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Why Isn't India a Major Global Player?
The Political Economy of Trade Liberalization

Jayanta Roy and Pritam Banerjee

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Abstract

The policy reforms initiated in India in the mid-1980s and expanded in 1991 helped support an expansion in India's trade. Trade reforms since the mid-1990s have been piecemeal. This paper argues that without significant further reform and adoption of a focused trade strategy, the competitiveness of India's industry will suffer, including in areas such as information technology and related services in which India has established a strong global niche. Critical building blocks of such strategic reforms include further reductions in tariffs, opening services sectors to foreign competition, serious initiatives to reduce trade transaction costs that prioritize integration into international supply-chains, and a greater focus on regional integration.

Keywords

India, political economy, trade policy, economic development

I. Introduction*

India has historically been one of the world's largest and most important trading nations, accounting for over 20% of global trade in the 1700s. While the industrial revolution and colonialism saw India's share of world output and trade decline significantly (India accounted for just 2.2% of world exports, and 2.3% of world imports in 1948), it was the post-colonial Indian state with its emphasis on planning and self-reliance through import substitution that turned India into an insular nation with insignificant participation in global trade (India's share of both world exports and imports was just 0.5% in 1973) (WTO, 2011).

Post-colonial trade policy in India was a major instrument of industrial development, with restrictions proliferating in the form of import licensing and high tariffs, often supplemented with numerous surcharges. The government managed the balance of payments through import controls and a steady inflow of remittances, with exports playing a marginal role. The trajectory of Indian economic and trade policy was a product of the institutions and politics of the last century. Post World War II saw most large nations undertake massive state-led development and industrialization. To that end, state intervention through the 'commanding heights' of the economy was not a peculiar Indian trend. However, what was unique to India was the evolution of a system that tolerated private enterprise but restricted both domestic and international competition through a combination of quotas, licenses, high tariffs, and strict controls on private access to foreign exchange. There was serious anti-competition and anti-trade bias.

Trade policy reforms were initiated in the mid-1980s under Prime Minister Rajiv Gandhi (1984-1989). These were strengthened and expanded under the comprehensive economy wide reforms in 1991, which saw India regain some of its lost ground in the global economy. India's share of global imports is now almost equal to its 1948 share of 2.3%, and the share of world exports has risen to 1.5%. More importantly, India's IT and IT enabled services revolution made it a significant player in world services trade. India is the world's seventh largest services importer and exporter. If long overdue next generation reforms are implemented successfully, India can again re-emerge as one of the world's largest trading nations. Buitert and Rahbari (2011), project that India could become the world's second largest trading nation by 2050, with a share in world trade of 8.4%, behind China (17%) and ahead of the US (5.9%).

This paper makes a case that without significant further reform and adoption of a focused trade strategy this scenario will not materialize. Current policies are reducing the competitiveness of India's industry, and dulling the competitive edge of IT and allied services where India has found such a strong global niche as an exporter. What is needed is a concerted effort to implement an ambitious agenda of strategic or next generation reforms. Some of the critical building blocks of such strategic reforms include continued liberalization of merchandise and services trade, serious initiatives to reduce the transaction costs of trading across borders in India through trade facilitation, strategic trade liberalization that prioritizes integration into international supply-chains, a greater regional focus, and reforms in services. Subsequent sections of the paper discuss each of these elements in greater detail. Our premise is that all of the reform areas identified are critical to enable India to become a more competitive economy.

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The views expressed are personal and should not be attributed to the organizations the authors are affiliated with.

The paper is organized as follows. Section II provides a brief overview of the political economy of India's trade policy since the 1980s. Sections III and IV discuss the slow pace of reforms in merchandise and services sectors and brings out the political economic considerations in these sectors that have led to a less than ambitious liberalization agenda. These two sections also discuss the implications of a more strategic focus in terms of policy to enable Indian entrepreneurs become more outward oriented and competitive through focused reforms and liberalization. Sections V and VI take up the broader discussion of institutional changes required in two key areas of trade policy, a greater degree of regional focus and concomitant trade liberalization, and a focused approach on trade facilitation that offers a bigger challenge to Indian exports going out, and imports coming in, than any tariff or non-tariff barrier. Section VII concludes.

II. A Brief Overview of the Political Economy of Indian Trade Policy

Economic liberalization under Rajiv Gandhi focused on liberalization of domestic policy regimes that held back private sector competition and participation, and, for the first time, a strong push for exports. The revised Electronics Policy paved the way for emergence of the IT revolution and a software export boom. This period also witnessed the initiation of a telecommunications policy that led, over the next few years, to a wide spread connectivity through mobile phones. Indian merchandise exports during 1986-1990 registered a volume growth of 12 percent, double the growth rate of world exports, and in sharp contrast to an average growth of 2.7 percent during 1980-1986 (Roy, 1996).

This impressive performance was the result of pursuing a realistic exchange rate, aided by liberalizing the import regime for exporters and extending GATT-compliant fiscal and monetary concessions to exporters to put them on par with their competitors abroad. This was the first serious attempt to reduce the massive anti-export bias, and made further liberalization in 1991 a much more manageable process. Rajiv Gandhi and his team, aided by some young rising entrepreneurs, were the real political drivers of trade policy liberalization. Surprisingly, these reforms have not received due recognition in international policy circles or in the media in India and abroad.

The government led by Rajiv Gandhi (1984-89) had a number of young ministers and advisers, some of whom had been professionals before becoming politicians and policy-makers. They were quick to realize that the enormity of the task of India's economic and infrastructural development required the support of a robust private sector, as well as foreign expertise and investment. A newer generation of bureaucrats, many of whom had had long stints in international organizations such as the World Bank, IMF, and the UN, only helped strengthen this policy resolve. With the help of a new generation of young entrepreneurs, Rajiv Gandhi also influenced the chambers of commerce and industry to accept the urgent need for a rapid switch from a protectionist regime to a more liberal one.

The face of Indian industry was also changing. As was the case for the political leadership, some of the younger generations of business leadership in India's entrenched family-run conglomerates were witnessing the rise of new technologies and business models globally, and realized that the old system which had allowed them to prosper behind protectionist walls in India could not be sustained. This younger generation of entrepreneurs emerged as a major support group for the political leadership.

The partial reforms were overtaken by the economic events of the late 1980s and early 1990s. This period saw a sharp deterioration on the fiscal front. GDP growth was maintained with a growing gap between public investment and public savings, largely financed by massive external borrowing, mostly short-term in nature. There was also a massive increase in the overall budget deficit. The combination of these factors, along with the collapse of India's largest trading partner, the former Soviet Union, and the Gulf War, which increased the price of crude oil and affected India's exports to the Middle-East, resulted in the economic crisis of 1991 when inflation spiraled, and the foreign exchange reserves were barely sufficient to cover two weeks of imports. After an emergency measure of selling gold reserves, India sought support from the World Bank. Such support was linked to conditionalities.

The Indian policy leadership, especially the group of reform oriented technocrats from the Rajiv Gandhi era, was quick to turn adversity into opportunity.

While ensuring that India only accepted those policy recommendations that were in Indian interests, the World Bank conditionalities were leveraged to push through some major reforms in a democratic framework where consensus could not be assured. Stewardship of these reforms required skillful management of the various regional, social, and political vested interests, and credit must go to Prime Minister Narasimha Rao who played this role. Prime Minister Rao's commitment to the reforms that were led by his outstanding Finance Minister Manmohan Singh (the current Prime Minister) was critical to their success. In a large democratic polity like India, with a large number of distinct pressure groups and interests, effective political management is the differentiator between success and failure. As discussed subsequently, this is a key reason for the relative success of reforms in the time of Prime Minister Rao and Vajpayee compared to the later period when it became more difficult to artfully manage the different groups within the ruling coalition. Matters were compounded by the erosion in influence of economic advisers in the key economic ministries in formulating policy.

Thus, starting from 1991, India started to liberalize its trade regime. The transition towards a more outward oriented market economy was done in stages to ensure that there were no sudden shocks to the system resulting in widespread unemployment and de-industrialization arising from exposure of long protected domestic industries in both the private and public sectors to external competition. In the first stage of reforms starting with budget presented in July 1991, the government abolished the need for import licensing for almost all capital goods. However, many consumer goods continued to remain under licensing till 2001. The second phase of reforms starting in the mid-1990s under Prime Minister Vajpayee (1998-2004) included a gradual but focused approach to tariff reduction and rationalization, agricultural trade policy, gradual liberalization of services, and ensuring connectivity through national road transport policy.

In 1990–91, the highest tariff rate stood at 355 percent, the simple average of all tariff rates at 113 percent, and the import-weighted average of tariff rates at 87 percent (Panagariya, 2005). The reform and liberalization of the tariff structure focused on substantially reducing the tariffs over-time as well as reducing the number of tariff bands. Today over 90% of non-agricultural tariff lines fall into three tariff bands of 5%, 7.5%, and 10%.

Despite sustained reforms, India continues to have one of the most restrictive trade regimes in the world. India has the highest average bound tariff rate among major emerging economies (Table 1). Applied rates in India are also very high, evinced by the fact that it is second only to Brazil in terms of the average applied rate for manufactured products. However, India is not very different from other emerging economies in having a significant difference between bound and applied rates.

