

Country Study: India

SAMPLE

Section 1 - Introduction

India is located in South Asia and bordered by Bangladesh, Bhutan, Burma, China, Nepal and Pakistan. With a population of over a billion, India is the second most populous country in the world. Hindi is the national language, with English being the second national language as it is widely spoken and the language for most national, political, and commercial communication. However, there are 21 other official languages. With 28 states and 7 union territories, India has a federal republic and its capital is New Delhi.

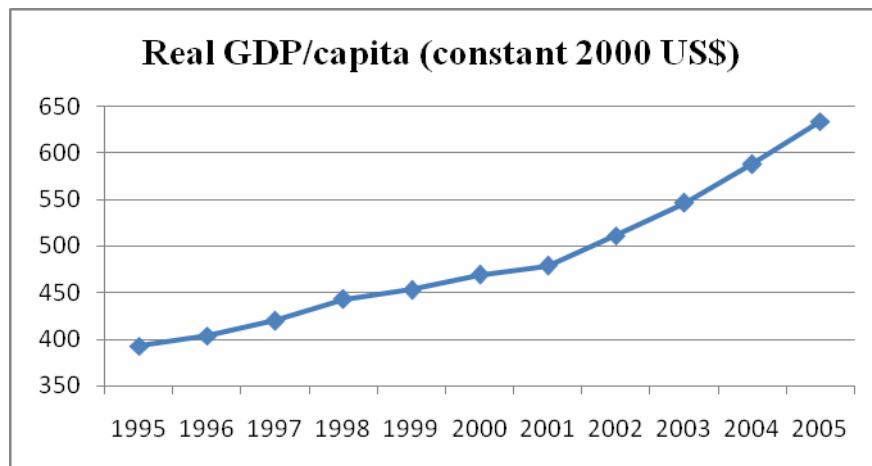
India's GDP is the 12th largest in the world, if measured in nominal US dollars, and is the 5th largest measured at purchasing power parity exchange rates. The Indian economy is quite diverse and includes traditional village farming, modern agriculture, handicrafts, various modern industries, and numerous services. Three-fifths of the workforce is estimated to be in agriculture. Services account for more than half of India's output with less than one third of its labor force, and are the major source of economic growth. The years used to analyze India's economy in this paper are 1995 – 2006.

Section 2 – International trade and finance

2.1 – Current trends

Business-process outsourcing, information technology, telecoms and manufacturing have surged in India, however, the economy remains mostly agricultural. This is because some parts

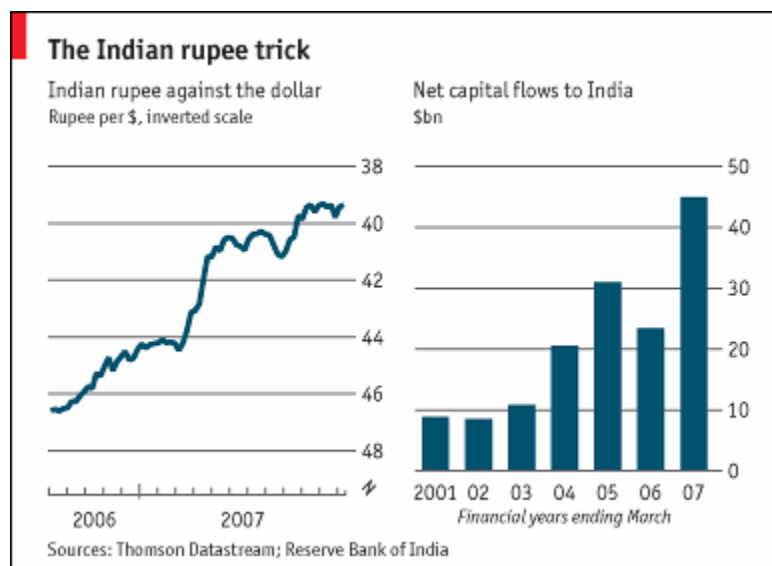
of India are cut off from the free trade benefits, and there are limits on foreign direct investment (FDI). FDI is needed to help develop manufacturing, which currently represents only 15% of the economy (Country Briefings, The Economist). However, India's Real GDP per capita has continuously been increasing.



