IV INTERNATIONAL TRADE DYNAMICS

Introduction

4.1 The benefits of buoyant world trade witnessed in the aftermath of the World War II could not be adequately reaped by a large number of developing countries. Policy makers in several developing countries took a pessimistic view on using international trade as the engine of growth and adopted instead, inward looking development strategies which emphasised import substitution rather than promotion of trade. The negative effect of the inward looking policies on efficiency, productivity and competition set off a process of rethinking among the policy makers in the 1970s. Consequently, a sizeable number of developing countries, especially from East Asia, opted for more outward looking policies. Over time, these countries transformed themselves from being producers of labour-intensive undifferentiated products to exporters of skill and technology-intensive products. The economic success of many of these countries encouraged other developing countries to increase their trade openness. As a result, since the 1980s, a large number of developing countries have unilaterally increased their openness towards international trade. The liberalisation of merchandise trade and other current account transactions by a large cross-section of countries provided a noticeable thrust to the world trade in the 1990s. Simultaneously, at the multilateral level, the successful conclusion of the Uruguay Round of trade negotiations under the aegis of the General Agreement on Tariffs and Trade (GATT) and the establishment of the World Trade Organisation (WTO) in 1995 created an environment for freer trade.

4.2 The US, East Asian countries and China played a crucial role in expanding world trade in the 1980s. Buoyancy in world trade in the 1990s was sustained despite the lacklustre economic performance of several industrialised countries especially those in Europe and Japan. Although the Asian crisis did cause a major disruption in international trade, the crisis-affected countries have rebounded in recent years with growing trade volumes. Interestingly, trade among developing countries has increased significantly in the recent years.

4.3 There have been a number of significant developments in global trade in recent times. First, following the spurt in commodity prices witnessed during the 1970s and 1980s, there was a downward pressure on many commodities during mid-1990s mainly due to slowdown in demand and increased competition. Second, with the shift of the international trade structure, analyses of price movements of manufactures traded by developing countries *vis-à-vis* those by developed countries have acquired greater importance. Third, there was a decline in net barter terms of trade for developing economies which was compensated to an extent by the surge in export volumes and consequent rise in the purchasing power of exports particularly for China, East Asia and India. Fourth, growing trade integration in emerging market economies witnessed since 1980s has been facilitated by significant reduction in import tariffs. Finally, overall experience suggests that greater trade openness tends to contribute positively to growth and is an important factor behind higher productivity and per capita income. It has also been observed that developing countries, which opted for exports as an engine of growth registered a substantial increase in the share of the manufacturing sector in their GDP.

4.4 India embarked on the path of globalisation in the early 1990s with the objective of improving overall productivity, competitiveness and efficiency of the economy in order to attain a higher growth profile. Concomitantly, industrial, financial and external sector reforms were initiated with a view to creating an environment conducive for the expansion of trade. As a result, growth in trade accelerated in the early part of the 1990s. This momentum, however, could not be sustained in the face of various domestic bottlenecks and exogenous constraints. In the later part of the decade with the crises in East Asia, Russia and some of the Latin American countries followed by the slowdown in the US economy, world trade witnessed a downturn. These external factors along with stagnation in investment rate, sluggish industrial growth and slowdown in manufacturing productivity predicated India's trade during the closing years of the 1990s. Clearly thus, while the opening up of the economy has presented a range of opportunities and advantages to the trade sector in India, the greater integration with the global economy has posed several challenges as well.

4.5 Since the initiation of economic reforms, India's outward orientation has increased considerably. The destination pattern of Indian exports has remarkably

changed whereby the importance of developing countries as an export market has considerably increased. There are, however, concerns that the country has not been able to fully utilise its potential in international trade. In contrast to the dramatic changes in exports of East Asia, India's experience has seemingly fallen short of expectation. India's share in global trade did not rise as impressively and the commodity structure of India's exports remained almost unchanged until the mid-1990s. Moreover, unlike the East Asian countries where industry has been the major driver of exports growth, the contribution of industrial exports in India has been comparatively low. This could perhaps be attributed to small scale industry reservations and inflexible labour laws besides other structural bottlenecks. The labour cost in India, however, is one of the lowest among its competitor countries. Moreover, given the exports structure of India, the potential for higher exports of manufactures, especially to the developed countries, is high.

4.6 On the imports side, despite some initial apprehensions, liberalisation has not adversely affected India's balance of payments. On the contrary, increased trade liberalisation along with prudent management and sequencing of capital account liberalisation has imparted significant strength to the balance of payments since the mid-1990s. With the increased competitiveness of Indian industry, imports of low and medium technology intensive products have declined. At the same time, imports of high-technology intensive products and imports used for export production have increased. There is growing evidence that accessibility to imports has a positive impact on the growth performance of the country. Moreover, the import intensity of India's exports appears to be steadily declining.

4.7 With the timing, pacing and sequencing of trade sector reforms attaining greater importance in an open economy framework, several issues have come into sharper focus: where does India stand in the evolving global trade pattern? Does global experiences suggest that trade liberalisation/ openness go together with higher growth? What is the link between international trade and foreign investment? Is there any discernible trend in the movement of terms of trade of developing countries like India *vis-à-vis* other industrial countries? How have India's exports and imports evolved since the reforms? Which are the areas of India's strength in exports? Has India's trade become more competitive in the international market over the years? What are the current issues concerning India in the multilateral and regional fora? How have India's trade policies shaped and what is the strategy ahead? These are some of the issues taken up in this Chapter.

4.8 This Chapter is organised in eight sections. Section I on global trade discusses trend and structure of world trade, growing integration of the world economy, terms of trade and other issues relevant to global trade with a focus on India's place in the evolving world trade landscape. Section II focuses on India's trade experience covering trade policy and trade openness. Section III examines the structure and composition of India's exports along with a gamut of relevant issues pertaining to it while Section IV analyses the various dimensions of India's imports. Section V looks into some select issues concerning India's trade dynamics. Section VI dwells on developments in the World Trade Organisation (WTO) and regional fora, while Section VII presents a future roadmap for India's trade sector. Finally, Section VIII offers some concluding observations.

I. GLOBAL TRADE: CHANGING PARADIGM

Developments in World Trade

4.9 The post-Second World War period has been associated with two broad phases of global trade integration: 1950-1980 and 1980 onwards. The period from 1950 to 1980 witnessed a revival of world trade, especially among the industrial countries. This was facilitated by the economic reconstruction following the two World Wars and reduction in transportation costs. Another important factor contributing to trade expansion was the multilateral initiative under GATT that enabled dismantling of trade barriers and non-tariff barriers among the industrial countries imposed during the inter-war period. The move towards currency convertibility on current account transactions by leading industrial economies which began in the late 1950s further facilitated growth in international trade.

4.10 The second phase of trade integration started during the late 1970s when a number of East Asian economies embarked on the path of export-led growth. This was reinforced further during the 1980s and the 1990s wherein a large number of developing countries gradually increased their degree of openness. During this period, outward oriented policies were undertaken on the grounds of efficient resource allocation, infusion of modern technologies, promotion of economies of scale, retention of consumer surplus, and reduction of rent-seeking and unproductive profit-seeking activities. For Latin America, the necessity to regain access to the international capital markets to refinance outstanding debt was an important consideration in their opening up during the 1970s.

4.11 In sharp contrast to the East Asian economies during most of this phase, India could not take full advantage of greater openness in trade regime. Despite some export promotion measures undertaken in the 1970s, Indian industries continued to remain protected. While the signs of liberalised trade policy were clearly discernible in the latter half of 1980s, it was only in the 1990s that the country embarked on a truly liberalised trade regime.