Table 1: WTO Bound and Applied Average Tariff Rates (simple means, percent)

	Bound Rate, Manufactured Products	Applied MFN Rate for Manufactures	Bound Rate, All Products	Applied MFN Rate, All Products
OECD members	10.22	4.16	11.85	6.29
Indonesia	35.49	6.91	37.45	6.81
South Africa	17.12	8.29	19.36	7.75
Malaysia	15.48	8.92	14.58	8.6
Russian Federation	NA	8.63	NA	8.7
China	9.63	9.25	10.04	9.68
Thailand	25.8	8.78	26.08	10.42
Korea, Rep.	11.55	7.46	16.1	12.21
Argentina	31.51	14.66	31.86	13.41
Brazil	30.61	15.16	31.43	13.65
India	35.62	11.38	50.18	14.03

Source: World Development Indicators, World Bank

Since Uruguay Round commitments required the removal of several border measures on agricultural products, India chose to replace them with high tariffs. Unlike in the case of non-agricultural goods, agriculture related tariffs continue to be high. In this, India is not different from many other developing and developed countries that continue to protect their agricultural sector. Unlike the industrial sector, the agriculture sector has seen little in the way of domestic regulatory reform or capacity building which would lead to greater competitiveness. Coupled with poor infrastructure and lack of targeted trade facilitation measures (to be discussed later in greater detail), this has resulted in stagnation in terms of productivity growth and has prevented the development of strong export oriented segments within the agricultural sector.

The same trajectory of gradual reforms and subsequent policy stagnation has been seen in the services sector. The government dominated core service sectors related to infrastructure and finance since post-independence. Rail transport, shipping, airlines, banking, insurance, and telecommunication were effectively government monopolies till the mid-1990s. Starting with the 'open skies' policy of 1991 that allowed private participation in domestic airline operations, and the national telecommunications policy of 1994 that opened up cellular telephony services to private operators, there has been gradual liberalization of some of the core services sectors. Domestic liberalization has in turn led to trade liberalization. Currently, with the exception of railways and domestic shipping, foreign stakeholders face no restrictions on ownership or operations in the transport sector, including related infrastructure services such as airport and port operations. Foreign ownership in domestic airlines is restricted to 40%. The trade regime for telecom services allows foreign ownership of up to 74% for cellular and allied services.

The mid- 1990s also saw domestic liberalization of the core financial services followed by some trade liberalization. The establishment of the Insurance Development and Regulatory Authority in 1999 saw the entry of private players, including foreign stakeholders in the insurance market. However, foreign stake in insurance companies is restricted to 49%. While most restrictions on private participation in the Banking sector have been removed, foreign stake in Indian Banks is limited 74%. However, foreign banks are allowed to operate in India subject to licensing and limitations on number of branches.

Three core areas where no liberalization has yet taken place are education services, professional services and retail. Strong domestic lobbies in professional services, specifically in legal and

accounting services prevent moves towards greater liberalization in this sector. While private investment in education has increased significantly in the last decade, reforms that allow greater and more transparent foreign participation in higher education has been stalled. Opening up of organized multi-brand retail to foreign investment remains a politically sensitive subject, with several previous attempts to allow FDI into this sector meeting with strong political opposition. The most recent policy announcement came on September 14th, 2012, but the final decision on implementation has been left to the states. This is a major departure from the practice of having single economic policy decision applicable for the entire country and testimony to the lack of political consensus on the issue. Table 2 below highlights the fact that India still remains a highly regulated and protected services market relative to other major SE Asian economies and industrialized countries.

Table 2: Services Trade Restrictions Index

	Overall	Banking	Insurance	Mobile Telephony	Retail	Road Freight	Professional Services
France	26	0	3	0	25	50	46
India	66	50	45	50	75	100	88
Malaysia	46	44	45	25	25	50	73
Thailand	48	58	37	50	25	50	74
United Kingdom	14	0	2	0	0	50	45

Source: World Bank. Index score range from 0 to 100, with 100 representing maximum levels of protection.

III. Liberalization of Merchandise Trade

Indian Domestic Industry in the face of Globalization

While domestic liberalization initiatives and multilateral commitments at the Uruguay Round led to significant reductions in tariffs, India's tariff structure remains protectionist in nature, especially relative to Association of South-East Asian Nations (ASEAN) economies. India has historically been part of a larger Southern Asian regional economy that encompasses current South Asian Association for Regional Cooperation (SAARC) and ASEAN member countries. As India seeks to re-build regional ties through its 'Look East' policy (see Section V), this comparison is particularly relevant.

The literature on political economy and the power of domestic vested interests has pointed out the disproportionate influence of well-organized and sufficiently large interests groups acting in tandem within a democratic structure.¹ The Indian political economy was no exception to this rule. As was pointed out earlier, the unique Indian situation that allowed particular industrial houses to prosper under a system that protected them from both international, and, more importantly, domestic competition, created incentives for both state-owned firms and private entrepreneurs to seek the continuation of such a system in some form as it allowed them to capture large profits with little entrepreneurial effort.² While many state enterprises were not profitable, the lack of competition made them effective monopolies and indispensable suppliers of critical goods for industry.

Over time, the most entrenched and well organized economic interests in the manufacturing sector were represented by three groups. The first was a small group of large domestic industrial houses that

¹ For discussions on incentives for collection action see Olson (1971); for state created incentives for rent seeking for incentives see Baumol (1990).

² See Banerjee (2007) for a detailed discussion on the interaction between state institutions and the Indian entrepreneur in light of the incentives offered in a controlled economy defined by licenses and quotas.

dominated some key consumer and capital good sectors like automobiles, agricultural machinery, cement, fast moving consumer goods (FMCG), and consumer durables. The second group comprised large state owned Public Sector Units (PSUs) that dominated the capital goods sector like steel, aluminum, and heavy machinery. The organized labor movement was strongest within these PSUs and while representing a very small percentage of the overall industrial labor force, the sustenance of these PSUs and the jobs they represented assumed disproportionate importance in the political economic discourse on trade liberalization.

The third group was represented by small and medium entrepreneurs whose economic existence was the result of incentives created over a period of time by state policy. The Indian government reserved a large number of industrial products exclusively for small and medium enterprises.³ Such firms therefore faced little competition from large domestic or international (tariff protection) firms. Thus the process of liberalization was seen as inimical to the prospects of such firms, and given their importance as employers in specific industries like textiles and yarn, some basic chemicals, and light industrial machinery, they coalesced into effective regional coalitions, with state (i.e. provincial) level political leaders becoming strong supporters of their interests. Since the period of liberalization (post-1991) also saw the gradual fragmentation of Indian politics that required governments to manage a large coalition of regional parties to maintain parliamentary majority and stay on in power, this ensured that well-organized groups of such small and medium entrepreneurs also had strong presence within the political economic calculus.

In light of the above political economic circumstances, the process of tariff reduction became less ambitious as policymakers were sensitive to the demand for continued protection from the most influential groups of vested interests. Thus, the official promise of taking Indian tariffs to ASEAN levels a decade after 1991 has yet to be fulfilled. Although average tariffs do not exceed 10% for manufacturing as a whole, and the standard deviation (i.e. difference in tariff rates within the chapter) is minimal, vehicles and parts and agriculture related chapters have higher rates of protection (Table 3). Relatively high tariffs continue to protect domestic players in many key sectors of the economy.

However, tariffs have continued to fall due to the continued pressure from various sections for greater tariff liberalization. Foreign investors in sectors such as electronics and automobiles have made a strong argument for liberalizing trade in parts and components related to these two industries to allow better integration of the India into international production networks. Indian exporters in niche high-end manufacturing have also pushed for greater tariff liberalization for the same reason. Negotiations in the Doha round,⁴ and in bilateral negotiations with ASEAN partner countries, Japan, Korea, and the EU (ongoing at the time of writing) have also seen trade partners seek greater tariff liberalization in various manufacturing sectors, but particularly in chemicals, machinery and machine parts, and automobiles and their components.

³ India was one of the few countries in the world which put in place a system that reserved entire segments of manufacturing industries for the small-scale sector, eventually leading to stagnation as such industries could by definition not attain economies of scale and concomitant technology and productivity improvements

⁴ There has particular pressure from the US to eliminate over a period of time tariffs in chemicals and automobile and their components in by India (and other large emerging economies) in what is known as sectoral zero-for-zero within the Doha round of negotiations. Indian stance has been that such sectoral negotiations were meant to be voluntary and should not be made an issue in the overall resolution of the Doha round of trade talks.