Source: Author's calculations, WDI Online

However, in early 2000 India announced the Special Economic Zone (SEZ) Policy in an attempt to overcome limitations such as the absence of excellent infrastructure and a volatile fiscal regime. This policy “intended to make SEZs an engine for economic growth supported by quality infrastructure complemented by an attractive fiscal package, both at the Centre and the State level, with the minimum possible regulations” (Special Economic Zones in India). The SEZs functioned under the Foreign Trade Policy provisions. The main objectives of the SEZ Policy are: “generation of additional economic activity, promotion of exports of goods and services, promotion of investment from domestic and foreign services, creation of employment opportunities, and development of infrastructure facilities” (Special Economic Zones in India). By implementing this policy, India hopes to attract investors in export-oriented industries with promoted benefits such as tax breaks and good infrastructure.

Special economic zones have previously been used in China and South East Asia to draw foreign investment for the last few decades. However, in 2006, people in India have been increasingly protesting against the government's plan to attract foreign investment through these zones. According to the protesters, mostly farmers, "special economic zones are an official way for Indian businesses to grab their land" (Vaswani, BBC News). Also, according to India's finance minister, P. Chidambaram, these zones will result in a vast loss of income, or tax revenues, for India, as they will encourage tax-paying businesses to move to the tax-free zones. The ministry estimates that by 2011, India will lose about \$40 billion, which is needed to help reduce the budget deficit (Vaswani, BBC News). Despite the fact that the zones are increasingly becoming real estate businesses and norms are being violated, the Indian government has made it clear that there are no plans to amend the Special Economic Zone Policy.



Source: The uncomfortable rise of the rupee, The Economist

India's currency has also strengthened by an estimated 15% against the dollar in the past year, due to a strong inflow of foreign capital which is steadily increasing as well as the dollar's decreasing trend. However, this influx results in the suffering of the labor-intensive

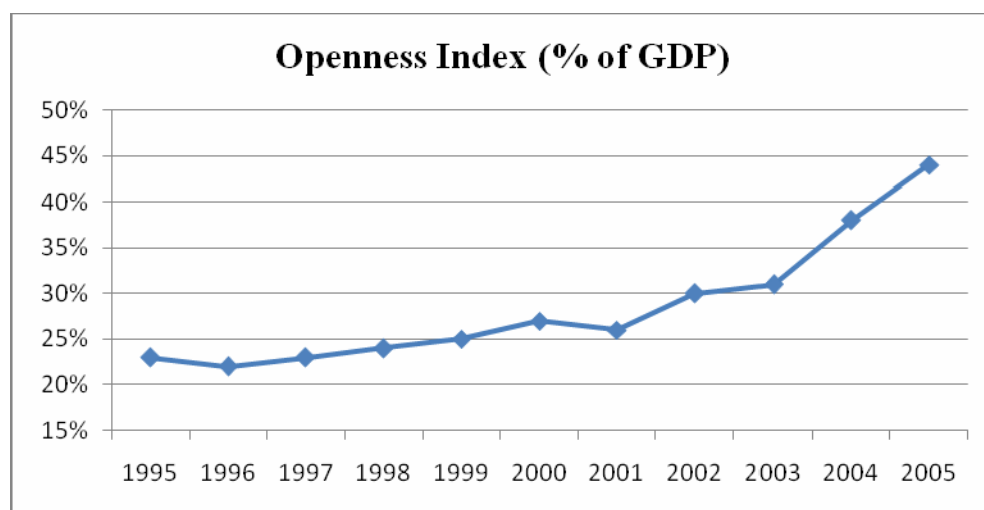
manufacturers in India, such as the textile industry. The Reserve Bank of India (RBI) has tried to contain inflation while simultaneously resisting the appreciation, which is difficult when there is a strong inflow of capital; “printing rupees to buy incoming dollars keeps the currency cheap but also adds to the money supply, stoking inflation” (The uncomfortable rise of the rupee, The Economist). While fiscal restraint might offer India temporary relief, Ila Patnaik of New Delhi’s National Institute of Public Finance and Policy, “thinks India has already gone too far down the road of financial liberalization to emulate the exchange-rate policies of its bigger neighbor [China]” (The uncomfortable rise of the rupee, The Economist). This is because the banks in India are less accommodating and the savers are particular, whereas the Chinese banks are passive and there is a steady supply of deposits as the savers in China have few other places to put their money. If an appealing interest rate is not presented to India’s savers, they buy shares, property or jewelry instead.

