The WTO Trade Policy Review of

India, 1998

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1. Introduction

The Contracting Parties of the General Agreement on Tariffs and Trade (GATT) established the Trade Policy Review Mechanism (TPRM) on a trial basis in April 1989 as a key accomplishment of the mid-term review of the Uruguay Round. TPRM was subsequently incorporated into the Marrakesh Agreement Establishing the World Trade Organization (WTO). The principal objective of the TPRM is to contribute to improved adherence by all Members to rules, disciplines and commitments made under the Multilateral Trade Agreements. This is to be accomplished by achieving greater transparency in, and understanding of, the trade policies and practices of Members.

Under TPRM, Trade Policy Reviews (TPRs) are carried out periodically by the WTO. The frequency of the review depends on size of the country. For the largest four trading entities (counting the European communities as one), the review is done every two years, for the next 16 trading entities, it is done every four years and for the remaining members, every six years. Longer periods can be permitted for the least developed countries. India is on a four-year cycle and was first reviewed in 1993. The present Review was delayed by a year, presumably at the request of the Government of India.

Traditionally, India has been one of the most protected countries in the world. Even as late as 1990, imports of 65% of all products were subject to non-tariff barriers (NTBs). The share of manufacturing value added protected by NTBs was as high as 90%. The simple average of all tariffs stood at 79%, with the highest tariff rate reaching as high as 355%. Consistent with this near autarkic regime, during 1985-90, the average annual exports to GDP ratio was a paltry 5%.

The good news, however, is that a considerable progress has been made towards opening the economy to competition, both foreign and domestic, since the launching of the economic reforms in

June 1991. Even though the level of protection remains high when compared with other developing countries, considerable trade liberalization has taken place within a matter of a few years. Less than one third of the goods are now subject to licensing, and the highest tariff rate has come down to 40%. The bulk of the remaining licensing restrictions are expected to be removed by June 2000.[1] The economy has responded well to liberalization, with exports-to-GDP ratio rising to 10%. The reforms have also led to a fundamental shift in the growth rate of GDP. Since 1993-94, the economy has been growing at unprecedented rates of 6 to 7% and is expected to continue to grow at similar rates in the immediate future.[2] Unlike the growth in 1980s, which was fueled by excessive borrowing at home and abroad, the current growth is based on good policies and is sustainable, provided reforms continue.

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[1]For a discussion of India's trade policies in relation to its neighbors in South Asia, see Panagariya (1999). Panagariya (1994a) and Pursell (1996) discuss in detail the trade-policy reforms during the first half of 1990s. Two influential book-length treatments of India's economic reforms are Bhagwati and Srinivasan (1993) and Joshi and Little (1996). Having been written at the invitation of the then Finance Minister Manmohan Singh, Bhagwati and Srinivasan (1993) played a key role in steering the course of the reforms.

[2]Based on a recent forecast by the Economist Intelligence Unit (EIU) for the year 1999, the *Economist* (January 16, 1999, p. 98) notes: "Although many Asian economies are likely to shrink again, the EIU expects India to be in the top of the league, with growth of 6.5%; China, whose figures are more dubious, is predicted to grow by 6.7%."

The Trade Policy Review of India, 1998 (TPRI, 1998) has four chapters. Chapter I discuss the recent performance of the economy with special reference to trade and foreign investment. Chapter II describes the institutional structure within which trade and investment policies are formulated and implemented. Chapter III details various trade policy measures in place. Finally, Chapter IV describes trade policies by sector rather than instruments. In the following, I will adopt this format with the modification that I will not discuss Chapter II explicitly.

2. The Economic Environment

In this section, an overview of the economy is provided with special emphasis on recent economic reforms and the structure of foreign trade. Also included is a discussion of foreign investment, which has shown a jump in activity in relation to its insignificant levels prevailing prior to the recent reforms.

2.1 Broad Structure of the Economy

According to the World Development Report of the World Bank (1998-99), in 1997, India's population was 961 million and its GDP $373.9 billion. Approximately 70% of the population owes its livelihood to agriculture which, along with fishery, forestry and logging, accounted for 27% of the GDP in 1995-96.[3] In the same year, the share of industry, which includes manufacturing; mining and quarrying; electricity gas and water; and construction, was 31%. The remaining 42% of the GDP was contributed by services. In recent years, the composition of output has shifted in favor of manufacturing and services and against agriculture.

[3] India's fiscal year runs from April 1 to March 31. Thus, 1995-96 refers to April 1, 1995 to March 31, 1996.

2.2 Structural Reforms

TPRI, 1998 begins by noting that the reform process has deepened since TPRI, 1993 but at a somewhat uneven pace across sectors. In trade area, liberalization has continued including a partial freeing of imports of some consumer goods through Special Import Licenses (SIL) (see Section 3 below). And the maximum tariff has come down to 45 percent (including the 5% special duty introduced in 1996-97).[4]

In the initial phase of reforms, India had a dual exchange rate. In March 1993, the two rates were unified and transactions on trade account were freed from foreign exchange control. This was followed by substantial additional liberalization of controls on current account transactions and acceptance by India, in August 1994, of the IMF Article VIII obligations.

The approval process of foreign direct investment (FDI) has been streamlined and Foreign Investment Promotion Board created to facilitate such investments. At present, automatic approval to FDI is available up to 74% of the equity in 9 industries, up to 51% of the equity in 48 additional industries and up to 50% of the equity in yet another 3 industries. The limit on shares held by an individual Foreign Institutional Investor (FII) in a company has been raised from 5 to 10% and the limit on shares held by FIIs in aggregate in a company has been raised from 24 to 30%.

But beyond these measures, capital-account transactions are subject to controls. For example, as a rule, residents are not permitted to hold foreign-currency accounts. Outward FDI by residents is also restricted. In June 1997, the Committee in Capital Account Convertibility, set up

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[4]Since the completion of TPRI, 1998, approximately another 6% across-the-board hike in tariffs has taken place [see below and Panagariya (1998a)].

by the Reserve Bank of India, proposed a three-year timetable for achieving capital-account convertibility. But, in the wake of the currency crises since the completion of the TPRI, 1998, there is a greater appreciation of risks involved in full convertibility on the part of international institutions as well as the Government of India. As such, it is unlikely that the country will move to full convertibility in the near future.

Measures have also been taken to broaden the tax base. The modified value-added tax (MODVAT) system has now been extended to all manufacturing products. The services sector has been included into the tax base. The corporate tax has been progressively reduced to 35% for domestic and 48% for foreign companies. The personal income tax rate has been reduced from 40% to 30%.

Reforms have also been introduced in the financial sector. More private banks have been given entry into the market. Interest rates have been deregulated except those applicable to deposits of less than one year, small commercial bank loans, and export loans. The cash reserve requirements on bank deposits have been eliminated. Screen-based trading system has been introduced in most stock exchanges. A central share depository system is also being set up.[5]

Participation of private sector is being introduced in infrastructure projects. In the telecommunications sector, private firms have been given entry into value-added services such as cellular phones and paging. In March 1997, the Telecom Regulatory Authority was established.

