Trading in Turbulent Times: A short Narrative of India's External Trade in Recent Times

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Abstract

This paper dwells on the changing structure of India's foreign trade in the post reform period and attempts to portray some of the recent trends in foreign trade and initiatives. The foreign trade scenario in the pre-reform period was guided by the protectionist policies of the government. The protectionist policies and the consequent expenditure that the Government doled out in an ambitious movement to aid the manufacturing sector prevented, in retaliation, our chances to squeeze international market for India's exports. In the post reform period, the easing of QRs and the cut in TRs led to augmenting the volume of trade which is evident from the fact that the share of foreign trade in the country's GDP burgeoned to over 40 percent in 2014 from a level as low as 14 percent in the initial years of post-reform period. This apparently shows greater and deeper diversification that the direction of trade has witnessed in recent times, thanks to change in foreign trade policies in terms both tariff and quota. However developments like GFM had its dampening effect on Indian economy although it withstood such effects thanks to the strong macroeconomic and structural bases. Trade variables of the country pertaining to the post-Brexit period do not show any substantiate evidence to prove that Brexit has had a strong disincentive effect on the foreign trade of India.

Key Words: Global Financial Meltdown, Balance of Payment (BoP), QR and TR, Brexit, Demonetization, Make in India, Current Account Deficit (CAD), Foreign Direct Investment (FDI)

The importance of foreign trade as an engine of economic growth has long been recognized by leading economies, and riding on the visible advantageous that trade showers many economies have been able to make dents on their long standing economic menaces like poverty and infrastructure bottlenecks. Starting with England which profiteered much from its colonial expansion thereby enhancing its trade volumes manifold, and to the latest example of China, flooding even the US markets with its products at varied prices, stand testimony to this. The increasing realization that economic interdependence is indispensable owing to different reasons as varied as from diversity in resource endowments that nations enjoy to the surmounting differences in the acquisition of technical knowhow might have played unquestionable roles in fueling the necessity of engaging in trade, thereby trying to squeeze the economic advantage it offers. Seeking new horizons in expanding trades, countries have grouped and regrouped themselves under different names of course on the bases of their regional proximity and to some extent ideological foundations. Although these groupings have cost much on the principles of free trade as advocated by Classical economists, together, it must be admitted, they appear to have been converting to the spirit of trade which derives benefits to their economies which would otherwise have remained untapped.

India's experiment with foreign trade over the last decades has been caught with both ups and downs. We had a glorious past in foreign trade in the pre-colonial period. Historical evidences suggest that India had good trade relations with the Middle East and other dominant nations of that time including China. Perhaps this fame in trade might have made Europeans envious about India and they invaded her to loot her resources, labor skills and finally to establish political power over her for more than ten decades. The Colonial India under the British rule for long time had to contend with persistent deficit in its Balance of Payments. India's traditional industries which had enjoyed an unbeatable comparative advantage in the international trade started evading and finished products from Britain flooded Indian markets.

Post-independence, India has had ups and downs in foreign trade owing to domestic factors encompassing the structure of the economy, its resource endowments, policy stance and changing foreign demand determined mostly by the economic and social development in the destination nations. Till the beginning of nineties, India had been dazzling with controlled regime in every sense and the reflection of which had felt in the foreign trade sector as well. We believed it would be better to be independent from the foreign trade as well by putting control on the exports and imports of commodities, services and foreign capital flows, both inflow and outflow. We nurtured a wrong notion that the continued reliance on foreigners would make us subservient to their words and deeds, and therefore to save the scarce foreign exchange that we had in those times, India opted to have lesser and controlled trade relations with the rest of the world. In all most all the spheres of the economy, the hands of government had its signature, not to speak of the foreign trade sector. But having accepted the Harrod-Domar model as an implicit strategy in the first five year plan, we proved ourselves not ashamed of copying the development strategy of others. Having embraced licensed and controlled policy dictums for decades, in 1991, on the brink of a BoP crisis, India decided to bid adieu to such policies, and embarked on a new regime of shackling the economy from the unnecessary bureaucratic controls. The BoP deficit that reached zenith in 1991 is the offshoot of misdirected economic policies which had been pursued in India for a long time under the stewardship of different governments with varying ideological bases.