Table 3: Applied Tariffs by Sectors

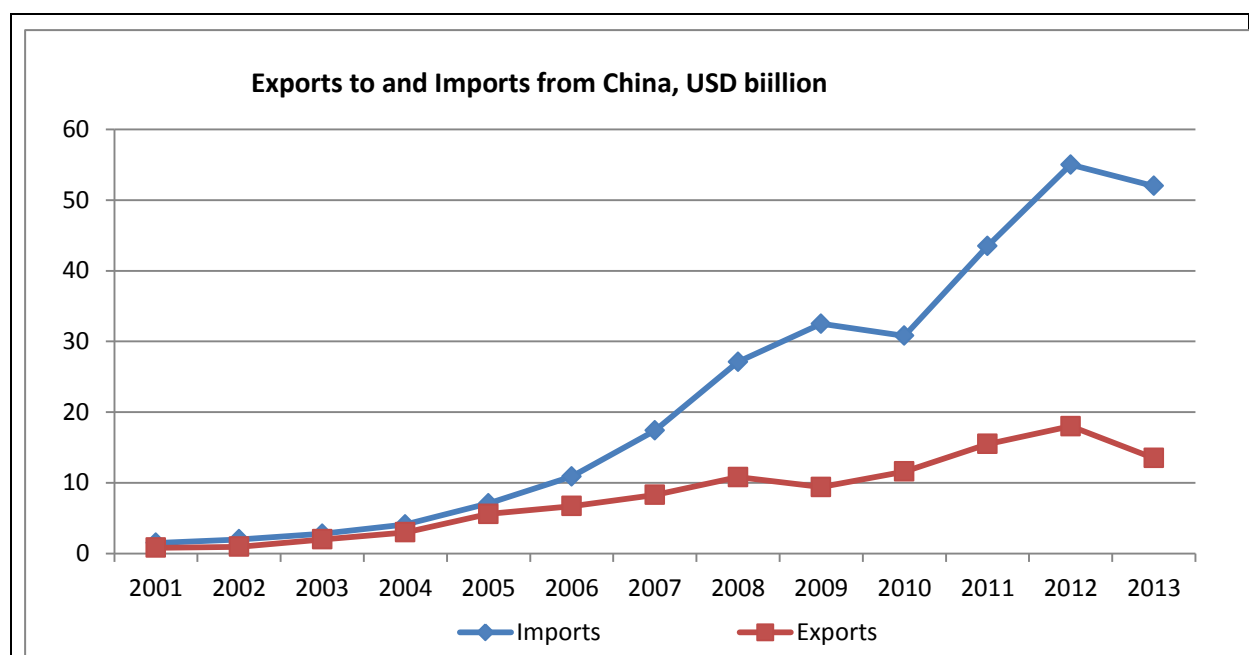
HS Chapter	Product Description	Simple Average	Standard Deviation	Maximum
04'	Diary Produce etc	33.8	9.5	60.0
07'	Vegetables etc	31.4	9.6	100.0
08'	Fruits etc	32.4	13.0	100.0
10'	Cereals	53.1	22.7	80.0
11'	Milling Industry Products	31.5	5.2	50.0
15'	Animal and Vegetable Fats and Oils	21.3	18.1	100.0
16'	Meat and Fish Products	35.4	18.7	100.0
17'	Sugar and Sugar Products	34.4	16.1	60.0
19'	Value-added Cereals etc	30.0	0.0	30.0
20'	Value-added Vegetables and Fruits	30.0	0.0	30.0
28'	Inorganic Chemicals	7.1	0.9	8.8
29'	Organic Chemicals	7.2	1.4	20.0
30'	Pharmaceuticals	10.0	0.0	10.0
31'	Fertilizers	6.4	1.2	7.5
34'	FMCG related Chemical Products	9.6	0.9	10.0
39'	Plastics	8.6	1.6	10.0
50'	Silk	14.4	8.3	30.0
51'	Wool	8.5	2.3	10.0
52'	Cotton	10.2	2.0	30.0
54'	Man-Made Filaments	7.4	2.5	10.0
55'	Man-Made Staple Fiberes	7.0	2.4	10.0
57'	Carpets etc	10.0	0.0	10.0
58'	Woven Fabrics	10.0	0.0	10.0
59'	Textile Fabrics etc	9.8	1.0	10.0
60'	Knitted or Crocheted Fabrics	10.0	0.0	10.0
61'	Apparel and Clothing	10.0	0.0	10.0
62'	Apparel and Clothin (not knitted)	10.0	0.0	10.0
84'	Engineering and Heavy Machinery	7.4	1.0	10.0
85'	Electrical Machinery and Electronics	8.5	1.7	10.0
87'	Vehicles and their parts	19.9	20.2	60.0

Source: WITS. Chapter names were modified to provide a better description of their production coverage

The China Factor and High Transaction Costs Arguments

Organized interest groups within Indian industry have reacted to the changing environment by making a more nuanced argument for protection linked to state failure, high transaction costs and the “China factor.” The China argument essentially points to the rapidly growing imports of manufactured products from China (see Figure 1, while highlighting the fact that exports to that country consist essentially of raw materials. Indian entrepreneurs have argued that an opaque system of state aid, direct and indirect subsidies, and state mandated labor policies in China offer its exporters an unfair advantage.

Figure 1: Exports to and from China: US\$ Billion and Share of Indian Basket



Source: Director-General of Commercial Intelligence (DGCIS), Ministry of Commerce, Government of India.
 Note: trade data are for financial years, thus annual numbers are for the 12 months from April to March

Indian industries also have regularly complained to Indian policymakers that public procurement, and in many cases private procurement in China are not dictated by market policies and there is a bias towards buying locally. Such perceptions have been substantiated due to instances of Indian manufactured products that do well in third countries not succeeding in the Chinese market. Indian industries differentiate between procurement in export-oriented industries in China that are necessarily defined by the global supply chains within which they operate (and thus have a high volume of imports from countries like Korea, Japan, and other Asian economies), and procurement by Chinese public and private enterprises that strictly supply the huge domestic market.

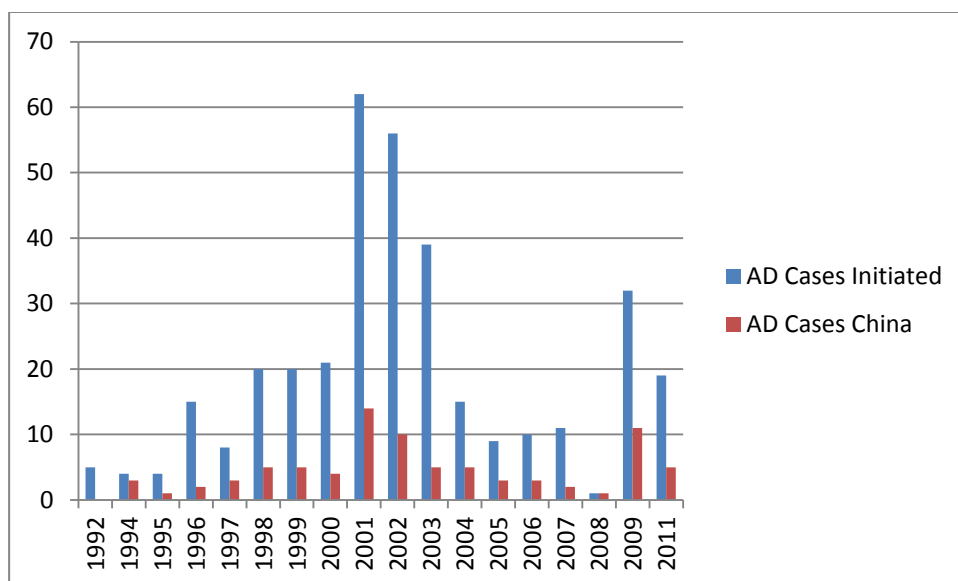
The China factor argument has led to distinct trends in Indian trade policy. One is the level of extreme caution in making any commitment beyond the minimum required in the Doha round of negotiations. India has strongly opposed the more ambitious levels of liberalization suggested by comprehensive sectoral negotiations, despite the fact that India has made far deeper tariff cuts in bilateral agreements with major economies like Japan, Korea, and the ASEAN. India has also been very cautious in its approach in areas such as negotiations on liberalization of environmental goods and on re-manufactured products.

While recognizing the positive environmental impact of liberalizing trade in environmental and re-manufactured goods, India's stand has been that this would reduce protection for a large number of industrial products and open the door for entry of used and cheap industrial goods from China in particular. The implicit belief is that China, with its huge manufacturing capacity, and opaque systems of state support would be the beneficiary of such multilateral liberalization. The China factor also explains the increasingly aggressive use of anti-dumping measures by India. Figure 2 maps the trajectory of anti-dumping (AD) cases filed by India overall, and specific to Chinese imports.

India aggressively pursued AD investigations in the period following the formation of the WTO in 1995 and during which tariffs were gradually reduced and domestic manufacturing started to feel the pressure of foreign competition. While the period of relatively high domestic economic growth between 2004 and 2008 (and therefore less political economic pressure for protectionism) saw a

decline in India's pursuit of AD investigations, following the global economic slow-down in 2008-09 there was a sharp increase. China is the major focus of AD investigations.

Figure 2: Anti-Dumping Cases Initiated by India (by year)-Overall and China Specific



Source: Brown, Chad P. (2012) "Global Antidumping Database," available at <http://econ.worldbank.org/ttbd/gad/>