4.12 The waves of greater trade openness by developed countries and later by developing economies have resulted in significant changes in the characteristics of world trade. The major structural changes witnessed could be summarised, *inter alia,* as:

i) noticeable increase of Asia's share in world trade mainly due to high export growth of China and East Asia since 1980s (Table 4.1);

ii) transformation of the exports basket of developing countries from primary commodities to manufacturing exports;

iii) faster growth in exports of technology intensive products by developing countries compared to industrial economies; and,

iv) growth in the South-South trade.

4.13 During the 1970s, although output growth decelerated on account of oil price shocks, there was a sharp rise in the value of merchandise goods traded. The spurt in the value of exports, however, underwent self-correction during the 1980s resulting in muted growth in both volume and value of trade. Despite considerable increase in trade volumes, international price situation during the 1990s, however, remained subdued, reflecting, *inter alia*,

Table 4.1: Share in World Trade

	1948	1953	1963	1973	1983	1993	2002
1	2	3	4	5	6	7	8
				Exports (US $ billion)			
World	58.0	84.0	157.0	579.0	1,835.0	3,671.0	6,272.0
				Share (per cent)			
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0
North America	27.3	24.2	19.3	16.9	15.4	16.6	15.1
Latin America	12.3	10.5	7.0	4.7	5.8	4.4	5.6
Western Europe	31.5	34.9	41.4	45.4	38.9	44.0	42.4
C./E. Europe/Baltic States/CIS a	6.0	8.1	11.0	9.1	9.5	2.9	5.0
Africa	7.3	6.5	5.7	4.8	4.4	2.5	2.2
Middle East	2.0	2.7	3.2	4.1	6.8	3.4	3.9
Asia	13.6	13.1	12.4	14.9	19.1	26.1	25.8
Japan	0.4	1.5	3.5	6.4	8.0	9.9	6.6
China	0.9	1.2	1.3	1.0	1.2	2.5	5.2
India	**2.2**	**1.3**	**1.0**	**0.5**	**0.5**	**0.6**	**0.8**
Australia and New Zealand	3.7	3.2	2.4	2.1	1.4	1.5	1.3
Six East Asian traders@	3.0	2.7	2.4	3.4	5.8	9.7	9.6
				Imports (US $ billion)			
World	66.0	84.0	163.0	589.0	1,881.0	3,768.0	6,510.0
				Share (per cent)			
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0
North America	19.8	19.7	15.5	16.7	17.8	19.7	22.0
Latin America	10.6	9.3	6.8	5.1	4.5	5.1	5.4
Western Europe	40.4	39.4	45.4	47.4	40.0	43.0	40.8
C./E. Europe/Baltic States/CIS a	5.8	7.6	10.3	8.9	8.4	2.9	4.6
Africa	7.6	7.0	5.5	4.0	4.6	2.6	2.1
Middle East	1.7	2.0	2.3	2.8	6.3	3.3	2.7
Asia	14.2	15.1	14.2	15.1	18.5	23.3	22.4
Japan	1.0	2.9	4.1	6.5	6.7	6.4	5.2
China	1.1	1.7	0.9	0.9	1.1	2.8	4.5
India	**3.1**	**1.4**	**1.5**	**0.5**	**0.7**	**0.6**	**0.9**
Australia and New Zealand	2.6	2.4	2.3	1.6	1.4	1.5	1.3
Six East Asian traders @	3.0	3.4	3.1	3.7	6.1	9.9	8.4

a Figures are significantly affected by: (i) changes in the country composition of the region and major adjustment in trade conversion factors between 1983 and 1993, and (ii) the inclusion of the Baltic States and the CIS mutual trade between 1993 and 2002.
@ Thailand, Singapore, Malaysia, Korea, Hong Kong SAR, Taiwan Province of China.
Source: International Trade Statistics, WTO, 2003.

Table 4.2: World Growth in Output, Trade and Prices (Period Average)

(Per cent)

	1951-60	1961-70	1971-80	1981-90	1991-2000	1951-80	1981-2002
1	2	3	4	5	6	7	8
Growth in Production (in real terms) @							
Total	5.2	6.0	3.8	2.5	2.6	5.0	2.3
Agriculture	3.0	2.5	2.2	2.5	2.2	2.6	2.2
Mining	4.6	5.4	2.8	0.2	1.5	4.3	0.8
Manufacturing	6.7	7.4	4.3	3.0	2.7	6.1	2.6
World GDP Growth (in real terms)	4.5	5.5	4.1	3.2	2.3	4.7	2.6
Exports Growth (in US $)							
Total	8.1	9.3	20.9	5.7	6.4	12.8	5.5
Agriculture	4.1	4.9	17.2	3.7	3.1	8.7	3.3
Mining	9.3	9.3	31.1	-0.7	6.9	16.6	2.4
Manufacturing	11.2	11.6	19.4	8.6	7.1	14.1	7.1
Exports Growth (in volume)							
Total	7.8	8.6	5.4	4.0	6.4	7.3	4.8
Agriculture	5.0	3.9	3.6	1.6	4.1	4.2	2.8
Mining	8.3	7.2	1.9	1.1	4.1	5.8	2.4
Manufacturing	8.9	10.5	7.2	5.6	7.2	8.9	5.9
Unit Exports Prices (in US $)							
Total	0.3	0.6	14.8	1.6	0.0	5.2	0.6
Agriculture	-0.9	0.9	13.4	2.1	-1.0	4.5	0.5
Mining	1.2	2.0	29.2	-1.6	2.6	10.8	0.1
Manufacturing	2.1	1.0	11.4	2.8	-0.1	4.8	1.2
Sectoral Share in Exports (in US $ terms)*							
Agriculture	35.5	25.3	17.4	13.9	11.1	26.1	12.2
Mining	17.7	16.9	22.2	20.1	11.8	18.9	15.7
Manufacturing	44.7	54.4	57.2	63.1	74.1	52.1	69.2

@ World merchandise production differs from world GDP in that it excludes services and construction.
***** The figures do not add up to 100 because of the presence of unspecified commodities.
Source: International Trade Statistics, WTO, 2003.

enhanced competition, productivity improvements and recessionary conditions in many industrialised countries (Table 4.2).

4.14 In contrast to earlier periods, global economic integration in the 1990s has been much more widespread and was primarily driven by liberalisation of trade and capital controls. The technological revolution witnessed in recent years and the emergence of the new economy has further aided this integration process. As the process of opening up of economies unfolded during the 1990s, world trade witnessed its strongest revival since the 1960s in terms of volume growth. Although the real growth performance of Western Europe, Japan, the transitional economies of Central Europe and Africa was rather lackluster during most of the 1990s, the strong revival in the volume of trade was mainly led by the US with support from developing countries including China, East Asia (especially prior to the 1997 crisis) and some Latin American countries (Table 4.3).