[5] Since the completion of the 1998 TPRI, the insurance sector, for long a state monopoly, has also been opened to private firms. Limited participation of foreign investment has also been permitted in this sector.

Private-sector involvement is also being increased in areas such as power generation, road construction, airports and ports.

TPRI, 1998 rightly expresses concerns about the pace of reforms, however. In the banking sector, in 1996-97, 76% of the deposits were still held by public banks. These deposits are subject to strict lending rules requiring them to make 40% of the loans to "priority sectors" and 12% to exporters. Delays in creating appropriate bidding procedures have slowed the expansion of private-sector participation in infrastructure projects; few private investments have been brought to closure. Finally, reforms in agriculture and labor sectors, crucial to achieving full benefits of trade liberalization, have not even begun. Labor market in the organized sector is characterized by extreme rigidities. The Industrial Disputes Act, the key legislation governing the rights and obligations of workers, is in dire need of reform. At present, for a firm that employs 100 or more workers, exit is virtually impossible because it is not permitted to discharge workers.

2.3 Foreign Trade and Investment

The composition of India's foreign trade has undergone a substantial transformation between 1980-81 and 1995-96. This is shown in Table 1 for merchandise trade in terms of broad aggregates. The share of manufactures has gone up substantially in exports as well as imports while that of agriculture has gone down. What is interesting, however, is that much of the transformation took place prior to the reforms. The impact of reforms is most pronounced on the magnitudes of exports and imports with their composition remaining largely unaffected. In 1995-96, the major export products were diamonds (14.5%), clothing (14%), textiles (13%) and chemicals (8%).

As regards the direction of merchandise trade, the major change has been the redirection of trade from the former Soviet Union and Eastern Europe to the United States, East Asia, and the Middle East. In 1990-91, the former Soviet Union and Eastern European countries together accounted for 17.7% of India's exports. By 1995-96, this share had fallen down to 4.2%. Over the same period, the share of the United States rose from 14.8 to 17.4%, of East Asia from 19.7 to 24.7%, and of the Middle East from 5.8 to 9.0%. The share of the European Union, the largest single trading partner, fell slightly from 28.9% to 27.4%.

India's trade in services has increased but the available data are inadequate to permit a complete analysis. Balance-of-Payments data indicate that receipts of non-factor services increased from $4.6 billion in 1990-91 to $9.2 billion in 1996-97. Tourism accounted for 40% of total receipts in 1995-96. Interest payments, amounting to $4.6 billion in 1996-97, dominate payments for factor services. There was a deficit of $5.0 billion on account of factor services in 1996-97.

The liberalization of foreign-investment regime has resulted in a substantial jump in foreign direct investment (FDI). Net FDI increased from $0.15 billion in 1990-91 to $2.7 billion in 1996-97. Portfolio investment over the same period rose from zero to $2.8 billion. Between 1992-93 to 1995-96, the largest sources of FDI have been the United States, United Kingdom and Japan, respectively, accounting for 18, 10 and 7 percent of the total FDI. The financial services sector has emerged as the largest recipient of FDI recently, accounting for 19% of the total in 1995-96. Foreign Institutional Investors (FII) constitute the main source of portfolio investment and accounted for 67% of such investments in 1996-97. The only other major source is Euro-issue/Global Depository Receipts (GDRs). The bulk of this issue took place in 1994.

TPRI, 1998 is pessimistic regarding continued growth in FDI, citing the difficulties faced by privately financed infrastructure projects. It also mentions a large discrepancy between actual and approved levels of FDI. Between August 1991 and January 1995, only 22% of the approved proposals had been transformed into actual flows. The explanation offered is that the regulations at the State level and regulatory framework may be impeding investments even though many sectors are formally open to foreign investors. Empirical evidence supporting this hypothesis has not been provided, however.

3. Trade Policies by Measures

In Chapter III, which is the heart of the review, TPRI, 1998 describes trade restrictions that continue to remain in force in India. The list is long and the picture that emerges is one of a country that still refuses to let the bureaucratic control slip away. A reader unfamiliar with India's past is bound to wonder how a trade-policy regime such as the one about to be described can be characterized as having undergone serious reforms.

The list of policy measures in force is divided into three categories: measures directly affecting imports, those directly affecting exports and those affecting production and, hence, trade. I discuss each of these below, with primary attention paid to the first two sets of measures. I also choose to discuss the important subject of preferential trade arrangements under a separate heading, though TPRI, 1998 subsumes it in measures directly affecting imports.

3.1 Measures Directly Affecting Imports

TPRI, 1998 divides measures affecting imports into as many as 18 categories. Not all of these categories of measures are in force in India; in some cases, the report explicitly notes the absence of the measures. Rather than enumerate all the measures, I will limit the discussion to those providing significant degree of protection currently or likely to do so in the near future.

Tariffs and Additional Duties

The classification of customs tariffs in India is based on the Harmonized Commodity Description and Coding Classification System (HS). As of 1 April 1997, the Indian tariff had 5,134 tariff lines classified at the HS six-digit level. India grants at least the Most Favored Nation (MFN) treatment to imports from all trading partners, including those not members of WTO. Virtually all tariffs (99.8% of the tariff lines) are levied on the *ad valorem* basis.

At present, there are three main protective tariffs in force: (i) the *basic rate*, which can only be changed by legislation, serves as the statutory MFN tariff, (ii) a *special rate* of 5%, introduced in 1997, is applicable to all imports except those completely exempt from the basic rate,[6] and (iii) a *special additional rate* of 4%, introduced in April 1998 after the completion of TPRI, 1998, is also applicable to virtually all imports except those exempt from the basic rate. The special duty is due to expire on March 31, 1999, though it is likely to be renewed. The special additional duty is applied to the landed price plus the basic and special duty. Since the highest basic duty is 40% and the special duty 5%, the incidence of the special additional duty can be as high as 5.8% (=4x1.45).[7]

[6]Crude petroleum, petroleum products, project imports and 31 other items at six-digit level are subject to only 2% special duty.

[7]A higher rate than the stated maximum rate applies to 23 tariff lines including some alcohol products (262%) and dried grapes (127%).

Thus, currently, the highest protective duty amounts to 51%.[8]

Table 2, summarizes the evolution of tariff reform since 1990-91. The Table reports applied MFN rates, which are referred to as "effective" rates. Effective rates are below statutory MFN rates whenever tariff reductions are brought about through exemption notifications. Notifications are the fastest way to lower tariffs pending legislative action to lower the statutory rate. The average effective rate (excluding the special duty and special additional duty) has gone down from 71% to 35% since the TPRI, 1993. Dispersion of tariff rates has not gone down significantly, however. The number of tariff bands is high at 22. The distribution of effective rates is skewed towards rates between 20 and 45% (including the special duty), which cover 90% of tariff lines.

