CHAPTER 15

EXTERNAL SECTOR IN INDIA

*No country in today's globalised world can be fully insulated from what happens in the global economy and India is no exception to the rule. As the country is increasingly integrated into the world, it cannot remain impervious to developments abroad. The unfolding of the Euro zone crisis and uncertainty surrounding the global economy have impacted the Indian economy causing drop in growth, higher current account deficit and declining capital inflows.**

In This Chapter...

- Definition
- Forex Reserves
- External Debt
- Fixed Currency Regime
- Floating Currency Regime
- Managed Exchange Rates
- Foreign Exchange Market
- Exchange Rate in India
- Trade Balance
- Trade Policy
- Depreciation
- Devaluation
- Revaluation
- Appreciation
- Current Account
- Capital Account
- Balance of Payment (BoP)
- Convertibility

* As many documents of the WTO, World Bank and OECD have accepted many times.

- LERMS
- NEER
- REER
- EFF
- IMF Conditions on India
- Hard Currency
- Soft Currency
- Hot Currency
- Heated Currency
- Cheap Currency
- Dear Currency
- Special Economic Zone
- GAAR
- Risks in Foreign Currency Borrowings
- India's External Performance
- New Steps to Promote Trade
- Exchange Rate Monitoring
- RTAs by India
- New Foreign Trade Policy
- Trans-Pacific Partnership
- Transatlantic Trade and Investment Partnership
- Deglobalisation and India

DEFINITION

All economic activities of an economy which take place in foreign currency fall in the external sector such as export, import, foreign investment, external debt, current account, capital account, balance of payment, etc. (***definition***).[1]

FOREX RESERVES

The total foreign currencies (of different countries) an economy possesses at a point of time is its 'foreign currency assets/reserves'.[2] The Forex Reserves (short for 'foreign exchange reserves') of an economy is its 'foreign currency assets' added with its *gold reserves, SDRs* (Special Drawing Rights) and *Reserve Tranche* in the IMF.[3] In a sense, the Forex reserves is the upper limit upto which an economy can manage foreign currency in normal times if need be.

The latest position of India's forex reserves, as per the *Economic Survey 2017-18* is as given below:

- By *January 12, 2018* India's foreign exchange reserves was US$ 413.8 billion (10.7 per cent rise from end-March 2017). This included gold reserves of US$ 21 billion and Special Drawing Rights (SDRs) with the IMF (inclusive of Reserve Tranche) of US$ 13.1 billion.
- The *import cover* of India's foreign exchange reserves was 11.1 months at end-September 2017 as compared with 11.3 months at end-March 2017.
- Within the major economies running current account deficit, India is among the largest foreign exchange reserve holder (*sixth* largest in the world).

1. Based on J.E. Stiglitz and C.E. Walsh, ***Economics***, (New York: W.W. Norton and Company, 2006), pp. 757-58.
2. Based on P.A. Samuelson and W.D. Nordhaus, ***Economics,*** (New Delhi: Tata McGraw Hill, 2005), p. 604.
3. Ibid., pp. 605–07.

OPTIMUM FOREX – THE RIDDLE

In recent times, there has been a debate over India's optimum level of the forex reserves. The RBI is aware of the downside risks to the exchange rate, as is reflected by its action of buying the US dollar. Officially, the RBI *targets neither* a particular exchange rate nor foreign exchange reserves, and maintains such interventions by it to just *reduce volatility* in the forex market. But in the process of supporting weakening rupee, RBI needs to buy dollar, ultimately, leading to higher forex buid-ups. The Chief Economic Advisor of the Finance Ministry, however, clearly stated the kind of reserve accretion the government is looking at. Citing the example of China, the *Economic Survey 2014–15* said India could target foreign exchange reserves of US$750 billion to $1 trillion.

Today, China has *de facto* become one of the lenders of last resort to governments experiencing financial troubles. China, in its own heterodox and multiple ways, is assuming the roles of both an IMF and World Bank as a result of its reserves. The question for India, as a rising economic and political power, is whether it, too, should consider a substantial addition to its reserves.

While forex reserves act as insurance when the rupee tends to be volatile against the dollar, there are costs attached to it. When RBI purchases dollars in the spot, it leads to infusion of rupee into the system which leaves *inflationary* effect on the economy. Since the RBI does not want such actions to create inflationary pressure, so, it converts spot purchases into forwards. This way, it is a direct cost because of the forward premiums. If RBI opts for open market operations (OMOs) to mop up excess liquidity, that also involves costs.

RBI invests these dollars in instruments such as US treasuries, which offer *negligible* returns, owing to lower yields. But experts say these are unavoidable costs. The returns from rupee assets are much lower compared to returns from dollar assets. But RBI is not into investment management, it is there to maintain stability in the system.

In August 2014, RBI chief Raghuram Rajan agreed foreign exchange reserves came at a cost. India earns next to nothing for the foreign reserves it holds—actually, this way India finances another country when it has a significant financing needs. It is very difficult to state the level of reserves considered adequate by RBI. Though there are costs involved, the costs to benefit cannot be quantified by any model. Globally, there has been no study on the adequacy of reserves. In such an environment, RBI will have to go by experiences.

EXTERNAL DEBT

As India started managing its balance of payment in a more prudent way after the reform period, its external debt position has also improved in a big way. Major features (as per the *Economic Survey 2017-18*) of its external debt position during 2017-18 (March-September) are given below:

- By September 2017, India's total external debt was at US$ 495.7 billion (5.1 per cent higher to the position of March, 2017).
- Long-term debt share was 81.3 per cent (5 per cent increase) while the short-term debt was 18.7 per cent (5.4 per cent increase).
- Share of Government (sovereign) debt in total debt was 21.6 per cent (19.4 per cent increase).
- Forex cover to total external debt improved to 80.7 per cent (from 78.4 per cent).
- The ratio of short-term debt was 41.7 per cent (from 41.5 per cent). Having idea of this part of the external debt is useful in assessing liquidity requirements to service them (within a year).
- International comparison of external debt situation based on *World Bank* data shows that among the top 20 developing debtor countries in 2016, India's external debt stock to Gross National Income (GNI) ratio at 20.4 percent was the *second lowest* after China's 12.8 per cent. In terms of the foreign exchange reserves cover to external debt, India's position is the *fifth highest* and India's debt service rate is the eight lowest. As per the World Bank data, though India is the *third largest* debtor country among developing countries (after China and Brazil), India's share of short-term debt to total debt is only 18.6 per cent (by end-June, 2017) compared to 60.1 per cent for China (end-June, 2017).

FIXED CURRENCY REGIME[4]

A method of regulating exchange rates of world currencies brought by the IMF. In this system exchange rate of a particular currency was fixed by the IMF keeping the currency in front of a basket of important world currencies (they were UK£, US $, Japanese ¥, German Mark DM and the French Franc FFr). Different economies were supposed to maintain that particular exchange rate in future. Exchange rates of currencies were modified by the IMF from time to time.

FLOATING CURRENCY REGIME[5]

A method of regulating exchange rates of world currencies based on the market mechanism (i.e., demand and supply). In the follow up to the fixed currency system of exchange rate determination,

4. Ibid., pp. 610–11.
5. Ibid., pp. 611–15.

it was the UK which blamed the system for its payment crisis of late 1960s. Looking at the major loopholes in this system, the UK government decided to switch over to the floating currency regime in 1973—the same year the IMF allowed an option to its member countries to go for either of the currency systems.

