, etc. to implement the new strategy later termed as Green Revolution.

However, the import liberalization measures initiated in 1966 were short-lived and from 1968 onwards, the approach of import controls, licensing and restrictions was reintroduced and a variety of export policies were also initiated.

5.3.1.1 Important Features of Import Restrictive and Import Substitution Policy

Some of the notable features of the import restrictive policy during the period from 1950s to 1970s are as follows -

- An import licence allowed a specified amount of a specified item to be imported by a specified user for a specified purpose sometimes even from a specified source of supply.
- Imports were divided into different categories namely, consumer goods, intermediate goods and capital goods.
- Further, each category was sub-divided into non-permissible(banned), limited permissible (with mandatory certification and mandatory clearance from the Chief Controller of Exports & Imports (CCI & E), automatic permissible (without mandatory certificate but with clearance from the CCI & E, and open general licence (OGL) without certification and without clearance from CCI & E.
Licences were also categorized on the basis of user type such as – established importer, actual user, newcomer, ad hoc, export promotion scheme etc.

Some of the imports were allowed only through state trading agencies like State Trading Corporation (STC), Minerals & Metals Trading Corporation (MMTC), etc. and these were known as canalized items.

Quantitative Restrictions were high and liberal for capital goods imports, and zero, low and rigid for the imports of ‘non essential’ consumer goods.

The operation of this cumbersome policy required comprehensive details and a complex administrative mechanism.

5.3.1.2 Performance of Balance of Payments in Phase I

Phase I (1950s to 1970s) of the trade policy was mainly characterized by import restriction and import substitution. It covers the first three Five Year Plans and the Annual Plans.

The key components of India’s Balance of payments from the First Plan to Annual Plans are given in Table 5.1. As is evident from Table 5.1, in the first Five Year Plan (1951-56) India did not experience any serious payments difficulties. Over this period, the total trade deficit which was a little more than ₹540 crore per annum, was financed largely by net invisibles (92 percent). A very small deficit on current account of ₹40 crore, was in turn, financed by inflow of external assistance and depletion of foreign exchange reserves in almost equal proportions.

During the Second Plan (1956 – 61) there was a dramatic change in the balance of payments situation. Throughout the Second Plan, exports were stagnant and the value of imports was almost double the value of exports. As we adopted the strategy of import substitution and high level of investment, there was a huge increase in the trade deficit which went up to ₹2250 crore. During this period, the invisibles were
able to finance about 25 per cent of this trade deficit. Similarly, the current account deficit (CAD) increased to ₹1.650 crore. This CAD was mainly financed by external assistance (40 percent) and by depletion of foreign exchange reserves (35 per cent).

Table 5.1: Key Components of India’s Balance of Payments : Plan - wise Total

( In ₹ Crore)

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<tbody>
<tr>
<td><strong>Merchandise</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A)Exports f.o.b</td>
<td>3109</td>
<td>3144</td>
<td>3737</td>
<td>3714</td>
</tr>
<tr>
<td>B)Imports c.i.f.</td>
<td>3652</td>
<td>5402</td>
<td>6137</td>
<td>5845</td>
</tr>
<tr>
<td><strong>I. Trade Balance (A – B)</strong></td>
<td>-543</td>
<td>-2258</td>
<td>-2400</td>
<td>-2131</td>
</tr>
<tr>
<td><strong>II. Invisibles Net</strong></td>
<td>501</td>
<td>609</td>
<td>412</td>
<td>71</td>
</tr>
<tr>
<td><strong>III. Current Account (I + II)</strong></td>
<td>-42</td>
<td>-1649</td>
<td>-1988</td>
<td>-2060</td>
</tr>
<tr>
<td><strong>IV. Capital Account (A to C)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A)Foreign Investment net</td>
<td>-43</td>
<td>997</td>
<td>1907</td>
<td>2121</td>
</tr>
<tr>
<td>B)External assistance, net</td>
<td>48</td>
<td>114</td>
<td>121</td>
<td>96</td>
</tr>
<tr>
<td>C)Other capital</td>
<td>55</td>
<td>675</td>
<td>1964</td>
<td>2298</td>
</tr>
<tr>
<td><strong>V. Overall Balance (III + IV)</strong></td>
<td>-85</td>
<td>-652</td>
<td>-81</td>
<td>61</td>
</tr>
<tr>
<td><strong>VI. Monetary Movements (VII + VIII + IX)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>VII. Reserves (increase - / decrease +)</td>
<td>126</td>
<td>598</td>
<td>5</td>
<td>-72</td>
</tr>
<tr>
<td>VIII. IMF net</td>
<td>-43</td>
<td>54</td>
<td>76</td>
<td>11</td>
</tr>
<tr>
<td>IX. SDR Allocation</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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</table>

The Third Five Year Plan (1961 – 66), witnessed a modest growth in export earnings. This was a distinct break from the stagnation of exports during the 1950s. During the Third Five Year Plan, we had to resort to large scale of imports of foodgrains due to unfavourable monsoons. Hence, the overall trade deficit during this period was ₹2,400 crore. However, the net invisibles showed a decline and were able to finance slightly more than 15 per cent of trade deficit. The CAD of ₹1,990 crore was mainly financed by external assistance (98 per cent).

During the Three Annual Plans (1966 – 69), there was a slight decline in trade deficit to ₹2,130 crore which could be mainly attributed to a decline in imports. However, there was a massive decline in invisibles to ₹71 crore. The CAD of ₹2,060 crore was once again mainly financed by external assistance.

Table 5.2 considers key indicators of India’s Balance of payments (Plan wise: Annual Average) as a percent of GDP. As is evident from Table 5.2 the trade deficit, (TD) to GDP ratio increased from 1.1 to 3.3 from the First Plan to Second plan. During the Third plan and Annual Plans it declined and remained stagnant at 2.2 percent of GDP. The CAD / GDP ratio which was a meagre 0.1 percent in the First Plan, increased to 2.4 percent during the Second Plan. It slightly declined during the Third and Annual Plan periods. Another notable feature was a decline in the import cover from 15 to 5 from First Plan and further to 3 during the Third and Annual plan periods. Furthermore, the export / import ratio too declined from 85 to 60 from the First Plan to the Annual Plan periods.
Table 5.2: Key Indicators of India’s Balance of Payments: Plan – wise Annual Average

(As Per cent of GDP)

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<tbody>
<tr>
<td>1</td>
<td>Exports</td>
<td>6.1</td>
<td>4.6</td>
<td>3.5</td>
<td>3.7</td>
</tr>
<tr>
<td>2</td>
<td>Imports</td>
<td>7.2</td>
<td>7.9</td>
<td>5.7</td>
<td>5.9</td>
</tr>
<tr>
<td>3</td>
<td>Total Merchandise trade</td>
<td>13.3</td>
<td>12.5</td>
<td>9.2</td>
<td>9.6</td>
</tr>
<tr>
<td>4</td>
<td>Trade Deficit</td>
<td>-1.1</td>
<td>-3.3</td>
<td>-2.2</td>
<td>-2.2</td>
</tr>
<tr>
<td>5</td>
<td>Current Account Deficit</td>
<td>-0.1</td>
<td>-2.4</td>
<td>-1.8</td>
<td>-2.1</td>
</tr>
<tr>
<td>6</td>
<td>Import Cover of Reserves ( in months) – Annual average</td>
<td>15.1</td>
<td>4.8</td>
<td>2.9</td>
<td>3.2</td>
</tr>
<tr>
<td>7</td>
<td>Export / Import Ratio</td>
<td>85.00</td>
<td>58.25</td>
<td>60.90</td>
<td>63.55</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India: India’s Balance of Payments 1948 - 49 to 1988 – 89 & Reserve Bank of India Bulletin (Various issues)

5.3.1.3 Evaluation of Trade Policy in Phase I

The important features of trade policy in Phase I & its effect on balance of payments can be summarized as follows:-

- This period was marked by three wars (1962 with China, and 1965 & 1971 with Pakistan).

- The Indian economy faced the first macroeconomic crisis between 1965 - 1967. During this period, the balance of payments deteriorated because of the two severe droughts in succession (1965 - 66 and 1966 – 67), which further led to an increase in food imports and reduction in primary product exports. This weakness of the balance of payments and the shortage of food increased the economy’s dependence on foreign aid.

- To overcome the crisis, the government undertook three important policy measures – (a) firstly, a restrictive fiscal policy was adopted, (b) secondly, the rupee was devalued in June 1966, along with import liberalization and rationalization of import duties and export subsidies, and (c) thirdly, a new...
agricultural strategy was adopted which encouraged the use of fertilizers and high yielding variety seeds.

- The measure of devaluation was highly criticized, though considered as a correct long term measure, its timing was improper because it was determined by the momentum of negotiations and not by the objective of economic situation.
- The favourable effects of devaluation were swamped by the drought and the balance of payments situation further deteriorated in 1966 – 67 and 1967 – 68.
- Finally, the balance of payments situation did improve after 1967 – 68, but it was mainly because of agricultural recovery in 1968, that led to a decline in food imports and capital goods imports.
- Overall there was slow growth in exports in relation to import requirements which was partly because of adverse external factors.

### 5.3.1.4 Critical Appraisal of Trade Policy of Phase I

The impact of trade policy of Phase I on industrial development, exports, and certain macroeconomic indicators is as follows:

(a) Effect on industrial development: The trade policy of Phase I which was mainly based on import substitution no doubt succeeded in achieving the objective of industrialization and saving of foreign exchange. This inward – looking strategy of industrialization resulted into high rates of industrial growth between 1956 and 1966. For instance, there occurred a noticeable acceleration in the compound (annual) growth rate of industrial production over the first three Plan periods up to 1965 from 5.7 per cent in the First Plan to 7.2 per cent in the Second Plan and
further to 9.0 per cent in the Third Plan. Moreover, the rate of growth of capital goods industries shot up considerably from 9.8 per cent per annum in the First Plan to 13.1 per cent per annum in the Second Plan and further to 19.6 per cent per annum in the Third Plan. The rate of growth of ‘basic goods’ industries also registered a significant increase from 4.7 per cent per annum in the First Plan to 12.1 per cent per annum in the Second Plan and stood at 10.4 per cent in the Third Plan. This shows that a strong base for industrial development was laid during the first three plan periods.

During the trade policy of phase I, the long – term growth rate of industrial production works out to be 7.7 per cent over the first three plan periods and 4.0 per cent during the three Annual Plans.  

(b) Effect on exports: It is argued that the trade policy discriminated against exports which led to poor export growth. As a result, there was consistent fall in exports as a proportion of GDP until the early 1970s. For instance, exports as a per cent of GDP fell from 6.4 per cent in First Plan to 4.2 per cent by the end of three Annual plans. Moreover, Indian exports as a proportion of world exports fell from 2.5 per cent in 1947 to 2 per cent in 1950 and further to one per cent by 1965. Thus, most of decline in Indian exports was caused by our own policies rather than external factors.

(c) Effect on Macroeconomic indicators: (a) The Gross Domestic Savings / GDP ratio was 9.6 per cent in 1950s which further increased to 12.3 per cent in 1960s. Similarly, the Gross Domestic Capital formation / GDP ratio was 10.8 per cent in 1950s, which further went up to 14.3 per cent in 1960s. (b) The Saving – Investment Gap / GDP ratio was – 1.2 per cent in 1950s, which increased to – 2.0 per cent in 1960s. (c) A notable impact can be seen on the inflation rate which increased from
1.2 per cent in 1950s to 6.4 per cent in 1960s. (d) From 1950s to the end of 1960s, there was stagnation in the growth rate of Real GDP. For instance, In 1950s, the average annual growth rate of Real GDP was 3.6 per cent while in 1960s it was 4.0 per cent.  