Despite a larger decline in the simple average effective tariff in manufactures, it is substantially higher than in agriculture or mining. In 1997-98, the rates were 36% in manufacturing, 26% in agriculture and 25% in mining. The corresponding rates in 1993-94 were 73%, 43% and 70%. Thus, despite a narrowing of the gap, the tariff structure continues to favor manufactures over agriculture.

India's tariff structure has been and continues to be cascaded, with higher tariff rates applying to processed products than unprocessed ones. This is evident from Table 3 which shows the simple average effective tariff on processed, semi processed and unprocessed goods to be 37%, 35% and 25% for the year 1997-98. Among the sectors with significant escalation of tariffs

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[8]In addition to the duties just described, there exist the usual countervailing duties corresponding to excise duties on similar, domestically produced goods. These duties are referred to as *additional duties.* In principle, these duties do not have a protective effect.

according to the stage of production are paper and paper products, wood and wood products, and food, beverages and tobacco.

The structure of tariffs is further complicated by the presence of exemptions, though they have been considerably reduced during recent years and incorporated into "effective" rates. Two major exemptions outside of the effective rate remain, nevertheless. These are (i) those targeting exports and (ii) those based on the end use. In the former category are duty drawbacks on imported inputs used in exports, advance duty exemptions on inputs to be used in exports, and reduced tariff rates on capital goods available to exporters. Performance requirements are linked to export obligations, net foreign exchange earnings and/or value added, to be achieved within a specified time period. Since TPRI, 1993, the proportionate benefits under concessional schemes have gone up.

A final tariff-related issue concerns bindings. Prior to the Uruguay Round (UR), India had bound only 6% of the tariff lines. Under UR, it has bound all agricultural lines and 62% of industrial-goods lines. Thus, at the aggregate level, 62% of all tariff lines are now bound. Lines remaining unbound cover consumer goods and some other industrial products. For non-agricultural goods, India bound its tariffs at 40% for finished goods and 25% for intermediate inputs, machinery and equipment. The reductions in tariffs to achieve these levels are phased between March 1995 and January 2005. In agriculture, India's bound rates range from 100 to 300 percent.[9] India is also a participant to the Information Technology Agreement. Its offer included zero tariffs on 217 items at

[9]For further details, see the relevant tables in Pursell (1996), reproduced in Panagariya (1999) as Tables 4 and 5.

the HS six-digit level by 2005.

Import Prohibitions, Licensing and State Trading

The Government's trade policy is formulated in the Export and Import Policy, normally announced for a five-year period by the Ministry of Commerce. But substantial changes are also announced annually. In March 1997, the policy for 1997-98 to 2001-02 was announced.

The import policy operates on a Negative List approach so that all items not on the list are freely imported. The Negative List has three categories: *prohibited items*, which may not be imported under any circumstances, *restricted items*, which require a specific import license or a Public Notice for imports, and *canalized items*, which can only be imported by public-sector undertakings.

Prohibited items (Part I of the Negative List) are essentially intended to address religious and cultural concerns. They amount to only 59 items at the HS eight-digit level. As such their impact on the degree of protection is minimal.

Restricted items, contained in Part II of the Negative List, may only be imported against a license or in accordance with a Public Notice issued for this purpose.[10] Almost all consumer goods are included in Part II. As of April 1, 1997, approximately 32 percent of total lines were subject to licensing. Of these, 18.9% relate to textiles and clothing, 50.7% to other industrial products and

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[10]Exceptions include ships, trawlers and boats, aircraft and helicopters, automobiles and newsprint for which no license is required but imports are subject to published conditions. Moreover, the actual user can import second-hand capital goods, with a minimum residual life of five years, without a license.

remaining 30.4% to agricultural products including fisheries. As of May 1995, in terms of value added, one third of manufacturing and 84% of agricultural and livestock sector were covered by licensing.

The key instrument used to permit imports of some items on the restricted list is the tradable *Special Import License* (SIL) issued to large established exporters, exporters of selected items, and exporters who achieve a certain quality standard. Items are typically moved from the restricted list first to the SIL list and eventually to the free list (i.e., taken off the restricted list). An additional channel for the imports of some restricted items is baggage imports. Passengers coming to India can bring these items in limited numbers as a part of their baggage.

To justify licensing restrictions to the WTO, India has claimed cover under balance-of-payments provisions of GATT Article XVIII:B. This cover was challenged at the WTO Committee on Balance-of-Payments Restrictions by India's trading partners affected adversely by the restrictions. Upon bilateral consultations, mutually agreed solutions were reached with Australia, Canada, the European Communities, New Zealand, Switzerland and Japan. Accordingly, India agreed to eliminate quantitative restrictions on 1,137 tariff lines (at HS eight-digit level) between 1 April 1997 to 31 March 2000, on 1,149 tariff lines between 1 April 2000 to 31 March 2002 and on 428 lines between 1 April 2002 to 31 March 2003. The United States did not agree to this plan and requested the appointment of a panel. Recently, in December 1998, the panel ruled in favor of the United States. Under the ruling, India must remove licensing restrictions on 2,700 items (at HS eight-digit level) by June 2000. Thus, in all likelihood, most licensing restrictions will be gone by that date. There are 600 lines that remain but they are also under attack, with EU leading the charge.

Canalized items, contained in Part III of the Negative List, are to be imported by designated state agencies only. In 1993, there were seven broad categories of items in Part III. Some sub-items including kerosene, liquified petroleum gas, naphtha and some fertilizers have been de-canalized since the 1993 TPRI. But the 1997-98 budget introduced an additional broad category covering cloves, cinnamon and cassia. Broad categories of products subject to canalization are: petroleum products; nitrogenous, phosphatic and potassic fertilizers; coconut oil, RBD palm oil and RBD palm stearin; seeds of copra, groundnut, palm, rapeseed, safflower, soya bean, sunflower and cotton; all other non-edible oils with some exceptions; palm stearin, palm kernal oil, and talow amines of all types; cereals, excluding feed grade maize poultry or animal feed; and cloves, cinnamon and cassia. Canalized imports accounted for 27% and 19% of total merchandise imports in 1988-89 and 1996-97, respectively. In 1996-97, petroleum products accounted for 78% and edible oils for 12% of total canalized imports. 47 out of a total of 176 items in Part III are on SIL list.

Anti-dumping, Safeguards and Countervailing Measures

Perhaps the most ominous development in recent years has been the rise in anti-dumping cases in India. According to TPRI, 1993, India imposed its first ever provisional anti-dumping duties in January 1993. TPRI 1998 notes that since then, India has already initiated a total of 45 anti-dumping cases, covering 18 products. Definitive duties have been imposed in 11 cases and a ruling of no injury reached in two. From the available reports, this trend appears to have continued since the publication of TPRI, 1998 with steel, rubber and acrylic fiber being some of the affected products. In some cases, especially relating to steel, minimum import prices as well as anti-dumping duties have been instituted.