Table 4.3: Growth Rate in Trade Volume during the 1990s

(Per cent)

	1990-2001		1995-2000		2001		2002	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
1	2	3	4	5	6	7	8	9
World	5.5	6.0	7.0	7.0	-0.5	-0.5	3.0	3.0
North America	6.0	7.5	7.0	10.5	-5.5	-3.5	-3.0	4.0
United States#	5.7	7.2	7.1	9.9	-5.6	-2.9	-4.1	4.6
Western Europe	4.5	4.0	6.0	6.0	2.0	0.0	0.5	-0.5
Japan#	1.8	4.9	3.9	5.6	-10.1	-1.3	8.6	1.6
Asia	7.0	7.0	8.5	5.5	-4.0	-1.5	10.5	9.5
C/E (Europe/Baltic States/CIS)	5.5	5.0	7.0	8.0	8.0	14.5	8.0	11.5
Latin America	8.0	10.0	9.5	10.5	2.0	-1.5	1.5	-5.5
Africa#	2.9	4.9	3.9	8.1	NA	NA	NA	NA
Developing Countries#	9.8	9.9	11.0	8.8	1.5	0.7	NA	NA

NA: Not Available.
Source: 1. International Trade Statistics, WTO, 2002 & 2003.
2. # International Financial Statistics, IMF.

Table 4.4: Impact of the Asian Crisis on Trade Volume and Value of Developing Countries

(Annual per cent change)

	Trade Volume				Trade Value in US $			
	Exports		Imports		Exports		Imports	
	1997	1998	1997	1998	1997	1998	1997	1998
1	2	3	4	5	6	7	8	9
Developing countries	13.4	5.2	10.3	0.4	8.2	-7.9	6.5	-5.4
Africa	6.7	0.1	8.0	3.8	3.4	-13.6	4.1	-2.4
Developing Asia, *of which*	18.1	6.9	5.7	-5.8	12.2	-2.3	1.0	-13.6
Excluding China and India	10.9	9.1	1.5	-14.3	7.4	-4.0	-0.9	-23.2
Middle East & Turkey	7.7	2.0	13.8	2.3	1.2	-22.2	6.5	-1.6
Western Hemisphere	13.2	6.8	17.9	8.3	9.8	-3.7	18.1	4.6

Source: World Economic Outlook, IMF, September 2003.

4.15 Although almost all of the East Asian countries posted double-digit trade growth during the 1990s up to 1997, trade expansion in these countries suffered a major setback following the crisis of 1997. Their performance took a severe downturn in the years immediately after the crisis. The impact of the East Asian crisis on growth in volume of exports was less pronounced than for imports (Table 4.4).

4.16 China's trade performance (both exports and imports), continued to remain impressive throughout the 1990s. India too posted a healthy growth during the 1990s, especially during the initial years of economic reforms. Amongst the Latin American economies, Mexico witnessed significant growth in trade during the 1990s. The East Asian countries, especially Malaysia, Korea and Philippines, have also rebounded strongly since 2000 (Table 4.5).

Changing Pattern of World Trade

4.17 Along with growth in overall volume, the pattern of world trade also underwent changes following structural shifts in production caused by new technologies, demand pattern, new logistical factors, ways of organising and locating production, policies and new international trade rules and preference (Box IV.1). Primary products and resource-based manufactures have been gradually losing importance with world trade witnessing a shift towards non-resource-based products of increasing technology intensity (Table 4.6). In keeping with this trend, there has also been a rapid change in the composition of developing country exports, which have transformed themselves during the last two decades from being primary commodity exporters to exporters of manufactures. Manufacturing exports now account for the bulk of developing country exports, with their share being more than 80 per cent

Table 4.5: Growth Rate in Trade Value during the 1990s

(Per cent)

Country	Average Growth Rate							
	1992-2001		1992-96		1997-2001		2002	
	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports
1	2	3	4	5	6	7	8	9
Brazil	11.2	6.5	21.2	8.7	1.2	4.4	-15.0	3.7
China	14.9	14.5	17.2	16.5	12.7	12.4	21.2	22.3
India	**9.8**	**9.6**	**13.7**	**13.4**	**5.9**	**5.8**	**12.3**	**13.6**
Indonesia	3.8	7.4	11.0	11.4	-3.5	3.4	0.9	1.2
Korea	7.9	8.3	13.6	12.9	2.2	3.6	7.8	8.0
Malaysia	8.7	10.5	17.0	18.1	0.5	2.9	8.1	6.0
Mexico	13.3	14.4	13.1	17.8	13.5	10.9	0.0	1.4
Philippines	10.3	14.8	21.6	18.5	-1.1	11.1	12.3	11.0
Thailand	6.8	9.2	14.4	14.8	-0.9	3.5	4.3	5.7
United States	9.0	5.8	10.1	8.2	7.8	3.4	2.0	-5.1
World	6.1	6.1	9.0	9.1	3.3	3.0	3.7	4.3

Source: International Trade Statistics, WTO, 2002 and 2003.

Box IV.1

Modern Trade Theory

Although the time honoured principle of comparative advantage and factor endowments still has paramount importance in determining the structure, extent and direction of trade flows across nations, the nature of trade and its evolution in the recent period could be explained better by new trade theories. These theories incorporate returns to scale (especially when dynamic economies of scale associated with R&D and the learning curve are included), imperfect competition among the producers (mainly monopolistic and oligopolistic competition) and product differentiation in trade models. These theories also attempt to formalise equilibrium trade patterns with increasing returns to scale, endogenous technological change, differences in factor composition and monopolistic competition. Within such frameworks, trade patterns, R&D efforts and various economic policies get dynamically interlinked.

The new trade theory highlights the role of knowledge accumulation and international dissemination in explaining how trade structure and trade policy affect rates of growth. Market integration, technical innovation and other external returns have recently emerged as central issues in the new trade theory. The integration of a nation into the world trading system unleashes powerful forces that speed up growth. The extent to which the accumulation of knowledge capital is country-specific or international in scope also plays an important role in the determination of trade patterns and growth differentials across countries.

These above factors propounded in the modern trade theory explain significant parts of specialisation patterns, volumes of trade, factor content of trade and the broad patterns of trade across regions. However, as the nature of world trade has been changing rapidly with constant technological change, recent trade theory and empirical research are focusing on greater technological orientation with more emphasis on dynamics to explain trade developments.

for South Asia, East Asia and the Pacific. It is pertinent to note that developing countries are growing faster than industrial countries in exports of more technology intensive products.

4.18 Product-wise analysis shows that items under 'office and telecom equipments', 'chemicals' and 'machinery and transport equipments' witnessed the highest growth during the 1990s (Table 4.7). A recent study by UNCTAD reveals that the 40 most dynamic products in world exports (comprising just 5 per cent of the 786 products as per the Standard International Trade Classification (SITC)) accounted for nearly 40 per cent of the value of total exports in 2000 (UNCTAD, 2002). Exports of these products grew at a rate of 12 per cent per annum between 1985-2000 (as against an overall export growth of 8.2 per cent) and their market share increased by almost 15 per cent. About half of these products relate to three items under manufacturing sector, namely, 'electronics', 'automotive products' and 'apparel'.

4.19 Another significant feature in the evolution of trade pattern in recent period has been that developing countries have become important markets for each others' products. This is, however, almost entirely on account of robust trade in the

Table 4.6: Structure of World Trade According to Technology Intensity

(Per cent)

Product	Developed Countries		Developing Countries	
	1985	2000	1985	2000
1	2	3	4	5
Primary Products	38.0	40.4	61.2	56.0
Manufactures based on natural resources	68.7	68.2	29.8	26.6
Manufactures not based on natural resources, *of which,*	81.9	66.8	17.5	30.8
Low Technology	66.4	49.7	32.4	46.6
Medium Technology	89.2	78.6	10.4	18.8
High Technology	83.2	63.4	16.6	35.4
Other Transactions	71.2	58.4	28.6	40.4
Total	**68.9**	**63.5**	**30.3**	**33.6**

Source: World Investment Report, UNCTAD, 2002.