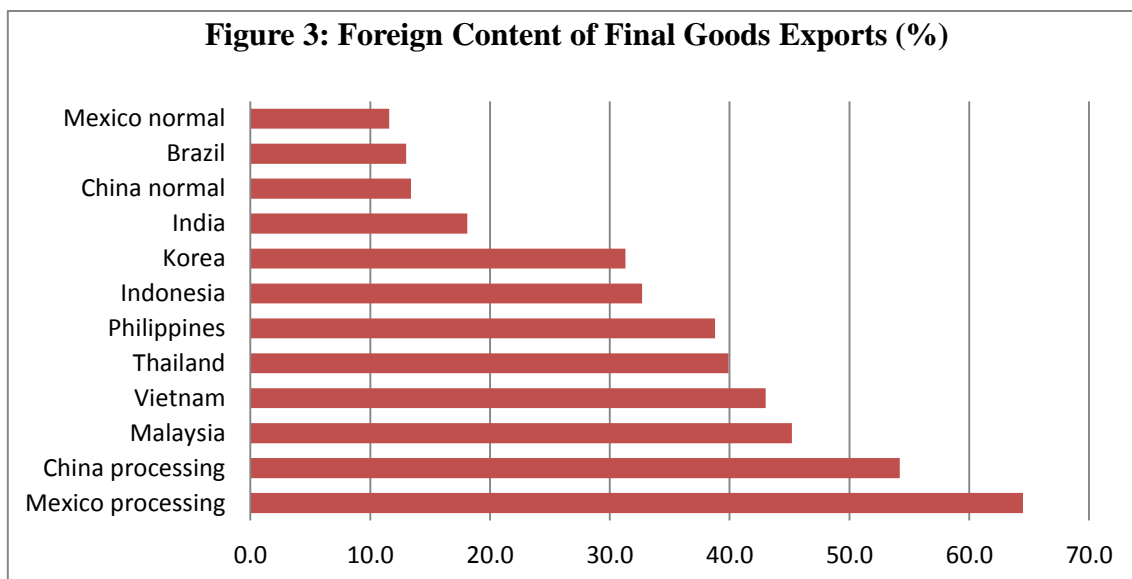
Another consistent argument made by Indian industries for continued protection centers on the high transaction costs of operations in India. High interest rates, electricity costs, and the administrative costs of setting up a basic factory are higher in India than in comparators, especially relative to Asian comparators. While the costs of setting up a light industrial unit are relatively low, infrastructure shortages and land acquisition difficulties raise the cost of leasing or buying land in India. Countries with comparable labor costs like China, Thailand, Philippines, and Indonesia have lower costs of construction compared to India. Investment in infrastructure and provision of basic services such as electricity supply, roads, and ports remains inadequate and private solutions to overcome such challenges significantly add to costs. This is coupled with high transaction costs related to an inefficient regulatory framework within which firms in India have to operate. However, as discussed below, industry commitment to seriously engaging on the factors that generate high transaction costs remains extremely low.

Adoption of a uniform tariff would remove incentives to demand sectoral tariff protection while at the same time simplifying customs procedures and thereby facilitating trade. Given the multiple objectives of mobilizing revenue, providing protection to the domestic industries and favoring "strategic" industries, import duties in developing countries tend to be characterized by high and multiple rates, as well as numerous exemptions. A uniform tariff rate is more easily administered, provides a more transparent tax system and would increase the efficiency and competitiveness of the entire economy. It avoids lobbying and the negative experience with picking the winners. Although there has been steady reform in India to rationalize and lower tariffs, the tariff structure is still plagued by multiplicity of rates and exceptions. Thus, as government pursues further tariff liberalization there is a strong case to be made for adoption of a uniform tariff. This will not result in severe adverse revenue implications. Roy and Pattnaik (2004) estimate that a uniform tariff rate of 6% on all non-agricultural products would actually increase net revenue earned by lowering administrative costs and increasing trade volumes. Discretionary exemptions imply that many Indian imports do not pay tariffs at the moment, lowering revenues and increasing transactions costs.

Integrating into Global Supply Chains: Focused Trade Liberalization Linked to Overall Reforms

One of the key objectives of broader trade policy reform in India has been to make Indian exports more competitive, and make exports a major contributor to overall economic growth and job creation. However, the policies that were put in place to achieve this objective did not address the broader challenge of helping Indian entrepreneurs integrating more fully with global supply-chains. Several export incentives were offered in the form duty rebates, subsidized interest rates for exporters of specific products, and support for acquisition of plant and machinery related to exports. Trying to emulate the success of export processing zones in other parts of the world, India also came up with its own version of such export processing zones, offering tax rebates and simplified labor laws as incentives for investment in such zones.

While these short-term measures yielded limited successes, India remains one of the least integrated emerging economies in terms of participation in global supply chains. Figure 3 shows that foreign content in final exports, a good proxy for capturing the level of integration in global supply chains, in India is just 18%. If one looks at the numbers for other emerging countries, they are over 30%. It is interesting to note the difference between the percentage of foreign content in exports from special economic zones in China (China Processing), versus normal Chinese exports, and likewise between normal Mexican exports and those from special economic zones in that country.



Source: Koopman et al. (2010)

The high foreign content of exports from processing zones in China and Mexico shows the success of both these countries in capturing value from highly integrated supply-chains through leveraging semi-skilled human resources. While there have been some criticisms of such models in terms of work-life quality related to labor and human rights, there is no doubt that they offer employment, and above average wages to a large number of people, and bring revenue into the country. An added benefit is that over time local entrepreneurs working within these supply-chains acquire technology, expertise, capital, and credibility to start capturing a larger share of the value within such global supply chains.

It also important to remember that some of the most important traded manufactured goods like electronics, automobiles, engineering, textiles, and certain classes of high-value chemicals are increasingly being produced and delivered within a highly fragmented global production network. An illustrative example is that foreign countries contribute 80% or more of the value added embodied in Chinese exports of computers, office equipment, and telecom equipment (Koopman et al., 2010).

The essential point is that integration into global supply chains is the key to overall development of the export sector. The critical elements of policy required to integrate into global supply chain are a) relatively low tariffs (to allow easy importation of intermediates), and a simplified tariff structure, b) regulatory environment that is attractive to FDI in manufacturing, c) a taxation system that ensures that no domestic taxes are exported (i.e. zero-rating of exports), d) an environment of low transaction costs of operating across borders, and e) strong logistical linkages, especially with regional economies.

India does not have comprehensive reform initiatives in place to achieve any of the five above mentioned critical elements. A basic policy objective in order to integrate into regional production chains in East and SE Asia should have been to bring Indian applied tariff levels down to at least the levels achieved by major ASEAN economies like Thailand and Malaysia. As has been pointed out earlier, political economic compulsions forced the government to go slow in terms of tariff liberalization in precisely some of those sectors where integration in regional supply chains should have been made an industrial policy priority. Any perceived lack of competitiveness could have been addressed through targeted industrial policy instead of either tariff protection or the piece-meal short-term export incentives that are on offer currently.

Of late, India has started to prioritize regional agreements with SE Asia and has comprehensive bilateral agreements in place with Malaysia, Singapore, Korea, Japan, and with ASEAN economies as a whole. Similar comprehensive agreements are to follow with Thailand and Indonesia. The discussion in section IV would elaborate on the larger ramifications of regionalism, which is a step in the right direction as far as integrating into regional production chains are concerned.

FDI into an economy can have two motivations. Outward-looking FDI seeks to leverage competitiveness in certain aspects of a global supply chain to develop export-oriented manufacturing. Inward-looking FDI on the other hand seeks to tap a large domestic market. If tariffs and costs of trading across borders of an economy are high, then FDI (i.e. investing in domestic production units) becomes the only vehicle through which a large domestic market can be accessed by foreign firms. Over time such investment and technology transfer coupled with the economies of scale offered by a large domestic market make such units competitive enough to become exporters. Some Indian policy-makers justify high Indian tariffs by pointing to such a trajectory (i.e. where FDI intended for accessing domestic market led to exports over a period of time) in areas such automobiles and auto parts and components.

However to effectively use this strategy of high-tariffs and large domestic market size to attract FDI and use such investment as a vehicle to achieve greater competitiveness requires a FDI-friendly regime that ensures that while tariffs remain high, there are minimum barriers to investment. In the Indian case, despite a liberal FDI regime, the transaction costs attributable to various sectoral, regional (i.e. state level), and local regulatory regimes were very high ensuring that FDI, and the prospect of integration into global supply chains they offered, did not materialize to the extent desirable.

Integrating into international production chains also requires a domestic taxation system that is relatively transparent, stable, simple, and ensures that no element of domestic tax is passed on to exports. It is obvious that if the added cost of domestic taxes is passed on to the price of the exported product it will make such products less attractive for procurement within a price-sensitive global supply chain. One long-standing demand of Indian exporters has been the implementation of a long overdue comprehensive nation-wide goods and services tax (GST), Indian version of VAT, to replace a complicated domestic tax structure. A related demand has been the removal of all state and local taxes that are not rebated to exporters to ensure complete zero-rating of exports in terms of domestic taxes. Also, the current procedure for obtaining the tax rebates available on exported products remains complicated, and delays in obtaining such tax refunds negatively impact cash flows and increase costs for Indian exporters.

The fundamental problem in India's lack of success in integrating into global supply chains is due to the high costs of trading across borders and the poor logistical connectivity with regional

economies. The time and costs associated with movement of goods in and out of India are much higher compared to SE Asian counterparts. As Tables 5 and 6 show, India fares poorly in trade facilitation terms when compared with SE Asian economies. Added to this challenge is the fact that cost of domestic movement within India remains high and beset by significant regulatory hurdles (Mitra, 2009). The cost of domestic logistics between certain parts of India can be equal or higher than the cost of logistics associated with much longer distance international movement of the same consignment. India continues to lag behind Asian comparators in terms of trade facilitation, and ranks below other major emerging countries on most trade facilitation indicators.⁵ Trade facilitation and regional connectivity are discussed further below.

Table 4: Number of Documents Required for Export and Cost to Export per Container

Documents Required for Import		Cost to Export (USD per container)	
Korea, Rep.	3	Malaysia	450
Mexico	4	China	500
China	5	Thailand	625
Japan	5	Philippines	630
Thailand	5	Indonesia	644
Taiwan, China	6	Taiwan, China	655
Indonesia	7	Korea, Rep.	680
Malaysia	7	Japan	880
Brazil	8	Turkey	990
Philippines	8	India	1,095
South Africa	8	Mexico	1,450
Turkey	8	South Africa	1,531
India	9	Russian Federation	1,850
Russian Federation	10	Brazil	2,215

Source: World Bank, Doing Business Indicators.