The foreign trade scenario till 1991that is in the pre-reform period, was guided by the protectionists policies of the government which derived its spirit from the controlled regime. In our pursuance towards ameliorating the dependence on foreign aid both in terms of finance and physical commodities, India adopted a policy of import substitution-replacing imported goods with domestically produced-rather than attempting to enhance the volume and the value of exports. This overemphasis on import substitution appears to have been a misplaced one as it limited our capacity to tap the foreign market. In addition to this, the import substitution itself turned out to be not encouraging as it failed to make considerable dent on the volume of import to India. Apart from this, the necessities of first and second five year plans, fueled by the ambition of the nation to build more 'industrial temples' did increase the domestic demand for high valued industrial output manufactured in foreign countries. The external sector of the nation continued to show similar trends in the pre-reform period with certain timely adjustments. The protectionist policies and the consequent expenditure that the Government doled out in an ambitious movement to aid the manufacturing sector prevented, in retaliation, our chances to squeeze international market for India's exports. In this background, this paper dwells on the changing structure of India's foreign trade in the post reforms period and attempts to portray some of the recent trends in foreign trade and trade policies.

An overview of India's External Trade in the post reform period

Let me first focus on the background of trade reforms in the immediate post reform period. As we know, this period saw much pessimistic attitude among the policy makers and traders as to what would happen to India's trade after it being opened to the free trade. The tide of trade volatility across the globe, it was feared, would spill over to the pattern, value of trade and capital flows both in and out of India, ultimately reflecting in a much volatile BoP condition. Remember that the immediate reason that cemented the argument of the then Government to go in for embracing neo-liberal open policies was *inter alia* the worsening BoP circumstances that prevailed in the early days of 1991. Nevertheless, much to the embarrassment of the authorities, the immediate post reform period witnessed a worsening BoP. But the things started bettering off with the inflow of capital to India mainly in the form of FDI besides FIIs and other mode of flows. Coupled with this, the easing of QR[i]s and the cut in TR[ii]s led to augmenting the volume of trade which is evident from the fact that the share of foreign trade in the country's GDP burgeoned to over 40 percent in 2014 from a level as low as 14 percent in the initial years of post-reform period. The same trend could be observed in India's share in global trade. In the early 90s, India could only share 0.6 percent of global exports whereas now it stands at 1.6 percent and in the imports too its share has gone up from 0.6 to 2.4 percent in recent times. Obviously, the second decade of post-reform period registered a marked improvement in the growth of foreign trade compared to the early decades. The backlash of global financial meltdown was too much over India's foreign trade that in 2014-15, both the growth in exports as well as imports plummeted to an unimaginable level.

Enlarging the horizon of export market

At the time independence, naturally, Britain emerged as the main export partner of our country. Later, improvements in our relationship with countries like USA and the erstwhile USSR tilted the export market to these countries, and the dominancy of Britain faded away. For long, thereafter, USA remained as the major export partner and, now, new trade policies have tended to symmetrize the pattern of direction of trade with the share of USA being brought down from 16 percent in 1991-92 to 13.7 percent, a drastic cut which many accurate predictors could not have imagined. UAE has emerged as India's second largest export destination replacing Japan. Today, 70 percent of India's export is distributed among major 20 countries in contrast to 80 percent being shared among them in early 90s. A noteworthy change could be observed in the share of developing nations to total export of India which has increased in recent times. The share of Asian and African nations in total export has substantially gone up challenging the age old domination of advanced western nations mainly Europe. This apparently shows greater and deeper diversification that the direction of trade has witnessed in recent times, thanks to change in foreign trade policies in terms both tariff and quota. Looking at the export basket too, considerable structural shift could be seen in India's foreign trade. Earlier, traditional and agro based products had a high share in our export basket, but today, value added commodities and engineering goods have occupied a substantial position[iii]. However, in the case of imports petroleum products still dominate the position with its share increasing from 27 percent of total imports in 1991-92 to 31 percent in 2014-15. But one can hardly ignore the fact that the volatility in global price of petroleum has been causing wild change in the share of petroleum in terms of its value[iv].