According to TPRI, 1998, India has taken no countervailing or GATT Article XIX Safeguards actions. But that has changed at least in the case of Safeguards. Safeguards duties were notified for two products in December 1998 and findings were available in two additional cases. The government is now preparing legislation to implement the quantitative restrictions, permitted by the UR Safeguards Measures Code, presumably to replace conventional licensing. It is likely that once licensing on consumer goods imports is withdrawn, Safeguards actions will be used on a large scale to delay the liberalization further.

3.2 Measures Directly Affecting Exports

I will divide the measures directly affecting exports into those aimed at restricting and those designed to promote exports.

Measures Restricting Exports

As one will expect, trade restrictions on exports are far less severe and complicated than on imports. Export taxes apply to only a handful of items: snake skins, some lamb skins and other hides and skins, and leather products. Revenues from export taxes are estimated to be .11% of total budget revenues in 1997-98.

As in the case of imports, direct export restrictions are administered through a Negative List of Exports in Export and Import Policy, 1997-98 to 2001-02. Part I of this list contains prohibited items which are only ten at the HS six-digit level. The prohibitions are maintained for socio-cultural and environmental reasons and to meet obligations arising out of international conventions such as the Chemical Weapons Convention and the Convention of International Trade in

Endangered Species.

Part II of the Negative List of Exports contains items that are subject to export licensing. There are 90 items at HS six-digit level in this part of the list, relating mostly to agriculture. Among significant items are pulses, paddy, rice bran, vegetable and groundnut oils, and mineral ores and concentrates. The number of items on the list has not changed since the 1993 TPRI though some items have been deleted while others have been added.

Part III of the Negative List of Exports contains items subject to canalization. The number of canalized items by broad categories has declined from seven in 1993 to six. The latter represent 23 items at HS six-digit level. Goods subject to export canalization are: petroleum products, gum Karaya, mica waste, mineral ores and concentrates, niger seeds, and onions. Canalized exports as a share of total exports declined from 5.9% in 1990-91 to 2.9% in 1996-97.

India's exports are also restricted on account of restrictions on its goods in other countries. Specific quantitative restrictions on textiles and clothing cover a large share of India's exports. The share of textiles and clothing exports to the United States affected by the quotas increased from 16% in 1986 to 89 percent in 1996. Steel, clothing and textiles products are also affected by anti-dumping and countervailing actions. Export restraints on agricultural products include regulations related to seafood (shrimp exports to the United States), high standards for pesticide residues on mangoes, bananas, grapes and potatoes (EU, Japan and the United States) and sesame and tobacco (Japan), hormones in livestock production (EU), and tariff-rate quotas on mushrooms (EU). Exports of professional services, involving movement of persons, are constrained by restrictive visa requirements.

Measures to Promote Exports

Though India does not give any direct export subsidies, it relies on a wide range of indirect subsidies, including duty and tax concessions, export finance, export insurance and guarantee, and export promotion and marketing assistance.

A variety of schemes permit imports of inputs and capital goods used in exports at either concessional duty rates or free of duty. The objective behind these schemes is to neutralize partially the pro-import bias of the prevailing trade regime. Typically, export performance requirements apply to such duty concessions. The schemes include duty drawback, advance licensing duty-entitlement passbook scheme, deemed exporter scheme, diamond, gem and jewelry export promotion scheme, and so on.

Commercial banks provide export financing at interest rates below market rates. The annual lending rates for this purpose are fixed by the Reserve Bank of India. The banks are required to extend a minimum of 12% of their net credit as export credit. The Government gives no subsidy to the banks for this purpose.

The Export Credit Guarantee Corporation of India Limited (ECGC), owned entirely by the government, provides exporters a range of insurance cover against non-realization of export proceeds due to political or commercial reasons. It also provides guarantees to financial institutions to facilitate the granting of credit facilities to exporters on a liberal basis. Premiums are charged according to the country of exports, increasing with the length of credit.

The government also places a strong emphasis on facilitating export promotion and marketing assistance. There are 15 broad schemes in operation for this purpose. Indian Trade

Promotion Organization (ITPO) promotes exports and imports and helps upgrade technology. It undertakes publicity, assists firms in developing new products and organizes export development programs. Indian Institute of Packaging assists firms in improving the standards of packaging and undertakes research into the raw materials for the packaging industry. Indian Institute of Foreign Trade develops human resources and organizes seminars on issues relating to trade.

Finally, the government has also established seven export-processing zones (EPZs) to promote exports. Hundred percent export units (EOUs), meant to complement the EPZs, can be established outside the zones. To promote the development and exports of the software industry, seven Software Technology Parks (STPs) and an Electronic Hardware Technology Park (EHTPs) scheme are also in existence.

EPZs are provided basic infrastructure, such as developed land for construction of factory sheds, roads, power, water supply and drainage. A wide range of benefits is extended to EPZs, EOUs, STPs and EHTPs. Units under the EOU/EPZ scheme are allowed zero duty on imports, exemption from excise duty on domestic supplies, deferred payment of custom duty on capital goods during a bond period and corporate tax holidays for a block of five years in the first eight years of production. STPs and EHTPs are also allowed zero duty on all imports, 100 percent foreign participation, and tax holidays.

3.3 Preferential trade Arrangements

Within India's tariff structure, there are *preferential area rates*, which are applicable to imports from declared "preferential areas" of Mauritius, Seychelles and Tonga. These preferences are separate from those provided by India under bilateral and plurilateral agreements.

Bilateral and plurilateral agreements within which India gives and grants tariff preferences are: (i) the Bangkok Agreement, (ii) South Asian Preferential Trading Arrangement (SAPTA), (iii) the Global System of Trade Preferences (GSTP), and (iv) India-Sri Lanka Free Trade Agreement. The last of these agreements was signed recently on December 28, 1998 and is not included in TPRI, 1998.

Signatories to the Bangkok Agreement include Bangladesh, India, Papua New Guinea, Republic of Korea and Sri Lanka. Under the agreement, India provides 13 to 30% preference margin on the MFN tariff on 67 items for all members and 13 additional items for least developed members. The items subject to preferences appear not to be consequential and, in some cases, subject to licensing in India. Among the items subject to preferences are fish, cloves, glycerine, some edible oils, some rubber products, transformers, induction furnaces, parts of railway or rolling stock and toys.

SAPTA members include Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. Preferences by India apply to 437 items for all members and to 571 additional items for least developed members. The margin of preference varies from 10 to 90% of the MFN tariff and goes up to 100% for least developed countries. Once again, many of the items on the list are not of much consequence. Though precise calculations have not been made, it is unlikely that these preferences affect more than 1 or 2% of India's trade.

The GSTP consists of 41 countries. India gives preferences on just 31 items that range from 10 to 30% of the MFN tariff. For least developed members, these preferences go up to 50%. Again, the impact of preferences would appear to be negligible.