Table 5: Logistics Performance Index-Asian and Emerging Country Comparisons

Customs Efficiency		Timeliness		International Shipments	
Japan	3.79	Japan	4.26	Japan	3.55
Korea, Rep.	3.33	Brazil	4.14	Malaysia	3.5
South Africa	3.22	Korea, Rep.	3.97	Korea, Rep.	3.47
China	3.16	Turkey	3.94	China	3.31
Malaysia	3.11	China	3.91	Thailand	3.27
Thailand	3.02	Malaysia	3.86	South Africa	3.26
Turkey	2.82	Thailand	3.73	Turkey	3.15
India	2.7	Mexico	3.66	India	3.13
Mexico	2.55	India	3.61	Brazil	2.91
Indonesia	2.43	South Africa	3.57	Mexico	2.83
Brazil	2.37	Indonesia	3.46	Indonesia	2.82

Source: World Bank, Logistics Performance Index Indicators.

⁵ While Table 4 indicates that only 9 documents are required for export, the reality is more complicated since several copies of such documents need to be made available to different agencies. Also, since many exports from India receive government incentives, the documentation required for obtaining such incentives also add significantly to level of documentation required.

IV. Liberalization in Services

Services play an important role in the quality of social and economic life of a country. Basic services like transport, communication, health, education, banking, and insurance are intrinsic to ordinary day to day lives of people, and are essential enablers of industrial and agricultural production, and their exchange. A competitive services sector with domestic and foreign private sector participation is an important factor in achieving sustained economic growth and national competitiveness (Hoekman and Mattoo, 2012). Thus, an efficient services sector is a necessity and not an option in the economic life of a country. The paradox remains that many countries are willing to tolerate inefficient services sectors for various political-economic reasons, and India is no exception.

As noted earlier, India undertook major reforms in the services sectors in terms of better regulation and trade liberalization. Some of the most important regulatory changes and liberalization took place in those services sectors that serve as critical inputs to all economic activity, and thus play a very important role in the overall competitiveness and business environment of the economy. Telecommunications, insurance, banking, express logistics, air-transport, airport operations (including cargo operations), and port operations were gradually opened up to private sector participation, followed by some degree of trade liberalization. Private sector participation and FDI in these critical services sectors played a major role in enhancing the productivity and competitiveness of Indian manufacturing in the period between 1992 and 2005 (Mattoo et al., 2006).

However, like in the case of tariff liberalization for manufactured products, certain sectors did not see full trade liberalization, while others were kept completely closed to foreign participation. This was largely due to political economy considerations. The key services sectors where trade liberalization was limited are retail trade, professional services, education, banking, and insurance. The political-economic drivers for financial services sectors, retail trade, education, and professional services are distinct, and deserve separate discussions.

Financial Services: Banking and Insurance

Policy decisions in the liberalization of financial services sectors were subject to two different influences. The decision to allow private participation in banking (1993) and insurance (1999) saw the rapid growth of private sector banks and insurance companies that fast gained market share at the expense of previously entrenched public sector entities, especially in urban areas (middle-class consumers and large corporate customers). Public-sector companies were quick to point out that while they have universal service obligations and are responsible for greater financial inclusion as a mandate from the government, that most private players do not serve non-urban less developed areas or regions, and do not offer the services that cover poorer and more marginalized customers. While this was a legitimate argument, it still did not excuse the operational inefficiency of such public sector firms. However, this created a strong political argument in protecting these entities from even more competition from foreign banks and insurance companies who seek to aggressively seek greater market share with the help of their deeper pockets and concomitant ability to expand their operations rapidly.

The Asian economic crisis in the late 1990s provided the second strain of argument against over exposure of the financial services sector to foreign participation and over de-regulation. Foreign investors in general, but specifically foreign participants in the financial sector, were not seen as long-term stakeholders who will not seek exit strategies in times of crisis when their presence would be required the most. The more recent global financial crisis has further deepened this argument. Thus, all policy attempts to liberalize these sectors, especially insurance (i.e. raise the limit on foreign equity from the current 49%) have met with strong political opposition.

Organized Retail Services: FDI and the Political Economy of Agricultural Support Services

Private retail has been one of the least regulated sectors in India. Single-brand retail stores and smaller ‘multi-brand’ retail stores (kirana or corner stores) have always existed in India. India has allowed foreign participation in wholesale operations and single-brand retail (since 2006) but not in multi-brand retail. While organized multi-brand and single-brand retail have been rising in popularity especially in urban middle-class pockets, traditional markets or ‘bazaars’ and the neighborhood small-scale retailer continued to have an important role in both urban and especially smaller towns and rural areas.

Single-brand retail was completely liberalized in mid-2012 (allowing 100% instead of a cap of 51%), but optimism around such liberalization was quickly dampened due to conditionalities requiring for such entities to source 30% of their sale value from local SME sources. These conditions made it unfeasible for many international investors to consider India as a viable option. For example a company like IKEA cannot maintain its product quality and design innovation commitments if they are forced to source 30% of their sale value from local vendors who are SMEs. Multi-brand retail was liberalized in late 2012, however, like single-brand retail, FDI in multi-brand retail was also made subject to stringent conditions on location, sourcing requirements from SMEs, and the need to invest at least 50% of the total FDI into back-end infrastructure. At the time of writing this article, India has not received a single proposal for FDI in the multi-brand retail sector, despite the government relaxing some of the conditions in August 2013 due to lack of interest on the part of foreign investors.

The political arguments against foreign participation in organized retail, especially in the multi-brand segment are two-fold. First, critics of foreign participation argue that while Indian- owned operations have not been able to attain the kind of scale to threaten the existence of the millions of small retailers in India, foreign giants like Walmart or Carrefour can do precisely that. The second argument contends that large scale retailers can establish a near monopoly in the distribution of food and fresh-produce in the lucrative urban markets and thus be able to dictate terms to India’s farmers.

Proponents of FDI in multi-brand retail argue that it will actually help agricultural supply chain and logistics in India. India wastes as much as 40% of its agricultural output in transit and storage due to grossly inadequate logistical capacity in agriculture (Banerjee et al. 2008). A key lobby against foreign participation in retail is that of some entrenched large-farmers and whole-sellers who would stand to lose from the competition offered by large-scale retail procurers buying direct from farmers using their captive supply-chains. These groups have used state level Agricultural Product Marketing Committee (APMC) Acts that mandate the purchase and sale of farm produce in government regulated wholesale markets to create monopolies over distribution and wholesale of agriculture produce.⁶

Education Services: Poor Regulatory Environment as an Impediment to FDI

Education is the administrative responsibility of state governments, and many state governments have actively encouraged private sector participation in higher education for several decades. Starting in the early 1990s, the burgeoning demand for higher education, especially technical education, led to an explosive growth of private sector engineering and technical education institutes. With a growing middle-class urban population, and an increasingly aspirational rural population driving demand for education, there is an increasing private sector presence in this sector.

Starting in the late 1990s such private sector participation has seen the entry of foreign players through joint-ventures with Indian education institutes. However, the sector remains poorly regulated. While institutions like All India Council for Technical Education (AICTE), University Grants

⁶ In April 2012 APMC traders associations in Maharashtra opposed the State government decision to allow farmers sell directly to retailers (APMC traders oppose direct selling by farmers in Mumbai. Daily News and Analysis, April 18, 2012, http://www.dnaindia.com/mumbai/report_apmc-traders-oppose-direct-selling-by-farmers-in-mumbai_1677369)

Commission (UGC), and Medical Council of India (MCI) have been given over-arching powers to regulate syllabus, fees, teacher and educator salaries, and ensure the quality of education, implementation of such regulations have been relatively poor and beset by scandals related to rent-seeking and opportunistic behavior by the regulators.

Complicating things further is the fact that the power to give permission to an institute to start operations lie with the state governments, while central government agencies like the All India Council for Technical Education (AICTE) and University Grant Commission (UGC) regulate their day to day operations. Such weak regulatory systems benefit the entrepreneurs running private colleges and institutes who profit from being left largely unregulated and therefore unaccountable on issues related to standards, consumer grievances, and transparent audit of financial accounts. A large number of private institutes are actually owned or managed by families of influential politicians (Banerjee et al. 2008).

Given this uncertain state of affairs, the better known Universities and adult and continuing education service providers have not invested in India significantly despite the huge demand for such services. The government has introduced legislation to address the issues related to quality standards in education and redress of consumer grievances⁷ but they are pending legislative approval. Another key piece of pending legislation is the Foreign Educational Institutions (Regulation of Entry and Operations) Bill, 2010 the objective of which is to create an enabling environment for the entry of foreign institutions into India.

However, the Bill lacks clarity on what provisions the foreign institutions may be given an exemption from since they have to follow all other laws in force. This effectively means that they have to conform to standards set by statutory authorities on curriculum, methodology and faculty and mandatory publication of prospectus (Sanyal, 2010), thus ensuring that foreign institutes would have to face a daunting task in bringing in best practices and innovations which could have helped offer alternative systems of education to Indian students than the one currently available in the Indian system.

The debate on education policies and the entry private players is expected to be long drawn given the domestic vested interests that control the huge private education industry in India, expected to touch USD 50 billion by 2015,⁸ and resolution of the above mentioned legislation and their approval would be strongly influenced by such vested interests.

Professional Services

There has been a strong domestic opposition to the liberalization of professional services, specifically legal and accounting services. A large part of the problem is the domestic regulatory environment for these services does not allow development of competitive professional service sector firms. Indian accountancy firms are restricted by regulations under the Chartered Accountants Act that require them to remain partnerships (restricting their size), and prevent them from fully participating in value-added services related to accounting like consultancy by mandating that a firm of chartered accountants engaged in consulting cannot advertise, adopt a chosen name, or solicit such business directly with clients for whom they audit. India does not allow FDI in audit services and restricts partnership to those individuals who have acquired an Indian chartered accountant qualification. However foreign accounting firms are allowed to offer all other services except audit through a fully owned Indian subsidiary.

