The Effects of India's Economic Liberalisation and the Uruguay Round on Trade Relationships Between the European Union.

Ruth Dowd
Senior Sophister

One of the most populace and poorest countries in the world, India, has undergone a liberalisation in an attempt to reproduce the success of its Asian neighbours. Ruth Dowd surveys India's attempts at deregulating the bureaucratic structure which has in the past hampered the country's development, emphasising the growing EU-India links as a source of future benefit for both parties.

During the past ten years Asia has become the focal point of the trading world. India stands on the precipice of becoming one of the world's great trading nations and in pursuit of this objective the country has embarked upon a policy of extensive economic liberalisation. This involved surmounting years of economic protection, bureaucratic regulations and corruption, all of which dominate India's economic profile. The active participation of India in the GATT Uruguay Round intensified this democratic nation's ambition to become a major concern in world economic affairs.

In this paper I will examine India's policies of liberalisation in the context of the Uruguay Round. I will present the considerable effects in terms of the opportunities they have presented for both the EU and India. I will also briefly explore some of the difficulties that must be overcome before these opportunities can be fully exploited.

The Liberalisation of the Indian economy

India's program of economic reform began out of necessity. In 1991 inflation reached 10% and both substantial external borrowing and the collapse of the USSR caused India to nearly default on its external debt. Emergency measures were taken which included devaluing the rupee and organising a twenty month standby arrangement with the IMF. An indication of the seriousness of the situation is the fact that the country's gold reserves had to be used as collateral.

This crisis led the government to establish its New Industrial Policy. The measures included:

- The abolition of industrial licensing in all but fifteen industries.
- The amendment of the anti-trust legislation to allow for greater competition.
- Liberalisation of the foreign investment rules.
- The number of industries reserved solely for the public sector were reduced from eighteen to five.
- A commitment was made to privatise 50% of public sector enterprises. (Business Monitor International, 1995 Country Report)

These measures are also a consequence of the government's recognition of the growing importance of services and industry in the Indian economy over the last decade. Growth in agriculture has been increasing on average by only 3% while industry has had a 4% growth rate and services have had three times that of agriculture with a 6% growth rate. Statistics show the changes in GDP of each of the three major sectors over the last fifteen years emphasising the declining importance of agriculture. (European Commission, 1996) The Indian governments' policies have given very positive signs to the EU of the enormous potential and opportunity available in the country. In April 1992, the Rao government followed these reforms with an eight year plan setting the macroeconomics goals at a GDP growth rate of 5.6% and a current account deficit of 1.6%.

Public Sector

The public sector has always had a record of poor performance in India. Steps have been taken to try and rectify this situation, with a decrease in budgetary support for the sector. The National Renewal Fund has been established to offset the negative effects due to the closure of non-competitive firms.

Foreign Investment Policies

Major changes have occurred in this area. A foreign investment promotion's board has been established. There has been automatic approval of 51% of proposed foreign investment schemes in 34 high priority industries. Limits on foreign equity participation in power industries have been removed. The 1973 Foreign Exchange Relations Act was amended in 1993 to remove discriminatory treatment of businesses with more than 40% foreign equity. The government also signed the Multilateral Investment Guarantee Agency Protocol. An early indication of the advances made is given by the recent entry of firms such as Coca-Cola, Proctor and Gamble, Kellogg's, Reebok and Sony.

Capital Markets

Progress has also been achieved within India's capital markets. The government has decreased reserve requirements to 40%. There is no longer extensive control of lending rates and the deposit ceilings have been lowered, steps which are hoped to encourage both competition and efficiency. In May 1995 financial sector businesses took measures to allow foreigners to own 24% of their shares. This is in line with the World Trade Organisation practises. Policies such as these across a broad spectrum send positive signals to EU investors and governments with regard to India's desire for investment.

General Agreement on Trade and Tariff's - Uruguay Round.
As the world's eleventh largest economy India played a major part in the Uruguay Round of the GATT talks. This 20,000 page agreement holds major implications for both the EU and India and will affect their trade interaction well into the future. The abolishment of the world's most well known voluntary export restraint, the Multi - Fibre Agreement (MFA) and tariff reduction is of greatest consequence for the relationship.

The Multi - Fibre Agreement
Textiles and clothing represent 20% of India's industrial output. Of these exports 8.2% were constrained by the Multi-fibre agreement which limited the amount of textiles that India could export (Business Monitor International). The MFA meant that India was voluntarily restricting the amount of textiles and clothing it exported to the EU. During the past few years the industry has been restructured to deal with the phasing out of the MFA. Great strides have been made in improving the quality of the goods and their image on the international market. India has the advantage of a very low cost production base and is able to engage in intense specialisation that has resulted in a substantial growth in exports. In 1994 the clothing industry had grown by 21%.