For India, perhaps the most significant preferential arrangement concluded so far is the recent Free Trade Area accord with Sri Lanka, signed on December 28, 1998. This agreement aims to turn the two countries into a free trade area. The agreement is to come into force on the 30th day after the two countries have notified each other that their respective constitutional requirements and procedures have been completed. Thus, there is some vagueness regarding the date of entry into force of the agreement.

Upon entry into force of the agreement, India is to eliminate tariff on Sri Lanka on 1,000 items. At this time, India is to also give Sri Lanka a 50% tariff preference on all other items except those on a Negative list. These latter preferences are to be expanded to 100% in two installments over a period of three years of the coming into force of the agreement. Exception is made in the case of certain textile items on which the preference is to be restricted to 25%.

In return for these concessions, Sri Lanka will give India a 100% tariff preference on 600 items upon entry into force of the agreement. It will also give 50% preference on 600 additional items. This preference is to be expanded to 70%, 90% and 100% at the end of the first, second and third year of the entry into force of the agreement. For the remaining items not on the Negative list, Sri lanka will give India a tariff preference of 35% within three years, 70% within six years and 100% within eight years. Thus, with the exception of the items on the Negative List, a free trade area will be created between the two countries within eight years of the entry into force of the agreement.

The Negative List is to be finalized within 60 days of the signing of the agreement (i.e., from December 28, 1998). Within the same time period, items on which up front preferences are to be given by the two sides are also to be finalized. India has agreed to retain no more than 400 items on the Negative List. It has also urged Sri Lanka to limit its Negative List to no more than 20% of tariff lines.

Rules of origin (ROOs) are to be applied for the grant of tariff preference. For this purpose, domestic value added has been kept at the relatively low level of 35%. If raw materials are sourced from the other member, this requirement is reduced to 25%. These liberal ROOs are tightened, however, by the additional requirement that the good undergoes a transformation at HS four-digit level.

The main attraction of the agreement for Sri Lanka is that it receives a duty-free access to India's relatively protected market. At present, it exports goods worth only $50 million, however. Therefore, unless it manages to expand its exports to India substantially, it is unlikely to make major gains. The attraction for India is that it already exports to Sri Lanka goods worth $500 million. But Sri Lanka's MFN tariffs are much lower than India's, averaging less than 10%.

From the overall welfare standpoint, the two countries are bound to lose from the agreement, however. Both are small in relation to the world market, together accounting for less than 1% of the world trade. For most products imported by them, more efficient producers are likely to be third countries. Therefore, tariff preferences can only result in trade diversion and, hence, a loss to consumers.

3.4 Measures Affecting Production and Trade

This rather long section of Chapter III of TPRI, 1998 discusses a host of domestic policies affecting production. These policies include adjustment and regional assistance, subsidies and tax concessions on production, industrial licensing, credit policies, exit barriers, reforms of public-sector enterprises, competition laws and regulations, trade- related investment measures TRIMs), and trade-related intellectual property rights (TRIPs). Since the domestic policies are covered extensively in the discussion of sectoral polices in Chapter IV (see Section 4 below), I will focus here exclusively on TRIMs and TRIPs.

Trade-Related Investment Measures (TRIMs)

Since TPRI, 1993, local-content requirements such as phased manufacturing program have been discontinued. But, according to a new requirement, investors in the automobile sector must sign a memorandum of understanding (MOU) with the Director General of Foreign Trade. The U.S. Trade Representative claims that this MOU requires increased indigenization of production. There are also dividend-balancing requirements for foreign companies in 22 sectors. Accordingly, export earnings must balance dividend payments made by foreign investor over a period of seven years from the commencement of production.

Trade-Related Intellectual Property Rights (TRIPs)

India is a member of the Berne Convention for the Protection of Literary and Artistic Works (since 1928), the Universal Copyright Convention, including the 1971 revision (since 1957), and the Geneva Convention for producers of phonograms. It ratified the Washington Treaty on Integrated Circuits in 1989. In October 1998, it also signed the Paris Convention on the protection of patents, trademarks and industrial designs. Since the entry into force of the WTO Agreement, India has amended to Copyright Act, 1957, bringing it in line with the TRIPs Agreement except for performers' rights. Action to amend the Patent Act, 1970 and Trade and Merchandise Marks Act, 1958 is under way. Legislation on geographical indications, plant variety protection and integrated circuits is being drafted. Due to its developing-country status, India has five years to implement the changes. In the case of pharmaceuticals and agricultural chemical technologies, it has ten years, i.e., until January 1, 2005.

Since patent protection in India has been a subject of dispute at the WTO, it is useful to summarize the issue here. The Indian patent Act grants product and process patent for a period of 14 years from the date of application. Exceptions are made, however, in the case of food, chemical and pharmaceuticals, where the term of protection is reduced to seven years from the date of application and only process patents are granted. As a part of the TRIPs Agreement, India must increase the term of patent protection to 20 years from the date of application in all categories and grant both product and process protection.

Although India has until January 1, 2000 to amend the patent law to comply with TRIPs Agreement, it is required to provide a "box" to receive product patent applications in pharmaceutical and agricultural chemical products and to provide exclusive marketing rights for these products. Though India's position has been that a procedure to receive patent applications in pharmaceuticals and agricultural chemical products is in place at the Patent Office, the United States challenged this position in the WTO Dispute Settlement Body. The panel ruled in favor of the United States. India took the matter to the Appellate Body, which largely upheld the panel ruling in its decision on January 16, 1998. India has now decided to implement the findings of the Appellate Body.

In the future, enforcement of property rights may become an issue as well. Currently, the infringement of a patent can be challenged by any person in a domestic court of law under Section

104 of the Indian Patent Act. The court can grant an injunction against the infringing party and demand either damages or an account of profits.

4. Trade Policies by Sectors

In the final chapter, Chapter IV, TPRI, 1998 revisits in greater detail many of the issues and policies from the sectoral angle. The chapter contains a wealth of information relating to both domestic and trade policies. The economy is divided into five broad sectors: agriculture and fisheries, food products, mining and petroleum products, manufacturing, and services. I discuss each of these in turn.

4.1 Agriculture and Fisheries

India's major food crops are rice and wheat. In 1996-97, rice production was 81.2 million tonnes and wheat production 67.1 million tonnes. Non-cereal crops such as sugar cane and cotton are also important. Agricultural exports accounted for 17% of India's merchandise exports in 1996-97. Imports, which are largely subject to quantitative restrictions, amounted to 5% of total imports in 1995-96.

India is the world's seventh largest producer of fish products, accounting for 5% of world output. Exports of fish and fish products are a small but growing proportion of domestic output. They accounted for 4.1% of total output in 1991-92 but rose steadily to 7.2% in 1996-97.