(d) Other weaknesses: Some of the other weaknesses of the trade policy followed in phase I were: (i) administrative delays and inflexibilities; (ii) lack of coordination among different agencies; (iii) absence of competition; (iv) protection to industries regardless of cost; and (v) loss of revenue.

5.3.2 Phase II – Export Promotion & Import Liberalization (From 1970s to 1990s)

Phase II of export promotion & import liberalization covers the period from Fourth Plan (1969 – 70 to 1973 -74) to Seventh Plan (1985 – 86 to 1989 - 90). One of the important features during the second phase is that the year 1977 – 78 initiated a new era of import liberalization in the country and the process was further carried forward in 1980s. After taking into account the defects of import substitution policy, the policy makers realized that there was a need to correct the “anti – export” bias which dominated the formulation of trade policy till 1970s. A revival of export promotional methods which started gaining momentum resulted in an Export Policy resolution by the Cabinet Committee as early as in 1970. Thus, during seventies, several export promotion measures were put in place to generate higher exports on a sustained basis. In this context, Panchamukhi (1987) noted – “From 1971 onwards, a new dimension to the export promotion effort was added in the form of creation of a number of organizations aimed at providing export services to the exporting
community. Creation of export promotion councils, commodity boards, and the Trade Development Authority in the early 1970s signifies these developments.9

The export promotion measures undertaken in the seventies implied a gradual shift in the policy stance from import substitution to export promotion. However, protective quotas remained more or less same, and the domestic industry continued to be protected from import competition.

In the early eighties, foreign trade policy issues became a matter of intensive discussion among the policymakers in India. It was realized that import licensing scheme which permitted imports to cover the shortfall in domestic demand, irrespective of difference in cost and prices, could only lead to inefficiency. Therefore, a more liberal policy of imports of capital goods and technology was necessary to get the benefits of international division of labour. It was realized that there was a need to move away from a policy of import substitution per se to efficient import substitution. Further, it also became increasingly clear that production for export could not be isolated from production for the domestic market and that trade policy had to be integrated with the policy for domestic industrialization.

It is pertinent to note that during seventies and eighties, the changes in trade policy were also influenced by the recommendations of a number of committees which were set up during the said period. Three important committees were – (1) Alexander Committee (1978) (2) Tandon Committee (1980) and (3) Abid Hussain Committee (1984).

The Alexander Committee (1978) 10 – recommended simplification of the import licencing procedures and provided a framework involving a shift in the emphasis from ‘controls’ to ‘development’. In a nutshell, it had recommended – replacement
of the licensing system by the tariff system, rationalization of export incentives, elimination of multiplicity of incentives, more liberal access to imports by exporters, coordination of the different policy instruments such as trade policies, industrial policies, monetary and fiscal policies, strengthening of the institutional infrastructure for export promotion, judicious combination of exports and import substitution etc.

On the basis of the recommendations of the Alexander Committee, selective import liberalization measures were initiated in the late seventies which aimed at import of capital goods easier. Similarly, imports of certain raw materials that were not available indigenously were also placed under the Open General Licence (OGL) list. The policy measures also gave emphasis to simplify the procedures governing India’s foreign trade. During this period, special measures were undertaken to boost the export of project goods.

The Tandon Committee (1980) was more explicit about the desirability of export promotional devices. It recommended a package of export promotional measures which included subsidies and fiscal concessions to exporters. The Committee suggested that there was a need for having an integrated approach towards the export activity right from production upto the marketing stage and export planning at the national level, state level and the corporate level should become an integral part of the decision making process. The following abstract from the Tandon Committee’s Report (1980) sums up the official position in India on exports during the early 1980s: “Rapid export growth will undoubtedly help the overall rate of growth of the economy because of efficiency gains obtained from the pursuit of dynamic comparative advantage and the flexibility regarding foreign exchange availability. The emphasis on exports is viewed as a case for reallocating future investment of resources from import – substitution to export promotion in a manner consistent
with dynamic comparative advantage for allocating productive resources optimally between import – substituting production and export – oriented production.” 12

There were two main reasons behind advocating export promotional strategy. The first reason was that it would increase export earnings. The second reason was that it would allocate resources efficiently. Thus, the policy which combined export promotion and import liberalization was looked upon as a second – best remedy which could be achieved in the face of prevailing ‘distortions’ in the domestic economy. It clearly favoured liberalization of trade and encouragement of other conditions to achieve dynamic comparative advantage.

The main message of the *Abid Hussain Committee’s Report (1984)* 13 seems to emphasize the importance of exports and rational export promotion policies. The Committee envisaged “growth led exports” rather than “export led growth”. It suggested simplification of the import policy for exporters by the introduction of the pass – book system. It also recommended that canalization of imports should be effected on a selective basis, based upon rational criteria. It recommended that the real effective exchange rate (REER) of the rupee should not be allowed to appreciate and should be maintained at a level considered appropriate for ensuring the competitiveness of exports. It stressed upon the need for harmonization of foreign trade policies with other economic policies and advocated for a phased reduction of effective protection. In order to maintain continuity and facilitate long term planning of exports, the Committee also suggested announcement of trade policies for longer periods. The Committee stressed on export promotion and import liberalization especially of technical know how through foreign equity participation in India. It was believed that a free flow of foreign direct investment would contribute to higher exports and lead to technological innovations in the export sector.
A comparative picture of the trade policy changes from 1950s to 1980s is rightly shown by Mehta (1997) as follows - “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 recommendations given by the above three Official Committees were implemented by the Government in the annual as well as long term policy announcements in ensuing years. Accordingly, for the first time a three year long term import export (LTMX) policy covering the period 1985 – 88 was announced on 31st March 1985, with an objective of bringing in continuity and stability in import – export policy. This policy was formulated with the aim of boosting exports and encouraging efficient import substitution. Subsequently, also three year policies were announced, but each time the policy was cut short by one year. However, for the first time in trade history, a five year Export & Import (EXIM) Policy was announced by the Government of India on 31st March, 1992. The announcement of the new EXIM policy covered the five year period from April 1992 to March 1997 and it coincided with the launching of India’s Eighth Five Year Plan (1992/93 to 1996/97).

In a nutshell, the trade liberalization measures undertaken especially after 1985 were directed towards two goals -

- To provide easy access to imports essential for maximizing production and exports;
- To gradually open up the economy and make selective capital goods industries internationally competitive.
The first three yearly import – export policy (1985 – 88) which coincided with the first three years of the Seventh Plan (1985/86 to 1989/90) therefore saw the injection of a dose of economic liberalization in general and trade liberalization in particular.

A major ingredient of the Export – Import Policy announced in March 1985 was the provision of easy access to essential capital goods, raw materials and components from abroad since these were viewed as a major incentive for exporters in undertaking technological upgradation for reducing costs and improving quality.

In the context of trade policy & trade liberalization, the Annual Report (1987 – 88) of Ministry of Commerce, observed – “The broad philosophy of the trade policy is to encourage production and modernization of the indigenous industry and to encourage international trade in accordance with the India’s long – term dynamic comparative advantage. Export promotion measures have received special attention during the current plan period. These measures focus on removing the disadvantages faced by Indian exporters and to increase their competitive ability in the foreign markets. The import policy on the other hand, aims to make available critical inputs and capital goods to domestic producers to increase production and to upgrade the existing production technologies.”

5.3.2.1 Important Import Liberalization Measures

Some of the important import liberalization measures undertaken in the first three LTMX policies were -

(1) Policy for Import of Capital Goods – As capital is considered as basic requirement of the industrial sector, the approach in these policies was to provide easy access to imported capital items by progressively delinking them from licensing formalities. Hence, a large number of capital goods were
placed under OGL category, that is, they could be imported without any import licence.

(2) **Policy for Import of Raw Materials** – A large number of raw materials and components and consumables were also placed under OGL in order to enable the actual users to procure them without going through licensing formalities.

(3) **Policy for Import of Technology** – The government also allowed liberal import of technology with a view to make export production of the country internationally competitive and also to help in the country’s technological advancement.

### 5.3.2.2 Important Export Promotion Measures

Some of the important export promotion measures undertaken by the Government of India during the period 1966 to 1990 were –

(1) **Cash Compensatory Support (CCS)** – It was introduced in 1966 and was designed to provide compensation for unrebated indirect taxes paid by exporters on inputs, higher freight rates, and market development costs. The rates varied from product to product and from exporter to exporter. However, the scheme was abolished after the devaluation of rupee in July 1991.

(2) **Duty Drawback Scheme** – The objective of the duty drawback scheme is to reimburse exporters for tariff paid on the imported materials and intermediates and central excise duties paid on domestically produced inputs which entered into export production.

(3) **Replenishment Licences** – In order to provide the export sector of the economy with access to importable inputs that enter into export production, at international prices, the import policy allowed special import facilities for
Registered Exporters. Registered Exporters were permitted to import capital goods against REP (Replenishment) Licenses.

(4) Advance Licenses and Duty Exemption Scheme – Advance licenses facilitated imports of specified raw materials without payment of any customs duty. Such licenses were available only against confirmed export orders and / or letters of credit.

(5) Establishment of Export Processing Zones and 100 per cent Export Oriented Units – To encourage exports, the government initiated setting up of Export Processing Zones (EPZs) which provided almost free trade environment for export production so as to make Indian export products competitive in the world market. Further, the scheme of 100 per cent Export Oriented Units (EOUs) was introduced in December 1980 to provide duty free access to imports of raw materials, intermediate goods, capital goods and technology on OGL.

(6) Fiscal concessions for exports – Export earnings also included fiscal concessions in the form of partial exemption from income tax or lower rate of taxes besides the benefit received through cash compensatory scheme and duty drawback scheme.

(7) Export Credit and Assistance to Export Promotion Councils – Assistance was granted in the form of grants – in – aid to the Export Promotion Councils and approved organizations and individual exporters to undertake various activities which would encourage exports.

(8) Blanket Exchange Permit Scheme – It was introduced in June 1987 to give a major thrust to the country’s export promotion drive. Under this scheme,
exporters were allowed, barring a few products, to utilize 5 to 10 per cent of their foreign exchange earnings for undertaking export promotion activities.

(9) *Policy for Export Houses* – Exporters who fulfill certain minimum export requirements for a specified period of time are granted the status of Export Houses, Trading Houses, Star Trading Houses, or Super Star Trading Houses. They were provided increasingly with a number of import benefits.

(10) *Organisational efforts* – In order to promote exports various organizational agencies were set up like – (a) Export Promotion Councils, (b) Trade Development Authority, (c) Export Credit & Guarantee Corporation of India, (d) Export Houses, etc.

### 5.3.2.3 Performance of Balance of Payments in Phase II

The trade policy of Phase II covered the period from Fourth Plan to Seventh Plan. Several important developments took place during this phase like – the two oil shocks of 1973 and 1979, increase in foreign exchange reserves, increase in the current account deficit, etc. These developments affected various indicators of balance of payments.

Table 5.3 depicts the balance of payments data from Fourth Plan to Seventh Plan. As is evident from Table 5.3, during the Fourth plan there was a decline in trade deficit to ₹1,730 crore and a massive increase in invisibles to ₹1,375 crore. Hence, the invisibles were able to finance almost 80 per cent of the trade deficit. There was a decline in the CAD to the extent of ₹350 crore. It was mainly financed by external assistance. In fact yearly data of BOP during the Fourth Plan reveals that there was a surplus in current account to the extent of ₹1,135 crore in the year 1973 – 74.

