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Raj Bhala, *First Generation Indian External  
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## FIRST GENERATION INDIAN EXTERNAL SECTOR REFORMS IN CONTEXT

**RAJ BHALA\***

*India's first generation external sector reforms are a fascinating case study of emergence from a post-Independence socialist-style economy to the world's largest free market democracy. Part I of this article reviews the Indian license Raj system that prevailed after the 1947 Partition of India until the decade of the 20th century. Part I explains the hallmarks and inefficiencies of that system. Part II discusses the reforms that began in earnest in 1991.*

*Part II focuses on reforms in the external sector, foreign direct investment, and the financial sector. Unfortunately, those reforms lost momentum by the early 2000s.*

*Thus, Part III analyses what happened, namely, backsliding on tariff cuts, persistent tariff escalations, and difficulties in the banking sector and in attracting FDI. Part III points out that India fared poorly as a result relative to its neighbours on the Sub-Continent.*

*Part IV concludes that the economic challenges India still faces in pushing ahead with reforms so that it remains not just the world's biggest free market democracy, but so that it becomes the most exciting and dynamic one, are largely political. Get the politics right, and India's future is bright.*

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## I. POST-INDEPENDENCE INDIAN LICENSE RAJ SYSTEM

A. *Partition*

An ancient civilisation, the modern Indian nation was born at the stroke of midnight on August 15, 1947. At that moment, the British Partition took effect, creating “India” in Hindu-majority areas, and “Pakistan” in Muslim-majority areas. The Partition was hardly perfect. Hindus and Sikhs on the Pakistan side of the line streamed into the Indian Punjab, while some Muslims on the Indian side shifted to Pakistan. Ten million people moved; the largest exodus in human history. One million were killed in communal violence, Hindus and Sikhs on Muslims, and vice versa. Ghost trains pulled into Amritsar and Multan, the occupants having been slaughtered.

Visually, Partition scenes are depicted in the epic film *Gandhi* (1982), which won eight of the eleven Academy Awards for which it was nominated, including Best Picture, Best Director (Sir Richard Attenborough), and Best Actor (Ben Kingsley as the Mahatma). Many writers have chronicled the Partition: Sir Penderel Moon, the former Chief Commissioner for Himachal Pradesh, in *Divide and Quit – An Eyewitness Account of the Partition of India* (1961); Anita Inder Singh, an

international affairs scholar, in *The Origins of the Partition of India: 1936-1947* (1987); and, Yasmin Khan, a historian, in *The Great Partition – The Making of India and Pakistan* (2007). But no book on the Partition bests *Freedom at Midnight* (1975), by journalists Larry Collins and Dominique Lapierre.

The debate strewn across thousands of pages about the cataclysmic events and repercussions of the Partition continues. Why did it occur? Was it necessary? And the debate about the giant figures of Partition continues: Jawaharlal Nehru (1889-1964), the first Indian Prime Minister (1947-1964) and an intellectual giant; Muhammad Ali Jinnah (1876-1948), the first Pakistani leader (1947-1948), its *Quaid-i-Azam* (Great Leader) and Baba-i-Qaum (Father of the Nation); Lord Mountbatten (1900-1979), the last British Viceroy of India (1947) and first Governor-General of the independent Union of India (1947-1948, from which the Republic of India emerged in 1950); and, of course, the *Mahatma*, Mohandas Karamchand Gandhi (1869-1948) or *Bapu* (Father of the Nation). What were their motives, their strokes of genius, and their tragic mistakes? The legacy of Partition lives on in the children (such as your author) and grandchildren of the parents who lived and died in that era through countless family stories, mementos, and novels like *Train to Pakistan* (1956), by Khushwant Singh, and *Midnight's Children* (1980) winner of the 1981 Booker Prize, by Salman Rushdie.

The legacy of Partition also lives on in international trade law.<sup>1</sup> GATT provided a *sui generis* provision, Article XXIV:11, for India and Pakistan, in light of the “exceptional circumstances arising out of” their creation.<sup>2</sup> Seeing that the two newly independent countries had “long constituted *an economic unit*”, the GATT contracting parties granted India and Pakistan special dispensation from multilateral trade disciplines to enter into “*special arrangements* with respect to the trade between them, pending the establishment of their mutual trade relations on a *definitive* basis”.<sup>3</sup> They forgot this special mercy, this permission naming only them to “depart from particular provisions of” GATT as long as they fulfilled its objectives.<sup>4</sup> Never taking advantage of it, never establishing definitive trade arrangements, they instead fought three wars. India won them all: in 1965; 1971, resulting in the split of West and East Pakistan, the latter becoming the new nation of Bangladesh; and 1999, an undeclared war fought in the icy climbs of the Himalayas in Kashmir, the key Muslim-majority area the British left to India.<sup>5</sup> To

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<sup>1</sup> See Raj Bhala, *The Forgotten Mercy: GATT Article XXIV:11 and Trade on the Subcontinent*, 2002(3) N.Z. L. REV. 301-337 (2002).

<sup>2</sup> General Agreement on Tariffs and Trade art XXIV:11, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 (emphasis added).

<sup>3</sup> *Id.* at art. XXIV:11 (emphasis added).

<sup>4</sup> *Id.* at art. XXIV: 11.

<sup>5</sup> See STANLEY WOLPERT, *INDIA AND PAKISTAN – CONTINUED CONFLICT OR COOPERATION?* (2010) (for a primer on the nearly seven decades of conflict between the

this day, mutual suspicion overrides what obviously is a geographically and culturally free trade region. Though original contracting parties to GATT, only recently did each side even grant Most Favoured Nation (MFN) treatment to the other.

*B. Socialism, Nationalism, and Anti-Colonialism*

Prime Minister Nehru and his economic leadership team were enamoured with socialism.<sup>6</sup> That was for understandable (if not entirely accurate) reasons, which had become deeply “embedded in the Indian freedom struggle”, concerning capitalist imperialism and income inequality:<sup>7</sup>

[S]ince the British had come to trade and stayed on to rule, Nehruvian nationalists were deeply suspicious of foreigners approaching them for commercial motives.

Nehru, like many Third World nationalists, saw the imperialism that had subjugated his people as the logical extension of international capitalism, for which he therefore felt a deep mistrust. As an idealist profoundly moved by the poverty and suffering of the vast majority of his countrymen under colonial capitalism, Nehru was attracted to non-capitalist solutions for their problems. ... As a democrat, he saw the economic well-being of the poor as indispensable for their political empowerment, and he could not entrust its attainment to the rich.<sup>8</sup>

The February 1927 Brussels International Congress Against Colonial Oppression and Imperialism, at which Jawaharlal Nehru represented the Indian National Congress Party, is said to have “confirmed his conversion to socialism”.<sup>9</sup>

He, like many leaders in the Quit India Movement seeking independence from Britain, had been schooled in England. Fabian Socialism was popular in the early 20<sup>th</sup> century, the way *laissez-faire* economics was in the 1980s, and continues to be in some ideological circles. And though from a supremely privileged background, Nehru was acutely aware of the desperate poverty of India. So, at the 1936 annual

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two countries).

<sup>6</sup> See SHASHI THAROOR, *NEHRU – THE INVENTION OF INDIA* 240 (2003) [hereinafter THAROOR].

<sup>7</sup> *Id.* at 239.

<sup>8</sup> *Id.* at 239-40.

<sup>9</sup> *Id.* at 55.

Congress Party meeting in Lucknow, Nehru confessed:

“I am convinced that the only key to the solution of the world’s problems and of India’s problems lies in socialism.... I see no way of ending the poverty, the vast unemployment, the degradation and the subjection of the Indian people except through socialism. That involves vast and revolutionary changes in our political and social structure,... a new civilisation radically different from the present capitalist order. Some glimpse we can have of this new civilisation in the territories of the USSR [Union of Soviet Socialist Republics].... If the future is full of hope it is largely because of Soviet Russia.”<sup>10</sup>

So:[l]ike many others of his generation, Nehru thought that central planning, state control of the “commanding heights” of the economy, and government-directed development were the “scientific” and “rational” means of creating social prosperity and ensuring equitable distribution.<sup>11</sup>

Yet, Nehru was nothing if not independent of mind, and nothing if not an Indian above a socialist.

He declared after the 1927 Brussels International Congress Against Colonial Oppression and Imperialism that “[p]ersonally I have the strongest objection to being led by the nose by the Russians or anyone else”.<sup>12</sup> Indeed, he wrote in 1919 that:

Present-day democracy, manipulated by the unholy alliance of capital, property, militarism and an overgrown bureaucracy, and assisted by a capitalist press, has proved a delusion and a snare. [But,] Orthodox Socialism does not give us much hope.... [A]n all-powerful state is no lover of individual liberty.... Life under Socialism would be a joyless and soulless thing, regulated to the minutest detail by rules and orders.<sup>13</sup>

Thus, when confronted with a tradeoff between nationalism and socialism, he chose the former, indeed being the glamorous face of Indian nationalism and

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<sup>10</sup> *Id.* at 174.

<sup>11</sup> *Id.* at 240.

<sup>12</sup> *Id.* at 57.

<sup>13</sup> *Id.* at 174.

modernity to complement the other-worldly, deific status of the Mahatma.<sup>14</sup>

Not surprisingly, when their quarters changed from the jails of colonial India to government offices, and their work changed from challenging the British Empire through non-violent means to running a nation, Nehru and his Independence movement colleagues put into practice economic strategies that were *de rigueur* in their era, but refused the political step of entering the Soviet or Chinese Communist orbit. For his entire tenure as Prime Minister, Nehru would strive for a middle path, picking the best of socialist economic strategies for the Indian context and avoiding capitalist extremes, but equally avoiding the excesses of socialism. In that effort, he was *avant-garde*: how many critics of the global economic order and the world trading system understand the failures of socialism, but are repulsed by American capitalism and its current crop of ignorant and petty champions?