Domestic Policies in Agriculture

Indian agriculture is characterized by extensive domestic-policy controls. At the beginning of each growing season, the Government announces minimum support prices for the main food crops including rice, wheat, maize, pulses and oilseeds and non-food crops such as cotton, jute, sugar cane and tobacco. Designated governmental agencies purchase these products at the support prices. The Public Distribution System (PDS), to which most of these agencies belong, provides grains, sugar and kerosene to consumers through fair-price shops, of which 430,000 existed in 1997. Because the PDS has not served the poor adequately, in 1997, a Targeted PDS (TPDS) was put in place. It is estimated that the TPDS will serve 320 million people living below the poverty line at an annual cost of approximately $2 billion.

Agriculture is also subject to an extensive network of subsidies. Fertilizer production and distribution, irrigation, power and food supplies (through PDS/TPDS) are all subject to large subsidies. The food subsidy increased by 37% in real terms between 1990-91 to 1995-96. Though the minimum support and procurement prices for wheat and rice were raised each year, the Central Issue Price, at which the Central Government sells these products to States for the PDS, remained unchanged between 1994 and 1997.

The price of urea, the principal fertilizer, is controlled at levels below the cost of production or imports.[11] The difference between production cost or import price (inclusive of the distribution cost) and controlled price is, in turn, covered through central government subsidies to producers and the importing agency. The 1997-98 budget provided for almost $2 billion worth of such subsidy. With the prices of some inputs used in urea having been decontrolled recently, the subsidy will rise further.

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[11] The price of urea remained unchanged from 1981 to 1991 and was raised 30% subsequently. The prices of phosphate and potassium based fertilizers were freed in 1992 but the Government has introduced a price subsidy to encourage their use.

Irrigation and power subsidies, provided by States, constitute yet another major agricultural subsidy. They account for 56% of all agricultural subsidies in 1994-95. Largely as a result of subsidized power, in 1995-96, State Electricity Boards taken together incurred losses amounting to $3.3 billion.

Trade Policies in Agriculture[12]

Prior to 1991, exports of most agricultural products were either canalized or on the restricted list and subject to minimum prices. As a part of the reforms during 1990s, rice has been moved to the list of freely exportable goods. Sugar exports were de-canalized in 1997. In October 1994, quantitative restrictions and minimum export prices were dropped from wheat exports but the Government retained the right to reimpose these restrictions. In 1996-97, durum and non-durum wheat exports were subject to ceilings of .50 and 2.5 million tonnes, respectively. Similar constraints were applied to coarse grain such as jowar, bajra, ragi, maize and barley, with limits of 50,000 tonnes per year. Raw cotton and sugar exports are also restricted.

Import restrictions on agriculture are also extensive, despite some liberalization during 1997. Imports of cereal products, except feed-grade maize, are canalized. In 1994, sugar imports were de-licensed and import duties dropped from 85% to zero. Imports of oilseeds remain canalized. Edible oil imports have been partially liberalized, however. In March 1995, all edible oils with the notable exceptions of coconut oil and palm kernel oil were moved to the list of freely importable goods. Import duties on all edible oils, with some exceptions, are 25%. Imports of cotton were de-

[12]A reasonably comprehensive item-wise list of import restrictions on agriculture is provided in Pursell (1996), which is reproduced as Table 5 in Panagariya (1999).

canalized in 1991 and the tariff on them has been reduced to zero.

4.2 Food Products

This industry has three main components: primary-food processors, the unorganized and cottage industries, and organized food industries. The primary-food processors include rice hullers, flour, lentil and oil millers. The unorganized and cottage industries include bakeries, pasta units, traditional food units, fruit, and vegetable and spices processing units. The organized food industry, the largest group, includes a range of processed food producers such as meat and fish processing units, confectionery manufacturing units, manufacturers of dairy products and beverages, and canned and processed fruits and vegetables.

Since the 1990-91 budget, duties on most agro-processing equipment have come down to 2-5% range and licensing for setting up production units has been essentially abolished. The effective average MFN tariffs on imports of food products vary from 29 to 39 percent for food manufacturers, 134 percent for beverages and 45 percent for tobacco products. There is a considerable escalation in tariff rates in this sector. Equity participation for FDI is normally limited to 51%, though non-resident Indians may hold equity up to 100%. In the small-scale sector, FDI is limited to 24%.

4.3 Mining and Petroleum Products

Mining

In the mining sector, average tariff on non-ferrous ores has come down from 46% in 1993-94 to 10% in 1997-98. Over the same period, the tariff on iron ore has come down from 20% to 10% and on coal from 65% to 13%. Coal has also been moved to freely importable list. The sector has also been opened to FDI. The mining of 13 minerals, including iron, manganese, bauxite, copper, lead and zinc, has become subject to automatic approval for equity participation up to 50%. Equity participation up to 74% is permissible in service for the mining industry.

Petroleum Products

In the petroleum sector, Oil and Natural Gas Corporation Limited (ONGC) produces 87% of the crude oil while Oil India Limited (OIL) and other private companies produce the remaining 13%. Most oil imports are canalized through Indian Oil Corporation (IOC). Imports account for 21% of the total consumption. Tariff rates on crude oil and gas imports have declined from 80% in 1993-94 to 27% in 1997-98. Domestic prices of petroleum products are administered and have a substantial element of subsidy in them.

Some reforms have been introduced in petroleum sector to reduce the fiscal burden resulting from subsidized prices. Imports of kerosene, liquified petroleum gas (LPG) and low sulphur high sulphide gas have been de-canalized. Private sector is being permitted to import and sell these products at market prices. The administered prices are also being gradually raised. In September 1997, prices of petrol, diesel and LPG were raised. The price of diesel, which accounts for half of petroleum product consumption in India, has been linked to prices of imported diesel. To encourage oil exploration, a New Exploration Licensing Policy was announced in 1997-98. The policy offers companies international prices for oil in return for new discoveries.

In November 1997, the Government announced a phase-out of the administered pricing mechanism for the sector by 1998-99. The program calls for parity between administered and import prices for most products. Imports and exports of most petroleum products are to be de-canalized gradually. Imports of crude oil will be allowed under a system of actual user licenses. Tariffs on petroleum products will be adjusted to provide "reasonable tariff protection" in the refining sector.

4.4 Manufactures

In 1995-96, manufactures accounted for almost three quarters of India's total exports. Textiles and clothing together accounted for 43.6% of the total manufacturing exports. Other major manufactures exports are diamonds, chemicals, transport equipment and leather products. Manufactures accounted for 53.8% of total imports. The leading imports were industrial chemicals, petroleum refineries and non-electrical machinery (including computers), respectively, accounting for 21%, 16.8% and 16.5% of total manufactured imports.

Textiles and Clothing

Textiles and clothing is the largest manufacturing sector in India. It accounts for 20% of industrial output. The sector is predominantly cotton based. Knitted fabrics, knitted and woven garments and many other products are reserved for production by the small-scale sector. Yarn is produced almost entirely by the organized, mill sector whereas cloth is produced predominantly by the decentralized sector. Powerlooms, which are in the decentralized sector, account for 70% of India's cloth output.