2.2 – International Trade

International trade is extremely important to India, as reflected in their Foreign Trade Policy (FTP), “For India to become a major player in world trade, an all encompassing, comprehensive view needs to be taken for the overall development of the country’s foreign trade. Coherence and consistency among trade and other economic policies is important for maximizing the contribution of such policies to development” (India: Foreign Trade Policy). According to the FTP, the purpose of trade is to stimulate greater economic activity. The two major objectives of the FTP are: “1)To double our percentage share of global merchandise trade within the next five years; and 2)To act as an effective instrument of economic growth by giving thrust to employment generation” (Foreign Trade Policy). India is a member of all major multilateral economic fora including the World Bank, the Asian Development Bank, and the

International Monetary Fund. India became a member of WTO on January 1st, 1995, and is one of the founding members of both the GATT and the WTO. At a more regional level, India has a free trade agreement with Singapore and is a member of the South Asia Association of Regional Cooperation (SAARC), BIMSTEC (Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation) and the Bangkok Agreement. India is also currently negotiating FTAs with Japan, Chile, Thailand, MERCOSUR, South Korea, GCC, ASEAN and the EU (European Commission).

In mid-2007, the US requested a session through the WTO with India to discuss “additional duties” or “extra additional duties” that India applies to US imports, which include wines and distilled products. The issue is expected to be resolved in mid-2008 (World Trade Organization). In 2006, the EU requested WTO consultations in regards to the high additional duties levied at the state level in India on imported wines and spirits, as access to this large Indian market was restricted, contrary to international trade rules. However, in 2007, the EU adjourned its WTO panel against India as they repealed the discriminatory high duties on EU wine and spirits (World Trade Organization).



Source: Author's calculations, WDI

According to WDI Online, India's openness index, or volume of international trade relative its GDP, was 44% in 2005. This has steadily increased from the 23% reported in 1995 due to a variety of reasons. Until the early 1990s, India "was a closed economy: average tariffs exceeded 200 percent, quantitative restrictions on imports were intensive, and there were stringent restrictions on foreign investment" (The World Bank). Since then India's liberalizing reforms have resulted in a great increase in trade, and now its economy is one of the fastest growing in the world. Tariffs have fallen, quantitative restrictions on imports have been eradicated, and foreign investment has increased due to the relaxed regulations in particular sectors. However, agricultural tariffs are estimated at about 30-40%, and anti-dumping measures are used to protect trade (The World Bank).

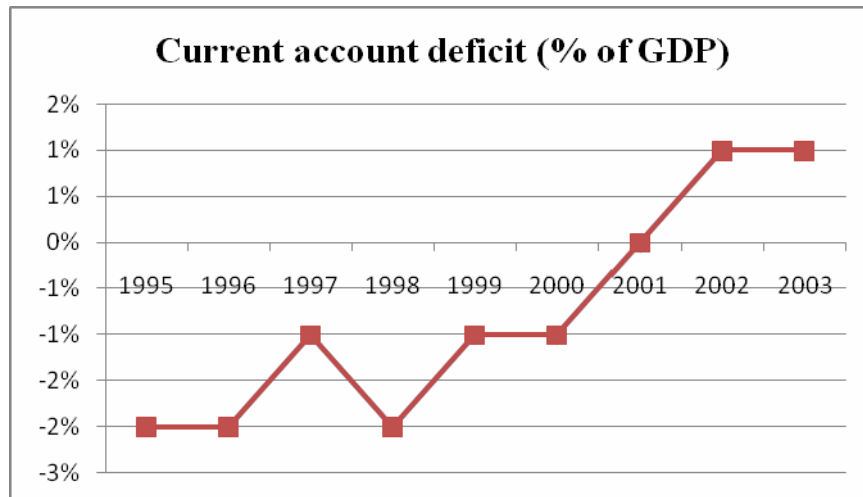
2.3 – Major trading partners





Source: Author's calculations, UN Comtrade

India's major export partners, according to UN Comtrade, in order of total volume, are USA, United Arab Emirates, China, Singapore, and the United Kingdom. The major import partners are China, Saudi Arabia, USA, Switzerland, and United Arab Emirates. The top goods exported to these major partners are: natural or cultured pearls, precious or semi-precious stones; mineral fuels, oils, and distillation products; ores, slag, and ash; apparel and clothing accessories, not knitted or crocheted; and machinery and mechanical appliances. The top goods imported to these major partners are: mineral fuels, oils, and distillation products; natural or cultured pearls, precious or semi-precious stones; machinery and mechanical appliances; electrical machinery and equipment; and organic chemicals. However, the EU as a bloc is also one of India's largest trading partners, and is India's largest source of foreign direct investment as well (European Commission).