⁷ Higher Education and Research Bill, The Accreditation Regulatory Authority Bill and The Unfair Practices Bill and the Educational Tribunals Bill

⁸ Includes revenues for private college and technical education, test and preparatory services related to high school and higher education, and adult continuing education (including distance learning courses).

Legal firms are also restricted to partnership form of business and prevented from advertising. Bar Council of India rules allow foreign citizens membership on the condition of reciprocity, i.e. allows foreign lawyers from countries where Indian lawyers are allowed to become members of the local bar. However foreign citizens are restricted from offering litigious services. There was a long-drawn debate on the status of foreign participation in non-litigious services, with different Indian courts taking opposing views on the matter⁹.

Engineering and Architecture services remain fairly open to foreign participation because of the fact that they are less regulated compared to legal and accounting services. However there are some restrictions on foreign nationals from offering architecture services that require licensing in terms of attaining equivalence with local qualifications. All professional services are essentially trade in skills and tasks. In the digitally enabled world of today with falling costs of communication and travel, any attempts to prevent such trade in skills and tasks is a meaningless exercise and restrictions serving no purpose in actually stopping trade. Foreign firms have found alternative ways to enter the market. Many foreign legal firms are now opening liaison offices in Singapore and using it as a base to enter the Indian market. A discussion on how such restrictions are actually detrimental to India's rise as a knowledge services exporter follows.

Strategic Trade Policy for the Services Sector

As has been indicated earlier, the IT services revolution was the outcome of far-thinking policies under the leadership of Prime Minister Rajiv Gandhi in the mid-1980s. The decision to liberalize IT hardware imports and actively pursuing IT implementation in government operations created enabling environment and market opportunities for Indian software firms like Infosys, HCL, TCS and Wipro to slowly develop the capabilities that led to their success in the outsourced IT services market.

The tremendous success of the IT outsourced services exports opened up the way to leverage relatively cheaper Indian skilled human resources for other tasks related to business and administrative services such as customer support, administrative back-office functions, transaction processing, sales, editing, and transcription. Identified by the catch-all phrase, Business Process Outsourcing (or BPO) this represented a fundamental shift in world services trade as developing countries led by India started to compete for white-collar jobs that were traditionally not traded across borders. As new technologies related digital imaging and secure data exchange started to develop and their costs of started to decline, it seemed to offer the possibility of India expanding beyond just IT and basic BPO services to capture larger shares of more value-added professional services in accounting and financial services, engineering, architecture, legal, design, and medical support services.

While this has happened to a limited extent, it has not taken off in a way earlier predicted. Part of the reason lies in the fact that business models and cultures still prevent the offshoring of some core functions even if there are significant costs advantages in doing so. This is especially true for countries like Japan, Germany and France. However part of the failure also lies with lack of more far-sighted trade policies and reforms in India. Indian trade policy in services became IT-centric with an over-emphasis in its trade negotiation priorities on Mode 4 (or liberalization of the movement of people), a critical demand of the Indian IT lobby. In doing so, it did not focus on the barriers preventing the take-off of other services such as behind the border regulatory restrictions on accounting, legal, engineering, architecture, or health related professional services in partner countries. It also paid little

⁹ The Mumbai High court had ruled in 2010 that foreign lawyers are not allowed the practice of law in general, covering both litigious and non-litigious services. The more recent Madras High court ruling of February 2012 held that while foreign lawyers are not allowed to offer litigious services in India, they can offer non-litigious services related to legal advisory and consulting. Very importantly, the Madras High court ruling clearly identified Legal Processing Services (or LPO) to be a non-litigious service. Expectations that the Madras High court ruling would lead to a more liberal trade regime for legal services were quickly dashed by the Supreme Court ruling of July 2012 directing the Reserve Bank of India (the Central Bank) to not permit foreign law firms from opening liaison offices in India

attention to emerging issues in data privacy and data restrictions which are becoming increasingly important¹⁰.

As pointed out earlier, the lack of reforms and liberalization in services like accounting and legal services have prevented Indian professionals from effectively participating in global networks of firms through which these services are offered. Regulations restricting Indian firms from incorporating (by only mandating partnerships as a form of business), offer single-window services (by not allowing association between different types of professionals), and advertise and solicit business have prevented them from attaining economies of scale and global ambitions. A firm mandate towards reform oriented regulation of professional services with a view to making them globally competitive and a trade and export promotion policy designed to make India a professional and knowledge services hub is a critical need of the hour if India is to look beyond IT services.

V. Trade Facilitation in the Context of Trade Policy

The centrality of trade facilitation to competitiveness and attempts to integrate with regional supply chains have already been discussed earlier. It is however important to reiterate that high trade transaction costs will negatively impact the competitiveness especially of those players in the international system that operate with relatively smaller margins and capital base. This means that developing country firms, especially small and medium enterprises, are the ones hardest hit in the absence of meaningful trade facilitation efforts. Since a large number of Indian exporters in some key sectors like textiles, leather and gems and jewelry belong to this small and medium enterprise category, trade facilitation as an issue assumes added significance for Indian policy makers (Roy and Banerjee, 2007).

But surprisingly, the Indian policy response to this critical issue related to India's competitiveness has been characterized by just sporadic attempts by the government to initiate reforms. Several committees and taskforces have been formed since the late 1990s to recommend specific reform initiatives related to export and import processes, customs reforms, administrative reforms related to domestic movement of goods, and trade related infrastructure, but such recommendations have for the most part not been fully implemented. Procedures related to customs and allied agencies and trade infrastructure have improved significantly. But the pace and consistency of such reforms process has not been impressive. This has resulted in India being substantially behind other major exporting countries in terms of key trade facilitation indicators (see Tables 5 and 6). Trade transaction costs still remain a major impediment to India's trade expansion.

India's engagement at the WTO or bilateral agreements in area of trade facilitation has also reflected this benign neglect of trade facilitation reforms. India chose to go with the overall developing country opposition to introduction of the so called 'Singapore' issues that included trade facilitation into the WTO agenda. The Indian position changed only at Cancun in 2003, where while rejecting the other three Singapore issues as distractions away from the core agenda of trade and development set in motion at Doha, India accepted Trade Facilitation as the only Singapore issue to which it was willing to engage in negotiations. But once again, India switched its stance to oppose the WTO Trade Facilitation draft and using it as a bargaining point to dilute WTO opposition to its introduction of the Food Security Bill. But hopefully wisdom has dawned on the policy makers who appear to be inclined to support Trade Facilitation in Bali. Given India's still persistent massive trade transaction costs, one would have expected India to be the developing countries champion of Trade Facilitation in the Doha Round.

¹⁰ The growing importance of these issues is highlighted by the fact that disciplines on data privacy and data security laws have been included in the US-Korea bilateral FTA and are a part of the draft for Trans-Pacific Partnership (TPP) trade talks. India is also expected to include disciplines on data security and privacy in the EU-India trade agreement

While there is a growing recognition of the fact that trade facilitation is a matter of highest priority in the domestic trade reform agenda given the severity of transaction costs prevalent in India, there was very little domestic debate or consultation in terms of arriving at a ambitious agenda that India could take to this discussion at the multilateral level. This lack of a concerted policy leadership to use trade agreements as a means to expedite fundamental domestic reforms related to trade facilitation has also characterized India's bilateral agreements that only refer to generalizations without offering any specific commitments on trade facilitation measures, including in areas related to harmonization of customs processes and recognition of standards and conformity assessment regimes (Roy and Banerjee, 2010).

Political Economy of Trade Facilitation in India

The administrative procedures associated with trade in India are probably one of the most complicated in the world. According to World Bank (1989), a comprehensive audit conducted at the request of one of the authors when he was the Economic Adviser, Ministry of Commerce, an exporter was required to obtain 258 signatures, from 29 agencies, make 118 copies of the same information, key punching of which took 22 hours (Roy, 1996). The entire process involves dealing with a multitude of government agencies that are located at various different places. This was also highlighted in the most comprehensive Ministry of Finance 2004 Working Group on Trade Facilitation (WGTF) Report which provided a detailed roadmap for trade facilitation reforms. Although some of these were implemented immediately after the release of the Report, a lot of reforms unfortunately are still in the pipeline. As a result, while things have improved somewhat since then; the current procedures still continue to be one of the most complicated in the world. This has not received the attention it deserves from Indian policy makers.

While one would have expected this to be a major area of concern for Indian industry, especially in the post-liberalization outward-oriented environment, this has not been so. India's high trade transaction costs hardly evoke protest from established exporters who have a knack of unscrupulously going around the system and getting prompt clearances. There are several other reasons to this general apathy and lack of industry pressure in engaging specific policy areas related to trade facilitation. First, most large organized business groups in India are domestically- oriented and accord a lower priority to issues related to trade facilitation. Secondly, as was pointed out earlier, the level of integration into global supply-chain for those entrepreneurs who export is to a much lesser degree than their counterparts in ASEAN economies and East Asia. This means that they are relatively less sensitive to the criticality of supply-chain management and costs, and are not as aggressive in pushing for related reforms.