### C. Three Hallmarks of Post-Partition Socialist Style Planning

In respect of international trade, steering a middle course did not mean complete autarky, or *laissez-faire* free trade. To the extent feasible, it meant self-sufficiency and self-reliance, “twin mantras” that disallowed western corporations from entering India to exploit its resources and oppress its people.<sup>15</sup> In turn, self-sufficiency and self-reliance translated into a trade strategy of import substitution, a preference for the use of domestic inputs into finished manufactured goods rather than imports.<sup>16</sup> Import substitution was one hallmark of post-partition socialist style planning. To implement it, India set up a system that came to be known as the “License Raj,” a term coined in 1959 by statesman and scholar Chakravati Rajagopalachari (1878-1972), or “Rajaji,” a lawyer, veteran of the Quit India Movement and the last Governor-General of India (1948-1950).<sup>17</sup>

Tariffs were levied at high rates to impede importation, and quantitative restrictions (QRs) were imposed. Licenses and quotas, anathema to free market economists as being inefficient, were the two key QRs used. So, to import or export most categories of merchandise, a government-granted license was needed,

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<sup>14</sup> *Id.* at 100-1, 175.

<sup>15</sup> *Id.* at 240.

<sup>16</sup> See Anne O. Krueger & Sajjid Z. Chinoy, *Introduction*, in REFORMING INDIA’S EXTERNAL, FINANCIAL, AND FISCAL POLICIES 1 (Anne O. Krueger & Sajjid Chinoy eds., 2003) [hereinafter ANNE & SAJJID – *Introduction*]; See RAJ BHALA, INTERNATIONAL TRADE LAW: INTERDISCIPLINARY THEORY AND PRACTICE 1245-46, 1265 (3<sup>rd</sup> ed. 2008) (for an explanation and analysis of import substitution) [hereinafter BHALA, INTERDISCIPLINARY THEORY].

<sup>17</sup> See Ramachandra Guha, *The Delhi Dilemma*, FINANCIAL TIMES, July 13-14, 2013, at 10 (*reviewing* AMARIYA SEN & JEAN DRÈZE, AN UNCERTAIN GLORY: INDIA AND ITS CONTRADICTIONS (2013)) [hereinafter Guha, *Delhi Dilemma*].



and the government fixed quantities of imports or exports by quota. Only private enterprises favoured by the Indian government were granted such licenses, and favouritism often resulted from historic pre-Partition relations between political officials in the Indian National Congress on the one hand, and agricultural landowners and capitalist industrialists on the other hand. To be sure, corruption and nepotism characterized many such linkages. Indeed, corruption, plus a decrepit physical infrastructure, remains India's greatest barrier to robust growth and sustained poverty alleviation.

Import substitution, however sorry its effects in historical and neo-classical economic perspective, was not a fanciful Fabian or economically irrational strategy. In agriculture, it reflected concerns about food security, which given the country's history of famines and dependence on Britain even for salt – an injustice Gandhi poignantly laid bare with his famous March 12 - April 6 1930 Salt March – was understandable. India pursued self-sufficiency in food. To feed its growing population, India did not want to be a “peripheral” country reliant on food imports from “centre” countries like Great Britain, much less food aid from the United States or Soviet Union that those donor countries could use to pressure India to support one or the other side in the Cold War.<sup>18</sup> Indeed, the population did grow from 361.1 million in 1951 to 447.8 million in 1960 to 1.241 billion in 2011.<sup>19</sup>

In industry, how else could India industrialize, develop vertically integrated manufacturing, mature to developed country status, and thereby avoid dependence as a “peripheral” country on “centre”, but through import-substituting production? India had just endured over a century of dependence on England for manufactured garments, being confined to the role of providing British textile and apparel (T&A) mills with cotton. Here again, the Mahatma had poignantly demonstrated the injustice with his *khadi* (homespun) campaign.

Import substitution was one of three hallmarks of socialist-style economic planning that characterized India in its first four decades of independence. The

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<sup>18</sup> The references to “center” and “peripheral” countries, and “dependency” or “reliance,” are to Dependency Theory and World Systems Theory. See DEPENDENCY THEORY – A CRITICAL REASSESSMENT (Dudley Seers ed. 1981) and IMMANUEL WALLERSTEIN, THE ESSENTIAL WALLERSTEIN (2000). These Marxist-tinged Theories are out of favour in the present era of free market economics and global supply chains. Yet, query whether such chains, which link low-valued added operations in poor countries with higher value-added activities in rich ones, actually are evidence in favour of these Theories. The Theories are reviewed in BHALA, INTERDISCIPLINARY THEORY, *supra* note 17, at 1265-1276.

<sup>19</sup> See *Demographics of India*, WIKIPEDIA, [http://en.wikipedia.org/wiki/Demographics\\_of\\_India](http://en.wikipedia.org/wiki/Demographics_of_India) (last visited Aug. 26, 2013).

second hallmark of socialist style economic planning that characterized India in its first four decades of independence was widespread use of state owned enterprises (SOEs). The government reserved large swathes of the economy – such as airlines, banking, electricity, insurance, oil and gas, shipping, telephones – entirely for SOEs.<sup>20</sup> There they held monopoly positions. SOEs even had monopoly positions on importation of bulk consumer goods. In other sectors, SOEs played a significant, sometimes pre-eminent, role: bakeries, fertilizers, heavy chemicals, hotels, infrastructure, machine tools, and steel.<sup>21</sup> Across all sectors, the government imposed strict investment licensing requirements, akin to its QRs in international trade. These licenses, too, were part of the License Raj system: to engage in private direct investment or technological development, a private enterprise needed a license.<sup>22</sup> Via them, the government directed private economic activity toward its overall aims of food self-sufficiency and industrialisation.

The third hallmark of post-Partition Indian economic strategy was conservatism in both fiscal and monetary policies. For the first 35 years of Independence, *i.e.*, from 1947 to 1982, these policies were less expansionary than in other developing countries.<sup>23</sup> Only in the mid-1980s did Indian fiscal policy turn expansionary, contributing to annual economic growth of over 5 percent. Yet, having been too conservative for too long, that policy was now too liberal. Inflation rose above 13 percent, foreign debt increased dramatically, and in 1991 India faced a balance of payments crisis (BOP), with foreign exchange reserves covering less than two weeks' worth of imports.<sup>24</sup> This unsustainable course had to be reversed, and therein was a catalyst for the 1991 reforms.

Underlying these hallmarks was fear. India was afraid of world markets and foreign and portfolio investors. To rely on their markets for export revenues from sales of Indian agricultural or industrial output, or for inputs into Indian goods, was to be vulnerable to their exploitation. Emerging from centuries of foreign control, why should Indians risk neo-colonial dependence, “neo” in the sense that such dependence was via the so-called “free” market?

In sum, “[f]or more than four decades after India attained independence in 1947, Indian economic policy was governed by a philosophy that emphasized inward-oriented, state-led development.”<sup>25</sup> Yet, India resisted Communism, that is, full public ownership of the means of production, in contrast to the China of Mao

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<sup>20</sup> See ANNE & SAJJID – *Introduction*, *supra* note 16, at 1.

<sup>21</sup> See *id.*

<sup>22</sup> See *id.*

<sup>23</sup> See *id.*

<sup>24</sup> See *id.*

<sup>25</sup> See *id.*

Zedong (1893-1976). “Red” China became independent under the Chinese Communist Party (CCP) on 1 January 1949, and before it, the Soviet Union, fell under Bolshevik control in November 1917. Indians would never accept the human rights cost incurred by Communist central planning, yet nor would they agree to unbridled Capitalism with its excesses. India sought a third way, and championed the Non-Aligned Movement (NAM), a highpoint for which was the April 1955 Bandung Conference, attended by India and 28 other newly independent Asian and African countries representing roughly 25 percent of the surface of the earth and 1.5 billion people.<sup>26</sup>

During the Cold War, India became adept at the balance of power politics. In August 1971, Prime Minister Indira Gandhi (1917-1984) signed the 20-year Indo-Soviet Treaty of Peace, Friendship, and Cooperation with Soviet General Secretary Leonid Brezhnev (1906-1982), which helped India offset the American alliance with Pakistan. Yet, as a democracy with a large Non-Resident Indian (NRI) population in the United States and its former colonial master, the United Kingdom, Indians – while not wanting to be a proxy for either the American or Soviet superpower – had no strong hostility towards, but rather warm links to, the non-Communist west.

#### D. 1970s: Inefficiencies

Indian economic policy in the first few decades after Partition achieved some successes. India became self-sufficient in food, and even a net exporter of certain farm products. That was thanks to the Green Revolution, particularly in Punjab.

However, by the 1970s, it was clear that Indian economic growth and development lagged behind that of its East Asian counterparts. India was anything but an international trade powerhouse under the License Raj system:

The result [of the system and its drive for self-sufficiency and self-reliance] was a state that ensured political freedom but presided over economic stagnation; that regulated entrepreneurial activity through a system of licenses, permits, and quotas that promoted both corruption and inefficiency but did little to promote growth; that enshrined bureaucratic power at the expense of individual enterprise. *For most of the first five decades since Independence, India pursued an economic policy of subsidizing unproductivity, regulating stagnation, and distributing poverty.* Nehru called this socialism.<sup>27</sup>

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<sup>26</sup> See *Asian-African Conference*, WIKIPEDIA, [http://en.wikipedia.org/wiki/Asian-African\\_Conference](http://en.wikipedia.org/wiki/Asian-African_Conference) (last visited Aug. 26, 2013).

<sup>27</sup> THAROOR, *supra* note 6, at 241 (emphasis added).

Indeed, the contrast between its performance and the export-oriented growth of East Asian countries, especially the Four Tigers (or Dragons) Hong Kong, Korea, Singapore, and Taiwan, was vivid. Bloated with underemployed, low-human capital workers, and plagued by politicized decision-making, Indian SOEs were infamously inefficient. During the Thatcher-Reagan Era (1979-1991), as other Asian countries began liberating their SOEs from government controls and converting them into private enterprises operating on commercial principles, India stood out as a laggard in privatisation.