The Fifth Plan period (1974 – 79) can be said to be a period of comfortable situation from India’s balance of payments point of view. During the said period, the trade
deficit was entirely financed by the invisibles. As a result, there was a current account surplus to the extent of ₹645 crore. Besides this there was a massive increase in foreign exchange reserves as compared to the earlier plan period. For instance, the foreign exchange reserves increased from ₹295 crore in the Fourth Plan to ₹4780 crore in the Fifth Plan. This period can be said to be the ‘golden years’ from the India’s balance of payments point of view.

Table – 5.3 Key Components of India’s Balance of Payments : Plan - wise Total ( In ₹. Crore)

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<tr>
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<tbody>
<tr>
<td><strong>Merchandise</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A) Exports f.o.b</td>
<td>8755</td>
<td>23549</td>
<td>45697</td>
<td>90165</td>
</tr>
<tr>
<td>B) Imports c.i.f.</td>
<td>10485</td>
<td>29138</td>
<td>78767</td>
<td>144370</td>
</tr>
<tr>
<td><strong>I. Trade Balance ( A – B )</strong></td>
<td>-1730</td>
<td>-5589</td>
<td>-33070</td>
<td>-54205</td>
</tr>
<tr>
<td><strong>II. Invisibles Net</strong></td>
<td>1378</td>
<td>6236</td>
<td>18554</td>
<td>13162</td>
</tr>
<tr>
<td><strong>III. Current Account ( I + II )</strong></td>
<td>-352</td>
<td>647</td>
<td>-14516</td>
<td>-41043</td>
</tr>
<tr>
<td>IV. Capital Account ( A to E)</td>
<td>622</td>
<td>4098</td>
<td>10389</td>
<td>41124</td>
</tr>
<tr>
<td>A) Foreign Investment net</td>
<td>186</td>
<td>49</td>
<td>0</td>
<td>2012</td>
</tr>
<tr>
<td>B) External assistance, net</td>
<td>635</td>
<td>4680</td>
<td>5573</td>
<td>12729</td>
</tr>
<tr>
<td>C) Commercial Borrowings, net</td>
<td>152</td>
<td>748</td>
<td>2972</td>
<td>10647</td>
</tr>
<tr>
<td>D) NRI Deposits, net</td>
<td>0</td>
<td>559</td>
<td>2355</td>
<td>12893</td>
</tr>
<tr>
<td>D) Other capital</td>
<td>-351</td>
<td>-1938</td>
<td>-511</td>
<td>2843</td>
</tr>
<tr>
<td>V. Overall Balance ( III + IV)</td>
<td>270</td>
<td>4745</td>
<td>-4127</td>
<td>81</td>
</tr>
<tr>
<td>VI. Monetary Movements ( VII + VIII + IX)</td>
<td>-270</td>
<td>-4745</td>
<td>4127</td>
<td>-81</td>
</tr>
<tr>
<td>VII. Reserves ( increase / decrease + )</td>
<td>-295</td>
<td>-4779</td>
<td>-190</td>
<td>5076</td>
</tr>
<tr>
<td>VIII. IMF net</td>
<td>-217</td>
<td>-91</td>
<td>4205</td>
<td>-5157</td>
</tr>
<tr>
<td>IX. SDR Allocation</td>
<td>242</td>
<td>125</td>
<td>112</td>
<td>0</td>
</tr>
</tbody>
</table>

As is evident from Table 5.3, the comfortable position of BOP of the Fifth Plan could not continue in the Sixth plan (1980 – 85). In fact, the Sixth Plan revealed several peculiar features of the balance of payments. Some of the important features were –

- First, during the Sixth plan, exports nearly doubled while imports increased by more than two fold as compared to the Fifth plan;
- Second, the resultant trade deficit increased nearly by six times as compared to the previous plan. As depicted in Table 5.3, the trade deficit increased from ₹.5590 crore in the Fifth plan to ₹.33,000 crore in the Sixth plan;
- Third, compared to the Fifth plan, invisibles showed an increase of three fold which could finance almost 55 per cent of trade deficit;
- Fourth, a small surplus in the current account during the Fifth plan turned into a massive deficit of ₹.14,500 crore in the Sixth plan;
- Fifth, there was almost four times increase in the commercial borrowings and NRI deposits. Moreover, both of them are considered to be costlier sources of finance.
- Sixth, the current account deficit was mainly financed by external assistance, (38 per cent), borrowings from IMF, (28 per cent), commercial borrowings (20 per cent) and NRI deposits. (14 per cent).

Table 5.3 shows that the balance of payments situation worsened in the Seventh plan (1985 – 90) period. Some of the important features of the balance of payments situation during the Seventh plan were –

- As compared to the Sixth Plan, both exports and imports nearly doubled during the Seventh plan period;
The resultant trade deficit of ₹54,200 crore showed an increase of more than one and half times compared to the previous plan period;

Invisibles however showed a decline and were able to finance only about 25 per cent of the trade deficit;

The current account deficit increased by more than two and half times as compared to the previous plan. It increased from ₹14,500 crore in the Sixth plan to ₹41,000 crore in the Seventh Plan.

The use of external assistance, commercial borrowings and NRI deposits as sources of finance increased considerably during the Seventh plan.

On the one hand, the use of external assistance more than doubled, while the use of commercial borrowings and NRI deposits more than quadrupled. In a nutshell, the use of costlier sources of financing increased substantially in the Seventh plan.

In fact, almost 88 per cent of the current account deficit was financed by external assistance, commercial borrowings and NRI deposits.

There was a massive decline in the foreign exchange reserves to the extent of ₹5000 crore in the Seventh plan period.

As shown in Table 5.4, TD / GDP ratio was 0.7 in the Fourth Plan which further increased to 1.2 in the Fifth Plan. However, this ratio doubled in the Sixth plan to 3.5 and remained more or less same in the Seventh plan. The CAD / GDP ratio was a meagre 0.3 in the Fourth plan, which turned into a surplus of 0.1 in the Fifth plan. The current account once again turned into a deficit in the Sixth plan and the CAD / GDP ratio went up to 1.5 in the Sixth plan and further increased to 2.2 in the Seventh plan period. The import cover of foreign exchange reserves showed a slight improvement from 5.2 in the Fourth plan to 6.7 in the Fifth Plan. However, it
declined to 4.1 in the Sixth plan and further to 3.4 in the Seventh plan. The export / import ratio which was about 80 per cent in the Fourth and Fifth plan, too declined to about 60 per cent in the Sixth and Seventh plan period.

Table 5.4: Key Indicators of India’s Balance of Payments:
Plan – wise Annual Average (As Per cent of GDP)

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<tbody>
<tr>
<td>1</td>
<td>Exports</td>
<td>3.6</td>
<td>5.0</td>
<td>4.7</td>
<td>4.8</td>
</tr>
<tr>
<td>2</td>
<td>Imports</td>
<td>4.3</td>
<td>6.2</td>
<td>8.2</td>
<td>7.7</td>
</tr>
<tr>
<td>3</td>
<td>Total Merchandise trade</td>
<td>7.9</td>
<td>11.2</td>
<td>12.9</td>
<td>12.5</td>
</tr>
<tr>
<td>4</td>
<td>Trade Deficit</td>
<td>-0.7</td>
<td>-1.2</td>
<td>-3.5</td>
<td>-3.0</td>
</tr>
<tr>
<td>5</td>
<td>Current Account Deficit</td>
<td>-0.3</td>
<td>0.1</td>
<td>-1.5</td>
<td>-2.2</td>
</tr>
<tr>
<td>6</td>
<td>Import Cover of Reserves (in months) – Annual average</td>
<td>5.2</td>
<td>6.7</td>
<td>4.1</td>
<td>3.4</td>
</tr>
<tr>
<td>7</td>
<td>Export / Import Ratio</td>
<td>83.50</td>
<td>80.80</td>
<td>58.00</td>
<td>62.45</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India – Handbook of Statistics on Indian Economy, 2005-06

5.3.2.4 Impact of the Oil shocks on India’s Balance of Payments

One of the crucial factors which affected India’s BOP during the decades between 1970s and 1980s was the emergence two oil shocks in 1973 & 1979.

(1) First oil shock 1973 & its management – One of the exogenous factors which affected India’s BOP during the Fourth Plan was the first oil shock of 1973. The Organisation of Petroleum Exporting Countries (OPEC) resorted to a substantial increase in the price of crude oil from $2.50 per barrel in October 1973 to $11.65 per barrel in January 1974. Its direct impact was a massive escalation in the foreign exchange expenditure on oil imports which, in turn, imposed a severe pressure on the balance of payments. For instance, India’s oil imports increased from ₹.204 crore in 1972 – 73, to ₹.560 crore in 1973 – 74, and further to ₹.1157 crore in 1974 – 75.
Apart from this the country had to resort to import of fertilizers, and foodgrains during the same period, which further aggravated the import bill.

Thus, Joshi & Little (1994) observed that - “there can be no doubt that the 1973 – 74 and 1974 – 75 were crisis years. The crisis had a political component and the macroeconomic component, and the latter in turn had an inflation component as well as balance of payments component.” Thus, the Indian economy faced second macroeconomic crisis between 1973 and 1975.

The immediate effect of this shock was the widening of CAD, which increased from ₹.312 crore in 1972 – 73 to ₹.956 crore in 1974 – 75. (Table 5.5). There was also domestic inflation due to severe droughts of 1972 and 1974. Besides this, the disturbed political situation led to imposition of national emergency by Mrs. Indira Gandhi in June 1975.

*Management of first oil shock* – The first oil shock was managed well due to following factors -

- To overcome the crisis, the import controls were tightened in 1973 – 74 and 1974 – 75 and measures were undertaken to restrain the consumption of petroleum products.
- On the export front, India’s exports grew rapidly, in the years 1974 – 75 and 1975 – 76, in spite of stagnancy in world trade and decline in the exports of non oil developing countries.
- It would be pertinent to note that despite the first oil shock of 1973, the current account showed a surplus of ₹.1135 crore in 1973 – 74. The reduction of CAD to ₹.178 crore in 1975 – 76, was a dramatic change. In the years 1976 -77 and 1977 – 78 there was a surplus in the current account of ₹.890 crore and ₹.1120 crore respectively. However, the current account
went into deficit again in 1978 – 79 (₹238 crore), but overall the balance of payments remained comfortable. (Table 5.5).

- Besides the import control measures, in the early stages the shock was mainly financed through substantial borrowings from the soft facilities of IMF like – CFF, low conditionality credit and oil facility. In addition, there were bilateral and multilateral grants and loans. However, these borrowings were mainly concessional and there was no borrowing from commercial sources.

- On the fiscal front, there was a control over the government’s current expenditure through a restrictive fiscal policy accompanied by a tight monetary policy.

Table 5.5: Current Account of India’s Balance of Payments - 1973 to 1979

(In ₹. Crore)

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<tbody>
<tr>
<td>Merchandise</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A) Exports f.o.b</td>
<td>1994</td>
<td>2357</td>
<td>3195</td>
<td>4180</td>
<td>5140</td>
<td>5440</td>
<td>5594</td>
</tr>
<tr>
<td>B) Imports c.i.f.</td>
<td>2161</td>
<td>2867</td>
<td>4482</td>
<td>5362</td>
<td>5450</td>
<td>6038</td>
<td>7806</td>
</tr>
<tr>
<td>I. Trade Balance (A – B)</td>
<td>-168</td>
<td>-510</td>
<td>-1287</td>
<td>-1183</td>
<td>-310</td>
<td>-598</td>
<td>-2212</td>
</tr>
<tr>
<td>II. Invisibles Net</td>
<td>-144</td>
<td>1646</td>
<td>331</td>
<td>1005</td>
<td>1204</td>
<td>1722</td>
<td>1974</td>
</tr>
<tr>
<td>III. Current Account (I + II)</td>
<td>-312</td>
<td>1136</td>
<td>-956</td>
<td>-178</td>
<td>894</td>
<td>1124</td>
<td>-238</td>
</tr>
</tbody>
</table>

Hence, contrary to the belief the economy was able to manage fairly quickly the first oil shock of 1973. In brief, the main reasons behind this were as follows –

- an improvement in export performance especially during the period 1972-73 to 1976-77;
- slow expansion in imports;
- a sustained increase in private transfer payments in the form of remittances from NRIs and Indian workers from middle–east; and
- foreign aid & large scale borrowing by government from abroad, especially from IMF.