Table 4.7: World Merchandise Exports by Product, 2002

Commodity	Value (US $ billion)	Share (Per cent)			Annual change (Per cent)			
	2002	1990	1995	2002	1990-2001	1995-00	2001	2002
1	2	3	4	5	6	7	8	9
All products @	**6,272**	**100.0**	**100.0**	**100.0**	**5.0**	**5.0**	**-4.0**	**4.0**
Agricultural products	**583**	**12.2**	**11.7**	**9.3**	**3.0**	**-1.0**	**0.0**	**5.0**
Food	468	9.3	9.0	7.5	3.0	-1.0	3.0	5.0
Raw materials	114	2.9	2.7	1.8	1.0	-2.0	-9.0	4.0
Mining products	**788**	**14.4**	**10.7**	**12.6**	**4.0**	**10.0**	**-9.0**	**-1.0**
Ores and other minerals	63	1.6	1.2	1.0	2.0	1.0	-4.0	1.0
Fuels	615	10.7	7.3	9.8	5.0	13.0	-9.0	0.0
Non-ferrous metals	110	2.1	2.2	1.8	4.0	3.0	-10.0	-2.0
Manufactures	**4,708**	**70.4**	**74.3**	**75.1**	**6.0**	**5.0**	**-4.0**	**4.0**
Iron and steel	142	3.1	3.1	2.3	2.0	-1.0	-6.0	7.0
Chemicals	660	8.7	9.7	10.5	7.0	4.0	3.0	10.0
Other semi-manufactures	460	7.8	7.9	7.3	5.0	3.0	-2.0	6.0
Machinery and transport equipment	2,539	35.7	38.8	40.5	7.0	6.0	-6.0	3.0
Automotive products	621	9.4	9.2	9.9	5.0	5.0	-1.0	9.0
Office and telecom eqpt.	838	8.8	12.1	13.4	10.0	10.0	-13.0	0.0
Other machinery and transport eqpt.	1,080	17.5	17.5	17.2	5.0	5.0	-2.0	1.0
Textiles	152	3.1	3.0	2.4	3.0	0.0	-5.0	4.0
Clothing	201	3.2	3.2	3.2	6.0	4.0	-2.0	4.0
Other consumer goods	553	8.8	8.7	8.8	5.0	5.0	-2.0	4.0

@ Includes unspecified products. They accounted for 3 per cent of world merchandise exports in 2002.
Source: International Trade Statistics, WTO, 2002 and 2003.

Asian region (Table 4.8). The share of developing country exports destined for Asia has more than doubled while the share of developing country imports from Asia has almost trebled between 1980 and 2000.

Terms of Trade

4.20 An analysis of commodity prices reveals that the world-wide spurt witnessed during 1970s and 1980s ebbed considerably by the beginning of the last

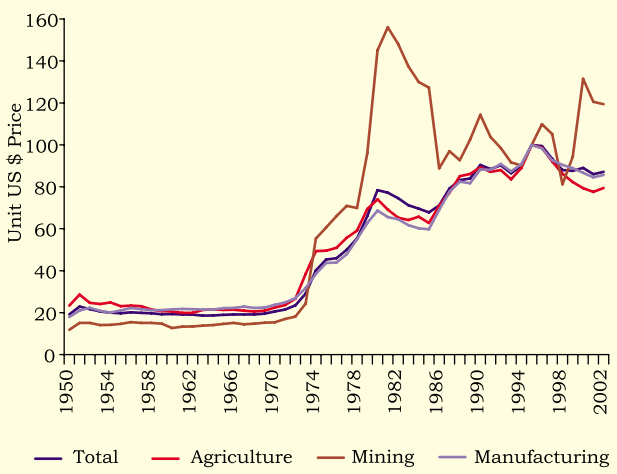
Table 4.8: Destination of Exports from and Source of Imports of Developing Countries

(Per cent)

	1980	1990	2000	2001	2002
1	2	3	4	5	6
Exports from developing countries to:					
Industrial countries	63.6	61.0	57.5	57.0	55.3
Developing Countries	27.7	35.8	41.0	41.5	42.9
Africa	2.4	2.0	1.7	1.9	2.0
Asia	10.1	20.2	26.4	26.2	27.1
Europe	4.0	6.0	5.3	5.4	5.9
Middle East	4.3	3.7	2.9	3.2	3.3
Western Hemisphere	7.0	3.9	4.7	4.8	4.6
Imports of developing countries from:					
Industrial countries	60.9	61.7	54.3	52.9	52.0
Developing Countries	30.1	36.2	44.1	45.6	45.6
Africa	2.4	1.7	1.9	1.9	1.9
Asia	8.1	19.0	26.5	27.2	27.2
Europe	2.8	5.8	6.0	6.4	6.0
Middle East	11.2	5.9	5.5	5.5	3.3
Western Hemisphere	5.5	3.9	4.3	4.6	4.6

Source: Direction of Trade Statistics, IMF, Various Issues.

Chart IV.1 : Index of World Export Commodity Prices (1995=100)



Source: International Trade Statistics, WTO, 2003.

decade. Nominal prices, in fact, started to exhibit a definite downturn by mid-1990s. The slowdown in demand in addition to enhanced competition were the main factors in keeping downward pressure on the prices of many commodities. At the same time, market support policies in developed countries for some agricultural commodities also contributed to weakness in their world prices (Chart IV.1).

4.21 The movements of terms of trade among economies, their determinants, and possible trends have important welfare implications. Although the downward movement of the terms of trade for exports of primary commodities continues to remain an area of concern for some developing countries, the recent trend among developing countries towards exporting manufacturing commodities has increasingly turned the attention on the relative movement in the prices

Table 4.9: Net Barter Terms of Trade

(1995=100)

	1970	1980	1990	2000	2001
1	2	3	4	5	6
World	89.3	90.0	95.5	97.6	97.7
Industrial Countries	103.2	85.6	95.3	97.2	98.3
Developing Countries	57.3	106.5	96.7	98.9	95.7
Asia	97.2	101.7	98.2	90.6	89.0
Brazil	148.7	122.9	109.9	83.5	79.5
China	96.8	101.5	101.4	101.2	102.1
India	**90.5**	**66.8**	**79.3**	**92.9**	**90.9**
Korea	111.7	83.4	97.6	64.0	61.1
Thailand	170.9	129.6	102.0	85.7	77.9

Source: International Financial Statistics, CD ROM, IMF, 2003.

Table 4.10: Purchasing Power of Exports

(1970-79=100)

	1970-79	1980-89	1990-2000
1	2	3	4
Argentina	100	150	299
Brazil	100	174	256
China	100	295	884
India	**100**	**167**	**386**
Indonesia	100	218	406
Korea	100	348	1,151
Malaysia	100	236	879
Mexico	100	204	458
Philippines	100	177	382
Taiwan Province of China	100	234	593
Thailand	100	214	784

Source : Trade and Development Report, UNCTAD, 2003.

of manufactures exported by developing countries *vis-à-vis* developed countries. Such price movements primarily reflect the differences in terms of technological capacity, labour market institutions and prevalence of surplus labour among the country groups. As a result, while some developing countries like China and India experienced a relatively stable terms of trade, others such as Korea, Brazil and Thailand witnessed a secular decline since the 1970s (Table 4.9).

4.22 The rapid volume increase in most of the developing country exports, however, has compensated to an extent, for the decline in the net barter terms of trade. While the purchasing power of exports increased for most of the developing countries, this rise was most rapid for East Asian economies and China. India has also registered a markedly high growth in its purchasing power of exports during the last three decades and especially since the 1990s (Table 4.10).