So, for all its fascinating ancient ethnic, culinary, linguistic, and religious traditions and pluralism, for all its lively post-Partition democratic elections, in the first 40 years after Partition, India had marginalized itself in the world economy.<sup>28</sup> Between 1950 and 1973, world exports grew at an annual average rate of 7.9 percent. Exports from India rose only 2.7 percent in that period.<sup>29</sup> The ratio of Indian exports to GDP actually fell from its high of 7.3 percent in 1951 to its low of 3 percent in 1965, and stayed under 4 percent until 1973.<sup>30</sup> In that respect, at least, import substitution was working. Among its neighbours to the east, India had fallen behind economically to the likes of the Four Tigers, and indeed most of East Asia. The gap between the Elephant and Tigers seemed to be widening as the decades after the Second World War and Partition passed. To be sure, Bollywood churned out movies and songs, but with poor quality, and only to the Sub-Continent, Middle East, and Africa.

While major multinational companies (MNCs) like Honda, Toyota, and Sony emerged from Japan, and Hyundai and Samsung from Korea, no household name or brand emerged from India:

The mantra of self-sufficiency might have made some sense if, behind these protectionist walls, Indian business had been encouraged to thrive. Despite the difficulties placed in their way by the British Raj, Indian corporate houses like those of the Birlas, Tatas, and Kirloskars had built impressive business establishments by the time of Independence, and could conceivably have taken on the world. Instead they found themselves being hobbled by regulations and restrictions, inspired

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<sup>28</sup> See T.N. Srinivasan, *Integrating India with the World Economy: Progress, Problems, and Prospects*, in REFORMING INDIA'S EXTERNAL, FINANCIAL, AND FISCAL POLICIES 17-19 (Anne O. Krueger & Sajjid Chinoy eds., 2003) [hereinafter Srinivasan].

<sup>29</sup> See *id.* at 17 (The year 1973 was a watershed, because of the Arab oil embargo and its adverse effects on the world economy).

<sup>30</sup> See *id.*

by Nehru's socialist mistrust of the profit motive, on every conceivable aspect of economic activity: whether they could invest in a new product or a new capacity, where they could invest, how many people they could hire, whether they could fire them, what sort of expansion or diversification they could undertake, where they could sell and for how much. Initiative was stifled, government permission was mandatory before any expansion or diversification, and a mind-boggling array of permits and licenses were required before the slightest new undertaking.<sup>31</sup>

Conversely, none of the foreign household names thought much of investing in India: at the start of the 1990s, of all foreign direct investment (FDI) attracted by developing countries around the world, India got less than 1 percent of it.<sup>32</sup>

India fared no better as a destination for portfolio investment, attracting just 3 percent of all investment funds obtained by developing countries at the start of that decade.<sup>33</sup> The lack of financial capital flows into India, coupled with socialist-style central government planning, doomed prospects for most would-be Indian private sector entrepreneurs. With foreign capital going to the likes of the Tigers, and with the Indian government taking loans from state-run banks, unless an entrepreneur had a pool of personal savings or family capital on which to draw, how could she establish and build a business? Even if she could, her company would have to navigate decrepit physical infrastructure and a stultifying, corrupt political bureaucracy. Small wonder that millions of Indians left the country, a major brain drain in the first 40 years after Independence.

Most tellingly, but unsurprisingly, was the bottom line statistic on economic growth: from the late 1940s to 1980, Indian Gross Domestic Product (GDP) grew at a pathetically low 2 percent *per annum*, nowhere close to the rates in East Asia:<sup>34</sup>

The combination of internal controls and international protectionism gave India a distorted economy, underproductive and grossly inefficient, making too few goods of too low a quality at too high a price. Exports of manufactured goods grew at an annual rate of 0.1 percent until 1985; India's share of world trade fell by four-fifths. Per capita income, with a burgeoning population and a modest increase in GDP, anchored India firmly to the bottom third of the world rankings. The public sector,

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<sup>31</sup> THAROOR, *supra* note 6, at 242-3.

<sup>32</sup> See Srinivasan, *supra* note 28, at 17-59.

<sup>33</sup> See *id.*

<sup>34</sup> See ANNE & SAJJID – *Introduction*, *supra* note 16, at 1.

however, grew in size though not in production, to become the largest in the world outside the Communist bloc. Meanwhile, income disparities persisted, the poor remained mired in a poverty all the more wretched for the lack of means of escape from it in a controlled economy, the public sector sat entrenched at the “commanding heights” and looked down upon the toiling, overtaxed middle class, and only bureaucrats, politicians, and a small elite of protected businessmen flourished from the management of scarcity.<sup>35</sup>

As intimated, under the License Raj system, well-connected families prospered. Names like “Ambani,” “Birla,” and “Tata” were household ones in India. But, few Americans would have recognized them as akin to the Carnegies or Rockefellers. India had proved itself a power on the Subcontinent in its victories over Pakistan, and even shown its scientific and military potential with its 1974 successful nuclear test. However, it was no match for China, which it found out in a brief 1962 border war. In sum, in a haunting phrase purportedly heard among the United States Departments, India was “the biggest country that didn’t matter.”

## II. 1991 FIRST GENERATION REFORMS

### A. Overview

Dr. Manmohan Singh (1932-), whose party, the Indian National Congress, had led the Quit India Movement and governed India for most of the post-Independence period, understood the need for reform. Coming to the position of Finance Minister in 1991 under Prime Minister P.V. NarasimhaRao (1921-2004), he eventually became Prime Minister in 2004. As Finance Minister, he faced the 1991 BOP crisis. He was well prepared. He had trained as an economist, culminating with a dissertation he wrote at Oxford entitled “India’s Export Performance, 1951-1960”, under the supervision of renowned development economist I.M.D. Little (1919-2012). (The dissertation became a book in 1964, *India’s Export Trends and Prospects for Self-Sustained Growth*.)

In 1991, Singh ushered in the dramatic, first generation economic reforms. They were dramatic in that they were “structural”, dismantling many post-Partition socialist-style policies.<sup>36</sup> The changes aimed to unshackle Indian firms and entrepreneurs from red tape, foster competition, and open India to the global economy.

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<sup>35</sup> THAROOR, *supra* note 6, at 243-44.

<sup>36</sup> ANNE & SAJJID – *Introduction*, *supra* note 16, at 2.

The reforms may be put into three broad categories: External Sector Reforms, Foreign Direct Investment (FDI) Reforms, and Financial Sector Reforms. Each is discussed in turn below, with greatest emphasis on the first category. Across all three categories were three common denominators: de-regulation, privatisation and rationalisation.

### B. *External Sector Reforms*

The “external sector” refers not only to international trade (imports and exports), but also to exchange rates and capital flows. Indian reforms on trade were particularly impressive, even dramatic:

Some of the most far-reaching reforms were focused on restoring the health of the external sector. They included the transition to a market-determined exchange rate, major reductions in customs tariffs, phased elimination of quantitative restrictions on imports, decisive opening up to foreign direct and portfolio investment, strict controls on external debt, and the deliberate buildup of foreign exchange reserves.<sup>37</sup>

More precisely, with respect to traditional international trade law matters, there were five dimensions to the 1991 reforms: (1) cutting the average level of tariffs; (2) reducing maximum tariff levels (peaks) in a phased manner; (3) attacking tariff dispersion and tariff escalation; (4) simplifying the tariff schedule; and (5) dismantling the License Raj. A sixth dimension, closely related to trade but not conventionally considered within the boundaries of multilateral trade rules, concerned exchange rate liberalisation.

#### 1<sup>st</sup>: Average Tariff Levels

India cut its applied (as distinct from bound) Most Favoured Nation (MFN) tariffs on industrial goods from an overall average of 15 percent to an average of 12.5 percent. In 1990-1991, across all merchandise categories, the average Indian import-weighted tariff was 87 percent, and 164 percent on consumer goods.<sup>38</sup> But, by 1996-1997, the average imported-weighted tariff tumbled to 24.6 percent.

#### 2<sup>nd</sup>: Tariff Peaks

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<sup>37</sup> Shankar Acharya, *Comment – Opening the Economy: Further Reforms, in REFORMING INDIA’S EXTERNAL, FINANCIAL, AND FISCAL POLICIES* 57 (Anne O. Krueger & Sajjid Chinoy eds., 2003) [hereinafter Acharya].

<sup>38</sup> See ANNE & SAJJID – *Introduction*, *supra* note 16, at 2; Srinivasan, *supra* note 28, at 18-20.

In these reductions, India addressed its tariff peaks (extremely high tariffs on particular products). In 1990-1991, the highest duty level hit 355 percent.<sup>39</sup> In 1997-1998, the highest duty level was 45 percent.

#### 3<sup>rd</sup>: Tariff Dispersion and Escalation

India also dealt with its problem of tariff dispersion (the spread of tariffs across large wide numerical ranges), which created a bias against the use of imports in domestic agriculture and manufacturing, distorted incentives in resource allocation, and ultimately discouraged exports. India did so by slashing the standard deviation of tariff levels to one-fourth of their 1990-1991 levels on intermediate and capital goods, and one third of those levels on agricultural goods.<sup>40</sup>

In so doing, India also began to address the problem of tariff escalation, whereby tariffs on merchandise increase with the degree of processing, with lower tariffs on raw materials, higher tariffs on intermediate items, and the highest tariffs on finished goods. (Escalation is designed to promote vertically integrated manufacturing, and higher value added production, domestically. It provides a higher level of effective protection for finished manufactured goods in comparison with the simple tariff on those goods, because of the tariffs at each earlier stage of processing.)

#### 4<sup>th</sup>: Simplification

By 2000-2001, India had simplified its tariff schedules, and narrowed the duty levels, to just four categories: 35, 25, 15, and 5 percent.<sup>41</sup> To be sure, most merchandise fell into the 35 and 25 percent categories. Nevertheless, after decades of protectionism, the change was remarkable – and, it may be added, one for which American trade negotiators in the Doha Round rarely if ever publicly credited India, choosing instead to castigate it for not doing enough.<sup>42</sup> All the more remarkable was the price tag: In 1990-1991, government revenue from import tariffs equalled 3.6 percent of Indian GDP, and total tax revenue accounted for 9.5

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<sup>39</sup> See Srinivasan, *supra* note 28, at 20.