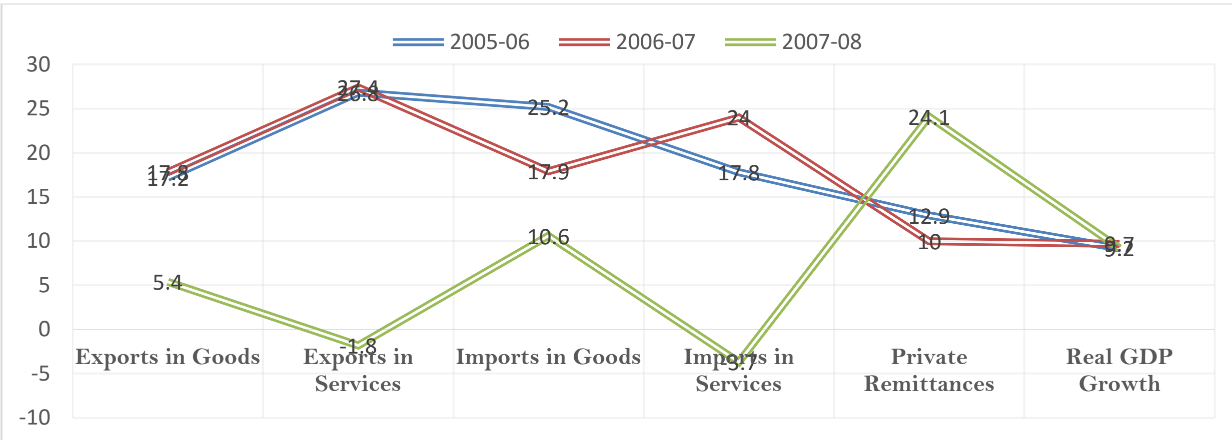
India's Trade in the backdrop of Global Financial Meltdown

Undoubtedly, the Global Financial Meltdown hereafter called GFM has had a profound impact on the foreign trade pattern of India, although not far reaching in nature. It was in a way a testing time for India's economy and it rendered an opportunity for the economy to showcase how resilient it was and would be to such external shocks that spilled over to India owing to its closeness with many trade partners which were the epicenters of GFM. But, magically, India could withstand the bad repercussions of GFM and the institutions indeed under the stewardship of the captains of such institutions[v] showed unparalleled professionalism in ensuring that India did not slip into the clutches of severe backlashes at the hands of the perpetrators of GFM. The limited openness of India to the rest of the world could be a reason why India continued to be resilient to the spillover effects of GFM. The financial institutions in India were not much prone to the waves of financial shocks that shattered the edifice of financial institutions in countries which brewed the global financial crisis. Barring some banks, Indian financial system as a whole stood firm when the crisis starting knocking its doors.

This financial resilience might have helped India withstand the ill effects of GFM. Obviously, the GFM had started creating its backlash effect on Indian economy which is evident from the plummeting of exports from India in 2008-09 to 3.6 percent from a figure as high as 28.9 in 2007-08. The sharp deceleration in exports got itself reflected on the widening current account deficit (CAD) from 1.5 percent of GDP in 2007-08 to 2.6 percent in 2008-09 (Kumar & MV, 2013).

Notwithstanding the widening of CAD, other indices of foreign trade remained calm and cool during the years of financial meltdown.

