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WORLD TRADE ORGANIZATION

# TRADE POLICY REVIEW

# INDIA

## Report by the Secretariat

This report, prepared for the second Trade Policy Review of India, has been drawn up by the WTO Secretariat on its own responsibility. The Secretariat has, as required by the Agreement establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), sought clarification from the Government of India on its trade policies and practices.

Document WT/TPR/G/33 contains the policy statement submitted by the Government of India.

**Note:** This report is subject to restricted circulation and press embargo until the end of the meeting of the Trade Policy Review Body on India.

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## *SUMMARY OBSERVATIONS*

*1. The Indian Government initiated a major programme of economic reform and liberalization in 1991, reversing a policy direction followed for decades. Since then, successive Governments have progressively reduced tariff protection and relaxed and simplified India's restrictive import licensing regime. Internal reforms have included reduced control over locational and industrial licensing controls, in addition to some loosening of controls on administered prices in some sectors. In this process, however, the policy focus was principally on liberalization of capital goods and inputs for industry, to encourage domestic and export-oriented growth: by and large, imports of consumer goods remained regulated.*

*2. These reforms contributed to a dramatic increase in growth in the 1990s, accompanied by larger flows of inward foreign investment and increased international trade. The balance of payments situation also improved greatly. To build on this success, India has recognized the need to continue the economic reform process, with an increased emphasis now on improving infrastructure, which appears to be a major constraint on the growth of industrial activity and exports; further liberalizing trade through reductions in tariffs and non-tariff measures; reforming the subsidy structure, which is estimated to cost around 14 per cent of GDP; and restructuring public sector enterprises, which continue to be a fiscal drain. These reforms, if fully implemented, should lower the anti-export bias that is still inherent in both the trade and industrial support structures. This would also permit India to lower export incentives, thus moving towards a more outward, rather than export, oriented policy framework, further integrating India into the multilateral system and providing a firm basis for future sustained growth.*

### *(1) The Economic Environment*

*3. Since its previous Review in 1993, India has continued liberalizing its economy, albeit at a somewhat slower pace. Economic reforms initiated in 1991 have produced strongly positive results, most notably annual real growth rates averaging 7 per cent between 1993/94 and 1996/97, led by strong industrial recovery. Over the same period, merchandise exports grew at an annual rate of some 20 per cent in current US dollar terms. In 1996/97, however, some economic slowdown occurred and export growth fell to 8 per cent, partly as a result of infrastructural bottlenecks and indicative of the need for continued structural reform.*

*4. In the area of trade reform, a tariff reduction programme has continued and is to progress further. Average rates have consequently declined. The number of goods subject to import licensing restrictions has been gradually reduced albeit with an emphasis on industrial and capital, rather than consumer goods until recently. The foreign investment regime has also been simplified with a number of sectors being opened up to foreign direct investment.*

*5. Further structural reform needs the support of continued macroeconomic stability. An important issue is the reduction of the public sector deficit, estimated at 8.5 per cent of GDP in 1996/97. The Central Government deficit fell to 5 per cent in 1996/97, but adjustments to reduce State deficits have not been as forthcoming and shoring up parts of the public sector, prior to planned reform and disinvestment, has been expensive. With the cost of supporting important sectors such as agriculture and related transfer programmes, it is unclear how far the public sector deficit may crowd out investment. Overall, subsidies remain a drain on Government revenue and lead to a misallocation of resources.*

### *(2) Trade Policy Features - Type and Incidence of Trade Measures*

*6. Since 1993, tariff reform has brought the simple average of all rates down to 35 per cent in 1997/98, from 71 per cent in 1993/94; the process of tariff reform and reduction is* *ongoing. However, the structure of the tariff remains complex, with a large number of bands; in several industries, notably paper and paper products, printing and publishing, wood and wood products and food, beverages and tobacco, tariff escalation remains high.*

*7. Reforms to the system of restrictive import licensing have moved ahead steadily, but further steps remain to be taken and are encouraged. In general, products are first moved to a Special Import Licence (SIL) list, with producers being exposed to limited foreign competition, before the product is moved to the list of freely importable goods. The list of freely importable goods currently covers some 68 per cent of tariff lines: remaining restrictions cover mainly consumer goods, and India has proposed a six year phase-out programme for these restrictions. India is currently in dispute settlement proceedings with the United States regarding its remaining restrictions. Approximately 10 per cent of all tariff lines are presently subject to the SIL list, increasing SIL coverage by around one-third from 1995/96. India also continues to use state trading monopolies to retain some control over exports and imports of certain products (canalization). Since the previous Review, the product coverage of imports through such canalization has increased slightly; however, private operators can also trade in some of these canalized products and the share of such products in total imports has declined to 19 per cent, compared to 27 per cent at the turn of the decade.*