In the floating exchange rate system, a domestic currency is left free to float against a number of foreign currencies in its foreign exchange market and determine its own value. Such exchange rates, are also called as *market driven* or *based* exchange rates, which are regulated by factors such as the demand and supply of the domestic and the foreign currencies in the concerned economy.

MANAGED EXCHANGE RATES

A managed-exchange-rate system is a hybrid or mixture of the fixed and flexible exchange rate systems in which the government of the economy attempts to affect the exchange rate ***directly*** by buying or selling foreign currencies or ***indirectly,*** through monetary policy[6] (i.e., by lowering or raising interest rates on foreign currency bank accounts, affecting foreign investment, etc.).

Today, most of the economies have shifted to this system of exchange rate determination. Almost all countries tend to intervene when the markets become ***disorderly*** or the ***fundamentals*** of economics are challenged by the exchange rate of the time. Some of the major examples of the managed exchange-rate system have been given below:[7]

(i) Some countries allow to ***free float*** their currencies and allow the market forces to determine their exchange rate with rare government intervention. This is the idea from which the ***floating currency regime*** basically emerged. The USA and the EU are the major examples in this category.

(ii) Some economies have ***managed but flexible*** exchange rates, under which the governments buy or sell its currency to reduce day-to-day volatility of currency fluctuations and sometimes go for systematic intervention for desired objectives. Canada and Japan fall in this category, besides many developing countries. India too falls under this category which follows the ***dual currency regime*** since 1992–93 financial year.[8]

(iii) Some economies, particularly small ones, peg their currencies to a major currency or to a ***basket*** of currency in a fixed exchange rate—known as the ***pegging of currencies.*** At times, the peg is allowed to glide smoothly upward or downward—a system which is known as ***gliding*** or ***crawling peg.*** Some economies have a ***hard fix*** of a ***currency board.*** A ***currency board*** is working well in Hong Kong while the same failed in Argentina in 2002.

FOREIGN EXCHANGE MARKET

The market where different currencies can be bought and sold is called the foreign exchange market.[9] Out of the trades in different currencies, the exchange rate of the currency is determined by the economy.[10] This is an institutional framework for the exchange of one national currency for another.[11] This is particularly correct either in the case of a free float exchange (i.e., floating currency) regime or is a managed or hybrid exchange rate

6. Ibid., p. 615.
7. The discussion is based primarily on Samuelson and Nordhaus, ***Economics,*** 613–15 and D. Salvatore, ***International Economics*** (New Jersey: John Wiley and Sons, 2004) pp. 717–22.
8. Ministry of Finance, ***LERMS, Union Budget 1992–93,*** (New Delhi: Government of India, 1992).
9. Stiglitz and Walsh, ***Economics,*** p. 757.
10. Samuelson and Nordhaus, ***Economics,*** p. 604
11. D. Salvatore, ***International Economics,*** p. 7.

system. It is altogether not allowed either in a ***fixed currency system*** or a ***hard fix*** (in a hard fix this happens once the currency to which the hard fix has been done itself starts fluctuating).

EXCHANGE RATE IN INDIA

Indian currency, the 'rupee', was historically linked with the British Pound Sterling till 1948 which was fixed as far back as 1928. Once the IMF came up, India shifted to the fixed currency system committed to maintain rupee's external value (i.e., exchange rate) in terms of gold or the US ($ Dollar). In 1948, Rs. 3.30 was fixed equivalent to US $ 1.

In September 1975, India delinked rupee from the British Pound and the RBI started determining rupee's exchange rate with respect to the exchange rate movements of the basket of world currencies (£, $, ¥, DM, Fr.). This was an arrangement between the fixed and the floating currency regimes.

In 1992–93 financial year, India moved to the floating currency regime with its own method which is known as the 'dual exchange rate'.[12] There are two exchange rates for rupee, one is the 'official rate' and the other is the 'market rate'. Here the point should be noted that it is the everyday's changing market-based exchange rate of rupee which affects the official exchange rate and not the other way round. But the RBI may intervene in the forex market via the demand and supply of rupee or the foreign currencies. Another point which should be kept in mind is that none of the economies have till date followed an ideal free-floating exchange rate. They require some mechanism to intervene in the foreign exchange market because this is a highly speculative market.

12. Ministry of Finance, ***LERMS.***

TRADE BALANCE

The monetary difference of the total export and import of an economy in one financial year is called trade balance. It might be positive or negative, known to be either favourable or unfavourable, respectively to the economy.

TRADE POLICY

Broadly speaking, the economic policy which regulates the export-import activities of any economy is known as the trade policy. It is also called the foreign trade policy or the Exim Policy. This policy needs regular modifications depending upon the economic policies of the economies of the world or the trading partners.[13]

DEPRECIATION

This term is used to mean two different things. In foreign exchange market, it is a situation when domestic currency loses its value in front of a foreign currency if it is market-driven. It means depreciation in a currency can only take place if the economy follows the floating exchange rate system.

In domestic economy, depreciation means an asset losing its value due to either its use, wear and tear or due to other economic reasons. Depreciation here means *wear and tear*. This is also known as ***capital consumption.*** Every economy has an official annual rates for different assets at which fixed assets are considered depreciating.

DEVALUATION

In the foreign exchange market when exchange rate of a domestic currency is cut down by its

13. D. Salvatore, ***International Economics,*** pp. 235–36.

government against any foreign currency, it is called devaluation. It means official depreciation is devaluation.

REVALUATION

A term used in foreign exchange market which means a government increasing the exchange rate of its currency against any foreign currency. It is official appreciation.

APPRECIATION

In foreign exchange market, if a free floating domestic currency increases its value against the value of a foreign currency, it is appreciation. In domestic economy, if a fixed asset has seen increase in its value it is also known as appreciation. Appreciation rates for different assets are not fixed by any government as they depend upon many factors which are unseen.

CURRENT ACCOUNT

It has two meanings—one is related to the banking sector and the other to the external sector:

(i) In the banking industry, a business firms bank account is known as current account. The account is in the name of a firm run by authorised person or persons in which no interest is paid by the bank on the deposits. Every withdrawal from the account takes place by cheques with limitations on the number of deposits and withdrawals in a single day. The *overdraft* facility or the *cash-cum-credit* (c/c Account) facility to business firms is offered by the banks on this account only.

(ii) In the external sector, it refers to the account maintained by every government of the world in which every kind of current transactions is shown—basically this account is maintained by the central banking body of the economy on behalf of the government. Current transactions of an economy in foreign currency all over the world are—export, import, interest payments, private remittances and transfers.

All transactions are shown as either inflow or outflow (credit or debit). At the end of the year, the current account might be positive or negative. The positive one is known as a surplus current account, and the negative one is known as a deficit current account. India had surplus current accounts for three consecutive years (2000–03)—the only such period in Indian economic history.

Current account deficit is shown either numerically by showing the total monetary amount of the deficit, or in percentage of the GDP of the economy for the concerned year. Both the data are used in analysis as per the specific requirement. As per a RBI release of April 2014, presently the sustainable level of current account deficit for India is 2.5 per cent of the GDP.

CAPITAL ACCOUNT

Every government of the world maintains a capital account, which shows the capital kind of transactions of the economy with outside economies. Every transaction in foreign currency (inflow or outflow) considered as capital is shown in this account—external lending and borrowing, foreign currency deposits of banks, external bonds issued by the Government of India, FDI, PIS and security market investment of the QFIs (Rupee is fully convertible in this case).