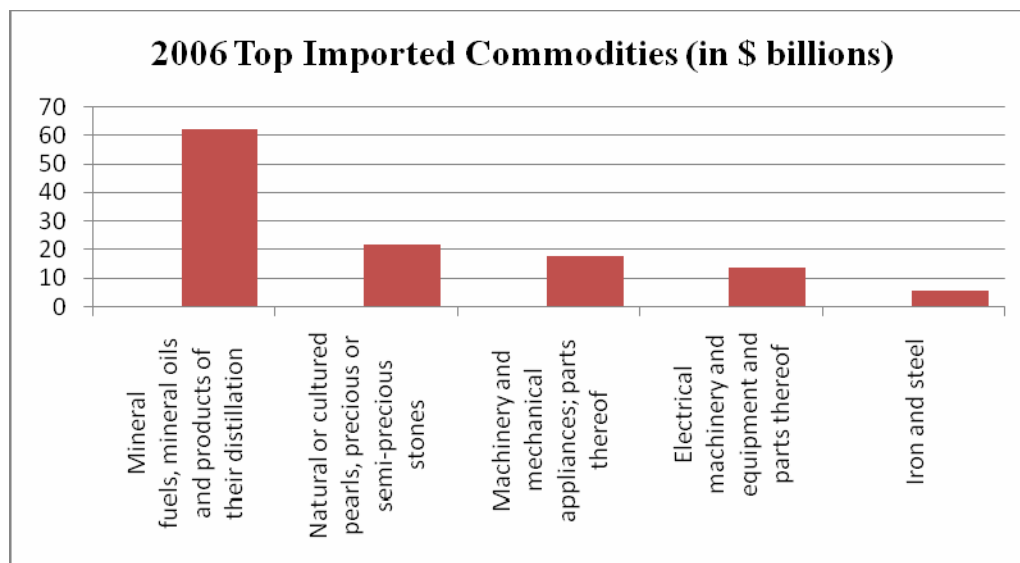
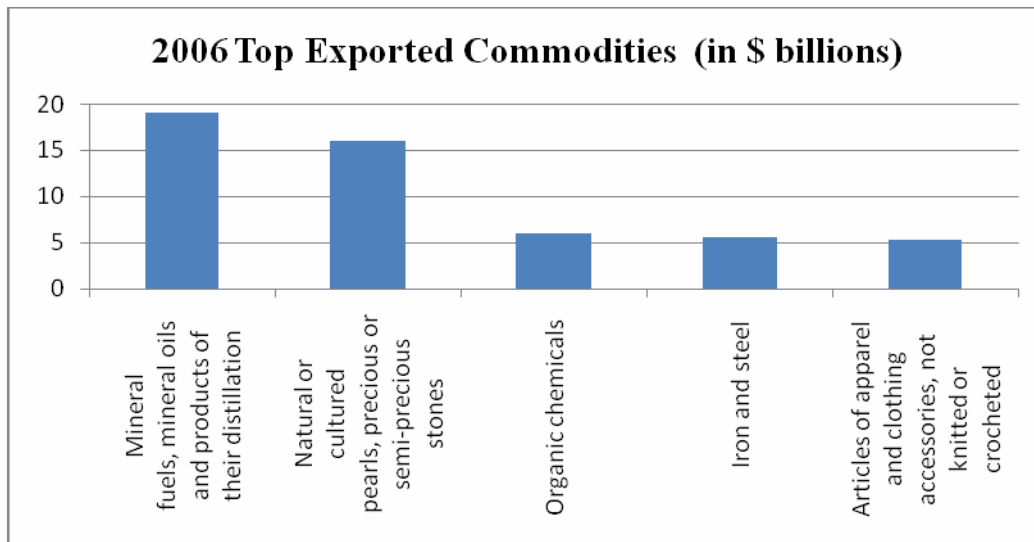


Source: Author's calculations, WDI Online

In the third quarter of 2007-08, India's current account deficit rose to \$5.4 billion due to the wide import-export gap, "despite a higher earnings surplus from software services, tourism, and remittances from abroad" (Rediff India Abroad). According to the Balance of Payment Data released by the Reserve Bank of India, "a sharp rise in trade deficit due to rise in imports caused the current account deficit to rise by \$1.7 billion from \$3.7 billion in the corresponding quarter last year" (Rediff India Abroad).