(2) Second oil shock 1979 & its management: The second oil shock came in 1979–80 as the oil prices were hiked by the OPEC from around $13.00 per barrel in late 1978 to around $35.00 per barrel in 1979. This had a serious negative impact on the India’s balance of payments situation. The full impact of the increase in oil prices was reflected in the trade balance of 1980–81. The trade deficit increased from ₹2200 crore in 1978–79 to ₹3400 crore in 1979–80 and further to ₹6200 crore in 1980–81. Similarly, the current account deficit increased from ₹230 crore in 1978–79 to ₹550 crore in 1979–80 and further to ₹2200 crore in 1980–81. Table 5.6 shows the impact of second oil shock on trade balance and current account balance, during the period from 1979–80 to 1980–81. Thus, between 1979 and 1981, the Indian economy faced the third macroeconomic crisis.
Table 5.6: India’s Trade Balance & Current Account Balance 1979 to 1981

( In ₹, Crore)

<table>
<thead>
<tr>
<th>Year</th>
<th>Trade Balance</th>
<th>Current Account Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978–79</td>
<td>-2212</td>
<td>-238</td>
</tr>
<tr>
<td>1979–80</td>
<td>-3440</td>
<td>-553</td>
</tr>
<tr>
<td>1980–81</td>
<td>-6211</td>
<td>-2214</td>
</tr>
</tbody>
</table>


Causes of deterioration in BOP – Economists have identified several causes behind the deterioration in BOP during and after the second oil shock. Notable among them were:

- Severe drought of 1979–80 which affected both kharif and rabi crops, leading to a drop in foodgrains and agricultural production.
- Rise in import prices to the extent of 50 per cent mainly accounted by rise in import prices of crude petroleum.
- Increase in import prices of fertilizers and non-ferrous metals.
- Rise in domestic fuel costs due to disruption in domestic oil production resulting from the agitation in Assam.
- Import liberalization measures leading to increase in imports of intermediate and capital goods.
- Stagnation in exports after 1976–77 mainly due to slow growth in world trade, appreciation of real exchange rate and stagnation in domestic savings.
• Fall in invisible receipts due to a fall in net factor income from abroad, decline in current transfers and earnings from transportation and tourism.

• Expansionary fiscal – monetary policy mix.

• Non concessional borrowing.

*Measures to overcome the second oil shock* – The following measures were initiated to overcome the second oil shock –

- **Import substitution in oil** - Import substitution program in oil was undertaken. Extraction of oil in the Bombay High field began in 1976 and domestic production of oil increased gradually. Expenditure on oil exploration was also stepped up sharply and by 1980 several new fields had been discovered in the Bombay offshore region.

- **Restraining domestic consumption** - Domestic consumption of petroleum products was restrained by increasing their prices.

- **Loan from IMF** – On this occasion, the government did not respond with fiscal contraction for stabilization and an intensification of import controls in order to reduce the current account deficit. Rather, it decided to maintain the increased level of the import bill, and to seek external borrowing for a programme of so-called ‘expansionary adjustment’, which would involve an increase in investment, especially to increase oil output and other infrastructural production, and also attempt to increase public savings and exports.

- It was to this end that the government negotiated a very large loan from the Extended Fund Facility (EFF) of IMF. In November 1981, after prolonged negotiations in which the US representative opposed the loan, India was granted a loan of SDR 5 billion, payable in three instalments over three
The conditionalities attached to this loan involved a set of performance criteria, specifying ceilings on net bank credit to government and total domestic credit, limits on money supply (M3) and a prohibition on any further import restrictions. In addition, the government issued a ‘statement of economic policies’ worked out in consultation with the IMF, with regard to the economic policies it proposed to pursue over the next five years. This set of proposed policies included not just increased public investment for domestic oil production and infrastructure, but also several commitments towards economic liberalization.

- **Borrowing from other sources** – Apart from the loan from IMF, there was non concessional borrowing from sources like the World Bank, and other external sources like NRI deposits etc.

**An evaluation of the management of two oil shocks** – A comparative analysis of the economy’s adjustment to the two oil shocks of 1973 and 1979 by Joshi & Little (1994)  & Kapur (1997) revealed the following:

- In both the shocks, there was a sharp increase in the price of oil imports which led to widening of the current account deficit.

- In case of both the shocks, measures were taken to stimulate oil production and to restrain domestic oil consumption.

- Import controls were tightened after the first oil shock, while they were liberalized after the second oil shock.

- The current account turned around very quickly after the first oil shock and then went into massive surplus for two years. After the second oil shock, however, the current account as a proportion of GDP showed no improvement.
➢ In the case of first oil shock, the fiscal – monetary policy mix was restrictive and tight. While in the case of second oil shock, it was expansionary and less severe.

➢ Foreign borrowing was concessional and accompanied by adjustment measures after the first oil shock. After the second shock, in addition to concessional borrowing there was also non concessional borrowing.

➢ Exports soared after the first oil shock, and stagnated after the second oil shock.

➢ There was a firm control over government’s current expenditure after the first oil shock, on the contrary it increased after the second oil shock.

➢ A pronounced world recession inhibited export growth in the aftermath of the Second crisis whereas the adjustment to the first oil shock was rendered painless by buoyant exports.

➢ The tight monetary policy and the other demand restraining measures helped moderate the inflation rate in the immediate aftermath of the first oil shock, in contrast, inflation rate was substantially higher in the years following the second oil shock.

➢ The stance of exchange rate policy was more conducive to containment of trade deficit in the first shock as compared to the second shock. REER depreciated by a massive 22 per cent during the three year following the first oil shock in contrast to the appreciation of 5 per cent in the three year period following the second shock.

➢ The support from private transfers which was quite conspicuous in the years following the first oil shock, was not forthcoming as they tapered off from 1980 – 81 onwards.
An assessment of IMF Loan: The loan taken from the IMF was criticized on following grounds – (1) First, given the extent of current account deficit, loan of such a magnitude was not necessary because adjustment would have been possible through internal economic policies. (2) Secondly, it would lead the country to internal and external debt trap. (3) Thirdly, it would lead to sacrifice of national autonomy in economic policy. (4) Fourthly, the conditionalities reflected a monetarist approach to balance of payments adjustment. (5) Finally, it was expected that it would lead to deflation.

However, the IMF programme in India was highly successful. The EFF helped India considerably in the financing of CAD during 1980 - 81 to 1983 – 84. In 1982 - 83, 60 per cent of the current account deficit was financed through EFF, and in the year 1983 – 84, this proportion was 50 per cent. In 1984 – 85, India terminated the EFF before fully utilizing the amount originally contemplated. Thus, due to IMF loan, the current account deficit as a proportion of GDP declined from 1.7 per cent in 1981 – 82 to 1.2 per cent in 1984 – 85. Table 5.7 reflects the changes in current account deficit as per cent of GDP from 1981 – 82 to 1984 – 85.

Table 5.7: Current Account Deficit as Per cent of GDP from 1982 to 1985

<table>
<thead>
<tr>
<th>Year</th>
<th>Current Account Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981- 82</td>
<td>- 1.7</td>
</tr>
<tr>
<td>1982 – 83</td>
<td>- 1.7</td>
</tr>
<tr>
<td>1983 – 84</td>
<td>- 1.5</td>
</tr>
<tr>
<td>1984 – 85</td>
<td>- 1.2</td>
</tr>
</tbody>
</table>

Table 5.8: Terms of Trade from 1970 – 71 to 1980 – 81

<table>
<thead>
<tr>
<th>Year</th>
<th>Terms of trade (1978 -79 = 100)</th>
<th>Percentage change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970 - 71</td>
<td>127.5</td>
<td>----</td>
</tr>
<tr>
<td>1971 – 72</td>
<td>140.2</td>
<td>9.96</td>
</tr>
<tr>
<td>1972 - 73</td>
<td>149.7</td>
<td>6.77</td>
</tr>
<tr>
<td>1973 - 74</td>
<td>127.2</td>
<td>- 15.03</td>
</tr>
<tr>
<td>1974 - 75</td>
<td>92.3</td>
<td>- 27.43</td>
</tr>
<tr>
<td>1975 - 76</td>
<td>84.7</td>
<td>- 8.23</td>
</tr>
<tr>
<td>1976 - 77</td>
<td>92.8</td>
<td>9.56</td>
</tr>
<tr>
<td>1977 - 78</td>
<td>114.0</td>
<td>22.84</td>
</tr>
<tr>
<td>1978 - 79</td>
<td>100.0</td>
<td>- 12.28</td>
</tr>
<tr>
<td>1979 – 80</td>
<td>92.4</td>
<td>-7.6</td>
</tr>
<tr>
<td>1980 – 81</td>
<td>80.8</td>
<td>-12.5</td>
</tr>
</tbody>
</table>


5.3.2.5 Impact on Terms of Trade

The two oil shocks also affected the terms of trade. For instance, the first oil shock worsened the country’s terms of trade (TOT) to the extent of about 43 per cent between 1972 – 73 and 1975 – 76. Similarly, due to second oil shock, the terms of trade deteriorated by about 30 per cent between 1977 – 78 and 1980 – 81. The impact of the two oil shocks on the terms of trade from 1970 – 71 to 1980 – 81 is depicted in table 5.8.
5.3.2.6 Performance of Exports & Imports

The trade policy implemented in Phase II (1970s to 1990s) involved several export promotion and import liberalization measures. Hence, it would be worthwhile to analyse the performance of exports and imports during the said period.

By considering the data for exports and imports during the period 1970 to 1990, the compounded annual growth rate (CAGR) for exports and imports in rupee terms, have been calculated and are reflected in Table 5.9.

**Table 5.9 Decadal Growth Rates of Exports & Imports (In ₹.terms)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports</td>
<td>17.90</td>
<td>16.80</td>
</tr>
<tr>
<td>Imports</td>
<td>22.10</td>
<td>14.55</td>
</tr>
</tbody>
</table>


As reflected in Table 5.9 during 1971 – 80, the compound growth rate of exports was 18 per cent and that of imports was 22 per cent. While, during 1981 – 90, the compound growth rate of exports was 17 per cent and that of imports was 15 per cent. Further, the compound growth rates are also calculated by dividing a decade into two sub-periods, which is shown in Table 5.10.
Table 5.10: Growth Rates of Exports & Imports ( In ₹,terms) 

( In Per cent )

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports</td>
<td>27.30</td>
<td>6.90</td>
<td>11.25</td>
<td>26.70</td>
</tr>
<tr>
<td>Imports</td>
<td>30.30</td>
<td>24.60</td>
<td>10.00</td>
<td>22.65</td>
</tr>
</tbody>
</table>


It is quite clear from table 5.10 that during the first half of 1970s, the export growth rate was quite robust. During 1971 – 75, exports and imports grew in tandem, as the compounded growth rate of exports was 27 per cent and that of imports was 30 per cent. However, in the second half of 1970s, there was a drastic fall in the growth rate of exports as compared to imports. During 1976 – 80, exports grew at a rate of 7 per cent, while imports grew at 25 per cent. In the first half of 1980s, there was slight improvement in export performance, as it grew at a rate of 11 per cent. During the same period, there was a drastic fall in import growth, as they grew at about 10 per cent. In the second half of 1980s, once again exports and imports grew in tandem. During 1986 – 90, exports grew at a compound rate of 26 per cent while imports grew at 22 per cent.