There is no deficit or surplus in this account like the current account .

BALANCE OF PAYMENT (BoP)

The outcome of the total transactions of an economy with the outside world in one year is known as the balance of payment (BoP) of the economy.[14] Basically, it is the net outcome of the current and capital accounts of an economy. It might be favourable or unfavourable for the economy. However, negativity of the BoP does not mean it is unfavourable. A negative BoP is unfavourable for an economy if only the economy lacks the means to fill the gap of negativity.

The BoP of an economy is calculated on the principles of accountancy (***double-entry book-keeping***)[15] and looks like the balance sheet of a company—every entry shown either as credit (inflow) or debit (outflow). If there is a positive outcome at the end of the year, the money is automatically transferred to the foreign exchange reserves of the economy. And if there is any negative outcome, the same foreign exchange is drawn from the country's forex reserves. If the forex reserves are not capable of fulfilling the negativity created by the BoP, it is known as a BoP crisis and the economy tries different means to solve the crisis in which going for forex help from the IMF is the last resort.

CONVERTIBILITY

An economy might allow its currency full or partial convertibility in the current and the capital accounts. If domestic currency is allowed to convert into foreign currency for all current account purposes, it is a case of full current account convertibility. Similarly, in cases of capital outflow, if the domestic currency is allowed to convert into foreign currency, it is a case of full capital account convertibility. If the situation is of partial convertibility, then the portion allowed by the government can be converted into foreign currency for current and capital purposes. It should always be kept in mind that the issue of currency convertibility is concerned with foreign currency *outflow* only.

CONVERTIBILITY IN INDIA

India's foreign exchange earning capacity was always poor and hence it had all possible provisions to check the foreign exchange outflow, be it for current purposes or capital purposes (remember the draconian FERA). But the process of economic reforms has changed the situation to unidentifiable levels.

CURRENT ACCOUNT

Current account is today fully convertible (operationalised on 19 August, 1994). It means that the full amount of the foreign exchange required by someone for current purposes will be made available to him at official exchange rate and there could be an unprohibited outflow of foreign exchange (earlier it was partially convertible). India was obliged to do so as per Article VIII of the IMF which prohibits any exchange restrictions on current international transactions (keep in mind that India was under pre-conditions of the IMF since 1991).

CAPITAL ACCOUNT

After the recomendations of the S.S. Tarapore Committee (1997) on Capital Account Convertibility, India has been moving in the direction of allowing full convertibility in this account, but with required precautions. India is still a country of partial convertibility (40:60) in the capital account, but inside this overall policy, enough reforms have been made and to certain levels of foreign exchange requirements, it is an economy allowing full capital account convertibility—

(i) Indian corporate are allowed full convertibility in the automatic route upto $ 500 million overseas ventures

14. Samuelson and Nordhaus, ***Economics,*** p. 601.
15. It means that each external transaction is recorded/ entered twice—once as a credit and once as a debit of an equal amount. This is because every transaction has two sides—we sell something and we receive payment for it, similarly we buy something and we have to pay for it (See Salvatore, ***International Economics,*** p. 432).

(investment by Ltd. companies in foreign countries allowed) per annum.

(ii) Indian corporate are allowed to prepay their external commercial borrowings (ECBs) via automatic route if the loan is above $ 500 million per annum.

(iii) Individuals are allowed to invest in foreign assets, shares, etc., upto the level of $ 2,50,000 per annum.

(iv) Unlimited amount of gold is allowed to be imported (this is equal to allowing full convertibility in capital account via current account route, but not feasible for everybody) which is not allowed now.

The Second Committee on the Capital Account Convertibility (CAC)—again chaired by S.S. Tarapore—handed over its report in September 2006 on which the RBI/the government is having consultations.

LERMS

India announced the Liberalised Exchange Rate Mechanism System (LERMS) in the Union Budget 1992–93 and in March 1993 it was operationalised. India delinked its currency from the fixed currency system and moved into the era of floating exchange-rate system under it.

Indian form of exchange rate is known as the 'dual exchange rate', one exchange rate of rupee is official and the other is market-driven.[16] The market-driven exchange rate shows the actual tendencies of the foreign currency demand and supply in the economy vis-á-vis the domestic currency. It is the market-driven exchange rate which affects the official rate and not the other way round.

16. Ministry of Finance, **LERMS**, **Union Budget 1992-93**, GoI, MoF, N. Delhi.

NEER

The Nominal Effective Exchange Rate (NEER) of the rupee is a weighted average of exchange rates before the currencies of India's major trading partners.

REER

When the weight of inflation is adjusted with the NEER, we get the Real Effective Exchange Rate (REER) of the rupee. Since inflation has been on the higher side in recent months, the REER of the rupee has been more against it than the NEER.

EFF

The Extended fund Facility (EFF) is a service provided by the IMF to its member countries which authorises them to raise any amount of foreign exchange from it to fulfil their BoP crisis, but on the conditions of structural reforms in the economy put by the body. It is the first agreement of its kind. India had signed this agreement with the IMF in the financial year 1981–82.

IMF CONDITIONS ON INDIA

The BoP crisis of the early 1990s made India borrow from the IMF which came on some conditions. The medium term loan to India was given for the restructuring of the economy on the following conditions:

(i) Devaluation of rupee by 22 per cent (done in two consecutive fortnights—rupee fell from '21 to '27 against every US Dollar).

(ii) Drastic custom cut to a peak duty of 30 per cent from the erstwhile level of 130 per cent for all goods.

(iii) Excise duty to be increased by 20 per cent to neutralise the loss of revenue due to custom cut.

(iv) Government expenditure to be cut by 10 per cent per annum (the burden of salaries, pensions, subsidies, etc.).

The above-given conditions to which India was obliged were vehemently opposed by the Indian corporate sector, opposition in the Parliament and majority of Indians. But by the end of 1999–2000, when India saw every logic in strengthening its BoP position there was no ideological opposition to the idea. It should always be kept in mind that the nature of structural reforms India went through were guided and decided by these pre-conditions of the IMF.

This is how the direction of structural reforms of an economy are regulated by the IMF in the process of strengthening the BoP position of the crisis-driven economy. The purpose has been served in the Indian case. India has not only fulfilled these conditions but it has also moved ahead.

HARD CURRENCY

It is the international currency in which the highest faith is shown and is needed by every economy. The strongest currency of the world is one which has a high level of liquidity. Basically, the economy with the highest as well as highly diversified exports that are compulsive imports for other countries (as of high-level technology, defence products, life saving medicines and petroleum products) will also create high demand for its currency in the world and become the hard currency. It is always scarce.

Upto the second world war, the best hard currency was the Pound Sterling (£) of the UK, but soon it was replaced by the US Dollar. Some of the best hard currencies of the world today are the US Dollar, the Euro(€), Japanese Yen (¥) and the UK Sterling Pound (£). Meanwhile, by late 2015, the IMF allowed the SDR to be denominated in the chinese 'Yaan'–paving the way for a new hard currency to be implemented in 2016.

SOFT CURRENCY

A term used in the foreign exchange market which denotes the currency that is easily available in any economy in its forex market. For example, rupee is a soft currency in the Indian forex market. It is basically the opposite term for the hard currency.