Trade Openness

4.23 Trade openness, conventionally measured as the sum of exports and imports of goods as a ratio of GDP, brings out clearly the growing trade liberalisation over time (Table 4.11). For most of emerging economies (including India), their openness in 2002 was almost double or even higher than that during the 1980s. This has been facilitated, *inter alia*, by significant reduction in import tariffs (Table 4.12). Tariffs have been reduced by more than half in most of the developing countries, including India, since the beginning of the last decade. Despite reductions, tariffs in India remain one of the highest amongst the emerging market economies (EMEs).

Table 4.11: Trade Openness

(Per cent)

Country	Average 1980s	Average 1990s	1995	1996	1997	1998	1999	2000	2001	2002
1	2	3	4	5	6	7	8	9	10	11
Argentina	12.2	15.1	15.9	17.5	19.4	19.3	17.2	18.2	17.4	37.3
Chile	37.0	44.8	44.3	45.9	46.9	45.6	45.4	50.4	53.1	53.3
China	19.9	35.6	40.1	35.5	36.2	34.2	36.4	43.9	43.3	49.0
Germany	48.8	43.2	40.2	41.2	45.3	47.3	48.2	55.8	56.9	55.4
India	**11.7**	**16.9**	**18.5**	**19.0**	**18.8**	**18.7**	**18.9**	**20.4**	**19.7**	**21.4**
Indonesia	37.0	47.0	42.6	40.9	44.1	79.8	51.9	63.7	61.8	48.2
Japan	20.7	15.7	14.7	16.1	17.6	16.9	16.3	18.0	18.0	18.9
Malaysia	97.0	156.7	170.7	155.4	157.5	182.2	189.5	199.9	184.0	182.5
Mexico	27.3	44.3	54.3	57.1	56.2	59.0	59.2	60.0	53.6	52.9
Philippines	38.6	63.8	60.7	64.6	75.8	91.5	90.8	102.6	93.8	94.5
Thailand	47.9	74.0	75.7	70.4	79.7	87.1	88.7	106.9	110.3	105.5
Turkey	27.8	30.2	33.1	37.5	39.3	35.5	34.3	41.1	49.8	47.3
United Kingdom	42.2	41.5	44.7	46.2	44.2	41.2	40.1	42.7	41.1	39.0
United States	14.9	17.4	18.3	18.5	19.1	18.5	19.0	20.8	18.9	18.2

Note : Trade openness is measured by the ratio of exports plus imports to GDP.
Source : 1. International Financial Statistics, IMF, 2002.
2. World Economic Outlook Database, IMF.

4.24 Indicators such as trade openness and reduction in tariffs, however, do not completely capture an economy's trade integration. A number of approaches are used to estimate barriers to trade. Sachs and Warner (1995) have used a series of trade related indicators - non-tariff barriers, average tariff

Table 4.12: Tariff Barriers: Cross-Country Comparisons

Country	Year	All Products					Primary Products		Manufactured Products	
		Simple Mean Tariff *	Standard Deviation of Tariff Rates	Weighted Mean Tariff@	Share of lines with international peaks #	Share of lines with specific tariff	Simple Mean Tariff *	Weighted Mean Tariff @	Simple Mean Tariff *	Weighted Mean Tariff@
1	2	3	4	5	6	7	8	9	10	11
Argentina	1992	12.2	7.7	12.8	31.0	0.0	12.8	5.8	12.3	13.6
	2001	11.6	7.2	9.2	39.1	0.0	9.2	4.8	11.7	9.7
Bangladesh	1989	106.2	79.2	88.2	98.5	1.0	88.2	53.6	108.7	109.6
	2000	21.6	13.6	21.0	52.9	0.0	21.0	18.6	21.5	22.3
Brazil	1989	42.2	17.2	32.0	92.4	0.2	32.0	18.6	42.4	37.1
	2001	12.9	7.2	11.1	46.3	0.0	11.1	4.7	12.9	12.5
China	1992	41.2	30.6	32.5	78.2	0.0	32.5	14.0	41.6	35.6
	2001	15.3	10.0	14.3	40.5	0.5	14.3	18.6	15.0	12.9
Egypt	1995	25.6	33.2	16.7	53.1	1.2	16.7	7.6	25.6	22.2
	1998	20.5	39.5	13.8	47.4	9.5	13.8	7.5	20.2	17.5
India	**1990**	**79.0**	**43.6**	**56.2**	**97.1**	**0.9**	**56.2**	**25.4**	**79.9**	**70.8**
	2001	**30.9**	**12.4**	**28.2**	**91.8**	**0.1**	**28.2**	**28.5**	**30.6**	**29.0**
Indonesia	1989	22.0	19.7	13.2	50.5	0.3	13.2	5.9	22.1	15.1
	2000	8.4	10.8	5.4	11.2	0.0	5.4	2.8	8.9	6.6
Korea	1988	18.8	7.9	13.8	73.0	10.3	13.8	8.2	18.6	17.0
	1999	8.7	5.9	6.0	4.8	0.8	6.0	5.6	7.8	6.1
Malaysia	1988	17.0	15.1	9.9	46.4	6.7	9.9	4.6	17.3	10.8
	1997	9.2	33.3	5.8	24.7	0.4	5.8	10.0	10.2	5.5
Mexico	1991	13.4	4.3	12.0	20.9	0.0	12.0	8.3	13.4	13.0
	2001	16.2	9.3	15.4	50.8	0.5	15.4	19.9	16.1	14.7
Pakistan	1995	50.8	21.6	46.3	92.3	3.5	46.3	24.0	51.5	50.8
	2001	20.6	19.2	14.7	58.5	0.5	14.7	8.5	20.5	16.8
Thailand	1989	38.5	19.5	33.0	72.9	21.8	33.0	24.3	39.0	34.9
	2000	17.0	14.3	9.7	47.1	1.2	9.7	7.7	15.9	10.1

* Simple mean tariff is unweighted average of the effectively applied rates for all products subject to tariffs.
@ Weighted mean tariff is the average of effectively applied rates weighted by the product import shares corresponding to each partner country.
# International peaks are tariff rates that exceed 15 per cent.
Source: World Development Indicators, World Bank, 2003.

rates, black market premia, social organisation and the existence of state monopoly on exports - to construct a composite openness index. Some authors have analysed the price differentials of commodities across international markets to measure goods market integration. Leamer (1988) used an empirical Hecksher-Ohlin model and took the differences between predicted and actual trade intensity ratios as indicators of trade barriers. More recently, many researchers have used Gravity Model of international trade to evaluate a country's actual trade *vis-à-vis* potential trade (Box IV.2).

Export as an Engine of Growth

4.25 Open trade and liberal capital account policies allow a country to exploit comparative advantage in production, promote lowest cost product import with embedded advanced technology, and to deploy larger variety of intermediate and capital goods to enhance the productivity of its own resources. Since 1985, the developing countries that achieved the fastest economic growth were the countries that had the highest ratio of exports and imports to GDP as well. Moreover, the countries that substantially liberalised their trade over this period

Box IV.2

Gravity Model of International Trade

The Gravity Model of international trade is increasingly used to derive measures of divergence in expected volume of trade between trading partners and their actual trade. Borrowing from Newtonian physics, the model consists of a single equation postulating that the amount of trade between two countries depends positively on the joint size of the two trading economies and is negatively related to the distance between them. Over time the Gravity Model of trade has been extended to incorporate a wide variety of other factors. This approach has the benefits of capturing the overall impact of a country's policy and institutional environment, including a wide variety of artificial impediments and not just trade policy. A country is found to "under-trade" if its actual trade across trading partners is, on an average, below the level predicted by the Gravity Model without explicit policy variables (Rose 2002; IMF, 2002).