The performance of exports can also be analysed in terms of unit value index and volume index of exports. While the unit value index of exports is largely a monetary phenomenon, volume index is a real phenomenon and thus, it is a better index of export performance compared to unit value. The rise in unit value is a function of a rise in domestic prices of exportables as well as the world prices of exports. On the
other hand, the rise in export volume is a function of domestic production, surplus between domestic production and domestic consumption as well as demand for exports in world markets. A rise in the unit value index of exports in relation to the unit value of imports improve the country’s terms of trade and has a stimulating effect on exports.

Table 5.11: Indices of India’s Exports 1971 to 1990

(1978 – 79 = 100)

<table>
<thead>
<tr>
<th>Year</th>
<th>Unit Value Index</th>
<th>Volume Index</th>
<th>Percentage Change (Unit value)</th>
<th>Percentage Change (Volume)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970 – 71</td>
<td>45.0</td>
<td>59.0</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>1971 – 72</td>
<td>46.0</td>
<td>59.2</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>1978 – 79</td>
<td>100.0</td>
<td>100.0</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>1979 – 80</td>
<td>105.4</td>
<td>106.2</td>
<td>129.13</td>
<td>79.40</td>
</tr>
<tr>
<td>1980 – 81</td>
<td>108.5</td>
<td>108.1</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>1981 – 82</td>
<td>124.1</td>
<td>110.1</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>1989 – 90</td>
<td>276.6</td>
<td>174.9</td>
<td>154.93</td>
<td>58.85</td>
</tr>
</tbody>
</table>


Table 5.11 gives the indices of India’s exports in terms of unit value and volume, from 1970 – 71 to 1989 - 90. It can be observed from table 5.11 that from 1971 -72 to 1979 - 80 the unit value index rose from 46 to 105, and the volume index rose from 59 to 106. Hence, during the 1970s, the percentage change in unit value index was about 130 per cent and that of volume index was 80 per cent. During 1981 – 82 to 1989 – 90, the unit value index rose from 124 to 276, and the volume index rose from 110 to 174. Thus, during the 1980s, the percentage change in unit value index
was 155 per cent and that of volume index was 59 per cent. A fall in the volume index in the decade of 1980s clearly reflects a fall in the export performance.

The decade of 1980s also involved import liberalization measures. Hence, the policy of import liberalization pursued with a vigour in the 1980s resulted in a substantial increase in volume of imports. Hence, the performance of imports can also be analysed in terms of unit value index and volume index of imports. The unit value of index and volume index of imports from 1978 – 79 to 1989 – 90 is given in table 5.12. Table 5.12 clearly indicates that both the unit value and volume index of imports more than doubled in a decade or so. For instance, unit value index increased from 100 in 1978 – 79 to 228.4 in 1989 -90. While, the volume index increased from 100 to 227.8 during the same period.

<table>
<thead>
<tr>
<th>Year</th>
<th>Unit Value Index</th>
<th>Volume Index</th>
<th>Percentage Change (Unit value)</th>
<th>Percentage Change (Volume)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978 - 79</td>
<td>100.0</td>
<td>100.0</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>1979 – 80</td>
<td>114.1</td>
<td>116.4</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>1980 – 81</td>
<td>134.2</td>
<td>137.9</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>1981 – 82</td>
<td>133.1</td>
<td>150.6</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>1989 - 90</td>
<td>228.4</td>
<td>227.8</td>
<td>128.4</td>
<td>127.4</td>
</tr>
</tbody>
</table>

**Evaluation of exports - imports performance:** There are several factors which caused exports to grow rapidly after 1970 – 71. Some of them are:

a) Intensified export promotion efforts by the government;

b) The emergence of Bangladesh as a trading partner since 1971;

c) Boom in prices of some primary commodities since 1970s;

d) Mild inflation and macroeconomic squeeze;

e) Depreciation in NEER and REER reflecting an improvement in profitability of exports;

f) Expansion in world trade resulting into increase in demand for India’s exportables; and

g) Emergence of new markets such as OPEC.

Similarly, during the period from 1976 to 1985, exports showed poor performance because of following reasons:

a) Drop in the rate of growth of agricultural production;

b) Increase in domestic demand for manufactured products;

c) Inflation;

d) Infrastructural or sectoral supply bottlenecks;

e) Lack of a consistent approach and long term perspective;

f) Lack of export culture among exporting community;

g) Stagnation in international trade; and

h) A steady increase in protectionism in the industrialized countries.

With reference to the performance of imports the following factors can be identified:

a) The rise in oil prices due to first oil shock in 1973 – 74 and second oil shock in 1979 – 80 increased India’s oil import bill;
b) High world inflation coupled with relative failure in agriculture caused the import bill on food grains to increase sharply;

c) Increase in the import of defence equipments in the 1980s;

d) The industrialization process and import liberalization measures resulted into increase in the imports of raw materials, semi finished goods, manufactured goods and capital goods;

e) The system of import replenishment licences (REP) increased significantly the import intensity of exports and;

f) Increase in the import intensity of Indian industry i.e. capital goods (engineering), iron and steel, and especially of consumer durable goods industries such as washing machines.

5.3.2.7 Trends in Foreign Exchange Reserves & Private Transfers

The second half of 1970s also saw a massive expansion in the foreign exchange reserves. In fact, it was the increase in net invisibles, foreign aid, and private transfer payments in the form of remittances that led to rapid accumulation of foreign exchange reserves. Moreover, remittances emerged as the most important factor affecting the balance of payments situation. The data in Table 5.13 shows the remarkable increase in foreign exchange reserves which took place in the second half of 1970s. As reflected in table 5.13, at the end of financial year 1970 – 71, the total foreign exchange reserves (excluding Gold & SDRs) were ₹.430 crore, which more than trebled to ₹.1490 crore by the end of financial year 1975 – 76. By the end of financial year 1979 – 80, the increase in reserves was more than three times and it was ₹.5160 crore.
### Table 5.13: Trends in India’s Foreign Exchange Reserves

(In ₹, Crore)

<table>
<thead>
<tr>
<th>End of Financial Year</th>
<th>Foreign exchange</th>
<th>Gold</th>
<th>SDRs</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970 – 71</td>
<td>438</td>
<td>183</td>
<td>112</td>
<td>733</td>
</tr>
<tr>
<td>1975 – 76</td>
<td>1492</td>
<td>183</td>
<td>211</td>
<td>1886</td>
</tr>
<tr>
<td>1976 – 77</td>
<td>2863</td>
<td>188</td>
<td>192</td>
<td>3243</td>
</tr>
<tr>
<td>1977 – 78</td>
<td>4500</td>
<td>193</td>
<td>170</td>
<td>4863</td>
</tr>
<tr>
<td>1978 – 79</td>
<td>5220</td>
<td>220</td>
<td>381</td>
<td>5821</td>
</tr>
<tr>
<td>1979 – 80</td>
<td>5164</td>
<td>225</td>
<td>545</td>
<td>5934</td>
</tr>
</tbody>
</table>


### Table 5.14: Trends in Private Transfers (Net inflows)

( In ₹.Crore)

<table>
<thead>
<tr>
<th>Year</th>
<th>Receipts</th>
<th>Payments</th>
<th>Net inflows</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970 - 71</td>
<td>101</td>
<td>13</td>
<td>88</td>
</tr>
<tr>
<td>1975 – 76</td>
<td>454</td>
<td>13</td>
<td>441</td>
</tr>
<tr>
<td>1976 – 77</td>
<td>762</td>
<td>7</td>
<td>755</td>
</tr>
<tr>
<td>1977 – 78</td>
<td>1108</td>
<td>6</td>
<td>1102</td>
</tr>
<tr>
<td>1978 – 79</td>
<td>1110</td>
<td>17</td>
<td>1093</td>
</tr>
<tr>
<td>1979 – 80</td>
<td>1762</td>
<td>8</td>
<td>1754</td>
</tr>
</tbody>
</table>

Similarly, private transfers (net inflows) were just ₹.88 crore in 1970 – 71. However, within a span of five year there was five fold increase in private transfers and they were ₹.440 crore in 1975 – 76. By 1979 – 80, the increase in private transfers was four times and it was ₹.1754 crore. Table 5.14 depicts the trends in private transfers.

5.3.2.8 Trends in Fiscal Deficit & Current Account Deficit

The link between the fiscal deficit and current account deficit can be derived from the following economy- wide financial balance identity –

Current Account Deficit = Income – (Consumption + Investment + Government Expenditure)


In the usual notation terms,

\[ X - M (CAB) = Y - (C + I + G) = (T - G) + (Sp - Ip) \ldots \text{(I)} \]

Where \( X = \) exports, \( M = \) imports, \( CAB = \) Current Account Balance, \( Y = \) GNP or national income, \( C = \) Consumption, \( I = \) Investment, \( G = \) Government expenditure, \( T = \) Taxation / tax receipts, \( Sp = \) Savings, \( Ip = \) Investment, and the subscript ‘p’ denotes private sector.

This relationship between the internal and external sectors is merely an \textit{ex post} identity and it does not bring out the dynamics that takes the economy from the initial balance to a new one. The identity, nevertheless underlines an important policy issue. An improvement in the current account balance can be achieved either by an improvement in the combined balances of the private and sectors or by an increase in national income relative to domestic absorption. There is, of course, one exception to this generalization, which stems from the Ricardian equivalence
proposition, which assumes that government fiscal plans will be fully neutralized by opposing economic behaviour of the private sector. Ignoring the debt neutrality proposition, the absorption approach recognizes the fiscal dimension to the current account improvement. Empirical evidence in support of the Ricardian equivalence is weak and in the real world, therefore, the fiscal roots of the current account are widely recognized. Thus, in reality, it is the fiscal deficit of the public sector that is found to be associated with excess demand and consequent deterioration in current account balance.

In a situation of crisis, the identity implies that serious policy measures aimed at curtailing domestic absorption will be a necessary prerequisite for improving the external situation. However, over the medium term, what the identity means is that a sustainable level of current account deficit is related to the relative rates of growth of income and absorption.