HOT CURRENCY

Hot currency is a term of the forex market and is a temporary name for any hard currency. Due to certain reasons, if a hard currency is exiting an economy at a fast pace for the time, the *hard* currency is known to be *hot*. As in the case of the SE Asian crisis, the US dollar had become hot.

HEATED CURRENCY

A term used in the forex market to denote the domestic currency which is under enough pressure (heat) of depreciation due to a hard currency's high tendency of exiting the economy (since it has become hot). It is also known as *currency under heat* or *under hammering.*

CHEAP CURRENCY

A term first used by the economist J. M. Keynes (1930s). If a government starts re-purchasing its bonds before their maturities (at full-maturity prices) the money which flows into the economy is known as the cheap currency, also called cheap money.

In the banking industry, it means a period of comparatively lower/softer interest rates regime.

DEAR CURRENCY

This term was popularised by economists in early 1930s to show the opposite of the cheap currency. when a goverment issues bonds, the money which flows from the public to the government or the money in the economy in general is called dear currency, also called as *dear money.*

In the banking industry, it means a period of comparatively higher/costlier interest rates regime.

SPECIAL ECONOMIC ZONE

The special economic zone (SEZ) policy was announced by the government in 2000 which was concretised through the SEZ Act, 2005. It mainly aims to develop 'export hubs' in the country to promote growth and development. As an idea it was not new—India had set up *Asia's first* 'export processing zone' (EPZ) in Kandla in 1965 itself. Later on the idea got another encouragement through the 'export oriented units' (EOUs). After the SEZ policy was formalised through an Act, the EOUs and EPZs are open to conversion to SEZ. The SEZs can be set up by either the GoI, States or even private sector—in all three sectors of the economy—agriculture, industry and services. As per the Ministry of Commerce and Industry, the principal objectives behind creating SEZs in the country include:

(i) generation of additional economic activity;
(ii) promotion of exports of goods and services;
(iii) promotion of investment from domestic and foreign sources;
(iv) creation of employment opportunities; and
(v) development of infrastructure facilities .

Recent steps (till ***March 2017***) taken by the Government to strengthen SEZs in the country are as given below[17]:

- Minimum Land Area requirement for setting up of new SEZs has been reduced to 50 per cent for multi-product and sector-specific SEZs.
- Sectoral broad-banding has been introduced to encompass similar and related areas under the same sector.
- A new sector 'agro-based food processing' sector has been introduced to encourage agro-based industries in SEZs (food processing getting government's nod by late 2016 for 100 per cent FDI by is expected to give a big push to it).
- Dual use of facilities like Social and Commercial infrastructure by SEZs and non-SEZs entities has been allowed in order to make SEZ operations more viable.
- Online processing of various activities relating to SEZ for improving 'ease of doing business'.
- 'SEZ India' mobile app launched to help the SEZs to track their transactions on SEZ Online System (launched in *January 2017*).

By ***March 2017***, the Government had approved 405 proposals for setting up SEZs (in addition to 7 SEZs of the GoI and 11 of States/ private sector which were set-up prior to the enactment of the SEZs Act, 2005)—out of which 206 SEZs are operational. Today, the SEZs are invested with Rs. 4.06 lakh crore and have created 16.88 lakh employment. They have 23 per cent share in India's total exports.

In recent times, the SEZs have lost their original synergy due to global economic slowdown which followed the great recession among the developed economies. Meanwhile, the Government has been taking various steps to encourage them.

GAAR

The GAAR (General Anti-Avoidance Rules), originally proposed in the *Direct Taxes Code 2010*, are targeted at arrangements or transactions made specifically to avoid taxes. The government had

17. **Ministry of Commerce and Industry**, Government of India, N. Delhi, March 2017.

decided to advance the introduction of GAAR and implement it from the financial year 2013–14 itself. More than 30 countries have introduced GAAR provisions in their respective tax codes to check such tax evasion.

The ***objective*** of the GAAR provisions is to codify the doctrine of *'substance over form'* where the real intention of the parties and purpose of an arrangement is taken into account for determining the tax consequences, irrespective of the legal structure of the concerned transaction or arrangement. It essentially comes into effect where an arrangement is entered into with the main purpose or one of the main purposes of obtaining a *tax benefit* and which also satisfies at least one of the following *four tests*:

(i) The arrangement creates rights and obligations that are not at arm's length,

(ii) it results in misuse or abuse of provisions of tax laws,

(iii) lacks commercial substance or is deemed to lack commercial substance, or

(iv) it is not carried out in a bona fide manner.

Thus, if the tax officer believes that the main purpose or one of the main purposes of an arrangement is to obtain a tax benefit and even if one of the above *four tests* are satisfied, the tax officer has powers to declare it as an impermissible avoidance arrangement and re-characterise the entire transaction in a manner that is more conducive to maximising tax revenues. There are many troubling aspects of this provision that will make doing business in India even more ***challenging***, than what it already is from a tax perspective—

(i) It is presumed that obtaining tax benefit is the main purpose of the arrangement unless otherwise proved by the taxpayer. This is an onerous burden that under a fair rule of law should be discharged by the revenue collector and not the taxpayer. In fact, the *Parliamentary Standing Committee on DTC* has specifically recommended that the onus of proving the existence of a tax-avoidance motive and a transaction lacking commercial substance, should rest with the revenue invoking GAAR and not shifted to the taxpayer. This is essentially to ensure that the revenue authorities exercise proper discretion, proper application of mind and gather enough credible data and evidence before attempting to invoke far-reaching provisions such as GAAR.

(ii) An arrangement will be deemed to lack commercial substance under GAAR if it involves the location of an asset or of a transaction or of the place of residence of any party that would not have been so located for any substantial commercial purpose other than obtaining tax benefit. This again is an amazingly wide provision that provides a great weapon in the armoury of the tax authorities to challenge almost every inbound or outbound transaction with respect to India, made through any of the favourable tax treaties that India has entered into. The governments intention becomes clear visibly by one of the finance ministry replies to the *Standing Committee on DTC*, where it has made it clear that the GAAR provisions will check *treaty shopping* by the taxpayer for avoidance of payment of tax in India.

(iii) GAAR allows tax authorities to call a business arrangement or a transaction 'impermissible avoidance arrangement' if they feel it has been primarily entered into to avoid taxes. Once an arrangement is ruled 'impermissible' then the tax authorities can deny tax benefits. Most aggressive tax avoidance arrangements would be under the risk of being termed impermissible. It has a provision according to which the onus to prove that an arrangement is 'impermissible' will lie with the tax department. The GAAR panel, the final body that will decide on the applicability of the law, will include an independent member. The rule can apply on domestic as well as overseas transactions.

(iv) GAAR is a very broadbased provision and can easily be applied to most tax-saving arrangements. Many experts feel that the provision would give unbridled powers to tax officers, allowing them to question any taxsaving deal. Foreign institutional investors are worried that their investments routed through Mauritius could be denied tax benefits enjoyed by them under the Indo-Mauritius Tax Treaty. The proposal *(announced on 8 May, 2012)* had spooked stock market as FII inflows dropped on concerns, and the rupee hit a low of Rs. 53.47 to the Dollar.

As per the decision taken last year, the Government in ***February 2017*** announced to enforce the GAAR from the financial year 2017-18. All consultations with the stakeholders have been completed and the regulatory framework for it is expected to be announced by late March 2017.