Tariffs
GATT also resulted in the reduction of many of the world's tariff's. In India the maximum tariff has come down from over 300% to 50%. Given the partial consensus behind the GATT, these changes are confidently believed to be permanent, a factor which is extremely important for European exporters. Businesses do not wish to spend valuable time and money building up trade relations with India if the possibility of them raising their tariffs again is available. Tariff revenue has always represented an important part of the Indian government's revenue and the inevitable future contraction will necessitate the raising of finance through other sources (Business Monitor International 1996).

Corporation tax still remains at a very high rate of 55%, which does little to encourage investment. An examination of the 1995/96 budget gives an indication of the governments' intentions towards taxation. Although there were no reductions in the corporation tax, strong moves were made, particularly in high technology areas (Source; India Business Intelligence 1996).

General System of Preferences (GSP)
India is also to be graduated from the EU GSP system which gives preferential tariff treatment to developing countries. India has maintained a 9% share of the GSP scheme. This is yet another sign to investors of India's strengthening position. Other positive signs include India's commitment to the General

Agreement on Trade in Services (GATS) which is a commitment not to increase protection in the services sector. They also signed the TRIP's which will extend the coverage of intellectual property rights to include India.

According to estimates by the World Bank, developing countries will gain between $55 and $90 billion US dollars as a result of the Uruguay Round. A study by a London group of economists (Davenport and Hewitt 1991) estimates that the benefits for India to be as follows: manufactured goods are to benefit by US$26m, textile and clothing by up to US$189m and fishing by US$42m, not to mention the above stated tax revenue.

Trade between the European Union and India

The liberalisation of the Indian economy and the country's participation in GATT have resulted in much closer relations between the Republic of India and the EU. This culminated in a co-operation agreement between the two countries in December 1993 on Partnership and Development. This agreement has been in operation since 1994 and since then numerous institutions have been established to further the cause of economic interaction. These include:

- The EU-India Joint Statement on Political Dialogue.
- The EU-India Cross Cultural Programme.
- A European Business Centre in Bombay.
- Asia-Urbs: An agreement to encourage co-operation between the local authorities between the EU and India.
- 3SE: This involves co-operation in Information Technology issues.

In addition, the majority of EU countries have set associations to increase awareness of Indian trade benefits such as the Ireland - India Business and Economic Association.

All these groups play a major part in promoting interaction in political and cultural areas as well as in the economic sphere. Understanding a country's culture and political ethos is vital to the promotion of good trade relations. Political adherence to the new measures in India is vital. The words of the present prime minister H. D. Deve Gowda that India "cannot give up liberalisation" are welcomed by EU investors.

However, India provides a valuable new market for EU producers in the form of a newly emerging consumer class consisting of 150 million people. India's financial system is good relative to its Asian neighbours and despite regulation its private sector is reasonably well developed. The potential is great for EU producers who face maturing markets at home. India is potentially the second greatest export market in the developing world (European Commission 1996).

The loss of the USSR as one of India's major economic partners has heightened India's interest in the EU. Links had been forged since as early as 1964, so EU - India relations are not a novel thing. As stated in a recent European Commission paper, *"It is in the EU's interest to help Asia play a more prominent role on the world stage."* The value of the EU to Indian trade is easily identifiable. The EU accounts for over 20% of total world trade and is India's most important trading partner as can been seen below (Central Statistics Office 1996).

In 1995 India's exports to the EU accounted for 33% of its external trade and 35.7% of it's imports. In nearly all cases there are substantial increases in exports and imports from India's main EU trading partners from 1994 to 1995 (European Commission and CSO 1996). However, India still only accounts for 1.3% of EU trade despite being the second most populous country in the world. There is obviously plenty of room for expansion of these figures. The EU has maintained a trade surplus but this has been declining strongly since India's change of policies in 1991.

Direct Foreign Investment (DFI)

Policy changes have led to large increases in the amount of direct foreign investment from the EU. The EU represents 18.4% of all foreign investments in India. The commerce minister Dr. B.B. Ramaiah told The Irish Times in a recent article that India is seeking foreign investment in four main areas. These are:

- Post harvest technology-processing, packaging and preservation of agricultural and marine products.
- The electronics and telecommunications equipment sector.
- Engineering industries.
- The chemicals and plastics' industries.