Analysis of developing countries' trading pattern, as per the Gravity Model, suggests the following: (i) balance of payments and trade restrictiveness remain important reasons for developing countries to trade less than industrial countries; and (ii) international vertical specialisation, which had played an important role in East Asia, is likely to become more significant for other developing countries with open trading regimes, abundant labour and flexible economies. Full liberalisation of both trade and balance of payments policies in all countries would increase trade between industrial countries (the North-North trade) by about 40 per cent, the North-South trade by about 63 per cent, and trade between developing countries (the South-South trade) by about 94 per cent (IMF, 2002).

According to the IMF estimates, India's merchandise trade between 1995-99 was, on an average, about 36 per cent below its "expected" level. This represents an improvement since the early 1990s, when under-trading is estimated to have been about 50 per cent. Estimates suggest that India's relatively restrictive policies accounted for about 25 per cent of the shortfall in its trade openness compared with other developing countries over 1995-99, with the remainder attributable to India's relatively low per capita income, geographic factors, and restrictions imposed by other countries.

Table: Trade Effects of Policy Liberalisation[1]

Region	Trade Policy[2]		Balance of Payments Policy[3]		Trade Policies
	Liberalisation[4]	Trade Effect	Liberalisation[4]	Trade Effect	Trade Effect
1	2	3	4	5	6
Liberalisation in Industrial Countries only					
North-North Trade	-5.3	30.5	-1.5	7.3	40.0
North-South Trade	-2.7	14.4	-0.6	3.1	17.9
Liberalisation in Developing Countries only					
North-South Trade	-3.9	21.4	-2.7	13.7	38.0
South-South Trade	-8.0	49.0	-5.4	29.9	93.6
Liberalisation in All Countries					
North-North Trade	-5.3	30.5	-1.5	7.3	40.0
North-South Trade	-6.5	38.9	-3.3	17.2	62.8
South-South Trade	-8.0	49.0	-5.4	29.9	93.6

1. Effects of reduction in indicators to lowest possible rank scale. Trade effects are given by the coefficient and the reduction in the indicators. The indicators are averages over bilateral trade relations for the period 1997-99 and were constructed under the assumption of additivity.
2. Indicator variable ranging from 2-20, based on restrictiveness indicated by the average tariff rate and the coverage of non-tariff barriers.
3. Dummy variable ranging from 0-8 indicating the degree of openness of a country's current account, capital account, the existence of multiple exchange rate for capital account transactions, and the stringency of surrender and repatriation requirements.
4. Reduction in average rank index values implied by liberalisation.

Source: World Economic Outlook, IMF, 2002.

Table 4.13: Developing Countries- Policies and Economic Performance[1]

	Low Growth [2]		Medium Growth		High Growth	
	1970-84	1985-95	1970-84	1985-95	1970-84	1985-95
1	2	3	4	5	6	7
Initial Conditions						
GDP per capita in initial years [3]	1,697	2,185	2,266	2,188	1,776	2,734
Human Capital [4]	2.2	3.3	3.2	3.8	3.5	5.4
Macro Conditions						
Savings [5]	17.8	16.5	18.5	19.2	26.0	31.4
Investment [5]	19.0	19.4	22.1	21.1	27.4	31.9
Inflation rate per year	11.0	14.1	10.9	11.1	11.3	7.8
Fiscal Conditions						
Fiscal balances [5]	-5.7	-5.6	-4.2	-3.3	-2.0	-2.4
Monetary Conditions						
Money plus quasi-money [5]	33.0	38.4	28.7	36.4	25.6	64.9
Bank Credit to the private sector [5]	20.4	25.4	18.5	31.0	21.0	63.1
External Sector						
Exports [5]	11.3	17.2	14.9	17.2	18.2	33.0
Imports [5]	12.2	17.7	17.4	18.1	19.5	32.4
Balances on current account [5]	-1.0	-2.6	-3.7	-1.4	-1.9	0.3
Net private capital flows [6]	20.2	11.8	12.9	19.9	66.9	68.3

1. Excludes major oil exporting countries, Cyprus and Malta.
2. Low growth is defined as per capita real income growth of less than one-half of 1 per cent a year, which is roughly the mean growth rate minus one-half of the standard deviation of growth in the sample for the specific period. Correspondingly, high growth refers to rates above the mean plus one-half of the standard deviation (2.9 per cent).
3. Group average in U.S. dollar terms, using purchasing power parity weights.
4. Average schooling years in population aged 15 and over.
5. In per cent of GDP.
6. In per cent of total private capital flow to developing countries. Excludes Asian newly industrialised economies.

Source : World Economic Outlook, IMF, 1997.

also experienced a noticeable increase in their absolute income levels (Table 4.13). This raises the issue as to whether trade liberalisation *per se* leads to higher growth. While the available empirical evidence as to whether exports cause economic growth or *vice versa* still remains inconclusive, most recent studies suggest that trade liberalisation contributes to growth and that trade openness is an important factor behind higher productivity and per capita income. At the same time, protected industries appeared to have slower growth than others, reflecting the fact that growth in productivity is as much because of acquisition of sophisticated technology as it is due to learning by doing. It may be difficult, however, to segregate the effect of trade openness on growth from other institutional mechanisms or policy reforms. Moreover, the differential impact of exports on economic growth depends also on the stage of economic or industrial development of the country. Empirical evidence shows that trade liberalisation alone is not sufficient for ensuring faster growth, unless trade liberalisation is accompanied by other complementary policies such as a stable and non-discriminatory exchange rate system and prudent monetary and fiscal policies (Baldwin, 2003).

4.26 In the Indian case, analysis of the nature of causal relationship between exports and economic growth, examined within the framework of bi-variate vector autoregression (VAR) model for the period 1951-2003, suggests that there is uni-directional Granger's causality running from real export growth to real GDP growth. This suggests that there are likely to be other factors besides domestic supply shocks that effect export performance. The long run co-integrating vector indicates that the elasticity of output growth with respect to export growth is highly significant at around 0.3.

Export-Led Industrialisation in East Asia

4.27 The benefits of trade liberalisation have been clearly evident in East Asia. The process of export-led industrialisation in these countries is perceived to have led to intra-regional spillover effects mainly emanating from technological transfers through direct investment from Japan,

and indirectly from "hollowing out" of the industrial economies. Each shift in the industrial focus of the Japanese economy, from light to heavy to electronics and high-tech industries, created market opportunities for other economies in the region such as Korea and Taiwan. Even within the electronics industries, mid-range goods gradually began to be supplied by Korea, Taiwan, Singapore, and Malaysia, and only the most sophisticated goods were produced in Japan. More recently, as Korea, Taiwan and Singapore started specialising in heavy and high-tech goods sectors, the light industries were picked up by Thailand, Philippines, and Indonesia. This sequence of industrialisation, often called the ''flying geese pattern'', succeeded in the East Asian economies in passing on the comparative advantages in manufacturing from a leader to the followers, and then to the followers' followers. A sequential pattern of industrialisation was observed from the agricultural sector to the industrial sector with small capital requirements to heavy and petrochemical industries, and to precision and electronics industries with late-comers repeating the changes in industrial composition.

4.28 High exports growth in the Asian countries has been possible on the back of a strong domestic industrial sector which created a base for sustainable growth. The value added in the industrial sector during the high growth phase exceeded 10 per cent (per annum) in these economies. In contrast, the growth in Indian industry has been comparatively lower, with only a marginal increase in the share of industry in GDP, thereby keeping the share one of the lowest among EMEs (Table 4.14).