RISKS IN FOREIGN CURRENCY BORROWINGS

Corporate borrowers in India and other emerging economies are keen to borrow in foreign currency to benefit from lower interest and longer terms of credit. Such borrowings however, are not always helpful, especially in times of high currency volatility. During good times, domestic borrowers could enjoy triple benefits of

(i) lower interest rates,

(ii) longer maturity, and

(iii) capital gains

due to domestic currency appreciation. This would happen when the local currency is appreciating due to surge in capital flows and the debt service liability is falling in domestic currency terms. The opposite would happen when the domestic currency is depreciating due to reversal of capital flows during crisis situations, *as happened during the 2008 global crisis*.

A sharp depreciation in local currency would mean corresponding *increase in debt service liability*, as more domestic currency would be required to buy the same amount of foreign exchange for debt service payments. This would lead to ***erosion in profit*** margin and have 'mark-to-market' implications for the corporate. There would also be 'debt overhang' problem, as the volume of debt would rise in local currency terms. Together, these factors could create corporate distress, especially because the rupee tends to depreciate precisely when the Indian economy is also under stress, and corporate revenues and margins are under pressure.

In this context, it is felt that one of the factors contributing to faster recovery of the Indian economy after the 2008 global crisis was the low level of corporate external debt. As a result, the significant decline in the value of rupee did not have a major fallout for the corporate balance-sheets. Foreign currency borrowings, therefore, have to be contracted carefully, especially when no 'natural hedge' is available. Such natural hedge would happen when a foreign currency borrower also has an export market for its products. As a result, export receivables would offset, at least to some extent, the currency risk inherent in debt service payments. This happens because fall in the value of the rupee that leads to higher debt service payments is partly compensated by the increase in the value of rupee receivables through exports.

When export receivables and the currency of borrowings is different, the *prudent approach* is for corporations to enter *currency swaps* to re-denominate asset and liability in the same currency to create natural hedge. Unfortunately, too many Indian corporations with little foreign currency earnings leave foreign currency borrowings unhedged, so as to profit from low international interest rates. This is a dangerous gamble for reasons described above and should be avoided.

INDIA'S EXTERNAL PERFORMANCE

India's external sector has a mixed performance in the fiscal 2017-18 (April-September). Major trends in it are being briefly discussed below[18]:

TRADE SCENARIO

India's export growth (non-fuel) which has generally been higher than world export growth (non-fuel) moved to negative territory in 2014 and was lower or in tandem with world export growth (non-fuel) since then. Other BRICS countries also show similar trends. India's exports since August 2017 again picked up and increased sharply in November 2017 in tandem with the sharp increase in export value growth. However, in December the growth rate of export volume and value index decelerated. Non-oil export volume index followed a similar trend. Major features have been as given below:

- India's merchandise ***imports*** grew by 22.1 per cent against 11.3 per cent increase in its exports. Higher import growth owed to POL (Petroleum, Oli and Lubricants) import growth at 17.8 per cent and gold and silver import growth.
- India's merchandise ***exports*** reached the level of US$ 314.4 billion in 2013-14. Following the global trend of decline in export growth, India's exports also declined during 2014-15 and 2015-16, by 1.3 per cent and 15.5 per cent respectively.
- India's export growth continued to be negative in the first half of 2016-17 at -1.3 per cent. However, in the second half of 2016-17 (recovering by 5.2 per cent). In 2017-18 (April-December) export growth picked up further to 12.1 per cent.
- India's ***trade deficit*** (on custom basis) which had registered continuous decline since 2014-15, widened to US$ 74.5 billion (from US$ 43.4 billion in 2016-17). In 2017-18 (April-December) trade deficit (on customs basis) shot up by 46.4 per cent to US$ 114.9 billion with POL deficit growing by 27.4 per cent and non-POL deficit by 65.0 per cent.

TRADING PARTNERS

India's trade with its major trading partners has been going through a process of restructuring in recent years. Major features related to this are given below:

- Among India's ***trading partners***, the top five countries with which India has *negative* bilateral trade balance are China, Switzerland, Saudi Arabia, Iraq and South Korea while the top five countries with which it has surplus trade balance are USA, UAE, Bangladesh, Nepal and UK.
- India has the *highest trade deficit* with China. Its share in India's total trade deficit increased from 20.3 per cent in 2012-13 to 47.1 per cent in 2016-17 and 43.2 per cent in 2017-18. India's major items of *imports from China* are telephone sets including mobiles, automatic data processing machines, diodes and other semi-conductor devices, electronic devices, chemical fertilisers, etc. India's major items of *exports to China* are

18. **Economic Survey 2017-18,** Vol. 2, Ministry of Finance, GoI, N. Delhi, pp. 82-88.

cotton yarn, copper, refined and copper alloys unwrought, PoL items, granite, aluminium ores, other fixed vegetable fats and oils, cyclic hydrocarbons, cotton, polymers and iron ore.

In the case of Switzerland, the *trade deficit* is mainly due to import of gold. This deficit has fallen in the last two years (2016-17 and 2017-18). Moreover, a part of it is used in exports. In the case of Saudi Arabia and Iraq, the deficit is due to crude oil imports, while for South Korea it is due to import of electrical machinery and equipment and iron and steel.

INVISIBLES

According to the *World Bank*, (October, 2017), the number of Indian workers emigrating to Saudi Arabia (India's *third* largest remittance sender) dropped from 3.0 lakhs in 2015 to 1.6 lakh in 2016; and to the United Arab Emirates (India's largest inward remittance contributor) from 2.2 lakh in 2015 to 1.6 lakh in 2016. Total Indian workers outflow fell from 7.8 lakh in 2015 to 5.1 lakh in 2016. Among the structural factors, tightening norms of hiring foreign workers in USA, labour market adjustment in GCC countries and rising anti-immigration sentiments in many source countries pose considerable downside risk. Major features are as given below:

- Notwithstanding uncertainties in the Indian IT industry from tougher *visa policies* in some countries, software exports recorded a growth of 2.3 per cent in 2017-18. Private transfer receipts, mainly representing *remittances* by Indians employed overseas, increased by 10.0 per cent to US$ 33.5 billion in 2017-18 over the corresponding period of the previous year (April- September).
- India has remained one of the major recipients of cross border ***remittances*** and according to the World Bank (October 2017), India will remain a top remittance recipient country in 2017, followed by China, the Philippines, and Mexico. However, the private transfers (gross) inflows to India declined by 6.1 per cent in 2015-16 and 6.5 per cent in 2016-17. This was due to constrained labour market conditions in the source countries, particularly GCC (Gulf Cooperation Council) countries, largely caused by the fall in international crude oil prices. Gross private transfer inflows fell to US$ 65.6 billion and US$ 61.3 billion in 2015-16 and 2016-17 respectively from US$ 69.8 billion in 2014-15.

COMPOSITION OF TRADE

Export growth in 2016-17 was fairly broad based with positive growth in major categories except textiles and allied products, and leather and leather manufactures. In 2017-18 (April-November) among the major sectors, there was good export growth in engineering goods and Petroleum crude and products; moderate growth in chemicals and related products, and textiles and allied products; but negative growth in gems and jewellery. Other features have been as given below:

- Import of Petroleum, Oil and Lubricants (POL) increased by 4.8 per cent in 2016-17 and 24.2 per cent in 2017-18 (Apr-December), mainly due to an *increase in international crude oil price* (Indian Basket) from US$ 46.2 /bbl in 2015-16 to US$ 47.6 /bbl in 2016-17 and to US$ 53.6 /bbl in 2017-18 (April-December).
- Among the other important import items, low or negative growth was registered in most of them in 2016-17, except electronic goods; ores and minerals and agriculture and allied products.
- Capital goods imports grew marginally, though the transport equipment sub-

category registered high growth. In 2017-18 (April- November) all major sectors registered positive growth with the capital goods imports, which are needed for industrial activity, registering a 11.3 per cent growth.