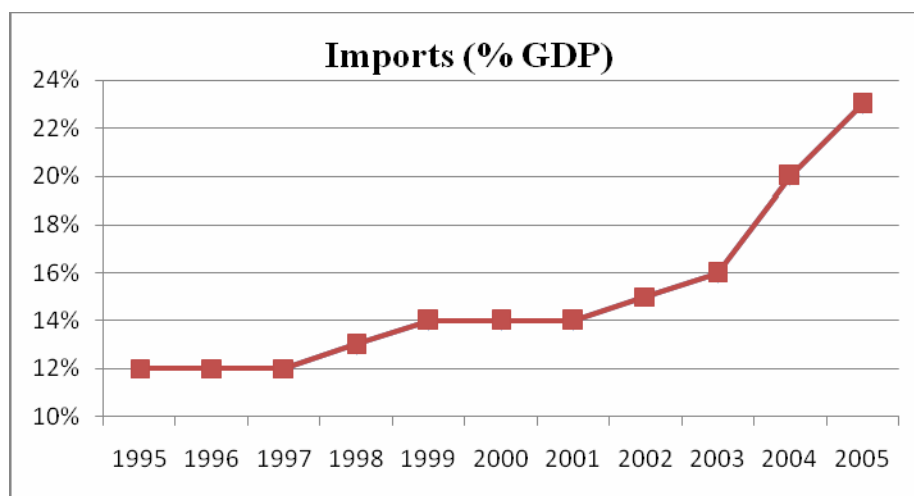
2.4 – Major export and import commodities

Mineral fuels, mineral oils and products of their distillation seem to constitute the majority of international trade in India, according to UN Comtrade. India's major export commodities are: mineral fuels, oils, and distillation products; natural or cultured pearls, precious or semi-precious stones; organic chemicals; iron and steel; and apparel and clothing accessories, not knitted or crocheted. Their major import commodities are: mineral fuels, oils, and distillation products; natural or cultured pearls, precious or semi-precious stones; machinery and mechanical appliances; electrical machinery and equipment; and iron and steel.



Source: Author's calculations, UN Comtrade

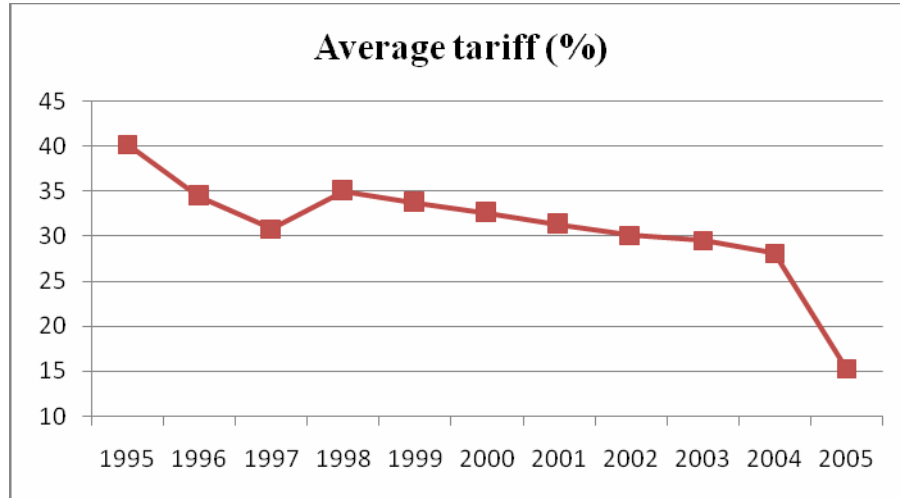
In the third quarter of 2007-08, import payments increased 41.4% “with growth in oil imports after international crude prices surged,” which widened the trade deficit to \$25.4 billion from \$16.5 billion (Rediff India Abroad). Due to remittances from overseas Indians and software services, “on a net basis, the invisibles account recorded a surplus of \$20 billion in Q3 against \$12.8 billion in the corresponding quarter last year” (Rediff India Abroad).