<sup>40</sup> See *id* at 18-21.

<sup>41</sup> *Id.* at 20. (India additionally cut the number of exemptions, also called use-based concessions, on tariff rates).

<sup>42</sup> See, Raj Bhala, *Poverty, Islamist Extremism, and the Debacle of Doha Round Counter-Terrorism: Part One of a Trilogy – Agricultural Tariffs and Subsidies*, 9(1) U. ST. THOMAS L.J. 5-160 (2011); Raj Bhala, *Poverty, Islamist Extremism, and the Debacle of Doha Round Counter-Terrorism: Part Two of a Trilogy – Non-Agricultural Market Access and Services Trade*, 44(1) CASE W. RES. J. INT'L L. 1-81 (2011); Raj Bhala, *Poverty, Islamist Extremism, and the Debacle of Doha Round Counter-Terrorism: Part Three of a Trilogy – Trade Remedies and Facilitation*, 40(1) DENV. J. INT'L L. & POL'Y 237-320 (2012).



percent of GDP.<sup>43</sup> India had taken the difficult step of starting to wean itself off customs duties as a key source of government financing.

#### 5<sup>th</sup>: License Raj

As part of its first generation reforms, India also began to dismantle the License Raj system and expose the country not to complete free trade, but freer trade. For most categories of merchandise, India abolished many import licensing requirements.<sup>44</sup> By 1998, seven years after the launch of the first-generation reforms, roughly 32 percent of all Indian tariff lines were subject to import licensing.<sup>45</sup> That figure, while still too high, was significant, because Indian import licensing had functioned in practice as an import ban.

Just before commencing the reforms, in 1988-1989, 95 percent of all products imported into India, and 80 percent of all manufactured products (excluding basic metals and certain miscellaneous items), were subject to one type of non-tariff barrier (NTB) or another.<sup>46</sup> More specifically, consider the percentage of internationally tradable goods India protected by QRs or NTBs in terms of total tradable GDP: at the end of the 1980s, it was 93 percent overall, and 90 percent for manufactured goods.<sup>47</sup> By May 1995, it fell to 66 percent overall, and by May 1996, to 36 percent for manufactured items. These staggering facts bespeak how pervasive the License Raj system had become in the decades following Partition: QRs had become the “dominant means for control of imports”.<sup>48</sup> They also show how dramatic the 1991 reforms to the License Raj system were.

To be sure, they could have been yet more dramatic. Most remaining QRs were on consumer goods, and the reforms still left the agricultural sector protected: the pre-1991 share of tradable agricultural goods as a percentage of total tradable GDP was 94, and in May 1994 it was down only to 84 percent.<sup>49</sup> Under Article XI:1 of the General Agreement on Tariffs and Trade (GATT) and Uruguay Round agreements, India was obliged to eliminate all QRs. Regrettably, it sought to retain many of them under the BOP exceptions of GATT Article XVIII. On 1 April 1999, India still had QRs on 1,200 tariff lines. It fought to keep them, but lost the 1999 *India Quantitative Restrictions* case at the World Trade Organization

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<sup>43</sup> See Srinivasan, *supra* note 28, at 19.

<sup>44</sup> See ANNE & SAJJID – *Introduction*, *supra* note 16, at 3; Srinivasan, *supra* note 28, at 18-21.

<sup>45</sup> See Trade Policy Review Body, *Trade Policy Review for India 1998*, PRESS/TPRB/71 (Apr. 1, 1998) [hereinafter *Trade Policy Review*].

<sup>46</sup> See Srinivasan, *supra* note 28, at 19.

<sup>47</sup> See *id.* at 20-1.

<sup>48</sup> *Id.* at 19.

<sup>49</sup> See *id.* at 21.

(WTO) Appellate Body.<sup>50</sup> So, on 1 April 2000, it cut QR-protected tariff lines to 600, and on 1 April 2001 eliminated all QRs. In brief, India phased out its QRs – albeit with external WTO adjudicatory pressure – across 10 years following the 1991 reforms.

Yet another type of NTB India addressed in its 1991 reforms was government import monopolies. On 50 categories of commodities, Indian government agencies had long held import monopolies: save for agricultural products and petroleum, India eliminated them.<sup>51</sup> Concomitantly, in government procurement, India eliminated preferences (stated in terms of partial purchases or prices) for domestic suppliers of goods, thus opening opportunities for foreign bidders.<sup>52</sup>

The 1991 reforms dealt not only with QRs on imports, but also on exports. India (as of 1 April 2001) eliminated them (*e.g.*, quotas) on agricultural exports, and dropped minimum export price requirements.<sup>53</sup> It also reduced the size of the list of merchandise subject to export restrictions or bans.

#### 6<sup>th</sup>: Market-Determined Exchange Rate

Finally, as for the *rupee*, the Indian government had allowed it to depreciate against hard currencies (such as the United States dollar and British pound sterling) ever since the Bretton Woods fixed exchange rate system ended in 1971.<sup>54</sup> Official devaluation was part of the 1991 reforms: in July of that year, India reduced its value by 22.8 percent against a basket of currencies where each currency was weighted by Indian exports to the country of that currency.<sup>55</sup> India also dismantled the dual exchange rate system it had created to cope with the 1991 BOP crisis, eliminated foreign exchange licensing, and requirements concerning export-based imports and import compression.<sup>56</sup>

By 1993, and since then, the *rupee* was freely convertible for all current account transactions (*i.e.*, for purposes of Article VIII of the *Articles of Agreement of the*

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<sup>50</sup> See Appellate Body Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile, and Industrial Products*, WT/DS90/AB/R (*adopted* Sept. 22, 1999). The case is excerpted and discussed in BHALA, INTERDISCIPLINARY THEORY, *supra* note 16, at 1284-1296.

<sup>51</sup> See Srinivasan, *supra* note 28, at 20.

<sup>52</sup> See *id.*

<sup>53</sup> See *id.*

<sup>54</sup> See *id.* at 17-20.

<sup>55</sup> See *id.* at 19-20. India also withdrew most of its subsidies to exports, so the devaluation of the real effective exchange rate for exporters was 16.3 percent.

<sup>56</sup> See *id.* at 20.

*International Monetary Fund*).<sup>57</sup> To be sure, the float is a managed one, but that is hardly peculiar to India. And full capital account liberalisation has yet to occur, which again is not an expectation unique to India.

Still, the result of exchange rate regime changes was predictably positive. Indian exports (in terms of volume) grew faster than the world average after 1973, though (as explained below) were insignificant in overall world trade.<sup>58</sup>

Notably, the aforementioned external sector reforms did not occur all at once in 1991.<sup>59</sup> India did not choose the shock therapy treatment that Poland used in 1989. Rather, it deferred tariff cuts and QR elimination on consumer goods until the mid-1990s. Also of significance, India sought to build up its reserves of hard foreign currency.<sup>60</sup> It did so with difficulty, particularly in the late 1990s with the rounds of nuclear tests vis-à-vis Pakistan, and the imposition by the United States of sanctions against both India and Pakistan in response to those tests.

### C. FDI Reforms

Amidst the first generation reforms were legal and policy changes to encourage FDI. Egregious regulations were wiped away in favour of aggressive inducements to attract multinational corporations (MNCs) to open, expand, and operate production facilities in India, and hire Indian workers. Three such clusters of measures stood out.<sup>61</sup>

First, India relaxed investment (equity share ownership) limits on foreign direct investment (FDI) in certain (albeit not all) sectors, such as telecommunications. In particular, reversing pre-1991 strictures, India dropped its insistence on restricting FDI entry to government-determined priority sectors, and eliminated its 40 percent cap on foreign equity participation in joint ventures (JVs).<sup>62</sup>

Second, India eliminated trade-related FDI restrictions. No longer was a foreign direct investor obligated to export a certain percentage of its production. That obligation had been as high as 100 percent in some sectors, and was manifestly designed to protect Indian producers of like products. India also dropped domestic production content obligations, so foreign investors could

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<sup>57</sup> *See id.*

<sup>58</sup> *See id.* at 17.

<sup>59</sup> *See id.* at 19.

<sup>60</sup> *See* Acharya, *supra* note 37, at 57.

<sup>61</sup> In this respect, the observation that “[t]he 1991 reforms did not significantly liberalize FDI” is arguable. Srinivasan, *supra* note 28, at 23.

<sup>62</sup> *See id.* at 18-19.

source inputs and intermediate items from the most efficient suppliers, whether they were Indian or not. Again, the pre-1991 rule had been designed to protect domestic suppliers.

Third, India created Special Economic Zones (SEZs). They were modelled loosely after the famous SEZs in China inaugurated in the late 1970s in the Deng Xiaoping era.

Fourth, India began improving its intellectual property (IP) regime. Foreign direct investors (as well as exporters) look carefully at the state of intellectual property rights (IPRs) as a factor in deciding where to place an investment: they expect not only protection at least at internationally-acceptable levels, but also actual IPR enforcement by legal and judicial authorities. And they do not want to be forced to transfer patents, trademarks, copyrights, or trade secrets to local firms. As the 1998 WTO Appellate Body Report in the *India Patent* dispute India emerged from the Uruguay Round (1986-1994) of multilateral trade negotiations with a sub-par record on enactment and enforcement of IP laws.<sup>63</sup> So, with the 1991 reforms, India loosened requirements about technology transfer. It extended patent protection to pharmaceuticals, agricultural chemicals, and certain food products.

#### D. *Financial Sector Reforms*

Financial sector reforms aimed to liberalize commercial and investment banking markets and institutions operating in India. Three market reforms were key: partial freeing of interest rates; promotion of competition among commercial and investment banks; and creation of a new securities exchange for equities trading.<sup>64</sup> The reforms also included technological innovations, such as electronic trading and un-certificated (*i.e.* paperless) securities, and greater efficiencies in clearing and settlement.