As per the ***Economic Survey 2017-18***, the prospects for India's external sector look bright with world trade projected to grow at 4.2 per cent and 4 per cent in 2017 and 2018 respectively (from 2.4 percent in 2016); trade of major partner countries improving and above all India's export growth also picking up. The *downside risks* lie in the rise in oil prices. However, this could also lead to higher inflow of remittances which have started picking up. The supportive policies like GST, logistics and trade facilitation policies of the government could help further in the years to come.

NEW STEPS TO PROMOTE TRADE

Several new initiatives were taken by the GoI, in recent times, to facilitate trade. These new steps (up to **March 2018**) were aimed at adopting internationally benchmarked best practices—major ones of them are as given below:

(i) *e-Filing and e-Payment:* Applications for various trade services can be filed online and application fees paid through electronic transfer. The number of mandatory documents required for exports and imports has also been cut down to just *three* each (which is comparable with international benchmarks).

(ii) *Single window for Customs:* Under this project, that importers and exporters electronically submit their *customs clearance* documents at a single point with customs. Permissions required from other regulatory agencies (such as animal quarantine, plant quarantine, drug controller and textile committee) could be obtained online without the having to separately approach these agencies.

The single window is aimed at providing importers/exporters a single point interface for customs clearance, thereby reducing personal interface with governmental agencies, dwell time and cost of doing business.

(iii) *24x7 customs clearance:* The facility of '24x7 customs clearance' has been made available at 18 seaports and 17 air cargo complexes. This move is aimed at faster clearance of import and export, reducing dwell time and lowering the transaction cost.

(iv) *Paperless environment:* The government aims to move towards a paperless 24x7 working trade environment. A new facility has been created to upload documents in exporter/importer profile so that exporters are not required to submit documents repeatedly.

(v) *Simplification:* Attention has also been paid to simplifying various *'aayat niryat'* forms, bringing in clarity in different provisions, removing ambiguities and enhancing electronic governance. A mobile application also launched by the DGFT (Director General of Foreign Trade) in October 2016.

(vi) *Training/Outreach:* 'Niryat Bandhu Scheme', a training/outreach programme is aimed at Skill India—organised at MSME (micro, small and medium enterprises) clusters with the help of export promotion councils (EPCs) and other willing 'industry partners' and 'knowledge partners'. The DGFT in collaboration with the IIFT (Indian Institute of Foreign Trade) has launched 'Niryat Bandhu at Your Desktop', an online certificate programme in export-import business. Another training programme has been launched by the Department of Commerce (DoC) for exporters located in the major export clusters/cities. It focuses on training exporters to utilize free trade agreements (FTA).

(vii) *Participation of States/UTs:* In July 2015, a Council for Trade Development and Promotion (CTDP) was set up to ensure continuous dialogue with the governments of states/ union territories (UTs) on measures for providing an international trade-enabling environment and for making them active partners in boosting India's exports.

(viii) Once 90 per cent of the FDI inflows are now under 'automatic route' together with fully converted to 'online' procedure, the Government decided in the ***Union Budget 2017-18*** to phase out (abolish) the multi-ministerial body foreign investment promotion board (FIPB) in the year. In future, the FDI proposals not coming under the automatic route will be considered by either the concerned ministries or the regulatory body.

(ix) The ***Union Budget 2017-18*** promised *further liberalisation* of the FDI policy regarding which the announcements came later on.

The Government of India has requested the state/UTs to develop their export strategy, appoint export commissioners, address infrastructure constraints restricting movement of goods, facilitate refund of value-added tax (VAT)/octroi/ state-level cess, address other issues relating to various clearances and build capacity of new exporters in order to promote exports.

EXCHANGE RATE MONITORING

Indian currency has seen frequent exchange rate volatility in recent times. External variables have been changing more frequently than any time in past. This forces India to closely monitor the exchange rate dynamics of the world, its major trade partners and the emerging competitors in its export market. India needs to *rethink its exchange rate policy outlook* and go for a shift in it—this becomes even more clear by considering the following points[19]:

(i) International trading opportunities are becoming scarcer in the aftermath of three major events—global financial crisis, the eurozone crisis and the stock market meltdown of China (2015). The world 'export-GDP ratio' has declined since 2011. Going forward a sharp rise in the US dollar is expected with a corresponding decline in the currencies of India's competitors, notably China and Vietnam. Already, since July 2015, the yuan has depreciated about 11.6 per cent (form July 2015 to December 2016) against the dollar and as a consequence the rupee has appreciated by 6 per cent against the yuan. Given the situation there has been a continuous pressure of capital outflows on India.

(ii) To sustain high growth rate, India needs support of exports in the coming times. And this is only possible once rupee's exchange rate is able to maintains the competitive edge over its competitors in the export market. The rise of countries such as Vietnam, Bangladesh, and the

19. **Economic Survey 2016-17**, Government of India, Ministry of Finance, N. Delhi, Vol. 1, pp. 23-25.

Philippines is a new matter of concern which compete with India across a range of manufacturing and services.

(iii) India's present exchange rate management policy gives unusually high weight to UAE (due to high oil imports and a trans-shipment point for India's exports). But this trade has almost nothing to do with India's export competitiveness. The policy currently considers overall trade in place of the sectoral situations and their relations with the exchange rate. Due to this India gives heavy weight to euro, even though it is really Asian countries which are India's main competitors (not Europe).

(iv) Ever since the developed countries came under the grip Great Recession, we have seen 'unconventional monetary policy' being pushed by most of them—with effective interest rates running in negatives, too. While the central banks in the west have been aiming to push up inflation and growth through it, RBI has been balancing them (till *March 2017*). Given the situation, it looks advisable for the RBI (through 'Monetary Policy Committee') to recalibrate its monetary policy outlook.

RTAs BY INDIA

In general, multilateral trade agreements are the first best solutions for deepening global trade and development as they are founded on the core principles of non-discrimination. Meanwhile, RTAs (Regional Trade Agreements) are efforts by nations aimed at deepening economic relations, usually with neighbouring countries, and tend to be *largely political* in nature. With the multilateral trade negotiations process under the WTO being a painfully slow one requiring broad-based consensus, RTAs have progressively assumed greater importance and a growing share in international trade.

While RTAs are broadly *compliant* with WTO mandates and remain broadly *supportive* of the WTO process, they remain ***second-best*** solutions that are discriminatory in nature against non-members and are inefficient as low cost producing non-members lose out to members. While bilateral RTAs have no equity considerations, mega-regional trading groups may not necessarily be equitable if membership is diverse and small countries may lose out either way—if they are part of it they may not have much say and if they are not, they may stand to lose.

India has always stood for an open, equitable, predictable, non-discriminatory and rule-based international trading system and views RTAs as building blocks in the overall objective of trade liberalization as well as complementing the multilateral trading system under the WTO.