*8. The reforms in tariff and non-tariff barriers have not been accompanied by similar reforms to export subsidies and incentives. India continues to maintain a large number of incentive programmes for exports, incentives which, according to the authorities, are intended to compensate for import restrictions. These include income tax exemptions, subsidized credit, export insurance and guarantees, export promotion and marketing assistance schemes and access to some imports that are normally subject to restrictive licensing. The overall scope of such incentives has been enhanced, turning India's overall policy stance more explicitly export-oriented and increasing the possibility of resource misallocation.*

*(3) Sectoral Policy Developments*

*(i) Agricultural products*

*9. The agricultural sector has thus far remained relatively untouched by the reform programme. Nevertheless, agriculture has benefited from the price realignments resulting from manufacturing sector trade reforms. Some progress has also been made in the removal of state controls on the inter-state movement of certain grains and of administered prices; however, controls on the export and import of certain products through licensing policies remain.*

*10. During the Uruguay Round, India bound its agricultural tariffs at ceiling rates ranging from 0 to 300 per cent. In reality, applied rates for 1997/98 are considerably lower, averaging 26 per cent for the sector, with a peak of 45 per cent. This is however likely to change as India tariffies its present licensing restrictions; in this context, India is currently renegotiating its tariff bindings on some zero-or low-duty products. Progress in changing the structure of agricultural incentives and subsidies is likely to remain constrained by the Government's policy of providing support prices to farmers and ensuring low cost supplies to the population through the public distribution system.*

*(ii) Food processing*

*11. Although tariff reforms have resulted in average duties in the food sector being halved since 1993 (currently around 29 per cent for food products and 134 per cent for beverages), industrial and import licensing restrictions continue to be maintained for a number of industries. In addition, a number of products are reserved for production by the small scale* *sector. Production by the food manufacturing sector has grown rapidly, especially following increased foreign investment where up to 51 and 100 per cent of participation is allowed automatically for foreigners and non-resident Indians, except for products reserved for the small scale sector.*

*(iii) Mining and petroleum*

*12. Major policy changes since 1993 include automatic permission for foreign equity participation of up to 50 per cent in the mining of 13 minerals; foreign equity above this share must be approved by the Foreign Investment Promotion Board (FIPB). In an attempt to increase exploration, liberalization has also taken place in licenses granted for exploration. Trade reforms include a reduction in tariff rates to averages of around 10 per cent (from 46 per cent in 1993/94) for non-ferrous and iron ores and to 13 per cent (from 65 per cent in 1993/94) for coal.*

*13. India depends on imports of petroleum. Prices, until recently, continued to be administered although some effort has been made since 1993 to raise these prices periodically to reduce the fiscal burden of the "oil-pool". Despite this, the growing subsidy for petroleum products prompted the Government in 1997 to declare a phase out of most administered prices in the sector. The Government has recently also placed an emphasis on increased oil exploration domestically to reduce import dependence, through the New Exploration Licensing Policy which offers companies investment incentives such as tax holidays to invest in India.*

*(iv) Manufacturing*

*14. Reforms have been most widespread in the manufacturing sector, including reductions in average tariff rates, import licensing restrictions, compulsory industrial licensing, and a liberalization of foreign investment policies. The sector has responded positively to the reforms, although some slowdown in growth has occurred in 1996/97 due, in part, to infrastructure constraints.*

*15. Since India's previous Review, the average tariff on imports of manufactures (ISIC3) has been lowered from 73 to around 36 per cent in 1997/98. Despite this, tariff escalation in some areas remains high, since the largest reductions in tariff rates have taken place for capital goods and intermediate inputs. Tariff escalation is important in sectors such as paper and paper products and to some extent in textiles and clothing, where India has traditionally maintained, and still has, high levels of protection. In certain sectors, such as automobiles, tariff reform has had little impact on imports of fully assembled items, because the liberalization of foreign direct investment without accompanying reform of import licensing restrictions has promoted local investment in manufacturing. Approximately 1,977 tariff lines, at the HS eight-digit level, in the manufacturing and mining sectors, continue to be subject to import licensing restrictions. As noted, the authorities have proposed a phase out of these restrictions over a six year period.*

*16. Foreign investment has also been considerably simplified, with an enlarged list of industries, including the automobile sector, where foreign equity participation of up to 51 or 74 per cent can take place automatically. Compulsory industrial licensing is now limited to nine industries, compared to 18 during India's previous Review; some reduction in the list of items reserved for production by the small-scale sector has also occurred.*