Of these three reform categories, the “centrepiece” and “focal point” of Indian economic reforms was the first.<sup>65</sup> That was for good reason. One clear result emerging from economic development research is the direct relationship between the outward orientation and growth: economies that are more open to trade (and FDI) experience faster gains in GDP than those pursuing protectionist policies like import substitution, or worse yet, autarky.<sup>66</sup>

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<sup>63</sup> See Appellate Body Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R (adopted Jan. 16, 1998). The case is excerpted and discussed in BHALA, INTERDISCIPLINARY THEORY, *supra* note 16, at 1625-1636.

<sup>64</sup> See ANNE & SAJJID – *Introduction*, *supra* note 16, at 2.

<sup>65</sup> Acharya, *supra* note 37, at 57; ANNE & SAJJID – *Introduction*, *supra* note 16, at 3.

<sup>66</sup> See BHALA, INTERDISCIPLINARY THEORY, *supra* note 16, at 1245-1259.

Underlying all three categories was a shift in economic ideology from the era of Prime Minister Nehru and his daughter, Prime Minister Indira Gandhi: away from central planning, and toward the market. Trade was not to be discouraged, but promoted. Foreign investment was not to be regarded with suspicion, much less hostility, but to be pursued. Finance was not to be a backward and inefficient sector, but rather a dynamic, innovative link between savings and investment. Among the many indicators of the paradigmatic shift was the shrinkage in the size of the Indian government. The central government fiscal deficit as a percentage of GDP dropped from 7.7 to 5.5 percent between 1990-1991 and 1992-1993.<sup>67</sup>

The reforms worked quickly. Spurred by a private sector unshackled from government strictures, real annual growth in Indian GDP exceeded 6 percent in the mid-1990s.<sup>68</sup> In 1996, the share of exports in Indian GDP rose to 9.2 percent, and between 1993 and 1996, Indian merchandise exports and imports (measured in U.S. dollar value terms) grew at an average rate of 20 percent per annum.<sup>69</sup> The share of India in the growth of world exports increased. So:

Together with deregulation of industry and fiscal stabilisation, these external sector reforms yielded exceptionally good results by the mid-1990s. Export growth soared to 20 percent in three successive years, inward remittances quadrupled to \$8 billion by 1994-95, foreign investment rose from negligible amounts to over \$6 billion by 1996-97, foreign exchange reserves climbed steeply from the precarious levels of 1991 to over \$26 billion by the end of 1996-97, and the debt-service ratio was halved over the decade.<sup>70</sup>

But (as explained below), the good news was not to last.

### III. 1990S AND EARLY 2000S: REFORMS SPUTTER

#### A. *Backsliding on Tariff Cuts*

By the late 1990s, first generation reforms sputtered, with predictable adverse consequences. Consider the external sector. A lurking problem with the impressive reductions in tariffs was that they were cuts to applied, not bound, MFN rates. Put in legal terms, the 1990-1991 tariff cuts were not locked in under the tariff binding

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<sup>67</sup> See ANNE & SAJJID – *Introduction*, *supra* note 16, at 2.

<sup>68</sup> *See id.*

<sup>69</sup> *See id.* at 3.

<sup>70</sup> Acharya, *supra* note 37, at 57.

principle of GATT Article II. Thus, India could post its applied rates back up again, up to its bound levels – and so it did, taking advantage of considerable “water” (*i.e.*, gaps between lower applied and higher bound rates) in its tariff schedules.

After 1996, Indian import-weighted average applied tariffs crept back up from its 1996-1997 low of 24.6 percent to 30.2 percent in 1999-2000.<sup>71</sup> For intermediate goods, the import-weighted average jumped nearly 10 percentage points in the same three year period, from 21.0 to 31.9 percent. The zenith of the economy-wide simple average tariff rates was 1997-1998, at 34.4 percent, after falling steadily from 128 percent in 1990-1991.<sup>72</sup> It rose to 40.2 percent in 1998-1999, and stayed essentially unchanged at 39.6 percent the next year.

Not surprisingly, backsliding on tariff cuts meant India compared unfavourably with other countries. Consider 1993, just two years into the first generation of reforms, and the end of Uruguay Round negotiations. A 1996 World Bank study examined 26 developing countries, asking what the post-Uruguay Round bound and applied tariff rates, as of 1993, were for 13 product categories.<sup>73</sup> It drew two key conclusions.

First, India had the highest or second highest applied rates for all product categories. Indeed, its average applied tariff rate for all categories was nearly thrice the average of all other countries: India had an exceptionally high average applied rate of 51.6 percent, whereas the average for the other developing countries was 19.2 percent. Second, the patterns for applied rates existed for bound tariff rates: Indian post-Uruguay Round bound levels were higher than all other countries, across all product groupings, and for some groupings, they were significantly higher.

Further research shows India’s first generation of tariff cuts were unimpressive relative to other poor or emerging countries.<sup>74</sup> In 1994, among 13 developing countries, India had the highest average tariff level, 55 percent, and save for Egypt, India had the highest maximum tariff level, 65 percent. Six years on, at the turn of the millennium, India still compared unfavourably: of all large countries (defined as ones with over 20 million people), the average Indian tariff rate was second only to that of Argentina, and well above the averages in the rest of Asia and Latin

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<sup>71</sup> See Srinivasan, *supra* note 28, at 20.

<sup>72</sup> See *id.* at 20-21.

<sup>73</sup> This World Bank study, G. Pursell & A. Sharma, *Indian Trade Policies Since the 1991/92 Reforms*, is discussed in Srinivasan, *supra* note 28, at 22.

<sup>74</sup> See Srinivasan, *supra* note 28, at 23 (citing a 1994 study for the International Monetary Fund by A. Chopra, *et al.*, and a 2000 study by the World Bank).

America.

Perhaps most disappointing is that the first generation of external sector reforms failed to enhance the relative status of India across the decade of the 1990s. That decade, of course, was a crucial one for free market-oriented reform across much of the developing and developed world after the November 1989 fall of the Berlin Wall and collapse of Communism. For India, however, though not a lost decade, it was a disappointing one.

Unsurprisingly, India fared poorly in respect of openness as measured by low tariffs when compared with East Asian countries. Table 1 shows India against them across approximately 1989 to 2000.<sup>75</sup> To be sure, in terms of percentage cuts to simple mean tariffs, India was in line with the other countries: all of them cut their average applied tariffs by at least 41.9 percent (Korea) and as much as 72.9 percent (Philippines). Likewise, on imported-weighted mean tariffs, India was in between the low of 36.2 percent (Malaysia) and 83 percent (Philippines), albeit at the low end of this range. But, the key is the final tariff rate: after the cuts, the Indian average (both simple and import-weighted) was still the most protectionist. Moreover, the Indian record on chopping tariff peaks manifestly was execrable: it cut by just 4.1 percent the share of lines in its Schedule with duty rates above 15 percent, whereas all other countries made large double-digit cuts. These points are true, even though India showed the most significant decrease in the degree of dispersion in its tariff Schedules, and two other countries (Korea and Malaysia) actually injected additional dispersion into their Schedules.

Surprisingly, the Indian record was undistinguished even against its Sub-Continental neighbours, except for Pakistan. Table 2 records tariff cuts on the Sub-Continent, again across the decade of the 1990s. At first glance, India looks to compare well: India cut its simple mean tariff by 58.9 percent, amidst a range from 8.4 percent (Pakistan) to 80 percent (Bangladesh); and, India dropped its average imported weighted tariff by 42.5 percent, while one country (Nepal) actually raised its average by 11.3 percent, and another country (Bangladesh) lowered its average by 76.5 percent. But, as intimated, it is Bangladesh and Sri Lanka that outshine India in respect of aggressive tariff reductions: after the cuts, India's simple and imported weighted average tariff levels were the highest, save for Pakistan. Similarly, India yielded the lowest percentage reduction in tariff peaks, though it did relatively well in reducing tariff dispersion.

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<sup>75</sup> Except for the calculations on percentage reductions (columns 4, 6, 8, and 10), data in Tables 1 and 2 are drawn from the 2002 World Bank *World Development Indicators*, which is discussed in Srinivasan, *supra* note 28, at 23.

**Table 1**  
**Indian versus East Asian Tariffs in the 1990s**

<i>Country</i>	<i>Year</i>	<i>Simple Average Tariff (%)</i>	<i>Percentage Reduction in Simple Average Tariff</i>	<i>Tariff Dispersion: Standard Deviation of Simple Average Tariff</i>	<i>Percentage Reduction in Tariff Dispersion (Percentage Cut in Standard Deviation of Simple Average Tariff)</i>	<i>Import-Weighted Average Tariff (%)</i>	<i>Percentage Reduction in Imported Weighted Average Tariff</i>	<i>Tariff Peaks: Percentage of Tariff Lines with Tariff Peaks (Tariffs Above 15%)</i>	<i>Percentage Reduction in Tariff Peaks (Percentage Decrease in Number of Tariff Lines with Tariffs Above 15%)</i>
India	1990	79.0	-58.9%	43.6	-71.8%	49.6	-42.5%	97.0	-4.1%
	1999	32.5		12.3		28.5		93.1	
China	1992	41.0	-60.2%	30.6	-65.0%	33.2	-55.7%	77.6	-94.6%
	2000	16.3		10.7		14.7		4.2	
Indonesia	1989	21.9	-61.6%	19.7	-45.2%	13.0	-60.0%	50.3	-77.7%
	2000	8.4		10.8		5.2		11.2	
Korea	1988	14.8	-41.9%	5.3	+10.2% (increased tariff dispersion)	10.5	-43.8%	12.5	-94.4%
	1999	8.6		5.9		5.9		0.7	
Malaysia	1988	17.0	-45.3%	15.1	+120.5% (increased tariff dispersion)	9.4	-36.2%	46.7	-47.3%
	1997	9.3		33.3		6.0		24.7	
Philippines	1989	28.0	-72.9%	14.2	-45.8%	22.4	-83.0%	77.2	-88.6%
	2000	7.6		7.7		3.8		8.8	
Thailand	1989	38.5	-56.9%	19.6	-28.1%	33.0	-69.4%	72.8	-37.0%
	2000	16.6		14.1		10.1		45.9	