Source: Author's calculations, WDI Online

For the April-December period the Reserve Bank of India's Balance of Payment Data also showed that the current account witnessed a deficit of \$16 billion as compared to \$14 billion and the trade deficit widened to \$66.5 billion from \$50.3 billion a year ago. Also, "the merchandise exports recorded a growth of 34.9 per cent in Q3 of 2007-08 as compared with 20.9 per cent in the same quarter last year, led by engineering good, petroleum products, gems and jewelry, and ores and minerals" (Rediff India Abroad).

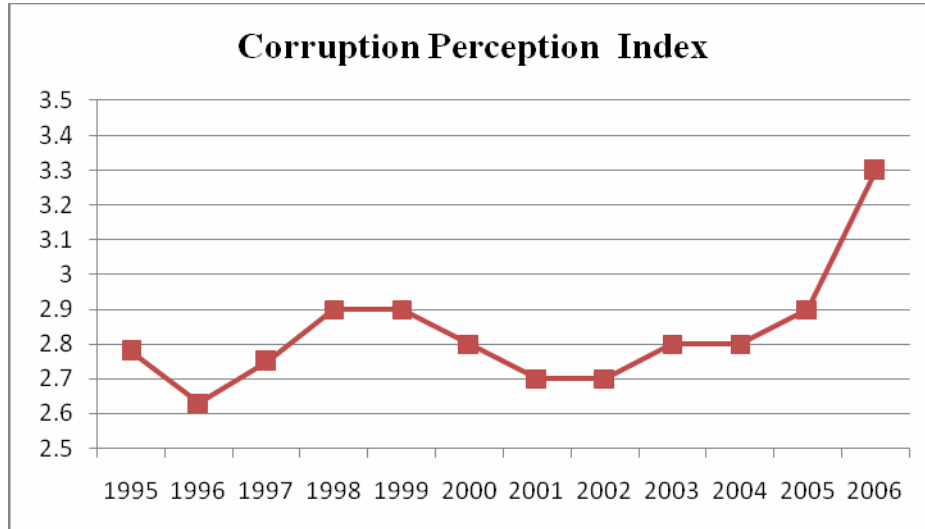
2.5 – Trade restrictions



Source: Author's calculations, UNCTAD

India has implemented a series of measures to increase exports by relaxing import duties and restrictions for several sectors of the economy. For example, the government eliminated duties on professional equipment for the services industry and on fuel for the manufacturing industry. “Restrictions on gold and silver imports by jewelers and by bullion traders were also eased” (Rai, The New York Times). The MFN tariff levy is applied to all WTO members and product specific, and tariff quota duties are set on imports of garments and tea from Sri Lanka. India also has preferential trade agreements with Bhutan, Burma, Egypt, Mauritius, Nepal, Seychelles, and Tonga. Goods that are prohibited from import include “items that damage the environment or wildlife, certain defense items, and goods threatening internal security, public order and various standards of decency and morality” (Trains, UNCTAD). The average applied tariff for MFN has fallen, however, tariffs for agriculture has risen, as well as for paper and printing, textiles and clothing, and food, beverages and tobacco (World Trade Organization). As mentioned earlier, India became a member of WTO on January 1st, 1995, and has liberalized its economic system and decreased trade barriers since its accession to the WTO.

2.6 – Institutional Development and Corruption



Source: Author's calculations, Transparency.org

India's administration tends to be inefficient due to the widespread corruption. In 2006, the Corruption Perception Index was reportedly 3.3 (Transparency.org). The CPI ranking system is designed such that countries that are the least corrupt are given the highest scores out of 10. According to a Congress estimate, "most development spending fails to reach its intended recipients" (Battling the babu raj, *The Economist*). Interfering politicians tend to be the root cause of this predicament. The main factors that seem to be responsible for the corruption in the Indian system include: "lack of transparency and accountability in the system; lack of an effective corruption reporting mechanism; lack of honesty in officials in the Government; acceptance of bribe as a way of life, custom and culture; ineffective judiciary; poor economic policies; and inadequate training and orientation of Government officials" (Transparency International India).