Figure 1 Growth in India's Trade in Real Terms from 2005 to 2008



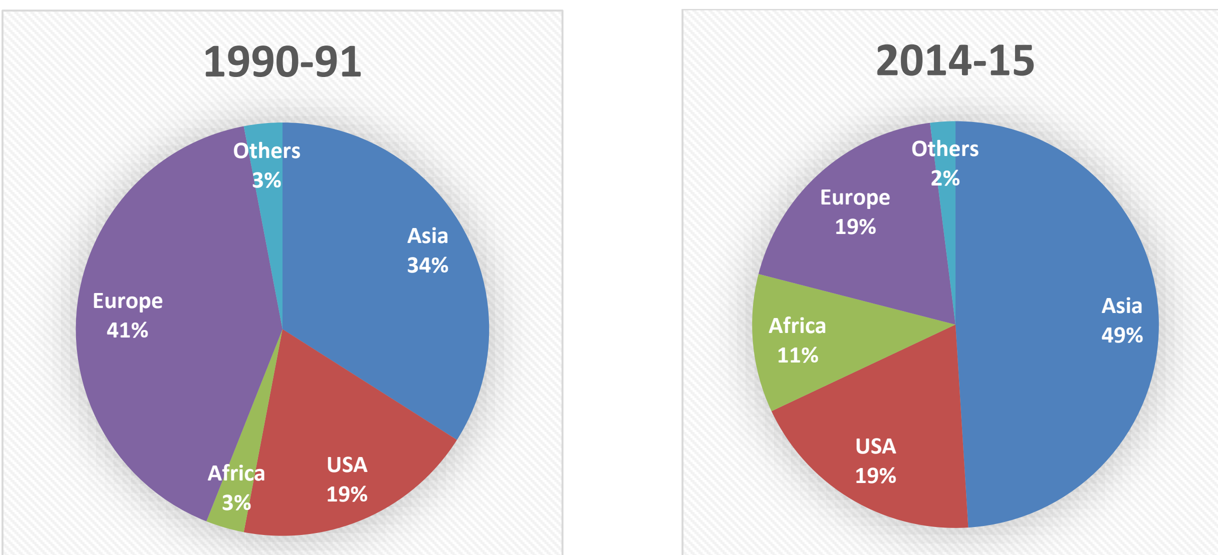
Source: NAS, CSO and RBI

As is evident from the figure (Figure No.1) in 2007-08, exports in goods and services and imports in goods and services witnessed a marked decline except the private remittances which was shot up to a relatively high position. This obviously throws light on the fact that GFM had its dampening effect on Indian economy although it withstood such effects thanks to the strong macroeconomic and structural bases for which we must be grateful to policy makers and planners who had made tremendous endeavors in building the foundation of Indian economy in the post independent period.

'Brexit' and India's Foreign Trade

The exit of Britain from the European Union (EU) popularly known as 'Brexit', it was feared, would turn out to be a dampener for India's trade in recent times. But the trade variables of the country pertaining to the post-Brexit period do not show any substantiate evidence to prove that Brexit has had a strong disincentive effect on the foreign trade of India. The main reason for this could be found in the deep fall in the share of Europe in India's total exports from 41 percent in 1990-91 to 19 percent in 2014-15 (Figure 2). Had the 'Brexit' happened in 1990s, it could have done strong damage to the Indian exports. But the sea change that occurred in the share of different regions in India's exports saved the country from some of the untoward developments in many traditional export partners like UK. As the above figure depicts the share of Asia in India's exports witnessed an upward trend from 34 percent in 1990-91 to 49 percent in 2014-15. Likewise, the share of Africa also improved substantially. All these clearly show that although India has been integrated intensively with the rest of world since 1991 thanks to the process of globalization, the financial and economic turbulence that the Western countries face have not turned out to be much disastrous for the Indian economy. The change and diversification both in the basket of exports and imports and in the direction of export and import that India has witnessed in recent times particularly with the onset of neo liberal reforms actually result in enhancing the resilient capability of our economy in dealing with the ill-spillover effects of international developments like the 'Brexit'.

Figure 2 India's Exports by Regional Origin



Source: Centre for Monitoring Indian Economy, Economic Outlook

Demonetization and India's foreign Trade

The menace of black money poses serious challenges to the legal and logical functioning of an economic system. The size of notorious parallel economy which deals in black money amounts to almost 50 percent of the mainstream economy in India. Besides many ethical and moral issues that the black money raises, the unabated presence of black money defeats the very purposes for which economic policies like monetary and fiscal policies are implemented. For instance, a tight monetary policy aiming at controlling the volume of money supply in an effort to tame inflationary pressures will find itself rendered ineffective when people continue to transact their business using black money. Thus for a quality growth and better economic sustenance, it is important to wipe out black money from the realm of transactions. Perhaps, towards materializing this objective, demonetization of high denomination currencies was effected by the government towards the close of 2016. It was obvious that the immediate withdrawal of Rs.500 and Rs.1000 notes which accounted for 80 percent of total currency transacted in India would produce a downward trend in all economic activities although digitalization was proposed to be an alternative to offset the effects of demonetization. Financial supervisors including institutions like RBI continued to maintain that likely shortfall in economic activities would be a short run phenomenon and in course of time demonetization would boost economic growth.