One of the important features which affected the India’s balance of payments in the decade of eighties, was the emergence of large fiscal deficits accompanied by current account deficits. Table 5.15 shows the current account deficit and fiscal deficit during the period from 1981-82 to 1990 – 91. It is clear from table 5.15 that both fiscal deficit and current account deficit were showing a rising trend during 1981 – 82 to 1990 – 91. In 1990 – 91, the current account deficit touched highest figure of 3.1 per cent of GDP which was clearly unsustainable from the balance of payments point of view. Similarly, the fiscal deficit touched the highest figure of 8.5 per cent of GDP in the year 1986 – 87. In the year 1990 – 91, it was close to 8 per cent of GDP. Thus, rising fiscal deficits along with current account deficits were a cause of concern in the decade of eighties.
Table 5.15: Current Account Deficit & Fiscal Deficit 1982 to 1991

(As Per cent of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>Current Account Deficit</th>
<th>Fiscal Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981 - 82</td>
<td>1.7</td>
<td>5.14</td>
</tr>
<tr>
<td>1982 - 83</td>
<td>1.7</td>
<td>5.64</td>
</tr>
<tr>
<td>1983 - 84</td>
<td>1.5</td>
<td>5.94</td>
</tr>
<tr>
<td>1984 - 85</td>
<td>1.2</td>
<td>7.09</td>
</tr>
<tr>
<td>1985 - 86</td>
<td>2.1</td>
<td>7.86</td>
</tr>
<tr>
<td>1986 - 87</td>
<td>1.9</td>
<td>8.47</td>
</tr>
<tr>
<td>1987 - 88</td>
<td>1.8</td>
<td>7.63</td>
</tr>
<tr>
<td>1988 - 89</td>
<td>2.7</td>
<td>7.34</td>
</tr>
<tr>
<td>1989 - 90</td>
<td>2.3</td>
<td>7.33</td>
</tr>
<tr>
<td>1990 - 91</td>
<td>3.1</td>
<td>7.85</td>
</tr>
</tbody>
</table>


Fig. 5.1 Current Account Deficit & Fiscal Deficit (1981 – 82 to 1990 – 91)

Fig. 5.1 shows the movements in current account deficit and fiscal deficit from 1981 – 82 to 1990 – 91. As is clear from fig. 5.1, that both the current account deficit and fiscal deficit moved in tandem indicating the existence of twin deficit phenomenon.
Table 5.16 shows the average current account deficit and fiscal deficit during the said period as well as averages for five year periods. Table 5.16 shows that the annual average current account deficit from 1981 – 82 to 1990 – 91 was 2 per cent of GDP, while during the same period, the average fiscal deficit was 7 per cent of GDP. In the first half of 1980s, the average current account deficit was 1.65 per cent while the fiscal deficit was 6.30 per cent of GDP. The remarkable increase was found in the second half of 1980s, when the average current account deficit was 2.35 per cent of GDP, while fiscal deficit was 7.70 per cent of GDP.

<table>
<thead>
<tr>
<th>Year</th>
<th>Current Account Deficit</th>
<th>Fiscal Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981-82 to 1990 - 91</td>
<td>2.0</td>
<td>7.02</td>
</tr>
<tr>
<td>1981- 82 to 1985 - 86</td>
<td>1.65</td>
<td>6.33</td>
</tr>
<tr>
<td>1986 - 87 to 1990 - 91</td>
<td>2.35</td>
<td>7.72</td>
</tr>
</tbody>
</table>


A detailed review of the data on public finances of the central government reveals that revenue deficit which was almost absent in the 1970s emerged as an important factor affecting the public finances in the 1980s and thereafter. Further, there was a gradual shift from capital expenditure to revenue expenditure during the 1980s. Hence, it was the revenue deficit which was the source of rising current account deficit, particularly during 1987 – 90. The gross fiscal deficit was met by borrowings, both domestic and foreign, which led to sharp rise in public debt.
Additionally, a portion of the external borrowings was utilized to finance revenue
deficit which gave rise to the critical BOP position.\textsuperscript{19}

Table 5.17 depicts the average revenue deficit of the central government. It is
observed from table 5.17 that the annual average revenue deficit of the centre during
the period from 1981 – 82 to 1990 – 91 was very close to 2.0 per cent of GDP.
During the first half of 1980s, it was slightly over 1 per cent of GDP. However, the
remarkable increase was found in the second half of 1980s, when it was more than
2.5 per cent of GDP.

\textbf{Table 5.17: Average Revenue Deficit of the Central Government}

(As Per cent of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981-82 to 1990 - 91</td>
<td>1.92</td>
</tr>
<tr>
<td>1981-82 to 1985 - 86</td>
<td>1.18</td>
</tr>
<tr>
<td>1986 - 87 to 1990 - 91</td>
<td>2.65</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India – \textit{Handbook of Statistics on Indian Economy, 2005 – 06.}

The RBI’s \textit{Report on Currency & Finance 2002 – 03} has calculated correlation
coefficient between fiscal deficit and current account deficit for various periods
which is depicted in Table 5.18. The correlation coefficient was 0.10 from 1970 – 71
to 1980 – 81, and 0.43 from 1980 – 81 to 1989 – 90.\textsuperscript{20} The trends in fiscal deficit
reflect that during 1980 – 81 to 1990 – 91, the fiscal policy was highly expansionary.
5.3.2.9 Trends in Invisibles

A study of invisibles account gives the financing of trade deficit, while the financing of current account deficit is reflected in the capital account of the balance of payments.

In general, it was observed that up to 1980s, the invisibles played an important role in financing trade deficit. The situation started changing from the second half of 1980s, due to a gradual decline in the net invisible receipts. Similarly, up to 1980s the current account deficit was mainly financed by external assistance which was available on concessional terms. The decline in net invisible receipts led to greater dependence on external capital. As Jalan (1992) has rightly remarked - “Net invisibles, which financed nearly half of the trade deficit during 1981 – 82 to 1984 – 85, contributed only 8 per cent to meet the financing requirements in 1990 – 91.”

Table 5.18 gives the main sources of financing trade deficit. It is quite clear from table 5.18, that during the Sixth Plan period, the invisibles were able to finance 56 per cent of trade deficit. However, there was a sharp decline in the Seventh Plan, as the invisibles were able to finance only 25 per cent of trade deficit.

Table 5.18 : Main Sources of Financing Trade Deficit

(In Per cent)

<table>
<thead>
<tr>
<th>Plan</th>
<th>Financing of trade deficit by Invisibles Net</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sixth Plan (1980 - 85)</td>
<td>56.00</td>
</tr>
<tr>
<td>Seventh Plan (1985 – 90)</td>
<td>25.00</td>
</tr>
</tbody>
</table>

Source: Calculated from table 5.3.

Table 5.19 gives the sources of financing current account deficit during the Sixth & Seventh Plan period. Table 5.19 depicts that during the Sixth Plan period, all the
three sources taken together i.e. external assistance, (38 per cent) commercial borrowings (20 per cent) and NRI deposits (16 percent) financed 74 per cent of current account deficit. The reliance on these sources further increased in the Seventh Plan, when they together accounted for financing 87 per cent of current account deficit. Moreover, the use of NRI deposit as a source of finance almost doubled in the Seventh Plan as compared to the Sixth Plan.

Table 5.19: Sources of Financing Current Account Deficit

<table>
<thead>
<tr>
<th>Plan / CAD Financed by</th>
<th>External Assistance</th>
<th>Commercial Borrowings</th>
<th>NRI Deposits</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sixth Plan (1980 – 85)</td>
<td>38.00</td>
<td>20.00</td>
<td>16.00</td>
<td>26.00</td>
<td>100.00</td>
</tr>
<tr>
<td>Seventh Plan (1985 – 90)</td>
<td>31.00</td>
<td>25.00</td>
<td>31.00</td>
<td>13.00</td>
<td>100.00</td>
</tr>
</tbody>
</table>

Source: Calculated from Table 5.3.

Another important aspect was that all these sources were costly sources of financing. This is because, the period of eighties was also marked by a reduction in flows of concessional assistance to India, particularly from the World Bank Group. The credits from International Development Assistance (IDA) on soft terms declined, while loans from the World Bank on market terms increased sharply.

In the context of sources of financing current account Kapur (1997) rightly pointed out that - “An important element of external sector developments over the past five decades is the changing character of the capital account. The first period from 1948 – 49 till the end of seventies represented the era of dominance of external assistance in the capital account. The second era began from 1982-83 / 1983 – 84 onwards when the more costlier external commercial borrowings (ECBs) and non – resident deposits together or even individually supplanted external assistance as the
predominant source of financing. This period coincides with a surge in current account deficits.”

Thus, the balance of payments situation turned grim during 1980 – 81 to 1990 – 91. With increasing trade deficits, flattening out of private remittances and a fall in concessional aid to finance the ever increasing deficits, India had to depend on high cost methods of financing the deficit, viz. external commercial borrowings, NRI deposits, and short term debt.

5.3.2.10 Problem of External Debt

The increased dependence of the Government of India towards expensive sources of financing resulted into problems associated with external debt. Table 5.20 shows that India’s external debt to GDP ratio increased from 12 per cent in 1980 – 81 to 26 per cent in 1990 – 91. Similarly, the debt service ratio increased from 9.5 per cent in 1980 – 81 to 35 per cent in 1990 – 91. In 1990 – 91, the ratio of short term debt to total debt was 10.2.

Thus, by the end of the decade of 1980s, there had been major changes in the country’s external debt position. According to World Debt Tables (World Bank, 1992), external debt increased from about $ 20.6 billion in 1980 – 81 to $ 64.4 billion in 1989 – 90. The general story was one of a continuation of the deterioration that began in the first half of the decade. Between 1984 – 85 to 1989 – 90, the following changes occurred –

- The total debt to GNP ratio increased from 17.7 to 24.5 per cent and the debt – to – exports ratio from 210 to 265 per cent. The debt service ratio rose from 18 to 27 per cent. Such high ratios had not been seen in India since the end of the 1960s.
The share of private debt in long-term debt increased from 28 to 41 per cent, and the share of non-concessional debt from 42 to 54 per cent. Variable-interest debt increased from 11 to 19 per cent of long-term debt. The average maturity of debt fell from 27 to 20 years. Thus, in addition to the increase in debt burden there was also a worsening of the debt profile. The composition of debt changed towards private sources of a rather unstable variety. By the end of the decade, the stock of non-resident deposits was $10 billion and short-term debt was $4 billion.23

Table 5.20: Indicators of India’s External debt

<table>
<thead>
<tr>
<th>Sr.No</th>
<th>Particulars</th>
<th>1980 - 81</th>
<th>1990 - 91</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>External debt to GDP ratio</td>
<td>12.4</td>
<td>26.4</td>
</tr>
<tr>
<td>2</td>
<td>Debt service ratio</td>
<td>9.7</td>
<td>35.3</td>
</tr>
<tr>
<td>3</td>
<td>Short term debt to total debt ratio</td>
<td>---</td>
<td>10.2</td>
</tr>
</tbody>
</table>


5.3.2.11 Effect on Industrial Development

During the trade policy regime of Phase II (1970s to 1990s), the overall industrial development can be divided into two Phases. They are: (a) Phase I from 1965 to 1980 of industrial deceleration and structural retrogression, and (b) Phase II from 1981 to 1990 of industrial recovery.

(a) Phase I from 1965 to 1980: With reference to industrial development, it is observed that the period 1965 to 1976 was marked by a sharp deceleration in industrial growth. The rate of growth fell steeply from 9.0 per cent per annum during
the Third Plan to a mere 4.1 per cent per annum during the period 1965 to 1976. The average industrial growth rate was 6.1 per cent per annum during the Fifth Plan period. Besides this, there was structural retrogression in the industrial sector during the period 1965 to 1980. This is because there was a decline in the growth rates of capital goods industries and basic industries during the period 1965 to 1980. For instance, from 1965 to 1976 the capital goods industries grew at annual rate of only 2.6 per cent and the average growth rate for the Fifth Plan was 5.7 per cent, which was substantially lower than the rates of growth recorded during the first three plans. Some of the causes of industrial deceleration and structural retrogression were as follows:

- Wars in 1965 and 1971;
- Drought conditions in 1965 – 66 and 1966 – 67;
- First oil shock of 1973;
- Infrastructural, financial, policy constraints and bottlenecks;
- Slow growth in agricultural sector;
- Decline in public investment;
- Wrong industrial policies, complex bureaucratic system of licensing, irrational and inefficient system of controls, etc. This can be termed as lack of good governance.

(b) Phase II from 1981 to 1990: The decade of 1980s can broadly be termed as a period of industrial recovery. The rate of industrial growth was 6.4 per cent per annum during 1981 – 85, (Sixth Plan) and 8.5 per cent per annum during 1985 – 90. (Seventh Plan). There was also significant improvement in the industrial growth rate of capital goods. For instance, the growth rate of capital goods sector was 6.2 per cent per annum from 1981 to 1985, and 14.8 per cent per annum from 1985 to
1990. Two main causes for industrial recovery during the 1980s were: (a) Liberal industrial and trade policies followed by the government; and (b) Increase in infrastructure investment.