The UK received the most approvals in 1994 with 414 approvals. This figure was more than double than that of the previous year. Germany followed with 182 proposals, a huge increase on the 17 that were approved for the country in 1991. Italy also received a large number at 122 which was also a huge increase from the 39 it received the year before.

The Public Sector

The public sector has long been an area of chaos in India, burdened with excessive regulation and bureaucracy. This could not continue in a country in such dire need of basic infrastructure requirements. At the GATT talks it was agreed that the public sector should be open to public procurement. The EU has already played a substantial part in India's development with its aid programs. EU donations represent 16% of the total and India is the largest recipient of EU aid in the developing world. The EU is also India's largest grant donor representing 60% of the total. As at June 1995, the total amount of projects to be funded by the EU in India came to 740 million ECU. The EU demonstrates through these commitments its recognition of India's growing importance in world trade. The state has ended its monopoly in telecommunications and it is expected that laws will be passed to allow the private sector to compete in post, air, rail and roads.

India is also taking positive steps to improve relations with its Asian neighbours. It is intent on joining the Asia- Pacific Economic Co-operation (APEC). It is also on increasingly good relations with the US, Japan and China. These are positive signs for the EU as they increase India's political and economic stability.

Steps have also been taken to curb inflation which has remained high but has begun to decrease over the last year. It has fallen 2.5% since 1992 to 7.5% in 1996. Bank credit for non-bank financial institutions have been curtailed. Bridge loans have been banned and the maximum deposit rate has increased from 1% to 12%.

Challenges For the Future

The outlook for India looks very positive indeed. However there are issues which must be acknowledged when considering India. India is still behind many other Asian nations in terms of its growth and development. Its pace has been much slower than that of China for example (European Commission 1996).

Social issues cannot be ignored as poverty touches some 210 million people in the country. Communication is extremely poor in terms of telephones, road's railways, etc,. Another major point of contention in the future will be the pressure from developed countries for India to comply with both environmental and labour standards. A major problem is also bureaucracy. This is having a major effect on the actual implementation of DFI approvals.

Declared amounts of DFI glow with optimism. However the reality is not as confidence inspiring. Implementation is bound by a mass of regulations and red tape. A survey by the Centre of Monitoring the Indian Economy (CMIE) covering 3000 foreign and domestic projects found that while approvals grew by 46% actual implementation grew by only 4.4%.

Another issue to consider is the problem of corruption. A bloated civil service and public sector breed corruption. In many parts of Indian society corruption is considered normal practice. Industrialists running inefficient companies fear the eradication of tariff's and therefore the protection enjoyed by their firm's. They have a large amount of influence - extortion and bribes continue to play a huge part in industry. This is emphasised by the fact that former Prime Minister Narashima Rao faced three court cases of corruption when he left government.

Seventy per cent of the Indian population are farmers who are relatively very poor by western standards. The government focus on liberalisation seems to benefit only business people who are already far more prosperous than the farmers themselves. These people still expect government support and no government wants to explain to 70% of the voting population that money will not be forthcoming. Thus the government have continued to provide agricultural subsidies which have negative effect on the budget deficit. Trade Unions continue to strongly oppose any government intentions to relax the labour laws. This prevents the essential downsizing that is so desperately needed in the public sector.

Perhaps the most dangerous consequence of these issues is the potential fall off in India's liberalisation policies. Although prime minister Gowda publicly advocates the liberal economic stance it seems he is having second thoughts. In October 1996 he stated that *"Those who believe economic liberalisation will usher a miracle are either living in a fool's paradise or trying to mislead their countrymen.... Nobody comes to India to do charity, everybody comes for profit."* Regressive comments have also been made by the Federation of Indian Chambers of Commerce and Industry. (FICCI). These comments are little helped by the fact that in the first five months of 1996 exports grew by just 9.8% compared with previous levels of 20%. India cannot afford to slip back into the old habits of regulation and bureaucracy.

Conclusion

The main points that can be extracted from this analysis of the Indian economy are summarised below:

- Liberalisation has lead to growth in all areas of the Indian economy.
- The most positive signals are coming from the countries foreign investment policies, capital markets and the public sector.
- India's participation in the Uruguay Round has been crucial for reform.
- EU - Indian trade relations will continue to grow in strength, despite some slackening of the enthusiasm shown earlier in this decade.

However let this last cautionary note not deter us from the potential of India - EU trade relations. Recent government publications such as "India Means Business" and "Opportunity India" are indications of India's appetite for stronger trade links with Europe. India has a buoyant, dynamic economy and is an immense nation with ascending expectations. The continuation of the policies of the last five years will ensure that both these expectations and those of the rest of the world are accomplished.

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