**Table 2**  
**Indian versus Other Sub-Continental Tariffs in the 1990s**

<i>Country</i>	<i>Year</i>	<i>Simple Average Tariff (%)</i>	<i>Percentage Reduction in Simple Average Tariff</i>	<i>Tariff Dispersion: Standard Deviation of Simple Average Tariff</i>	<i>Percentage Reduction in Tariff Dispersion (Percentage Cut in Standard Deviation of Simple Average Tariff)</i>	<i>Import-Weighted Average Tariff (%)</i>	<i>Percentage Reduction in Imported Weighted Average Tariff</i>	<i>Tariff Peaks: Percentage of Tariff Lines with Tariff Peaks (Tariffs Above 15%)</i>	<i>Percentage Reduction in Tariff Peaks (Percentage Decrease in Number of Tariff Lines with Tariffs Above 15%)</i>
India	1990	79.0	-58.9%	43.6	-71.8%	49.6	-42.5%	97.0	-4.1%
	1999	32.5		12.3		28.5		93.1	
Bangladesh	1989	106.6	-80.0%	79.3	-82.8%	88.4	-76.2%	98.2	-47.2%
	2000	21.3		13.6		21.0		51.8	
Nepal	1993	21.9	-18.3%	17.8	+17.4% (increased tariff dispersion)	15.9	+11.3% (increased imported weighted average tariff)	58.9	-68.3%
	2000	17.9		20.9		17.7		18.7	
Pakistan	1995	50.9	-8.4%	21.5	-1.4%	46.4	-10.1%	91.4	-5.6%
	1998	46.6		21.2		41.7		86.3	
Sri Lanka	1990	28.3	-65.0%	24.5	-62.0%	26.9	-72.5%	51.7	-57.4%
	2000	9.9		9.3		7.4		22.0	

In sum, the economic evidence is clear: neither the 1991 reforms nor the 1986-1994 Uruguay Round catalysed dramatic applied or bound tariff reductions in India relative to other countries. India did cut them in the early 1990s. But, it failed to stay the course, and thus failed to liberalize to the extent of its competitors.

Note that the East Asian Financial Crisis is not a plausible explanation for these failures. That largely unanticipated (but in retrospect, foreseeable) crisis occurred between 1997 and 1999. So, it would be chronologically inaccurate to argue Indian external sector reforms intentionally were at a slower pace than those of East Asia, so as to avoid adverse contagion effects of rapid trade liberalisation. If anything, then it is the admixture of a legacy of post-Partition protection and domestic political problems that accounts for deceleration and reversals in the 1990s of first-generation reforms.

#### B. *Persistence of Tariff Escalation*

Concomitantly, India had yet to rid itself of tariff escalation.<sup>76</sup> In 1997-1998, its lowest tariff duties, averaging 25 percent, were on unprocessed items. Semi-processed goods attracted a higher tariff, averaging 35 percent. The steepest tariff was on processed merchandise, 37 percent. Manifestly, India still concocted its tariff schedules to promote domestic industry as per its history of import substitution.

No less troubling than the aforementioned points was the unwinding of the depreciation of the *rupee*:

India's trade reforms of the early 1990s were characterised by a significant nominal depreciation of the exchange rate, which translated into a substantial real devaluation in the early 1990s. ... India's export-weighted multilateral real exchange rate in relation to the country's five largest export markets (the United States, Japan, Germany, the United Kingdom, and Hong Kong) depreciated by almost 60 percent by 1993 relative to its level in 1990. From that point, however, there seems to have been a persistent – albeit gradual – real appreciation vis-à-vis these currencies – thus eroding some of the early gains. This pattern is also evident in India's real exchange rate in relation to the labor-abundant Asian countries – which constitute India's major competition in export markets. India's real exchange rate vis-à-vis these countries depreciated significantly (relative to its level in 1990) until the mid-1990s. With the onset of the [1997-1999]

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<sup>76</sup> See *Trade Policy Review*, *supra* note 46.

Asian crisis and the subsequent depreciation of most East Asian currencies, however, the *rupee* began to appreciate significantly in relation to these currencies. Indeed, as of September 2000, India's real exchange rate had appreciated almost 20 percent vis-à-vis the East Asian countries – relative to its value just before the crisis – thus offsetting much of the real depreciation that India had experienced in the early 1990s.<sup>77</sup>

In short, as with tariff reforms, on exchange rate reforms, the benefits of *rupee* depreciation in the early 1990s, which helped fuel high growth rates, were “undone” by *rupee* appreciation by the end of that decade.<sup>78</sup> Export growth, in particular, slumped, especially in relation to other Asian emerging countries, like Korea, and even Latin American ones, like Chile. Thus, Indian exchange rate policy failed to provide the stimulus exporters needed to sustain their growth, and concomitantly to ensure a healthy balance between foreign exchange revenues they generate as against foreign exchange expenditures incurred by importers.<sup>79</sup>

### C. *Almost Standing Still*

Export growth slowed. Perhaps most tellingly, India – an original contracting party to the 30 October 1947 GATT and founding Member of the WTO – stood in the same position in world trade for over half a century. In 1948, the share of Indian exports in world merchandise exports (in value terms) was 2.2 percent. It fell to 0.5 percent by 1983. It grew back to just 0.7 percent in 2000.<sup>80</sup> Not only had its post-Partition trade policy failed, but also its 1991 reforms had yet to bear full fruit.

Indeed, its status as a founding member of the modern multilateral trading system arguably belied, to some extent, its commitment to open markets. At the 1948 Havana Conference, throughout much of GATT history, and all of the Doha Round of WTO negotiations, India championed special and differential (S&D) treatment for developing countries.<sup>81</sup> That is, India argued for asymmetric obligations on developed countries, once again fearful that dramatic opening by developing countries would “retard industrialisation,” and thereby lead to neocolonialist exploitation. In brief, the Indian position seemed to be open markets, yes, but more importantly, balance, and if there had to be imbalance, then it should favour poor countries.

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<sup>77</sup> See ANNE & SAJJID – *Introduction*, *supra* note 16, at 5.

<sup>78</sup> See *id.*

<sup>79</sup> See *id.*

<sup>80</sup> See Srinivasan, *supra* note 28, at 18.

<sup>81</sup> See *id.*

#### D. FDI and Banking Sector Difficulties

As regards FDI, the twin devils of decrepit physical infrastructure and rampant top-down corruption highlighted the disadvantages of establishing or expanding production facilities in India vis-à-vis China. The share of FDI to developing countries for which India accounted reached a highpoint of 2 percent in the 1990s – a paltry figure for a country the size of India.<sup>82</sup>

In the financial sector, the Indian government deficit jumped to 10.8 percent.<sup>83</sup> Financing government expenditures crowded out bank lending to the private sector, throttling its rapid growth. Indian banks were saddled with non-performing loans (NPLs) and other poor quality assets at levels in excess of international standards. Banking and securities regulation proved inadequate, even corrupt, and scandals struck equities trading on the Bombay Stock Exchange.

#### E. Reasons

Why did Indian economic reforms decelerate after a promising start? India faced (again) domestic political uncertainty and international turmoil. Domestically, enthusiasm for reforms among Indian leaders declined amidst concerns of rising socioeconomic inequality. Liberating the economy to boost growth was welcome, but that growth should alleviate, not exacerbate, poverty. After all, governments can and do rise and fall when citizens find “reforms” injure their interests. The Congress Party came to power in 2004, defeating the Bharatiya Janata Party (BJP), with the support of hundreds of millions of poor, minority, lower-caste, and rural voters who had not benefitted economically as had the upper and middle classes from the BJP policies.

Additionally, within India, the reforms had not operated long enough to root out entirely the mindset of post-Partition socialist-style policies. For instance, some Indian industrialists failed to push for a more depreciated *rupee*, even though the producer-exporters among them would benefit from a weaker currency, and non-exporters would see opportunities in foreign markets:

A significantly cheaper *rupee* would at a stroke neutralize all the arguments about India’s lack of competitiveness coming from electricity tariffs, poor infrastructure, and high interest rates, and provide ... [a] level playing field....

In short, many Bombay Club captains of Indian Industry still thought in terms of a

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<sup>82</sup> See ANNE & SAJJID – *Introduction*, *supra* note 16, at 4.

<sup>83</sup> See *id.* at 2, 6.

strong *rupee* to (1) make raw materials and intermediate goods they used to produce finished goods cheaper, and (2) function as a protective tariff against foreign finished goods.<sup>84</sup>

Internationally, there was an undeclared war with Pakistan centred on Kargil, in which India triumphed at great cost, plus (another) military *coup d'état* in Pakistan, this one led by General Pervez Musharraf (1943-) against the elected Prime Minister, Nawaz Sharif (1949-). There were pressures associated with the American invasions of Afghanistan and Iraq. Indian Muslims numbered in the range of 200 million, and the possibility of Islamist extremism lurked – and manifested itself in the horrific Mumbai bombings of November 2008, which were perpetrated by Lashkar-e-Taiba, a militant organisation based in Pakistan.

Exogenous threats to Indian stability were not the only reason India lost focus on domestic economic reforms. There was a loss of faith in reforms, which to some Indians seemed rather like a neocolonialist trick. Some Indian constituencies were wary about more integration into the global economy.<sup>85</sup> After all, the Grand Bargain of the Uruguay Round (1986-1994) was disappointing. Via this promising trade-off, developing countries like India would gain improved market access for T&A and agricultural products into developed country markets, and developed countries would cut their farm subsidies. In return, developing countries would grant access to their markets for service suppliers from developed countries, and strengthen their protection for intellectual property (IP) of developed country firms.

But, in phasing out the global quota system for T&A that had been in place under the 1974 *Multi-Fibre Arrangement*, the WTO *Agreement on Textiles and Clothing* (ATC) created a near-*laissez faire* regime.<sup>86</sup> T&A companies from the United States and European Union (EU) consolidated their production facilities in a handful of cheap-labour countries, as they no longer had to spread operations across dozens of countries to stay within quota limits. Here, then, from an Indian perspective was divide and conquer: pitting India, China, Vietnam, Sri Lanka, Indonesia, and other countries with T&A plants against one another to avoid local shutdowns. As for farm product exports from poor to rich countries, the international competitive playing field had hardly levelled. Tariff spikes and non-tariff barriers remained.