2.7 – Suggestions for improving trading practices

To continue advancing economically, India should reform the civil service. India's civil service, about 10 million, and the unreformed public sector are a huge barricade to a faster rate

of sustainable growth and to the dispersion of the benefits of a growing economy to the poor. The government's debt and infrastructure impede the economy from growing faster (What's holding India back, The Economist). According to the OECD, India must make some drastic reforms in order to continue growing, such as "reducing government meddling in the economy, labor-market reform and improving the infrastructure" (A Himalayan challenge, The Economist). India has one of the most restrictive employment-protection laws for collective dismissal. Thus, smaller firms endure lower productivity than big firms as they cannot obtain economies of scale or use the latest technology. Unprofitable companies remain in business as it is so difficult to lay off workers, and growth in manufacturing has consequently been weak. Also, "India has the second-highest government subsidies relative to GDP of all countries surveyed and the highest import tariffs" (A Himalayan challenge, The Economist). As a result, India must implement more relaxed labor and product-market regulations in order to experience higher labor productivity and to allow the economy to grow exponentially.

Section 3 - Conclusion

India has one of the riskiest economies due to the current-account deficits and relatively high consumer-price inflation. Because its budget deficit is large and inflation and credit growth are already high, if the economy weakens there is not much scope to ease monetary or fiscal policy. Various financial services, computer services, and manufacturing are some of the sectors open to foreigners, illustrating that India is overall as open as other emerging markets. However, there are still restrictions on foreign direct investment, especially in some of the fastest growing Indian industries, such as banking, telecoms, aviation, newspapers, and retailing. Also, "according to Chetan Ahya, an economist at Morgan Stanley, 85% of India's capital inflows this

year have been in the form of debt or portfolio investment, much of which has gone to the stockmarket” (Dizzy in Boomtown, The Economist). India still needs to obtain significant investment in manufacturing, and to do so, it must do more than simply adjust its policies limiting FDI. India needs to enhance its degenerating infrastructure, relax its labor laws and remove the various governmental policies that obstruct the growth of its companies.

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Appendix 1 - 1995 - 2006

India

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Real GDP/capita (constant 2000 US\$)¹	372	393	404	420	443	453	469	479	511	546	588	634
Real GDP/capita (current LCU)¹	16,437	17,344	17,808	18,552	19,540	19,990	20,694	21,135	22,569	24,101	25,969	27,967
Openness Index/Trade (% of GDP)¹	23%	22%	23%	24%	25%	27%	26%	30%	31%	38%	44%	..
Import (% of GDP)¹	12%	12%	12%	13%	14%	14%	14%	15%	16%	20%	23%	..
Export (% of GDP)¹	11%	11%	11%	11%	12%	13%	13%	14%	15%	18%	20%	..
Current account deficit (current account balance (% of GDP))¹	-2%	-2%	-1 %	-2 %	-1 %	-1 %	0 %	1%	1%
Corruption Perception Index²	2.78	2.63	2.75	2.9	2.9	2.8	2.7	2.7	2.8	2.8	2.9	3.3
Average tariff³	40.20%	34.40%	30.80%	35.00%	33.70%	32.60%	31.30%	30.10%	29.50%	28.10%	15.30%	..

¹WDI Online, 1995 - 2006, <<http://ddp-ext.worldbank.org.floyd.lib.umn.edu/ext/DDPQQ/report.do?method=showReport>>

²Transparency.org, 1995 - 2006, <http://transparency.org/regional_pages/asia_pacific/resources/surveys_and_indices>

³UNCTAD, 1995 - 2005, <http://www.unctad.org/en/docs/tdstat31ch4_enfr.pdf>

Appendix 2 - 2006

Major trading partners -Imports¹

China	\$17 B
Saudi Arabia	\$13 B
USA	\$11 B
Switzerland	\$9 B
United Arab Emirates	\$8 B

Top Imported Commodities¹

Mineral fuels, mineral oils and products of their distillation	\$62 B
Natural or cultured pearls, precious or semi-precious stones	\$22 B
Machinery and mechanical appliances; parts thereof	\$18 B
Electrical machinery and equipment and parts thereof	\$14 B
Iron and steel	\$6 B

Major trading partners - Exports¹

USA	\$19 B
United Arab Emirates	\$12 B
China	\$8 B
Singapore	\$6 B
United Kingdom	\$5 B

Top Exported Commodities¹

Mineral fuels, mineral oils and products of their distillation	\$19 B
Natural or cultured pearls, precious or semi-precious stones	\$16 B
Organic chemicals	\$6 B
Iron and steel	\$5.6 B
Articles of apparel and clothing accessories, not knitted or crocheted	\$5.3 B

¹UN Comtrade, 2006, <<http://comtrade.un.org/db/ce/ceSnapshot.aspx?r=699>>