Thirdly, given the complications in the regulatory architecture related to international movement of goods, entrepreneurs in India are typically more dependent on agents and middle-men to facilitate trade on their behalf. This has resulted in the formation of a strong lobby of Custom House Agents (CHAs) and other agents who have a vested interest in keeping the system complicated. This is exacerbated by the strong nexus between such agents and middlemen and regulators and administrative agencies leading to a vicious cycle. This is also the primary reason why despite best intentions many reforms do not get adopted, and in if adopted do not get implemented properly at the grass-roots level.

Fourthly, there is no nodal Ministry or government department whose primary focus is trade facilitation. There is also no central Ministry taking the lead in terms of logistics issues. Areas of concern related to trade facilitation are the administrative responsibility of several Ministries and departments such as the Ministry of Commerce and Industry, Finance (Customs and Excise), Shipping and Ports, Road Transport, Railways, and Civil Aviation. Allied agencies at the border that govern regulations related to technical standards include the Ministries of Agriculture, Food, Consumer Affairs, Health, Environment, and Textiles among others.

This means that some genuine industry efforts to lobby for reforms get diluted given the multiplicity of agencies they have to engage with. This also results in poor coordination and lack of administrative urgency in implementing any reforms. Since reforms often involve disempowering departmental fiefdoms it invariably leads to bureaucratic resistance to change. The multiplicity of departments involved ensures that these challenges get compounded. Essentially then industry bodies and other interested stakeholders end up with a sense of fatigue pushing for even small changes in the system.

Recognizing this problem, The WGTF Report recommended setting up a High-Level Inter-ministerial Committee comprising all the agencies listed above. However, this Committee hardly had more than a few meetings. Clearly, this situation needs to change, and the government should assign full authority and accountability to this Committee with the task of implementing trade facilitation reforms.

The Taskforce on Transaction Costs that was established in 2009 by the then Minister of State for Commerce was a positive attempt to solve inter-ministerial coordination problems. The recommendations of this taskforce were actually integrated in the foreign trade policy document in 2010 and implemented accordingly. But the achievements of this taskforce have so far been extremely modest. Hence as recommended in Section V, a National Trade Facilitation Council under a Director General should be a key office of the Independent Trade Policy Council which reports directly to the Prime Minister and is outside the operating line ministries. This will ensure proper inter-ministerial coordination and regular monitoring of the yardsticks of trade facilitation such as cargo dwell time of imports and exports, and speedy administrative approvals for ability to export and import.

Trade Facilitation as Strategic Trade Policy Reform

There is absolutely no excuse for the lack of vision on the part of Indian industry and government as far as trade facilitation is concerned. Both entrepreneurs and the government have become used to a system where solutions to issues of India's trade competitiveness lie in announcing an increasing number of export sops and incentives. While such sops provide short-term incentives that are increasingly difficult to sustain in the face of a growing budgetary deficit, a serious attempt at trade facilitation reforms can add up to 10% of cost reduction to Indian exporters..

A comprehensive agenda for future reforms was offered in the recommendations of the WGTF Report cited earlier. The key recommendations of the WGTF are to:

- To rely on a system based on trust with reliance on self-certification of importers, and ex-post audits, and minimal physical inspection;
- Speedy clearance with full reliance of a state-of-the art risk management system
- Introduce full automation leading to a paperless system with minimum face-face-contacts and signatures, aiming at achieving the following targets:
- Move to a comprehensive single-window system that is genuinely paperless;
- Reducing cargo dwell time to levels comparable to the best performers in South-East Asia;
- Regular monitoring of cargo-dwell times by a High-Level Inter-Ministerial Committee with the full attention of the Prime Minister

In addition, a comprehensive program to reduce the cost of movement of goods within different parts of India and from hinterland to ports needs to be undertaken. The primary goal of this program would be to identify the regulatory bottlenecks to quick and efficient cargo movement within India and their rectification. The regulatory bottlenecks holding up development of ports, coastal shipping, and air-cargo should also need to be addressed.

The above mentioned recommendations represent a critical element of trade policy reforms, and needs to be made a central element in broader policy initiative to reduce the costs of trading across Indian borders. Such reforms would have to also include mid-term goals related to logistics development that prioritize supply-chain facilitation and seek to create infrastructure to support value-added logistics services such as express logistics and cold-chain.

VI. Trade Policy and Regionalism: A Missing Link in India's Strategy

The global economy has been characterized by increasing regional economic integration, more so after the collapse of the Doha round. Several factors have led to the development of ever-closer trade and investment relations between regional partners. Manufacturing supply chains have sought to leverage regional specializations. Firms have sought to take advantage of the economies of scale and market size offered by the larger region in which they operate. Particular natural resource and skill endowments have led to the development of cross-border exchange of natural and human resources. But in several cases it was the strategic considerations that initiated the process of regional integration and paved the way by creating institutions and incentives that led the way to regional economic integration.

The EU, ASEAN, North American Free Trade Agreement (NAFTA), and MERCOSUR were all part of a larger political commitment to regionalism. Trade policy that facilitated regionalism was the product of such strategic decisions, and regional trade and investment agreements were designed to ensure that the overall competitive strengths of the region are maximized. The depth and quality of institutions and incentives coming out the design of such trade agreements played an important role in the relative success of such regional integration. While there is considerable debate in the trade policy literature about the pros and cons of regionalism vis-à-vis a more comprehensive multilateral approach¹¹, regionalism is a reality today and defines the trajectory of globalization. More recent new initiatives such as the US-led Trans -Pacific Partnership (TPP) Agreement and the trilateral trade agreement between China, Japan, and Korea show that countries are continuing to seek to create clusters of economic relations along regional lines. A global economy defined by such clusters of economic relationships along the Pacific and Atlantic rims essentially puts forward the challenge to Indian policy-makers as to where they are as a part of this larger process of economic integration along regional clusters.

The initial steps towards regionalism in India were also dictated by strategic considerations. India chose to reach out to its South Asian neighborhood to leverage economic diplomacy as a means to improve ties with its neighbors. The South Asian Free Trade Agreement (SAFTA) and India-Sri Lanka Free Trade Agreement came out of such initiatives of the mid-1990s. Indian attempts at regionalism have been thwarted by the lack of cooperation from Pakistan. Pakistan still restricts free movement of Indian goods and services in spite of recent initiatives at bilateral rapprochement. Simultaneously India's inability to offer comprehensive and generous market access on a non-reciprocal basis to smaller South Asian neighbors due to vested domestic interests in industries like textiles and ready-made garments represent a more systemic political-economic program. All of these factors have ensured that South Asia remains one of the least integrated regions in the world (Table 6).

The slow progress of the Doha Round since the mid-2000s prompted India to seek bilateral agreements. However, these efforts were largely un-coordinated and FTAs were put into motion even with relatively insignificant markets like New Zealand and Chile. India also invested a lot of negotiating energy in FTAs with industrialized economies like Japan and the EU. One has to question the merit of such FTAs, as industrialized economies have low tariffs on most manufacturing items anyway, with some textile related products being the only exception.

¹¹ A summary of the opposing perspectives are provided by Bhagwati (2003) and Baldwin (2006).

Table 6: Share of Intra-regional Exports and Imports in Total (2011, percent)

	Imports	Exports
Intra-South Asia	2	3
Intra-ASEAN	24	25
Intra-MERCOSUR	17	15
Intra-EU	59	64
Intra-NAFTA	33	48

Source: International Trade Centre, Geneva.

Since agriculture is not included in these FTAs, and India's most critical demand in services, liberalized visa regimes for its professionals is also not included, the marginal gain for India, especially in the light of the negotiating resources invested, is not significant. The authors' efforts to initiate a US India FTA in services in 2004 as a first step to India-US FTA (Roy and Banerjee, 2004) met with stiff opposition from all quarters in the United States. The government of India had fully supported it as it would have removed the main impediments imposed in a major export market on trade in services.

With India's rise as a global economic power in the same period, platforms such as BRICS (Brazil, Russia, India, China and South Africa), IBSA (India, Brazil and South Africa), and RIC (Russia, India and China) evolved to forge partnership with emerging countries like Brazil, China, Russia, and South Africa. While providing India with a space to cement its presence at the global table, such platforms will not serve the purpose of advancing India's international economic priorities in actual terms. Engagement in so many multiple platforms has somewhat eroded the focused regionalism strategy of the late-1990s (Roy, 2012).

The main reason behind this ad hoc approach to bilateral and regional trade agreements is the total lack of a vision and an overall strategy on the part of the Ministry of External Affairs (MEA). Given that economic policy, especially trade policy, is now an integral part of foreign policy and diplomacy, it is most surprising to find that no thought was ever seriously given to have a strong economic cell within the MEA headed by a well-qualified economic adviser. There also appears to be no strong collaboration between the MEA and the Ministry of Commerce and Industry (MOCI) in formulating multilateral and regional strategies. The Trade Policy Department (TPD) in MOCI mostly focuses on WTO policies, leaving the task of bilateral and regional agreements to individual regional division heads. The current institutional arrangement that disperses strategic decisions to the Ministries of Commerce and Industry (MOCI), Finance, and External Affairs, with the support of a Trade and Economic Relations Committee (TERC) chaired by the Prime Minister lacks the necessary depth.

In order to separate the strategic decision making process related to trade and industrial policy from day to day operational issues, a new, independent Trade Policy Council (TPC) needs to be developed outside the line ministries and which reports directly to the Prime Minister (Roy, 2013a). Its role could include strategic decisions on multilateral, bilateral, and regional trade policy, policy related to FDI, policies related to trade facilitation and reducing transaction costs of trade, policies related to domestic regulatory reform in various sectors to reduce the costs of doing business in India, strategic policy making on improving India's competitiveness, policies to improve India's logistical capacity and connectivity with rest of the world, and policies to make India ready for the structural changes in global production focusing on skilling and technological acquisition. The TPC would have three offices--- Office of the Chief Trade Negotiator (OCTN), Office of the Chief Economist (OCE), and Director-General of National Trade Facilitation Council (DGNTFC).