By **March 2017**, India had signed 12 FTAs (Free Trade Agreements) and 6 PTAs (Preferential Trade Agreements) and all of these were in force. The *net impact* of the RTAs on export performance and trade outcome is a mixed bag and requires detailed analysis. India follows a gradual approach of widening the process of negotiating the FTAs. Presently, negotiations on ***24 FTAs*** (including review) is under way:[20]

India-Thailand Comprehensive Economic Cooperation Agreement (CECA): Early Harvest Scheme has been implemented on 82 items. So far 29 rounds of India-Thailand Trade Negotiation Committee (ITTNC) meetings have been held. The 29th round was held in Bangkok in June 2015.

India- New Zealand FTA/CECA: Ten rounds of negotiation have been held so far. The 10th Round was held in Delhi by February 2015.

20. Ministry of Commerce and Industry, Government of India, N. Delhi, March 2017.

India--SACU (South Africa, Botswana, Lesotho, Swaziland and Namibia) PTA: Five rounds of negotiations have been held so far. The Ninth Joint Ministerial Commission (JMC) meeting was held at Durban in March 2015.

BIMSTEC (Bangladesh, India, Myanmar, Sri Lanka, Thailand, Bhutan and Nepal) FTA: Twenty meetings of the Trade Negotiating Committee (TNC) have taken place. The 20th meeting was held in September 2015 in Khon Kaen Province, Thailand.

India-Canada FTA: Nine rounds of negotiation on the India-Canada Comprehensive Economic Partnership Agreement (CEPA) have so far been held. The ninth round was held in Ottawa, Canada by March 2015.

India--Australia CECA: Nine rounds of negotiations have been held so far. The ninth round was held between by September 2015 in Delhi.

Regional Comprehensive Economic Partnership (RCEP) Agreement among ASEAN + Six FTA Partners (Australia, China, India, Japan, South Korea and New Zealand): Based on the Declaration of the Leaders during the ASEAN Summit in November 2012, negotiations for a comprehensive economic partnership between the 10 ASEAN member states and its six FTA partners commenced in May 2013. Fourteen rounds of negotiations have so far been held.

NEW FOREIGN TRADE POLICY

The GoI announced the new Foreign Trade Policy 2015–20 on April 1, 2015. The new five year Foreign Trade Policy, 2015–20 provides a framework for increasing exports of goods and services as well as generation of employment and increasing value addition in the country, in keeping with the Make in India. The focus of the new policy is to support both the manufacturing and services sectors, with a special emphasis on improving the 'ease of doing business'. The special features of the FTP 2015–20 are as follows:

(i). Two new schemes have been intorduced, namely—
   (a) Merchandise Exports from India Scheme (MEIS) for export of specified goods to specified markets.
   (b) Services Exports from India Scheme (SEIS) for increasing exports of notified services, in place of a plethora of schemes earlier, with different conditions for eligibility and usage.

   There would be no conditionality attached to any scrips issued under these schemes. Duty credit scrips issued under MEIS and SEIS and the goods imported against these scrips are fully transferable. For grant of rewards under MEIS, the countries have been categorized into 3 Groups, whereas the rates of rewards under MEIS range from 2 per cent to 5 per cent. Under SEIS the selected Services would be rewarded at the rates of 3 per cent and 5 per cent.

(ii) Measures have been adopted to nudge procurement of capital goods from indigenous manufacturers under the EPCG scheme by reducing specific export obligation to 75 per cent of the normal export obligation. This will promote the domestic capital goods manufacturing industry. Such flexibilities will help exporters to develop their productive capacities for both local and global consumption.

(iii) Measures have been taken to give a boost to exports of defense and hi-tech items. At the same time *e-Commerce* exports of handloom products, books/periodicals, leather footwear, toys and customized fashion garments through courier or foreign post office would also be able to get benefit of MEIS (for values upto INR 25,000). These measures would not only capitalize on India's strength in these areas and increase exports but also provide employment.

(iv) In order to give a boost to exports from SEZs, government has now decided to extend benefits of both the reward schemes (MEIS and SEIS) to units located in SEZs. It is hoped that this measure will give a new impetus to development and growth of SEZs in the country.

(v) Trade facilitation and enhancing the *ease of doing business* are the other major focus areas—

(a) One of the major objective of new FTP is to move towards paperless working in 24×7 environment.

(b) The government has reduced the number of mandatory documents required for exports and imports to three, which is comparable with international benchmarks.

(c) A facility has been created to upload documents in exporter/importer profile and the exporters will not be required to submit documents repeatedly.

(d) Attention has also been paid to simplify various *Aayat Niryat Forms*, bringing in clarity in different provisions, removing ambiguities and enhancing electronic governance.

(e) Approved Exporter System (AES) has been launched to enable manufacturers to self-certify their manufactured goods originating from India with a view to qualifying for preferential treatment under various forms of bilateral and regional trade agreements This will help these manufacturer exporters considerably in getting fast access to international markets.

(vi) A number of steps have been taken for encouraging manufacturing and exports under 100 per cent schemes. The steps include a fast track clearance facility for these units, permitting them to share infrastructure facilities, permitting inter unit transfer of goods and services, permitting them to set up warehouses near the port of export and to use duty free equipment for training purposes.

(vii) Considering the strategic significance of *small and medium scale enterprise* in the manufacturing sector and in employment generation, *MSME Clusters-108* have been identified for focused interventions to boost exports. Outreach activities will be organized in a structured way at these clusters with the help of EPCs and other willing *Industry Partners* and *Knowledge Partners*.

(viii) *Niryat Bandhu Scheme* has been galvanized and repositioned to achieve the objectives of Skill India.

The FTP Statement describes the market and product strategy and measures required for trade promotion, infrastructure development and overall enhancement of the trade ecosystem. It seeks to enable India to respond to the challenges of the external environment, keeping in step with a rapidly evolving international trading architecture and make trade a major contributor to the country's economic growth and development. The Government of India promised to have regular interactions with all stakeholders, including state governments to achieve the national objectives.

Need of Shift: The environment for global trade policy has probably undergone a *paradigm shift* in the aftermath of Brexit and the US elections. The Brexit was motivated by protectionist sentiments in the UK. Similar sentiments are being signalled by the new US government, too. This may lead to sharp appreciation in the US dollar—it has already appreciated 5.3 per cent during November-December 2016, settling at 3.1 per cent higher by January 2017 (against an index of partner currencies). During the most protectionist phase of the USA (mid to late 1980s) a sharp rise was seen in the dollar—caused by tighter monetary policy and relaxing fiscal policy.

A vacuum is being created in international trade leadership under the possible resurgence of protectionist pressures. In such a scenario needs to promote open markets and tap domestic growth. Similar moves are needed from the emerging market economies (EMEs), too. In this way, for India two specific opportunities[21] arise:

(i) India could get much benefits by promoting labour-intensive exports and negotiating free trade agreements with the UK and Europe. The potential gains for export and employment are substantial—additional export of US$ 3 billion (specially in the apparel and leather and footwear sectors) and additional employment of 1.5 lakhs.

(ii) The likely retreat of USA from regional initiatives such as the Trans-Pacific Partnership (TPP) in Asia and the Trans-Atlantic Trade and Investment Partnership (TTIP) with the EU, it is possible that the relevance of the WTO might increase. As a major stakeholder and given the geo-political shifts under way, India should proactively pursue to revive WTO and multilateralism.

21. **Economic Survey 2016-17**, Government of India, Ministry of Finance, N. Delhi, Vol. 1, pp. 25-26.