Table 4.14: Growth Rate of Value Added in Different Sectors and Sectoral Share of GDP: Select Asian Countries

(Per cent)

Country	Sector	Growth rate of Value added				Sectoral Share of GDP			
		1971-80	1981-90	1991-96	1997-2003	1970	1980	1990	2001
1	2	3	4	5	6	7	8	9	10
China	Agriculture	3.5	5.5	4.3	2.9	42.2	30.1	27.0	11.3
	Industry	8.9	11.7	16.6	9.4	44.6	48.5	41.6	64.5
	Services	5.2	12.4	9.7	7.7	13.2	21.4	31.3	24.1
Korea	Agriculture	1.4	5.3	2.1	0.8	29.8	14.9	8.5	5.2
	Industry	14.2	10.4	7.7	5.4	23.8	41.3	43.1	44.8
	Services	7.8	17.7	8.2	4.5	46.4	43.7	48.4	50.0
India	**Agriculture**	**1.9**	**3.1**	**3.8**	**1.2**	**44.5**	**38.1**	**31.0**	**23.9**
	Industry	**4.0**	**7.1**	**6.1**	**5.0**	**23.9**	**25.9**	**29.3**	**26.7**
	Services	**4.5**	**6.8**	**7.3**	**7.9**	**31.6**	**36.0**	**39.7**	**49.5**
Indonesia	Agriculture	3.9	3.5	3.2	1.4	35.0	24.8	19.4	16.2
	Industry	12.5	6.1	10.4	1.4	28.0	43.4	39.1	43.7
	Services	9.4	7.5	7.5	0.7	37.0	31.8	41.5	40.2
Malaysia	Agriculture	3.9	3.9	1.9	0.6	NA	22.9	15.2	8.7
	Industry	9.1	7.4	11.3	2.2	NA	35.8	42.2	41.1
	Services	8.4	3.9	9.5	6.0	NA	41.3	42.6	50.2
Philippines	Agriculture	4.9	1.0	1.9	2.4	28.2	25.1	21.9	20.0
	Industry	8.3	-0.9	2.9	2.7	33.7	38.8	34.5	34.0
	Services	5.2	2.9	3.2	4.6	38.1	36.1	43.6	46.0
Singapore	Agriculture	2.2	-6.2	1.9	-3.5	2.2	1.3	0.4	0.1
	Industry	9.8	5.4	8.7	3.6	36.4	38.1	34.4	31.3
	Services	8.8	7.2	8.2	4.1	61.4	60.6	65.3	68.6
Thailand	Agriculture	5.7	3.8	3.8	1.8	30.2	23.2	12.5	10.4
	Industry	12.0	10.3	10.0	2.2	25.7	28.7	37.2	44.2
	Services	11.2	7.7	7.5	0.4	44.1	48.1	50.3	45.4

NA: Not Available.

Source: Asian Development Bank, Asian Development Outlook, Various Issues.

Table 4.15: Trade Share of Major Products in Select Asian Countries

(Per cent)

Country	Exports				Imports			
	Agricultural Products		Manufacturing Products		Fuel		Manufacturing Products	
	1990	2001	1990	2001	1990	2001	1990	2001
1	2	3	4	5	6	7	8	9
Average	**16.3**	**7.4**	**68.8**	**82.4**	**10.4**	**12.7**	**72.6**	**73.4**
China	16.2	6.2	71.4	88.6	2.4	7.2	79.5	78.0
Taiwan Province of China	5.6	2.6	92.5	95.0	10.9	11.0	67.1	76.3
India	**19.5**	**15.5**	**69.7**	**79.5**	**27.5**	**34.4**	**51.6**	**44.0**
Indonesia	16.2	12.5	35.2	56.0	8.9	17.8	76.2	61.1
Korea	4.6	2.6	93.2	90.0	15.8	24.1	63.1	60.0
Malaysia	25.4	8.2	53.7	80.1	5.1	5.2	78.2	80.9
Philippines	20.7	6.1	69.7	91.0	14.9	11.4	68.7	75.8
Singapore	7.8	2.7	71.2	84.3	15.8	12.6	73.1	80.3
Thailand	33.8	18.5	63.2	74.1	9.3	12.0	75.1	75.1

Source: International Trade Statistics, WTO, 2002.

4.29 The trade structure of East Asia has been dominated by manufacturing sector (Table 4.15). At the same time, foreign investment in these countries was primarily directed to reduce the technology gap and enmesh it in their production line. On the other hand, the compulsion of petroleum import pre-empted a large portion of India's capital imports. This led to a comparatively low industrial growth with technological obsolescence, which in turn affected the competitiveness of India's exports.

Foreign Investment and Trade

4.30 Existing empirical evidence appears inconclusive on whether FDI serves as a complement or as a substitute to trade, since the nature of investment strategy, the level of data aggregation, and host and home-country specifics complicate this relationship. A growing proportion of world trade is conducted by the multinationals that are also active in undertaking FDI. It is widely held that these companies may export capital goods and intermediate goods from host countries to their overseas affiliates so as to assist the latter to import products from them to serve their home market, thereby promoting the linkage between FDI and foreign trade. It is, however, accepted that this relationship is not uniform across developing countries. The overall relationship between trade and FDI needs to be judged taking into account the whole menu of the relevant country-specific factors including the size of the local market, factor cost in the host market, locational advantage as also trade and investment restrictions/regime in the host/home countries. As a generalisation, it may be stated that FDI in developed countries is market seeking while that in most of the low-cost developing countries is mainly efficiency seeking.

4.31 The liberalisation of FDI especially since the 1980s in East Asian economies is widely acknowledged to have provided a boost to their exports with inward FDI shifting the incentives from import substitution production to export orientation (Table 4.16). The contribution of FDI to export expansion has been particularly large for the ASEAN members and China as against exporting economies of Hong Kong, Korea and Taiwan, as the former countries attracted mainly export oriented FDI. Foreign affiliates accounted for about half of total export of China during 2002 and even higher in some high-tech industries. In contrast to these economies, inward looking trade and investment policies have stymied exports and FDI inflows to India upto the 1990s.

Table 4.16: Ratio of Exports and FDI to GDP in East Asia

(Per cent)