The OCTN could be responsible for all trade negotiations at the multilateral, regional, and bilateral levels. Trade negotiations are a strategic economic objective, and not an administrative one. It is critical to have a small dedicated secretariat that is not burdened with day to day administrative

responsibilities to deal with it. The OCTN could have units to look after multilateral negotiations, bilateral (and regional) negotiations, and specific institutional issues respectively.

The OCE could consist of two units dedicated to two working groups-- the Economic Advisors Working Groups and the National Competitiveness Councils Working Groups. Since the primary function of these working groups would be to draw on a wide range of economic and commercial expertise and intelligence and develop strategies related to improving the overall competitiveness of Indian economy, as well as to provide inputs for negotiations, it is essential that the officers responsible for these two working groups are senior economists with sufficient experience in public policy related work.

The DGNTFC would have the NTFC Policy Working Group (PWG) headed by the DGNTFC, with the mandate to essentially develop trade facilitation solutions in consultation with all stakeholders, both public and private. Thus, the PWG would have senior-level representation from all key line ministries and the private industry. The recommendations of the PWG, once agreed upon would have to be made time-bound in terms of implementation under the close surveillance of the PM. The NTFC would also have a Single Window Committee to ensure a single-window environment for all trade related transactions. The NTFC would also be mandated for developing robust measures of trade facilitation and logistics quality and monitor them on a regular basis by ports and by process.

While the TPC with a small dedicated team would focus on the strategic policy, the administrative and implementation functions would have to be carried out by the MOCI, and the other line ministries. It is high time to create the 21st century institutional framework for India's global trade and investment engagement. In all developed and successful economies, strategic trade decisions are taken at the highest political level, and not left to the narrow focus of the line ministries whose task should be the detailed implementation of these strategic decisions.

Given the current global scenario, it would make sense for India to look to a deeper regionalism with the more dynamic economies in the South East Asia, and simultaneously consider joining the TPP. It already has an FTA with ASEAN in goods and services, and India is also a member of the wider Regional Comprehensive Economic Partnership (RCEP)—ASEAN plus India, China, Japan, South Korea, Australia and New Zealand. The entire focus now should be towards a link to regional supply chains of ASEAN countries. This will require policies to attract FDI that would help create these regional linkages. It would also require Indian government supporting outward FDI by Indian entrepreneurs seeking to invest in the larger South East Asian region and beyond. Well targeted industrial policy to help selected sectors like heavy-engineering, chemicals, industrial machinery, textiles, and electronics improve productivity, acquire technology, and develop new product lines would also help in increasing regional linkages. A more competitive and diverse manufacturing base in India would have more opportunities to find a place in the regional production network.

The critical element of this regionalism is connectivity. India has overland routes connecting it to all of Southern Asia (i.e. Bangladesh, Sri Lanka, and ASEAN economies). It also shares a coastline along the Bay of Bengal with the wider Southern Asian region. An ambitious long-term vision to ensure economic connectivity between India and the rest of Southern Asia is critical to India's trade policy objectives in pursuing regional agreements with ASEAN economies. Connectivity would not only encompass road, rail, air, and sea linkages but also linkages between Indian and Southern Asian energy networks (pipelines and electricity grids). It would also include institutional mechanisms to facilitate movement of people (thus enabling services trade), customs and other regulatory harmonization, and liberalization of education, health, banking and financial services.

India also needs to have some form of trade agreement with its strategic partner USA, and also with some other countries in the Pacific region. In this regard, TPP offers the best opportunity for India. Apart from US, and some RCEP countries, India would also be able to link with the growing markets of Canada, Mexico, Peru and Chile. India would benefit greatly by ultimately linking to these mega-

regional supply chains. Most importantly, this would help revive the lost momentum of a decade old US-India Strategic Partnership.

Membership of TPP however is not automatic. India will have to fulfill the strict requirements of elimination of tariffs and other barriers to trade and investment, a WTO + IPR regime and trade in services, adherence to competition policy, trade facilitation, investment policy, and government procurement. Labor and environment policies are also in the agenda though how far these will be enforced is not yet clear. Given the diversity of membership in TPP, same rules obviously will not apply to all countries. Also, India does need to move swiftly on most of these policies on its own to fulfill its objective of becoming a major global player. It is high time that India develops a bold and well-focused 21st century regionalism strategy (Roy, 2013b).

VII. Conclusion

India's size, demographics, and economic resources make it a natural candidate for being one of the major global economic players. Preventing this from happening is a lack of an outward-oriented mindset in both government and industry circles. There is still a lurking fear that exposure to foreign competition may be risky, and free inflow of unrestricted FDI will not serve national interests. The necessity of external competition to be fully competitive is still not widely accepted. However, exposure to international competition and participation in global production networks are the only way to ensure sustainable growth through achieving both domestic and international competitiveness. Limiting exposure of national industries to global competition cannot be sustained in an increasingly inter-connected global economy, and in the longer-term only reduces the capability of Indian domestic players from gearing up to face competition head-on and establish themselves as major players in the international stage. The rise of a new breed of Indian MNCs only highlights what is possible with a proper vision.

The reforms process since the mid-1980s dismantled a highly protectionist and regulated system and replaced these with a more open trade regime subject to less internal government control over production and investment decisions. The expectation was that after a decade of such structural reforms that represented the first phase of transition, more strategic, or next generation reforms would follow on a natural course. Such reforms would include policies that remove institutional and regulatory barriers to trade and investment, reduce massive transaction costs of trading and investing in India, and create incentives for greater investment in productivity, technology, and participation in cross-border production networks.

However the Indian political economy had powerful entrenched lobbies in both the manufacturing and services sectors. They have managed to slow down the pace of structural reforms by not allowing full implementation of the next generation trade reforms even after two decades of very successful and comprehensive trade liberalization. An additional obstacle to reforms is managing parties with different political agenda within the ruling coalition. Some of these parties, and the principal opposition party, are at the helm in important states. This has unfortunately resulted in a reduced focus in deliberation, development, and roll-out of the more strategic aspects of trade policy and institutional reforms related to trade and investment facilitation, efforts to incentivize manufacturing and services competitiveness and global supply chain integration, and focused regionalism.

Strategic trade policy has been taken over in India's Foreign Trade Policy by a continuation of short-term fiscal measures related to offering of export incentives as sops for exporters. Although import licensing was dismantled in 1991, there are still hangovers of incentives for exporters that are still the eagerly awaited center piece of the official annual Exim Policy.

The global economy is getting increasingly specialized along value-chains that have regional dimensions. Firms based in the industrialized countries are becoming specialized in supplying intellectual property, technical and management expertise. They are also developing global supply-

chains based on brand-equity and large investments in logistics and distribution channels. Actual production of goods and services are becoming increasingly fragmented with regional production networks playing a key role.

Emerging country firms are seeking to maximize their participation within this international system by both integrating more rapidly within regional production and distribution networks, and by acquiring greater technological capability and intellectual property so as to claim a larger share within the international value-chain. India cannot afford to be a by-stander in this process of evolution. It needs to ensure that its trade and related economic policies are designed according to the needs of this evolving system. Large Indian firms are already finding their way through their own initiatives. The rest should follow their directions with the government providing them with the enabling environment through trade policy.

However, to ensure that Indian participation in the global economy is not restricted to a few players, a more long-term strategic view is the need of the hour. This calls for the completion of structural reforms that started in 1991 and initiation of a robust set of next generation trade policy reforms. As discussed in this paper, next generation reforms include comprehensive trade and business facilitation, a proactive policy for the development of services trade linkages, and strategic engagement in regionalism with an ambitious and comprehensive trade negotiation agenda with the aim of concluding trade agreements that have depth. Next generation reforms also include significant domestic reforms agenda that goes beyond conventional trade facilitation and addresses the broader concept of business facilitation focusing on such areas such as inter-state movement of goods, labor laws and regulatory simplification at both the central and state level¹². The government must push through these reforms by continuous dialogue within the ministries, and among the various political parties, private sector, parliamentarians, and the media.

There is no indication so far that the government has the political will to carry out the next generation trade reforms described in this paper. Nor is there a serious move to formulate a regionalism strategy that will benefit India. From our discussions in this paper it is clear that India should focus more towards the East, and the ultimate aim of the Look East Policy should be for India to be a prominent member of the enlarged RCEP and TPP. , the latter will ensure a strategic economic partnership with India's largest trading partner, USA. It needs to be pointed out that TPP and RCEP need not be mutually exclusive geo-economic strategies as the thinking among some policy-makers and intelligentsia in India seems to suggest. Several Asian countries, including Japan, Malaysia, Vietnam, and Singapore are pursuing both.

Hopefully, since the elections are just a few months away, the next government, will, soon after it takes office, come out with a clear vision that outlines the urgency of implementing the next generation trade reforms, and a well-articulated regional strategy. Failure to do so will be costly in terms of growth and poverty alleviation. The success of an outward oriented development strategy that India adopted in 1991 is intrinsically tied to it. So is the achievement of a high and sustained growth that is both inclusive and employment generating. Trade policy more so now needs to be an essential pillar to India's development strategy in a rapidly integrating and volatile global economy.

¹² Most of these reforms have been discussed at length in this paper. A broader and more comprehensive approach to such reforms can also be found in Roy (2013c).

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