Demonetization indeed is a domestic economic affair of a country executed to deal with certain internal disturbances. But for an open economy or near open economies like India, changes that affect the availability of liquid money domestically will have consequences on foreign trade via exchange rate dynamism. The paucity in money supply lowers the exchange rate thereby appreciating the value of domestic currency in relation to foreign currencies which brings exports down. And conversely, imports may go up following demonetization. A down in exports lowers domestic income, output generation and employment opportunities. On the other hand, increase in imports lead to the outflow of income in the form of import payments. Coming to the impact of demonetization on foreign trade, it is pertinent to point out that it is difficult to discern the impact of demonetization from the trends either in exports or in imports or any in other foreign trade variables. But it can be safely inferred that demonetization has hit foreign trade flows in the form of a reduction in exports which the government intends to offset with the help of traditional ways of encouraging export oriented industries. However, we need to wait and see how far such attempts will turn out to be advantageous for the economy in future. Studies have shown that demonetization slowed down the pace of exports from India. Figure given below clearly shows that the exports from India nosedived in November, 2016 following demonetization. But as per the official version, in the year 2016-17, exports have registered the fastest growth in the five years despite the impact of demonetization, although some economists do not appear to have been buying this official version citing that high exports growth might have been calculated using a wrong base year. There is also an alternative opinion that better performance by the exports segment in the aftermath of demonetization can hardly be considered as a sustainable one. During the same period imports outstripped exports and the Current Account Deficit (CAD) got widened. It is to be understood that widening CAD is not a good sign of healthiness for an economy. The ‘America First’ policy of US President, Donald Trump and the ‘Brexit’ episode of UK have started clouding India’s dreams of increasing its share in global trade to 5 percent by 2020 from the current share of 1.6 percent (Ahuja & Ray, 2017).

‘Make in India’ and the foreign trade

Formally introduced on 25th September, 2014, ‘Make in India’, a programme that falls under the Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce, Government of India, aims at facilitating investment, foster innovation, enhance skill development, and build best in class manufacturing infrastructure in India (IBEF, 2017). In line with the Chinese strategy of enhancing exports, the present government at Centre has been vehemently popularizing ‘Make in India’ to make India a destination for investment. Make in India undoubtedly has more implications and it can surely spawn far reaching consequences on all sectors and can transform the economy constructively. As said at the outset, China has driven its economy to enviable accomplishments in terms of sustaining a double digit growth for many years thanks to its export led growth strategy. India has now started eyeing on the possibilities of tapping potential of export led growth by way of ‘Make in India’ campaign. But ‘Make in India’ is much easier said than done! This is because to make India a destination of production for exports, many more domestic macroeconomic and sector-wise policy level preparations need to be made mainly in the form of relaxing or doing away with regulations, changing labor laws in an investor friendly manner and establishing infra-both social and economic (to put simply, the *‘easy of doing business’*). It is appreciable that Make in India focuses on raising the share of manufacturing sector in India’s GDP from the present 15 percent to 25 percent by 2022. The government is reported to have identified 25 sectors in which India wants to become a global leader in manufacturing by producing goods with *‘zero defect’* and *‘zero impact’* on environment. Now for Make in India to be a success, what is required is a total overhauling of the investment mechanism in India. Investment if determined by the market can make ‘Make in India’ worthy of addressing growth concerns of our economy.

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[i] Quantitative Restrictions. The removal of QRs has mainly led to an increase in trade with China, making Asian nations important trade partners of India replacing the European nations.

[ii] Tariff Restrictions. Although tariffs still persist, rates have been drastically brought down in respect of many commodities following different bilateral and multilateral trade agreements.

[iii] In recent times, India has emerged as a principal exporter of Cars to nations like Sri Lanka.

[iv] Owing to wild oscillations in global oil prices, countries like India now adopt a daily absorptive mechanism to reflect the international oscillations on domestic oil prices. Although this decision is likely to spawn uncertainty in business decisions, the external debt emanating from changes in oil prices could be tackled to a greater extent.

[v] It needs to be mentioned at this juncture the name of Dr.Y V Reddy, the former governor of RBI who was key in protecting India from GFM.