Country		Average 1980s	Average 1990s	1995	1996	1997	1998	1999	2000	2001	2002
1		2	3	4	5	6	7	8	9	10	11
Argentina	: Exports/GDP	7.3	7.5	8.1	8.7	9.0	8.8	8.2	9.3	9.9	27.7
	FDI/GDP	0.5	2.6	2.2	2.6	3.1	2.4	8.5	3.7	0.8	0.8
Chile	: Exports/GDP	19.1	21.8	22.2	20.7	21.7	20.6	23.5	25.7	27.1	27.6
	FDI/GDP	1.8	4.8	4.1	6.6	6.4	6.1	12.3	4.9	6.6	2.6
China	: Exports/GDP	9.3	18.8	21.2	18.5	20.3	19.4	19.7	23.1	22.6	25.7
	FDI/GDP	0.5	3.9	5.1	4.9	4.9	4.6	3.9	3.6	3.8	3.9
India	**: Exports/GDP**	**4.5**	**7.8**	**8.7**	**8.9**	**8.6**	**8.2**	**8.2**	**9.2**	**9.1**	**10.0**
	FDI/GDP	**..**	**0.4 ***	**0.6**	**0.6**	**0.9**	**0.6**	**0.5**	**0.6**	**0.9**	**0.6**
Indonesia	: Exports/GDP	22.3	27.1	22.5	22.0	24.8	51.2	34.8	41.4	39.9	33.5
	FDI/GDP	0.4	1.1	2.2	2.7	2.2	-0.4	-2.0	-3.0	-2.3	-0.9
Malaysia	: Exports/GDP	52.3	80.3	83.2	77.7	78.6	101.5	106.9	108.9	100.0	98.3
	FDI/GDP	3.2	5.8	4.7	5.0	5.1	3.0	4.9	4.2	0.6	3.4
Mexico	: Exports/GDP	15.1	21.0	27.8	28.9	27.5	27.9	28.4	28.6	25.4	25.2
	FDI/GDP	1.2	2.2	3.3	2.8	3.2	2.8	2.7	2.8	4.2	2.3
Philippines	: Exports/GDP	16.3	26.7	23.2	24.2	29.7	44.2	48.0	53.2	45.3	46.8
	FDI/GDP	0.6	1.9	2.0	1.8	1.5	3.4	2.3	1.8	1.4	1.4
Thailand	: Exports/GDP	20.9	34.6	33.6	30.6	38.0	48.7	47.7	56.3	56.5	54.4
	FDI/GDP	1.0	2.6	1.2	1.3	2.6	6.5	5.0	2.7	3.3	0.7
Turkey	: Exports/GDP	9.9	11.4	12.5	13.0	13.8	13.1	13.6	13.9	21.5	19.4
	FDI/GDP	0.2	0.4	0.5	0.4	0.4	0.5	0.4	0.5	2.2	0.6

.. Negligible
* Pertains to 1991 to 1999.
Source : 1. International Financial Statistics, CD ROM, IMF, 2003.
2. World Economic Outlook Database, IMF.

II. INDIA'S TRADE PERFORMANCE

Trade Policy of India: A Review

4.32 India adopted an inward looking development strategy after independence wherein import substitution constituted a major element of both trade and industrial policies. The strategy was based on the premise that given the export base, technological capabilities, production structure, "elasticity pessimism" of the traditional export sector and a large domestic market, it may be difficult for the country to have a growth strategy mainly based on exports. The focus in the initial stages of planned development was on stimulating "home-grown" industrialisation, essentially based on the "infant industry argument", wherein production for domestic market was shielded behind high tariff walls and high effective protection. This strategy of import-substituting industrialisation created self-fulfilling biases against the export-producing sectors and as such, exports were relegated to the periphery as a "residual" sector. This policy not only underestimated the export possibilities but also the import intensity of the import substitution process itself (Rangarajan, 1993).

4.33 The need to correct the "anti-export" bias was gradually recognised and, in the 1970s, several export promotion measures were put in place in the form of export incentives and export services to generate higher exports on a sustained basis. Protective quotas, however, remained more or less intact and domestic industry continued to be shielded from import competition. The policies relating to foreign trade became subject of intense discussions in the early 1980s with exports competitiveness receiving maximum attention. It became increasingly clear that production for exports cannot be isolated from production for the home market and that trade policy would have to be integrated with the policy for domestic industrialisation. The licensing and highly regulated trade policy slowly started giving way to a more open regime from the early 1980s, gathering further momentum during the second half of the decade. A three-yearly Export-Import Policy was introduced in 1985 to provide a definite focus to the trade sector. A major ingredient of this policy 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. Notwithstanding these measures, the trade regime in the 1980s continued to be characterised by the overwhelming presence of the licensing mechanism and a high level of tariffs isolating the economy from external competition, constrained further by restrictive industrial and foreign investment policies.

Table 4.17: India's Trade Sector Performance Since the 1950s

Annual Average	Growth Rate								
	In Rupee Terms		In US Dollar terms		In Real terms (Volume)#		As per cent to GDP		
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	(Exports+ Imports)@
1	2	3	4	5	6	7	8	9	10
1950-51 to 1959-60	3.6	6.1	3.6	6.1	3.0	4.1	5.1	6.7	11.8
1960-61 to 1969-70	8.9	6.3	3.5	0.8	2.7	1.4	3.4	5.5	8.9
1970-71 to 1979-80	16.8	20.7	15.8	20.1	7.3	6.7	4.5	5.3	9.8
1980-81 to 1989-90	16.4	14.9	8.0	7.2	4.2	7.3	4.6	7.2	11.8
1990-91 to 1995-96	25.3	23.4	11.8	10.7	14.4	14.5	7.5	8.5	16.0
1992-93 to 1995-96	24.7	26.8	15.7	17.5	17.5	21.3	8.1	9.0	17.1
1996-97 to 2002-03	13.6	13.6	7.9	7.9	8.6*	7.1*	8.9	10.8	19.7
1990-91 to 1999-2000	19.5	20.1	8.6	9.6	11.0	12.2	7.8	9.3	17.1

Refers to calendar year. Volume obtained by dividing value of exports (f.o.b) and imports (c.i.f) with their respective unit prices.
* 1996-97 to 2001-02.
@ Figures may not add-up due to rounding off.
Source: 1. Directorate General of Commercial Intelligence and Statistics, Government of India.
2. International Financial Statistics, CD ROM, IMF, 2003.

4.34 In the 1990s, a liberalised trade regime was put in place, which marked a significant turnaround from the earlier controlled regime. The challenge of restoring the macro-economic balance initially was combined with a long-term new trade policy which formed a major ingredient of the economic reforms programme. It was recognised 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. Apart from devaluation of the exchange rate and a move-over to a unified market-determined exchange rate system in 1993, the new trade policy was characterised by a short negative list of exports and imports, lowering of the level and dispersion of nominal tariffs, withdrawal of quantitative restrictions on imports and phasing out of the system of import licensing. The trade policy reforms also encompassed significant changes in the system of export incentives, moving away from direct subsidies to indirect export promotional measures.

4.35 The multi-pronged strategy undertaken in the beginning of the 1990s gradually had its desired effects on the economy and ushered in a phase of a stable and high growth (Table 4.17). The rising exports combined with significant surge in capital flows provided opportunities for further liberalisation of essential imports from quantitative restrictions (QRs). The stability in the exchange rate of the rupee maintained the competitiveness of Indian exports and at the same time prevented the upsurge of cheap imports, which could have fuelled protectionist sentiments to gain ground and stalled the tariff and non-tariff liberalisation measures. The loss of the East European markets since the early 1990s was successfully countered by diversifying into newer markets of developing countries of Asia and the Organisation of the Petroleum Exporting Countries (OPEC).

Tariff and non-Tariff barriers: Increasing Openness

4.36 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 Tax Reforms Committee, 1991 (Chelliah Committee). India's customs tariff rates have been declining since 1991. The "peak" rate has come down progressively from 150 per cent in 1991-92 to 25 per cent in 2003-04. Effective January 9, 2004, the peak rate of customs duty on non-agricultural goods has been furthur reduced to 20 per cent. The average tariff rate has also declined over the 1990s. The share of customs duty in GDP has come down significantly from about 3.9 per cent in 1987-88 to 1.8 per cent in 2002-03 (Chart IV.2). Customs duty collection as a proportion of total imports, which increased during the major part of 1980s reaching a peak of 61.6 per cent in 1987-88, declined significantly over the years and bottomed to about 15.3 per cent in 2002-03 (Chart IV.3). The collection rates fell drastically across all commodity groups during the 1990s. The most significant reduction in collection rates was observed in 'chemicals', 'man-made fibre' and 'metals' (Table 4.18).