5.3.2.12 Effect on Macroeconomic Indicators (a) The Gross Domestic Savings / GDP ratio was 17.2 per cent in 1970s which further increased to 19.0 per cent in 1980s. Similarly, the Gross Domestic Capital formation / GDP ratio was 17.3 per cent in 1970, which further went up to 20.8 per cent in 1980s. (b) The Saving – Investment Gap / GDP ratio was – 0.1 per cent in 1970s, which increased to – 1.8 per cent in 1980s. (c) The average rate of inflation was 9.0 in 1970s which slightly reduced to 8.0 per cent in 1980s. (d) The Real GDP growth rate was 2.9 per cent per annum during 1970s, which almost doubled to 5.6 per cent per annum during 1980s.24

5.3.2.13 Critical Appraisal of Trade Policy of Phase II

With reference to inward – oriented and outward strategies, World Bank (1987)25 had conducted a study for 41 countries over the period 1963 to 1985 (divided into two sub – periods (a) 1963 to 1973 and (b)1973 to 1985) to examine the links between trade strategy and economic performance. These countries were divided into four categories – strongly outward oriented, moderately outward oriented, strongly inward – oriented and moderately inward – oriented. Hongkong, Singapore, and Korea fell in the group of strongly outward-oriented countries, while India (along with some other countries) fell in the group of strongly inward-oriented countries.
The study revealed the following –

- The economic performance of the outward – oriented economies was found to be broadly superior to that of the inward oriented economies in almost all respects. The annual average growth rate of GDP for the 1963 -73 period was 9.5 per cent for the strongly outward oriented group, more than double the 4.1 per cent attained by the strongly inward – oriented group. The respective rates for 1973 – 85 were 7.7 per cent and 2.5 per cent.

- In both the periods, the average annual growth of manufactured exports for outward oriented group was more than that of inward oriented group. This was probably an important factor in producing rapid overall economic growth.

- It seems that countries have industrialized faster under outward orientation as revealed from indicators like- growth of manufacturing and agricultural value added, the share of manufacturing value added in GDP, the share of active labour force employed in industry and the growth of employment in manufacturing. For instance, during both periods, average annual growth of manufacturing value added was highest in the strongly outward oriented group and lowest in the strongly inward – oriented group – 15.6 per cent versus 5.3 per cent during 1963 – 73, and 10.0 versus 3.1 per cent during 1973 – 85.

- The outward oriented economies also achieved a higher share of manufacturing value added in GDP in 1963 (20.1 per cent compared with 15.2 per cent for the inward – oriented economies ) and in 1985 (23.0 per cent compared with 15. 8 per cent ).

195
➢ The study also revealed that an outward oriented strategy (a) promotes efficient use of resources, and (b) leads to a more equitable distribution of income.

The trade policy of export promotion & import liberalization adopted in Phase II (From 1970s to 1990s) can be criticized on following grounds:

a) The Indian planners instead of considering foreign trade as an engine of growth, sought to minimize the import demand and viewed exports mainly to generate foreign exchange earnings to meet that part of import bill not covered by external assistance. The effect of this policy resulted into a decline in India’s share in world trade from 0.98 per cent in 1965 to 0.5 per cent in 1990. Further, its share in world manufacturing exports declined from 0.65 per cent in 1965 to around 0.4 per cent in 1990.

b) It is observed that India’s failure in exports has been largely policy induced. For instance, in the case of textile exports India had a natural comparative advantage. In 1973 – 74, India’s share in world markets for textiles & clothing exports was 4.5 per cent and by 1985 – 86 it declined to 3.8 per cent. During the same period, the share of other countries like China, Korea, Thailand, Hong Kong increased substantially. For instance, China’s share increased from 4.5 per cent to 14.6 per cent, while that of Korea increased from 7.7 per cent to 13.6 per cent. Further, most of the growth in exports in the 1980s was accounted for by just four products: leather, gems & jewellery, textiles and garments. Exports of engineering goods and chemicals which were once dynamic, suffered a decline in the first half of the 1980s and recovered somewhat in the second half.
c) The import liberalization policy instead of strengthening production of manufactured exports encouraged the production of import intensive elitist consumer goods.

d) India adopted import liberalization strategy when the developed countries had shut their own doors against imports from the developing countries. Thus, the timing of the strategy was wrong.

e) Overall, it can be observed that even though some measures to liberalize trade were undertaken in the latter half of the eighties, the trade regime in the 1980s continued to be characterized by overwhelming presence of licensing mechanism and a high level of tariffs isolating the economy from external competition, constrained further by restrictive industrial and foreign investment policies.

5.3.3 Phase III – Outward Orientation (From 1990s onwards)

By the beginning of 1990s the policy makers realized the various drawbacks of the inward – oriented policy and suggested that India should go in for globalization and open up its economy considerably by liberalizing the import – export regime. This would imply the conversion of quantitative restrictions to low and uniform tariffs, and the use of exchange rate (rather than quantitative restrictions or tariffs) for bringing about balance of payments equilibrium. There was a strong support for this policy among many economists and international financial institutions like IMF and World Bank.

As Srinivasan (1994) has rightly put it – “It is clear that to achieve sustained, rapid, equitable, and efficient growth, India must abandon its inward-oriented, capital – intensive, and inefficient development strategy implemented through an
administrative allocation system based on QRs. Instead a system of economic management must be put in place that relies largely on market forces.”

Further, the policy package offered by the World Bank and IMF to the developing countries facing balance of payments problems in 1980s, specifically included import liberalization, and a more “open’ trade and industrial policies as a condition for the grant of assistance.

It is to be noted that the decade of 1990 is marked with a complete U turn as India adopted a path of economic liberalization. It followed the policy of Liberalization, Privatization and Globalization (LPG) to solve its BOP and related problems. Hence, a series of economic reforms were introduced in various sectors to tackle the BOP and other problems.

As far as the foreign trade sector is concerned, the year 1991 is a ‘watershed’ as a massive trade liberalization measures adopted since this year mark a major departure from the relatively protectionist trade policies pursued in earlier years. It was recognized that trade policies, exchange rate policies and industrial policies should form part of an integrated policy framework if the aim was to improve the overall productivity and efficiency of the economic system, in general, and the external sector, in particular.

In this context, Mehta (1997) observed – “The trend towards liberal policy had found full expression with the government of India announcing a series of packages of trade and industrial policy reforms during the years 1991 – 92 to 1995 – 96. This is certainly a major departure from the relatively protectionist trade policies pursued till late 1970s. Such a break stems from the change in the perception of the trade policy mindset in the country… The current trade policy reforms, seem to have been
On 4th July 1991, the government announced major changes in the Trade Policy, and after extensive consultation with industry, a more comprehensive Statement on Trade Policy was issued on 13th August, 1991. The Statement on Trade Policy stated: “Trade policy reform has to aim at quick revival of the momentum of exports. It is only through rapid growth of exports that we can expect to overcome our persistent balance of payment problems, restore international confidence, and achieve true self-reliance with an expanding economy…. The world economy is changing rapidly and most countries, including developing countries and the countries of Eastern Europe are gearing up to the challenges of competing in an increasingly integrated, highly global market place. India cannot afford to ignore these changes. India can grow faster only as a part of the world economy and not in isolation.”

An important development in the international trade sphere in the late 1990s was the formation of World Trade Organisation (WTO). The World Trade Organisation was established on 1st January 1995, and it replaced the earlier General Agreements on Tariffs & Trade (GATT) which was formalized in 1947. India became a founder member of WTO, by ratifying the WTO Agreement on December 30, 1994. Thus, WTO is an international organization set up as a permanent body and is designed to play the role of a watchdog in the spheres of trade in goods, services, foreign investment, intellectual property rights, etc. The Government of India has made a number of commitments to WTO in relation to reduction in tariff lines, reduction of quantitative restrictions, etc.
5.3.3.1 Distinctive Features of Outward – oriented Policy

The distinctive features of outward – oriented policy which has been implemented since 1990s are as follows –

➢ There has been a clear shift in emphasis from Import Substitution to Export Promotion.

➢ The reach of the export incentives has been broadened to cover a large number of non – traditional and non – manufactured export items.

➢ The policy stance marks a move away from the provision of direct export subsidy to indirect promotional measures.

➢ Introduction of a five year Export – Import policy, instead of a three year one.

➢ Introduction of a negative list of imports and exports.

➢ Lowering of the level and dispersion of nominal tariffs, withdrawal of quantitative restrictions on imports and phasing out of the system of import licensing.

➢ It started an era of market based exchange rate regime.

➢ Simplification of procedural formalities.

➢ Simultaneous reforms introduced in finance, banking, and industrial sectors.

5.3.3.2 Major Trade Policy Reforms

Some of the major trade policy reforms reflecting outward orientation initiated in 1990s were as follows –

(1) Reduction in Tariff Rates - A key aspect of the trade reforms of the 1990s was the reduction in import duties. The broad approach to reforms regarding customs tariffs and exemptions was laid out in the Report of the Tax Reforms Committee,
India’s customs tariff rates have been declining since 1991. The ‘peak rate’ has progressively come down from a level of over 300 per cent during the pre-reform period to 150 per cent in 1991 – 92 and further to 25 per cent in 2003 – 04.

As a member of WTO, India bound about 67 per cent of its tariff lines whereas prior to the Uruguay Round, only 6 per cent of the tariff lines were bound. In fact, in most items, India’s customs tariff rates are at present significantly lower than the corresponding “bound” rates stemming from the obligations undertaken in the WTO.

(2) Phasing out Quantitative Restrictions (QRs) - In the Indian context, for several decades QRs on imports of a wide range of products were justified for balance of payments reasons. Out of the nearly 5000 Harmonised Tariff Lines at the 6 digit level, about 80 per cent were subject to some form of import licensing restrictions as in mid – 1991. However, as a founder member of WTO, India is under obligation to strike down all quantitative restrictions, on imports and reduce import tariffs so as to ‘open up’ the economy to world trade and the forces of globalization.

India has been following a consistent policy for gradual removal of restrictions on imports since 1991. In the initial phase of reforms in 1991 – 92, about 3000 tariff lines, covering raw materials, intermediates and capital goods, were freed from licensing restrictions.

Tariff line – wise import policy at 10 digit level of Harmonised System (HS) International Trade Classification (ITC) was first announced in 1996 wherein 6161 tariff lines out of a total number of 10,202 lines were freed. Till March 2000, this total had gone up to 8066. QRs in respect of 1429 items remained till this date. The Exim policy of 2000 – 01 removed quantitative restrictions on 714 items and the Exim policy of 2001 – 02 removed quantitative restrictions on balance 715 items.
Thus, in line with the commitments to WTO, quantitative restrictions on all import items has been removed.

(3) Five Year Export – Import Policy - In order to bring stability and continuity in export – import policies, the Government has started announcing Export – Import (Exim) Policy covering a period of five years \(^5\) instead of three years. Accordingly, the first five year Exim policy covering the period 1992 – 97 (which also coincided the commencement of Eighth Five Year Plan 1992 - 93 to 1996 - 97) was announced in March 1992. Since then two more policies have been announced – (a) Exim Policy 1997 – 2002 and (b) Exim policy 2002 – 07.\(^1\)

In general, the objectives of Exim Policies were –

- Accelerating the country’s transition to a globally oriented vibrant economy with a view to derive maximum benefits from expanding global market opportunities;
- Stimulating sustained economic growth by providing access to essential raw materials, intermediates, components, consumables and capital goods required for augmenting production ;
- Enhancing the technological strength and efficiency of Indian agriculture, industry and services, thereby improving their competitive strength while generating new employment opportunities;
- Encouraging the attainment of internationally accepted standards of quality; and
- Providing consumers with good quality products and services at reasonable prices.