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<sup>84</sup> See Naushad Forbes, *Comment – Indian Exports and Exchange Rate Policy*, in REFORMING INDIA'S EXTERNAL, FINANCIAL, AND FISCAL POLICIES 90 (Anne O. Krueger & Sajjid Chinoy eds., 2003).

<sup>85</sup> See REFORMING INDIA'S EXTERNAL, FINANCIAL, AND FISCAL POLICIES, *Preface* at xvii (Anne O. Krueger & Sajjid Chinoy eds., 2003).

<sup>86</sup> See RAJ BHALA, *DICTIONARY OF INTERNATIONAL TRADE LAW* 63-64, 579-580 (2<sup>nd</sup> ed. 2012).

Spending by rich countries on domestic agricultural support measures and agricultural export subsidies did not fall dramatically.

Conversely, developed countries – again, from an Indian perspective – seemed to be the primary beneficiaries of the WTO *General Agreement on Trade in Services (GATS)* and *Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs)*. Many of their services suppliers, across sectors such as banking, construction, engineering, finance, insurance, and telecommunications, expanded into the markets of emerging countries in what seemed to be a one-way trade flow. Developed countries insisted developing countries do more to protect corporate patents, trade and service marks, copyrights, and semiconductor mask works, and opposed efforts to liberalize *TRIPs* Article 31 in respect of compulsory licensing in situations when a country lacks capacity to manufacture pharmaceuticals.

#### IV. PATH AHEAD

##### A. Challenges and Complementarity

The first generation reforms and their aftermath have borne some fruit. Perhaps most impressively, India has recorded high growth rates and cut into poverty. In the first term of Prime Minister Singh (2004-2009), Indian GDP grew roughly 8-9 percent annually, and hit a historical high of 9 percent in 2007, then the second fastest growing major economy in the world.<sup>87</sup> In 2010, the Indian economy grew at an even faster clip than that of China.<sup>88</sup> The poverty rate (*i.e.*, the percentage of the total population falling below the absolute poverty line) in 2004-2005 was 27.5 percent, down from 44.5 percent in 1983.<sup>89</sup>

But, in a number of serious respects, the first generation of Indian reforms proved inchoate.<sup>90</sup> Growth has fallen off to half its peak level, at about 4.5 percent

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<sup>87</sup> See Manmohan Singh, WIKIPEDIA, [http://en.wikipedia.org/wiki/Manmohan\\_Singh](http://en.wikipedia.org/wiki/Manmohan_Singh) (last visited Aug. 26, 2013) (citing the CIA *World Factbook* and *The India Report* by Astaire Research); India's Economic Growth at Slowest Rate in a Decade, BBC News, <http://www.bbc.co.uk/news/business-22726279> (last visited Aug. 27, 2013).

<sup>88</sup> See *What a Waste*, THE ECONOMIST, May 11, 2013, at 12 (This comparison presumes the measurements used for each country are consistent, also reporting that from 2005 to 2007, the Indian economy grew by roughly 9 percent annually) [hereinafter *What a Waste*].

<sup>89</sup> See JAGDISH BHAGWATI & ARVIND PANAGARIYA, WHY GROWTH MATTERS: HOW ECONOMIC GROWTH IN INDIA REDUCED POVERTY AND THE LESSONS FOR OTHER DEVELOPING COUNTRIES (2013) (The poverty statistics are from the Indian Planning Commission, and the figure for 1983 obviously pre-dates the first generation reforms); See also James Crabtree, *A Robust Defense of India's Growth Story*, FINANCIAL TIMES, May 20, 2013, at 8 (reviewing *Why Growth Matters*).

<sup>90</sup> See *A Himalayan Challenge*, THE ECONOMIST, Oct. 13, 2007, at 84-85; Gary G.

*per annum*.<sup>91</sup> Unacceptable still is not only the poverty rate, but also the facts that:

- (1) 43 percent of Indian children go hungry, which is twice the rate of Sub-Saharan Africa;
- (2) 50 percent of all Indians defecate in the open, leading to deaths from diarrhoea and encephalitis;
- (3) India spends just U.S. \$39 per person annually on public health, as against \$203 in China and \$483 in Brazil, or 1.2 percent of Indian GDP, as against a global average of 6.5 percent;
- (4) 400 million Indians, about one-third of the population, have no electricity; and
- (5) Roughly 600,000 babies are aborted every year because they are girls.<sup>92</sup>

Manifestly, then, the 1991 reforms left many challenges unaddressed. They include:

- (1) Upgrading and expanding physical infrastructure needed to support economic growth, such as roads, railroads, air and sea ports, energy (especially electricity) generation, sanitation facilities, and telecommunication systems.
- (2) Opening certain sectors to FDI, including retail stores (especially large, multi-brand retailers).<sup>93</sup>

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Yerkey, *U.S. Expects India to Play Greater Role in Coming Months to Help Revive WTO Talks*, 24 INT'L TRADE REPORTER (BNA) 10 (2007).

<sup>91</sup> See *Wasting Time*, THE ECONOMIST, May 11, 2013, at 23.

<sup>92</sup> See *Beyond Bootstraps*, THE ECONOMIST, June 29, 2013, at 74-74 (*reviewing* AMARTYA SEN & JEAN DRÈZE, AN UNCERTAIN GLORY: INDIA AND ITS CONTRADICTIONS (2013)).

<sup>93</sup> In September 2012, the government of Prime Minister Manmohan Singh pushed through long-stalled reforms on FDI in the retailing sector, allowing foreign companies to own up to 51 percent of local supermarkets. See Avantika Chilkoti & Barney Jopson, *Wal-Mart's India Chief in Sudden Departure*, FINANCIAL TIMES, June 27, 2013, at 13. (Their doing so posed a threat to the millions of mom-and-pop stores in India's "vast but fragmented retail market"). But, foreign retailers could do so only if they fulfilled local infrastructure investment requirements. Thus, by June 2013, no foreign retailer had taken a controlling stake. By then Wal-Mart had opened only 20 wholesale stores through a 50-50 joint venture (JV) with Bharti Enterprises (controlled by Indian billionaire Sunil Mittal). In June 2013, the head of Wal-Mart India since 2007, Raj Jain, abruptly resigned. Wal-Mart India had complained about the investment restrictions against its expansion.

- (3) Continuing privatisation of SOEs, which (as of October 2007) still account for 38 percent of total output in the formal non-farm sector, are one-third less productive than private firms, and have grown less rapidly than firms benefiting from privatisation (*e.g.*, in the information technology (IT) and privatisation sectors).
- (4) Eliminating investment (equity) caps on foreign ownership of local financial service providers, especially in banking and insurance, and in other key sectors, such as agriculture, civil aviation, and telecommunications. In this respect, the July 2013 announcement that India would scrap its 74 percent cap on foreign holdings in mobile phone operations was welcome.<sup>94</sup> So, too, was the Indian pledge to foreign investors in defence production: if they had state-of-the-art technology, then they could exceed the 26 percent equity cap limit, subject to the approval of a Cabinet Committee on National Security. But, the reforms with respect to other sectors, including commodity exchanges, oil refining, and single-brand retailing, was less impressive: the foreign equity caps would stay, but a larger percentage would be permissible without requiring government approval (*i.e.*, via the so-called “automatic route”). Likewise, a commitment to ease or abolish restrictions on outside investment in other sectors, such as insurance and tea plantations, seemed vague, as well as disappointing absent lifting equity cap limits.
- (5) Cutting tariffs further, which (as of October 2007) average about 20 percent, among the highest figures in the world, and also continuing to compress tariffs so as to reduce tariff dispersion and reduce tariff peaks.
- (6) Continue the movement to a fully and freely convertible *rupee* for current and capital account purposes, local foreign exchange markets, and even internationalisation of the *rupee* (*i.e.*, its hardening as an internationally tradable and acceptable means of payment), even if such developments entail greater volatility in exchange rates for the *rupee*.<sup>95</sup>
- (7) Drastically reducing government subsidies, which (as measured as a percentage of GDP) are the second highest in the world among countries surveyed by the Organization for Economic Cooperation and Development (OECD).
- (8) Reforming the labour market, specifically to make it more flexible by

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<sup>94</sup> See Victor Mallet, *India to Loosen Curbs on Foreign Holdings*, FINANCIAL TIMES, 17 July 2013, at 4.

<sup>95</sup> See Acharya, *supra* note 38, at 57-58.



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- (a) restrictive employment protection laws against collective dismissals, and
  - (b) the requirement that manufacturing firms obtain government permission to lay off workers at any factory with more than 100 employees.
- (9) Modernizing and strengthening copyright and patent laws.
- (10) Enforcing IP laws, especially with respect to pharmaceuticals (India is a leading centre for counterfeit medicines), software (74 percent of which in India is pirated), and entertainment (notably, movies and music, the pirating of which damages Bollywood).
- (11) Reducing social stigmas based on gender, caste, religion, and ethnicity, which aside from being against both secular and natural law inhibit the full realization of India's tremendous human capital potential.