TRANS-PACIFIC PARTNERSHIP

The **TPP** (Trans-Pacific Partnership) is a ***new mega-regional*** agreement. The 12 Pacific Rim nations (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US and Vietnam) signed the TPP agreement on 5 October 2015. It is likely to set higher standards for goods and services trade and is considered a mega regional FTA which can be a *pioneer* in many ways and is likely to be a *game-changer* for the world economy and global trade.

The block accounts for around 40 per cent of global GDP and around 60 per cent of merchandise trade. In terms of economic size, it is larger than the existing NAFTA (North America Free Trade Area). The agreement is very comprehensive and not only encompasses the scope of tariff-eliminating mega regional trade pacts, but also aims at—

(i) setting higher global standards for international trade through lower benchmarks for non-tariff barriers;

(ii) more stringent labour and environment regulation;

(iii) higher IPRs (intellectual property rights) protection;

(iv) greater transparency in government procurement and limiting advantages to state-owned enterprises (SoEs);

(v) transparency in health care technology, competitiveness and supply chain.

(vi) it also includes new and emerging trade issues and cross-cutting concerns such as *internet* and *digital economy* and participation of state-owned enterprises (SoEs) in global trade and investment.

Experts have highlighted serious impact on the current global trade pattern once this agreement comes into force. India has its own share of concerns regarding it[22]. Meanwhile, by late ***January 2017***, the USA (under its new President Mr. Donald Trump) pulled out from the ongoing negotiations of the TPP. Once the US (the biggest force behind it) has opted out from it, the pact looks losing its real steam. This may look a relief for India and other similar economies it may be temporary—as the new dispensation in the country has given clear signs of becoming protective regarding trade and globalisation (these issues were the benchmark of Trump's presidential election campaign).

TRANSATLANTIC TRADE AND INVESTMENT PARTNERSHIP

Considered a companion of the TPP (Trans-Pacific Partnership), the **TTIP** (Transatlantic Trade and Investment Partnership)[23] is a newly proposed trade agreement (a regional trade agreement of different kind which includes investment also) between the European Union and the United States. Planned to be finalised by 2014, the pact is still (by March 2017) under the negotiation process. This agreement touches three broad areas—market access; specific regulation and co-operation. The possible features and its impact are available in international media and other documents as given below:

- The major provisions included under this pact are—dilution in regulatory provisions to promote trade and investment, liberal banking regulation, liberal role and access given to the transnational companies, diluting sovereign powers of the nations.
- As per experts, it could liberalise *one third* of global trade and create millions of new jobs.
- As per the estimates of the European Commission, it will boost the EU's economy by €120 billion, the US economy by €90 billion and the rest of the world by €100 billion.

The agreement has been severely criticised and opposed by majority of the unions, charities, NGOs and environmentalists across Europe. Critics have highlighted several apprehensions also related to it such as—the number of net job gains as there are chances of job losses, and low economic gains accruing at the household level. The reports on the ongoing negotiations and its contents are not available in the public domain as only authorised persons can access them. Whatever comments, reactions or criticisms we find on it are on the multiple leaks which the world had by now through different sources.

As in case of the trans-pacific partnership (TPP), the new government in the USA—the most important force behind the pact—has dropped out (by late ***January 2017***) of the TTIP, too. This way, the proposed pact looks becoming weaker before its finalisation. And finalising the partnership without USA is neither possible nor will it have much substance. In this case, the EU may be more open to new regional trade agreements with other nations—India may also explore one such pact with it.

DEGLOBALISATION AND INDIA

Global factors are yet to stabilise since the financial crisis hit the developed economies. Recovery among these economies are getting tough job—even unconventional monetary policies have been tried (pursuing for negative interest rate regime). Meanwhile, several of these economies have

22. We find a very detailed discussion on it in the **Economic Survey 2015-16**, Government of India, Ministry of Finance, N. Delhi (Vol. 2, pp. 76-78) which quoted several international studies in this regard.
23. Based on the several issues of **The Economist**, London, UK from 2013 to March 2017.

signalled ‘protectionist’ rhetoric—the Brexit. The new government in the USA has already taken various protectionist measures by now and many more are supposed to come in the coming times.

Besides, in past few years the world has seen increased debate on the drawbacks of the globalisation process. Among experts as well as several nations, a general feeling looked evolving against globalisation. The negotiations related to the WTO look almost stalled. At the end of the tunnel, by late 2016, the world witnessed rise in the ‘protectionist sentiments’ among important economies.

The above-given two events show as if the world (or at least the economies which matter most) has started to move slowly away from the much-celebrated idea of globalisation—***de-globalisation*** taking over the world—shrinking scope for multilateral trade and economic inter-dependence. Again, this lack of willingness towards globalisation among different economies is not of the same degree nor universal to every economy—better say it looks selective.

India’s prospects of export growth depends on its trading partners’ carrying capacity of globalisation to it. Today, for India, three external developments are of significant consequence—

(i) In the *short-run*, global interest rates (as a result of the US elections and the implied change its fiscal and monetary policy) will impact on India’s capital flows and exchange rates. Experts are already expecting high fiscal stimulus, more dependence on unconventional monetary policy, etc. to follow in the developed world.

(ii) The *medium-term* political outlook for globalisation and in particular for the world’s ‘political carrying capacity for globalisation’ may have changed in the wake of recent developments. A strong US dollar and declining competitiveness might incline many countries to follow protectionist policies. This will result into declining global trade hitting India hard.

(iii) Developments in the US, especially the rise of the dollar, will have implications for China’s currency and currency policy which will impact India and the world—if China is able to successfully re-balance its economy, the spillover effects will be positive; otherwise quite negative. China with its underlying vulnerabilities remains the country to watch for its potential to *unsettle* the global economy.

India’s trade in goods and services both will be important in this case. India’s services exports growth will test the world’s ‘globalisation carrying capacity’ in services—depending on the restrictions in developed countries on two variables—*firstly,* the labour mobility and *secondly,* outsourcing.

It is possible that the world’s carrying capacity will actually be *much greater* for India’s services than it was for Chinese goods. After all, China’s export expansion over the past two decades was imbalanced in several ways—

- the country exported far more than it imported;
- it exported manufactured goods to advanced countries, displacing production there, but imported goods (raw materials) from developing countries; and
- when it did import from advanced economies, it often imported services rather than goods (though capital goods is a major exception).

As a result, China’s development created relatively few export-oriented jobs in advanced countries, insufficient to compensate for the jobs lost in manufacturing—and where it did create jobs, these were in advanced services (such as finance), which were not possible for displaced manufacturing workers to obtain.

In contrast, India's expansion may well prove much more balanced:

- India has tended to run a current account deficit, rather than a surplus; and
- while its service exports might also displace workers in advanced countries, their skill set will make relocation to other service activities easier; indeed, they may well simply move on to complementary tasks, such as more advanced computer programming in the IT sector itself.
- on the other hand, since skilled labour in advanced economies will be exposed to Indian competition, their ability to mobilize political opinion might also be greater.[24]

Precisely speaking, the *political backlash* against globalisation in advanced countries, and China's difficulties in rebalancing its economy, could have major implications for India. And it will be advisable for India to close track of the changing global dynamics.

24. Based on the discussion given in the **Economic Survey 2016-17**, Government of India, Ministry of Finance, N. Delhi, Vol. 1, pp. 6-9.