Since the initiation of reforms, some steps have been taken to make the industry more competitive. Compulsory licensing, which was required for setting up mills in the powerloom sector, was abolished in 1993. In January 1997, automatic approval for FDI was extended for up to 51% of foreign equity participation in spinning, weaving and processing of cotton, wool, silk and man-made fibers in integrated mills, the spinning of staple fibers and weaving of synthetic textile fabrics in mills, and manufacture of water-proof textile fabrics. For the small-scale sector, FDI is permitted up to 24% equity participation.

Turning to trade policy, exports of cotton yarn have been subject to quantitative ceilings to ensure adequate supply of yarn to weavers in the handloom and powerloom sector. The traditional reservation of garment production for the small-scale sector was relaxed in 1997 whereby large-scale units with a capital investment up to $750,000 can enter the activity provided they export at least 50% of the output of which 25% must go to non-quota countries. For capital investments exceeding $750,000, export obligation is 75%.

India has bilateral export quota agreements with Canada, European Union (EU), Norway and the United States under the Multifibre Agreement (MFA), replaced by the Agreement on Textiles and Clothing (ATC) starting January 1, 1995. A large proportion of the quota is allocated among potential exporters on the basis of the past performance in both textiles and garments. But a part of the quota is also given on a first come first serve basis. The allocation system has not worked efficiently and sometimes led to multiple applications and unfilled quotas. Nevertheless, in garment categories relating to blouses and shirts, ladies' dresses, skirts and trousers, India has used up its entire quota at the aggregate level in most years.

Under ATC, textiles and clothing sector is to be fully integrated into GATT 1994 in four stages, ending on January 1, 2005, by all Members. This means that India's exports to Canada, EU, Norway and the United States will be fully freed from quotas over a ten-year period starting January 1, 1995. On its part, India must also dismantle import licensing on textiles and clothing. It signed bilateral agreements with EU and the United States under which import restrictions will be phased out on an MFN basis over a seven-year period.

TPRI, 1998 raises some concern about ATC having a negative impact on India's textiles and clothing industry. It notes that, to some degree, the quotas have provided protection to the Indian industry by limiting competition from other countries in the US and EU markets. Moreover, a virtual ban on imports has given the industry a protected domestic market as well. The legal framework makes the closure of sick industries, especially in the mill sector, virtually impossible. The implication seems to be that the removal of MFA quotas and import liberalization may lead to losses and adjustment problems.

It can be argued, however, that this fear is overstated. The presence of protection has been presumably responsible for huge inefficiencies in the sector. India is a labor abundant country and at least clothing, if not textiles, is a highly labor intensive. Therefore, the country can be highly competitive in this industry. There is no doubt that a virtual ban on the exit of firms in the organized sector is a major barrier to adjustment. It also discourages the entry of new, more efficient firms. But, to a large extent, this ban has itself been the outcome of years of monopoly practices that were encouraged by import protection and industrial licensing in product markets.[13] Once the industry is forced to compete in the product market and rents disappear, margins for unions to demand high wages will be squeezed and the support for laws mandating the ban on exit will be diluted.

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[13]Under existing labor laws, firms that employ 100 or my workers are not permitted to retrench workers. See Panagariya (1998b) for details.

Other manufactures

TPRI, 1998 discusses four additional sectors in detail: pharmaceutical products, steel, automobiles and auto components, and electronics and computer software. Let us consider briefly each of them.

In the **pharmaceutical** sector, India produces 70% of its consumption of bulk drugs and almost 100% of all formulations. It is a net exporter pharmaceutical products. There are 250 large firms and 8,000 small-scale firms in the sector. The new Drugs Policy, 1994 removed all industrial licensing for bulk drugs and their formulations and intermediates except five drugs that remain reserved for the public sector, drugs involving the use of recombinant DNA technology and specific cell/tissue targeted formulations. Automatic approval to FDI is available up to 51% of equity participation. Imports of some drugs remain subject to licensing through the Negative List because they are classified as consumer goods, or reserved for public sector or, in the case of several intermediates, for the small-scale sector. A key feature of policy is the continued use of price controls to make drugs available to all Indians. The Drugs Policy, 1994 reduced total number of drugs subject to price controls from 142 to 74 out of a total of approximately 500 drugs.

Steel production in India is dominated by public sector. In 1994-95, total production capacity for crude steel was 33 million tonnes, of which 45% was in the public sector. Total steel imports were 1.5 million tonnes in 1994-95 while exports were 1.3 million tonnes in 1995-96. Though quantitative restrictions had been removed in 1992, at the time of TPRI, 1993, steel imports were subject to tariff rates averaging 80%. In 1997-98, this average had fallen to 34%.

In the past two years, industrial slowdown world wide has led to recession in steel industry.

Consequently, there has been an upsurge in anti-dumping and countervailing-duty actions around the world in steel industry. India has appeared on the scene both as a victim and an aggressor. EU has imposed a countervailing duty on stainless steel bright bars from India and is investigating wire ropes for possible violations. Domestically, India has introduced minimum prices on Russian HR coils and exempt inputs used in the production of steel from the 5% special duty. Proposals for the introduction of further floor prices and anti-dumping duty are under consideration.

For a long time, India's **automobile** sector was subject to very strict licensing on investments and imports. In 1983, a joint venture between Japan's Suzuki Limited and India's Maruti Udyog Limited allowed the first multinational into the Indian automobile sector. The small car this venture introduced was an instant success. Today, Maruti controls 77% of the automobile market in India.

In 1993, the Indian car industry was de-licensed. Foreign equity participation was allowed up to 51%. The Foreign Investment Promotion Board can now give permission for 100% foreign equity participation while the permission for 51% is automatic. The changes have generated a strong response, with world's major car manufacturers--Mitsubishi, Honda, Ford, General Motors, Toyota, Mercedes Benz, etc.--entering the market. Though the option to set up wholly owned subsidiary is available, most manufacturers have chosen to go via the joint-venture route. Only Hyundai has established a wholly owned subsidiary. The total amount of FDI approved between August 1991 to December 1996 for passenger cars was approximately $0.51 billion. Though the foreign-investment regime is, thus, very liberal, import regime is still stringent. Automobile imports are subject licensing through the Negative List and the tariff is 51% (including the special duty and special additional duty).

Two key problems of automobile sector relate to poor roads and environmental pollution. India's road and national highway network is crumbling under the pressure of the vehicles already on the road. And pollution levels in India's four major cities are already very high, with New Delhi ranking as the third most polluted city in the world. Since April 1995, all cars have to be fitted with catalytic converters. But since the average life of a car in India is long, this requirement will take a while before yielding a *reduction* in the level of pollution.

India's automobile component industry has been traditionally export oriented, accounting for a little more than 1% of total exports. This sub-sector is less insulated from imports than automobile production; imports are not subject to licensing and tariffs ranged from 15 to 40% in 1996-97. Export orientation of the sector has led it to set high technical standards for itself. At 119, this sub-sector has the largest number of companies with ISO 9000 certification.