*(v) Services*

*17. Services contribute more than 40 per cent to India's GDP. Their overall growth has been underpinned by rapid expansion of activities in the area of finance, and, to a leser extent, commerce and tourism.*

*18. Significant headway has been made in liberalizing telecommunications. While the government-controlled corporation VSNL operates as the exclusive provider of international long-distance services and the monopoly Department of Telecommunications for the domestic long-distance services, private investors in joint ventures are allowed to provide intra-voice telephone services in various States and metro areas. Many value added services - including voice mail, radio paging and cellular mobile telephone - are now open to 49 per cent foreign equity participation. In the area of financial services, the banking sector remains fairly closed to foreign participation, while the insurance sector is still monopolized by the Government. Under the Financial Services Agreement, the Government has offered to remove reciprocity requirements in the banking sector and also raised the annual limit on new banking licenses from eight to 12. Other services areas - such as shipping, roads, ports and air - are beginning to open up, but foreign participation remains relatively low and significant administrative barriers remain.*

*(4) India in the Multilateral Trading System*

*19. India was, from the start, an active member of the GATT and a founding member of the WTO. As a result of the Uruguay Round, India bound 67 per cent of its tariff lines; lines remaining unbound include those on certain industrial items and many consumer products. Under the General Agreement on Trade in Services (GATS), India has made commitments in 33 activities (compared with an average of 23 for developing countries) out of a total of 161. In addition, India also took part in the Information Technology Agreement - covering computers, telecommunication equipment, semiconductors, semiconductor manufacturing equipment, software, and scientific instruments. India's anti-dumping and countervailing legislations have been amended in line with relevant WTO Agreements. With respect to intellectual property rights, India's Copyright Law was amended in 1994 in accordance with its obligations under the TRIPS Agreement. India plans to make use of the transition period available to developing member countries of the WTO to implement other changes to its intellectual property rights; however, in a dispute with the United States over "pipeline" patent protection and exclusive marketing rights, the WTO's Dispute Settlement Body has found that India is obliged to implement the necessary measures. India is currently in two WTO disputes: one as a defendant with the United States, as noted above, and the other as a complainant with Hungary, relating to restrictions on textiles and clothing.*

*20. In terms of WTO tariff commitments, India has bound 67 per cent of its tariffs in manufacturing and 100 per cent in agriculture in consequence of its Uruguay Round commitments; however, most of these bindings are at ceiling levels, ranging up to 300 per cent in agriculture. The bound simple average tariff to be implemented by the year 2005 is 54 per cent, compared with the present applied rate of 35 per cent, itself set to decline further. In the services area, the initial commitments made under GATS are such that the existing policy framework is either more liberal, or equivalent to the bound measures. In both areas, thus, India, like most other developing countries, has put a ceiling on its protective structure, rather than binding it at effective levels, while pursuing unilateral liberalization.*

*21. India maintains several plurilateral agreements with countries in the region: the angkok Agreement, the South Asian Preferential Trading Agreement (SAPTA), and the Global System of Trade Preferences (GSTP). Further concessions to some of these ountries are also provided within the framework of bilateral trade agreements. However, the impact of these agreements on India's trade seems to have been minimal. India' merchandise imports resulting from the eighth Bangkok Agreement and SAPTA* *member countries accounted for only 3 per cent of total merchandise imports and about 7 per cent of its merchandise exports in 1995/96.*

*(5) Outlook*

*22. India's increased openness and integration with the world economy have been important factors in explaining the healthy economic growth recorded in the 1990s. The recent economic slowdown demonstrates the need for continued and even accelerated reform. Transparency in decision-making, especially with regard to foreign investment, should also be increased if India is to reach its foreign investment targets. Continued opening of the trade regime and liberalization of the foreign investment regime are likely to be translated into even higher growth rates than have been experienced so far.*

*23. Other factors constraining economic growth may include the fiscal deficit, which may, for example, contribute to high interest rates. There is also concern with regard to the large share of subsidies in government expenditures: while many of these are aimed at assisting the very poor, it is not clear that this target is being reached. Second, the poor quality and coverage of certain infrastructure facilities - notably power and transportation services - which are all essential for the development of both domestic and export markets, needs to be addressed. Third, reform efforts in industrial restructuring, need to be accelerated, especially to enable the closure of unviable units in order to release resources for use in more productive areas. Internal deregulation could therefore complement India's ongoing trade liberalization process in promoting a more efficient and productive economic structure.*