(4) Negative List of Imports & Exports - The five year Exim policy 1992 – 97 aimed at eliminating licensing and quantitative restrictions substantially. Under this
policy, exports and imports were allowed freely subject to the regulation by a Negative list of exports and Negative list of imports. The Negative list of imports has been altogether removed under the revised Exim policy 1997 – 2002. Similarly, controls on exports has been liberalized to the extent that now all goods may be exported without any restrictions except a few items from negative list.

(5) Decanalisation - A large number of exports and imports used to be canalized through the public sector agencies in India. However, from 1991 onwards there has been an emphasis on decanalisation. For instance, the proportion of canalized items in total imports declined from 27 per cent to 19 per cent between 1988 – 89 and 1997 – 98. In the subsequent Exim policies the number of decanalised items has been increased gradually. Further, there has been continuous effort to increase the coverage of items included in OGL List. For example, during 1997 – 98, the items included under the OGL List accounted for as much as 68 per cent of India’s total tariff lines. The list has been further broadened by the subsequent modifications incorporated in Exim policy 1997 – 2002.

(6) Policy for Trading Houses - The 1991 policy allowed export houses and trading houses to import a wide ranging of items. Further, the government also permitted the setting up of trading houses with 51 per cent foreign equity for the purposes of promoting exports. In 1994 – 95 a new category of trading houses called Super Star Trading Houses was created. In the Exim policy of 1992 – 97 policy, export houses and trading houses were provided the benefit of self certification under the advance license system, which permits duty free imports and exports.

(7) Setting up of Special Economic Zones (SEZs) - A scheme of setting up Special Economic Zones on (SEZs) to promote exports was announced by the Government

**(8) Agriculture Export Zones (AEZs)** - To promote agricultural exports, the Exim policy 2001, introduced the concept of Agri Export Zones (AEZs).

**(9) Concessions & Exemptions** - A large number of tax benefits and exemptions have been granted during the 1990s to liberalize imports and promote exports in the Exim policies of 1992 – 97, and 1997 – 2002. Successive annual Union budgets also extended a number of tax benefits and exemptions to the exporters. Some of these included: (a) reduction in peak customs duty to 10 per cent, (b) 10 year tax holiday to the developers of SEZs. (c) tax benefits for the three important sectors – the Information Technology sector, the Telecommunications sector and the Entertainment industry, etc.

### 5.3.3 Foreign Trade Policy 2004 – 09

The New Foreign Trade Policy (FTP) was announced by the Union Commerce Minister Mr. Kamalnath, on August 31, 2004 covering the five year period 2004 – 09. This policy replaces the earlier Exim policy of 2002 – 07. Thus, for the first time a comprehensive foreign trade policy was formulated.

**(a) Objectives of New Foreign Trade Policy**

The objectives of new Foreign Trade Policy (2004 – 09) were two fold –

- First, to double India’s percentage of global merchandise trade by 2009; and
- Second, to act as an effective instrument of economic growth by giving thrust to employment generation, especially in semi – urban and urban areas.


The new Foreign Trade Policy (2004 – 09) had the following important features –
1) *Doubling the share of global merchandise trade* - In the beginning of 1990s, India’s share in world exports was only 0.5 per cent. Over a period of time, it increased to 0.7 per cent. Further, the Medium Term Export Strategy (MTES) announced in 2002 for 2002 – 07, aimed at achieving one per cent share for India in world trade by 2007. The new policy has envisaged a doubling of India’s share in world exports from 0.75 in 2004 to 1.5 per cent by 2009. This would be possible if exports increase by more than 20 per cent per annum on a sustained basis during the next five years. In Dollar terms, the target implies export levels of $300 billion by 2009.

2) *Five thrust sectors* – The policy has identified ‘thrust sectors’ which have significant export prospects coupled with potential for employment generation in semi-urban and rural areas. The five thrust sectors identified are – (a) Agriculture, (b) Handicrafts, (c) Handlooms, (d) Gems & Jewellery, and (e) Leather & Footwear. Various strategies have been announced for these sectors.

3) *Encouragement to service exports* – Presently services contribute more than 50 per cent of the country’s GDP. Hence, to provide a boost to service exports, the new foreign trade policy has announced a number of steps.

4) *New category of star houses* – On the basis of export performance in three years, FTP has announced a new category of star houses. The categories are – (i) One Star house (Export of 15 crores) (ii) Two Star house (Export of 100 crore) (iii) Three Star house( Export of Rs.500 crore) (iv) Four Star house (Export of Rs.1500 crore ) and (v) Five star house (Export of Rs.5000 crore).
5) **Setting up of Free Trade and Warehousing Zones (FTWZs)** – To create trade related infrastructure to facilitate the import and export of goods and services with freedom to carry out trade transactions in free currency, the new policy has introduced a scheme to establish Free Trade and Warehousing Zones (FTWZs).

6) **Benefits for Export Oriented Units (EOUs)** – A number of benefits have been announced for EOUs like – (a) to be exempted from service tax in proportion of their exports of goods and services (b) to retain 100 per cent of export earnings in EEFC account (c) import of capital goods on self certification basis, etc.

7) **Other measures** – Besides above other measures include – (a) reducing transaction costs and simplifying procedures, (b) focus on infrastructure development, (c) setting up of biotechnology parks, (d) revamping the Board of Trade, etc.

To conclude, the new FTP reflects not only a major shift in government’s attitude on foreign trade by integrating the trade policy with the country’s economic development but also puts equal emphasis on export promotion and import liberalization. Further, the policy has also given importance to employment generation in the semi – urban and urban areas of our country.

**5.3.3.4 Critical Evaluation of Outward - orientation Policy of Phase III**

The trade policy reforms initiated since 1991 has drastically changed the foreign trade scenario and resulted in the shift from inward – oriented to an outward – oriented policy. As a result of trade liberalization policy adopted since 1991, the level of protection to Indian industry has declined as the government has resorted to
a massive cutting down of import tariffs and allowing more liberal imports of number of goods whose imports were earlier either totally banned or severely restricted. Hence, the foreign trade sector is considered as ‘leading sector’ of the economy that will change the face of the economy in the years to come giving a strong push in the world economy.

However, there are certain issues which should not be neglected and are strategically important for industrialization. They are:

- In a country like India, where the domestic market is overwhelmingly important, sustained industrialization can only be based on the growth of the internal market.
- The State initiative should play a supportive role in the process of industrialization.
- The government should take initiative in the acquisition or development of technology which is necessary for industrialization.

5.4 SUMMARY

Trade policy can be (a) inward – oriented and (b) outward – oriented. An inward – orientation policy protects the domestic market and is also known as ‘import substitution’ strategy, while the outward – oriented policy links gives encouragement to exports and is also known as ‘export promotion strategy.

In a broader sense, after independence for almost forty years or so India adopted inward oriented strategy with a view to achieve rapid industrialization through import substitution. This strategy covers the period from First Five Year Plan (1951 – 56) to the Seventh Five Year Plan. (1985 – 90). However, from 1990 onwards India adopted an outward oriented strategy which can be considered as a significant
turnaround from the earlier period. The adoption of outward oriented strategy was a major departure from the relatively protectionist trade policies pursued in earlier years.

In a broad sense, trade policy of India can be broadly divided into the following phases (1) Phase I – Import Restriction and Import Substitution (From 1950’s to 1970s), (2) Phase II – Export Promotion & Import Liberalisation (From 1970s to 1990s), and (3) Phase III – Outward Orientation – (From 1990 onwards).

Import substitution or inward – orientation was considered as a correct and inevitable strategy in our earlier decades of economic planning. It was supported by appropriate monetary and fiscal policies, tariffs, and physical interventionist policies like licensing, quota, etc. Phase I of import restriction and import substitution covers the period of three Five Year Plans (1951 – 52 to 1965 – 66) and the Three Annual Plans (1966 – 1969). During Phase I there were three wars (1962, 1965 & 1971) and two severe droughts (1965 – 66, and 1966 – 67), which led to deterioration in balance of payments. However, this inward – looking strategy of industrialization resulted into high rates of industrial growth between 1956 and 1966. It is argued that the trade policy discriminated against exports which led to poor export growth. As a result, there was consistent fall in exports as a proportion of GDP until the early 1970s. There was also stagnation in the growth rate of Real GDP and from 1950s to 1970s, the average Real GDP growth rate was 3.5 per cent per annum.

Phase II of export promotion & import liberalization covers the period from Fourth Plan (1969 – 70 to 1973 -74) to Seventh Plan (1985 – 86 to 1989 - 90). During seventies and eighties, the changes in trade policy were also influenced by the recommendations of committees like – Alexander Committee, Tandon Committee & Abid Hussain Committee. As a result, several export promotion and import
liberalization measures were undertaken during the said period. The performance of balance of payments which was comfortable in Fifth Plan, deteriorated in Sixth and Seventh Plan. Some of the factors which affected the balance of payments adversely were – the two oil shocks of 1973 and 1979, poor performance of exports especially after mid – 1970s, etc. The performance of balance of payments was severely affected in the Seventh Plan due to – fall in net invisibles, increase in fiscal deficit to GDP ratio, costly sources of external finance like – external commercial borrowing, NRI deposits, etc. As a result, the average CAD/GDP ratio was 2.2 per cent during the Seventh Plan. The increased dependence of the Government of India towards expensive sources of financing resulted into problems associated with external debt. For instance, India’s external debt to GDP ratio increased from 12 per cent in 1980 – 81 to 26 per cent in 1990 – 91. Similarly, the debt service ratio increased from 9.5 per cent in 1980 – 81 to 35 per cent in 1990 – 91. The industrial development reflected a mixed picture of industrial deceleration (from 1970s to 1980s) and industrial recovery (1980s to 1990s). The average rate of inflation was 8.0 per cent per annum during 1970s and 1980s. The growth rate of Real GDP showed some improvement and it was 5.6 per cent per annum during 1980s. The outward – orientation strategy (Phase III) was adopted from 1990s onwards. Hence, the year 1991 is a considered as ‘watershed’ because of massive trade liberalization measures adopted since this year mark a major departure from the relatively protectionist trade policies pursued in earlier years. The major trade policy reforms adopted were – reduction in tariff rates, phasing out quantitative restrictions, five – year export – import policy, negative list of exports and imports, decanalisation, etc.
The New Foreign Trade Policy (FTP) announced on August 31, 2004, covers the period from 2004 – 2009 and it replaces the earlier Exim policy of 2002 – 07. Some of the important features of this new foreign trade policy are: doubling of India’s share in world exports, identification of ‘thrust sectors’ which have significant export prospects coupled with potential for employment generation in semi-urban and rural areas, encouragement to service exports, etc. Thus, the new FTP has given equal emphasis to export promotion and import liberalization. It has also given importance to employment generation in the semi-urban and urban areas of our economy.

NOTES & REFERENCES

NOTES

a. Although analysis is done on the basis of various phases, sometimes there may be overlapping of data from one phase to another phase.

b. The exchange rate was altered from ₹ 4.76 per dollar to ₹ 7.50 per dollar on June 6, 1966.

c. For the sake of convenience and simplicity, all figures and percentages, if any, have been rounded off wherever necessary.


e. The EFF provides assistance to member countries that need to make structural adjustments in their economies with a view to achieve balance of payments viability in the medium term.


g. A country “binds” a tariff rate by committing that it will not raise tariff on that product beyond that “bound”.

h. Though an Exim Policy is announced for a period of five years, it is renewed and modified on annual basis.

i. In 2004, it was replaced by a new Foreign Trade Policy (2004 – 09).
REFERENCES