India's **electronics and computer software** industry has grown at rates exceeding 20% per year since early 1980s. It accounts for 2% of the GDP currently. In 1996-97, exports accounted for 23.6% of the sector's output. In Software, the fastest-growing component of this sector, the proportion of exports was 59% in the same year.

Compulsory industrial licensing was abolished in 1996 for all electronics-related industries except electronic aerospace and defence equipment. Automatic approval to foreign investment is granted up to 51% of equity share. Non-resident Indians receive automatic approval up to 100% of equity. For export industries, additional incentives, such as a five-year tax holiday, tax exemption on income from exports, duty-free imports of inputs and access to some imports on the restricted list through Special Import Licenses are also available. There is no ceiling on foreign equity participation in the software and hardware technology parks and export-processing zones (EPZs) or in 100% export-oriented units.

Approximately 80% of all electronic items are imported freely. Of the remaining 20%, some are on the Special Import License list. Tariff rates have also come down in recent years on most electronic items. Under the Information Technology Agreement, India will eliminate tariffs on 95 products by the year 2000 and all 217 items covered by the agreement by the year 2005.

4.5 Services

Barriers to trade in services normally do not take the form of border measures such as tariffs and quotas. Instead, they take the form of regulations on the presence of the provider and entry into the relevant industry. As such, trade liberalization in this sector is intimately linked to regulatory policies, commercial presence and the movement of natural persons.

Limits on FDI in services sectors are more constraining than in industry. In telecommunications, foreign equity up to 49% is permitted. In banking, the limit is 20%. Other areas such shipping, roads, ports and air travel are beginning to be opened up but actual foreign participation is low so far. Railways constitute one of the six areas reserved for public sector. The insurance sector has just been opened up to private sector with foreign equity permitted up to 24%.

The General Agreement on Trade in Services (GATS) provides the essential framework for the liberalization of trade in services. As a part of the UR Agreement, India made commitments in 33 activities out of a total of 161 activities. This compares with an overall average of 23 activities for developing countries taken together. Broadly, India's commitments bind its existing policies.

India has listed MFN exemptions under Article II of the GATS, reserving the right to offer more favorable treatment to some WTO members. In the financial services negotiations that concluded subsequent to the UR Agreement, it withdrew the MFN exemption in that sector. It also increased the annual limit on new foreign bank branches from eight to 12.

India participated in telecommunications negotiations, the results of which entered into force in early 1998. India committed to permitting one new operator, in addition to the present government-owned monopoly supplier, in each service area. India also committed to automatic approval of up to 25% foreign equity participation in the area of voice telephone services. This is below the current *practice* of 49% foreign equity participation.[14]

5. Concluding Remarks

Like most other TPRs I have reviewed, TPRI, 1998 is an impressive document. The ability of WTO to produce comprehensive and systematic reviews such as these, despite a limited staff, is to be admired. TPRI not only provides a detailed and up to date discussion of India's trade policies but also offers an excellent coverage of domestic policies. The latter is especially relevant in the case of India since reforms of domestic policies there are needed as urgently as trade policies.[15]

[14]TPRI, 1998 provides a detailed discussion of banking, insurance, transportation, telecommunications, tourism and software services. This discussion largely relates to domestic regulations in the respective sectors and is not covered here due to space restrictions.

[15]This is reinforced by the findings of Chadha et al. (1998), who show that the gains from trade liberalization in India are magnified when combined with domestic reforms.

The present review shows that despite substantial reforms, India's domestic and trade policies remain highly distorted. In the area of trade policies in agriculture and industry, the abolition of licensing has been long overdue. As I had argued in Panagariya (1994b), the case for the virtual ban on the imports of consumer goods is indefensible. Therefore, the development that the recent WTO ruling asking the Government of India to remove 2,700 tariff lines from the Negative List by June 2000 is to be welcome. It makes the task of fighting special interests easier for the Government.

Canalization, applicable to many agricultural products and petroleum, deserves to be similarly ended unless it can be justified on grounds such as national security. This may turn out to be a more difficult task, however, since canalization is permitted under GATT Article XVII and is, therefore, may not be subject to challenge by other WTO members. As liberalization proceeds, special interests may in fact demand an expansion of the list of canalized items. It is essential for the Government of India not to give in to these pressures. In this respect, the inclusion of cloves, cinnamon and cassia among canalized items in the 1997-98 budget set a bad example.

Further tariff liberalization remains essential since India's tariffs are still among the world's highest. But, as I have argued in Panagariya (1998a), this task may turn out to be more difficult than generally believed. Tariffs constitute a significant source of revenue and can no longer be reduced to any significant degree without alternative taxes. The natural candidate is excise tax, applied to all sales whether domestically produced or imported. But increases in excise duties are unpopular with domestic producers so that successive governments in the past two or three years have chosen to raise tariffs through back door (special duty and special additional duty) while lowering excised duties at the margin. This trend must be reversed.

Finally, domestic-policy reforms must continue in virtually all sectors but specially in services. Banking, insurance, telecommunications and power generation will all benefit from increased competition and private entry, both domestic and foreign. The government also needs to mobilize more resources to build infrastructure. Without it, the benefits from trade liberalization cannot be fully exploited.

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Table 1: Product Composition of Merchandise Trade

	Exports			Imports		
	1980-81	1990-91	1995-96	1980-81	1990-91	1995-96
Total (billion dollars)	7.5	17.9	31.7	13.8	23.8	36.1
Agriculture (%)	33.2	19.6	20.0	10.7	7.2	8.3
Mining (%)	7.9	8.1	4.9	50.6	35.4	30.8
Manufacturing (%)	58.6	70.7	73.5	38.7	51.2	53.8
Other (%)	0.3	1.6	1.6	0.0	6.2	7.1

Table 2: Structure of 'Effective' Tariffs in India, 1990-91 to 1997-98
(Percent)

	1990-91	1993-94	1995-96	1996-97	1997-98
Average Unweighted					
Agriculture	113	43	27	26	26
Mining	100	70	30	26	25
Manufacturing	126	73	42	40	36
Economy-wide	125	71	41	39	35
Coefficient of Variation	32	42	47	49	42
Maximum Tariff Rate	355	85	50	52	45
Average Import Weighted (by 1992-93 import values)	87	47	25	22	20

Note: These are effective MFN rates, i.e., actual applied rates after basic rates have been reduced through exemption notifications. The Special Duty of 5% is included.

Source: TPRI, 1998.

Table 3: Average Unweighted 'Effective' Tariffs by Processing Stage, 1990-91 to 1997-98

(Percent)

	1990-91	1993-94	1995-96	1996-97	1997-98
Unprocessed	107	50	27	25	25
Semi-processed	122	75	44	38	35
Processed	130	73	43	42	37

Note: These are effective MFN rates, i.e., actual applied rates after basic rates have been reduced through exemption notifications. The Special Duty of 5% is included.

Source: TPRI, 1998