The complementarity of these 11 reforms to changes in international trade rules cannot be over-emphasised. Nor can the need for urgency be over-emphasised. Foreign (and domestic) portfolio and direct investors have lost considerable confidence in India, and shown their displeasure at the stymied reforms by pushing down the value of the *rupee* relative to the dollar. In August 2013, it hit a record low of nearly 70 *rupees* to the dollar, a decline of about 12 percent theretofore in 2013, and of almost 4 percent on 29 August.<sup>96</sup> The crash of the *rupee* raised the prospect of import-driven inflation (which could be reinforced by ambitious Indian government plans to provide subsidized rice, wheat and other essential commodities to 67 percent, roughly 800 million Indians<sup>97</sup>), which if manifest

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<sup>96</sup> See James Crabtree & Avantika Chilkoti, *Rupee Hit by Worst Sell-off Since 1995*, FINANCIAL TIMES, 29 August 2013, at 11; Amy Kazmin & Victor Mallet, *New Delhi's Critics Call for Longer-term Thinking to Tackle Problems*, FINANCIAL TIMES, 21 August 2013, at 3; Amy Kazmin, Robin Wigglesworth & James Crabtree, *Rupee Blow As Emerging Markets Hit By Turmoil*, FINANCIAL TIMES, Aug. 20, 2013, at 1; James Crabtree, *Q&A – Low Growth and Rising Deficit Leave Rupee on the Ropes*, FINANCIAL TIMES, Aug. 20, 2013, at 3. Not surprisingly, in trying to defend the *rupee*, the Reserve Bank of India spent hard currency reserves (using them to buy up *rupees*), and in the few months up to and including August 2013, used 5.5 percent of those reserves, with a fall in reserves in July alone from \$280 to \$277 billion. See Robin Wigglesworth, *Developing World Central Banks Lose \$81 bn in Reserves Since May*, FINANCIAL TIMES, 23 August 2013, at 1. India risked running its reserves to below the conventionally minimum prudent level of three months' worth of imports, as occurred in its 1991 balance of payments (BOP) crisis.

<sup>97</sup> See Andy Mukherjee, *Breaking News – India Grain Subsidy May Only Outsource Hunger*, Reuters, 10 July 2013, [n.reuters.com/article/2013/07/10/breakingviews-india-food-](http://n.reuters.com/article/2013/07/10/breakingviews-india-food-)

would disproportionately injure the poor.

The full fruits of external sector changes cannot be realized simply because they are made. Those changes operate in tandem – or not – with other reforms. So, sclerosis caused by an unresponsive and overweening state, stifling labour laws, strictures on small and medium sized enterprises (SMEs), a backward financial sector, a crumbling infrastructure, disrespect for IP rights, and segregating women or minorities away from education and jobs must be tackled. Until they are, external sector reforms – however good – will operate sub-optimally.

It is worth commenting that the difficulties India faces with its reform project contrast in some respects with the experience of China. For instance, in respect of economics, because Indian labour laws make hiring and firing so difficult, 87 percent (as of October 2007) of employment in the manufacturing sector is with firms that employ less than 10 workers. In China, only 5 percent of industrial jobs are at firms with fewer than 10 workers. Consequently, Chinese firms can develop and maximize economies of scale, absorb new technology, and enjoy labour productivity advantages vis-à-vis their Indian counterparts.<sup>98</sup>

#### B. *Importance of Real Effective Exchange Rate*

Also of importance to sustaining an outward-oriented international trade

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subsidies-idINDEE96903920130710 (last visited Aug. 27, 2013).

<sup>98</sup> See BARRY EICHENGREEN, POONAM GUPTA & RAJIV KUMA EDS., *EMERGING GIANTS: CHINA AND INDIA IN THE WORLD ECONOMY* (2010) (especially the Ark study, Chapter 4, noting falls in unit labour costs in China, but not India); Linda Yueh, *How Productive is Chinese Labour? The Contributions of Labour Market Reforms, Competition and Globalisation*, University of Oxford Discussion Paper Series ISSN 1471-0498 (December 2008), <http://www.economics.ox.ac.uk/Research/wp/pdf/paper418.pdf> (last visited Aug.27, 2013) (finding that “[b]y 2005, ... China’s GDP per worker in the broader economy as well as in manufacturing was still modest relative to other comparable sized economies due to its low level of development, which contributes to its cost advantage. However, it has had faster labour productivity growth even against a similarly poor country such as India, which contributes to China’s faster overall GDP growth.”); Bart Van Ark et al., *The Cost Competitiveness of Manufacturing in China and India: An Industry and Regional Perspective*, INDIAN COUNCIL FOR RESEARCH ON INTERNATIONAL ECONOMIC RELATIONS (Dec. 2008), available at: [http://www.conference-board.org/pdf\\_free/ICRIER\\_vanArk.pdf](http://www.conference-board.org/pdf_free/ICRIER_vanArk.pdf) (last visited Aug. 27, 2013). (concluding that (1) “China has increased its labour productivity to a level above that of India, but due to a somewhat higher compensation level, China is still somewhat at a disadvantage in terms of unit labour cost in manufacturing relative to India”, and (2) “rapid declines in unit labour cost across industries and provinces in China, but increases in many instances in India ... suggest that productivity and compensation growth have become much more aligned across regions in China whereas this is not (yet) the case in India”).

regime is continued reform of the exchange rate, with particular attention to the real effective exchange rate (REER).<sup>99</sup> The REER is: “The weighted average of a country's currency relative to an index or basket of other major currencies adjusted for the effects of inflation. The weights are determined by comparing the relative trade balances, in terms of one country's currency, with each other country within the index.”<sup>100</sup>

Simply put, the REER is the value of the currency of one country (*e.g.*, the Indian *rupee*) against the value of other major (*i.e.*, hard) currencies in an index (namely, the United States dollar, Japanese *yen*, European Union *euro*, and a few others), with adjustments for the effects of inflation. Gauging the currency against others makes the REER “effective” (as distinct from a value against just one other currency, *i.e.*, a bilateral rate), while correcting for inflation makes the REER “real” (as distinct from nominal). Using a basket is more realistic in a globalized world in which any one country, (*e.g.*, India) trades with many countries, with payment often made in a major currency.<sup>101</sup> Correcting for inflation obviously makes the REER unadulterated by price level changes in any one country.

Economists teach that the REER ought to be judged by a two-pronged test: (1) Does the REER keep foreign exchange earnings and expenditures roughly in balance over the intermediate term?, and (2) Does the REER give exporters a sufficient incentive such that exports grow at a satisfactory pace?<sup>102</sup>

As a country seeks to grow through export-orientation, and does so by dismantling tariff and non-tariff barriers, passing the test is particularly important: the level and path of the REER must not undermine the salubrious effects of eliminating trade barriers.<sup>103</sup> That is, the exchange rate must not operate orthogonally to trade law reform. So, the exchange rate must be devalued in real

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<sup>99</sup> See ANNE & SAJJID – *Introduction*, *supra* note 16, at 4.

<sup>100</sup> *Definition of “Real Effective Exchange Rate – REER”*, INVESTOPEDIA.COM, [www.investopedia.com/terms/r/reer.asp](http://www.investopedia.com/terms/r/reer.asp) (last visited Aug 26, 2013).

<sup>101</sup> Note that the basket of currencies selected may be weighted according to trade between the other countries (United States, Japan, European Union, etc.), on the one hand, and the country of the currency being valued, on the other hand (India). That weighting may be based on exports, imports, or exports plus imports (total trade). If so, then the full and proper term is “trade weighted effective exchange rate”. See *Trade-Weighted Effective Exchange Rate*, WIKIPEDIA, [http://en.wikipedia.org/wiki/Trade-weighted\\_effective\\_exchange\\_rate\\_index](http://en.wikipedia.org/wiki/Trade-weighted_effective_exchange_rate_index) (last visited Aug. 26, 2013) (A trade-weighted rate, such as for the *rupee*, gives a more accurate picture of the prices Indian exporters receive for their exports, and the prices Indian importers pay for their imports).

<sup>102</sup> See ANNE & SAJJID – *Introduction*, *supra* note 16, at 4.

<sup>103</sup> See *id.*

terms to an appropriate degree.<sup>104</sup> That way, domestic factors of production (land, labour, physical capital, human capital and technology) will respond by shifting into export-oriented production. And, those devaluations, by making imports more expensive, also will offset (at least in part) increased competition from imports to domestic producers that comes with lower trade barriers.

### C. *Three Economic Options*

Going forward, in theory India has three economic options. These are ably discussed by Amartya Sen (1933-), winner of the 1998 Nobel Prize in Economics, and his co-author, Jean Drèze, in their 2013 book, *An Uncertain Glory: India and its Contradictions*. The first option is to go back to post-Partition policies: turn again to the Indian government to re-occupy the commanding heights of the economy, this time with the benefit of experience (1947 to 1991). The idea here is India committed a fatal blunder departing from its leftist policies, as only “[h]igh rates of taxation, expropriation of large holdings [including land, which is essential for industrialisation], and nationalisation of large companies” can “redistribute wealth to the backward regions and poorer parts of the population”.<sup>105</sup> This option, the darling of unreconstructed Marxists, is seductive: it seems to be a panacea for the excesses concomitant with the first generation reforms, and the persistence of mass poverty.

The second option is to accelerate the pace of free-market reforms: drive India as quickly as possible to a deregulated, *laissez-faire* economy. The idea here is India did not go far enough down the free market path, and its problem is not too much capitalism, but too little. Stop regulating the conditions under which businesses hire and fire, and the wage rates they pay, and continue to dispose of state-owned land so that private businesses can use those plots to industrialize. Indeed, “[i]f labor laws were liberalized, and companies allowed to buy land directly from peasants at the prevailing market rate, then ... more jobs and more wealth would be created.”<sup>106</sup> This option, the darling of Neo-Classical fundamentalists, is seductive: ostensibly, the failure to follow through after 1991 on reforms, and to tolerate backsliding, are the source of India’s woes.

But, as Sen and Drèze astutely argue, both options are extreme, and neither jogging back to the past nor sprinting straight ahead is satisfactory, or even realistic. What is needed is a third way, a course that continues privatisation, bolsters entrepreneurship, rewards innovation, and welcomes openness to globalisation, but also reduces the absolute poverty rates and enhances broader

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<sup>104</sup> *See id.*

<sup>105</sup> *See Guha, Delhi Dilemma, supra note 17, at 10.*

<sup>106</sup> *See id.*

human development indicators, including access to and enhancement of education and health care, and the empowerment of women. Growth rates matter, but so do real wage rates (which have been stagnant), levels of malnutrition (which are high), gender ratios (which are unequal), sanitation (which is monstrous), and social stigmas (like caste and region, which persist). The private sector should take the lead in activism, but the state must be activist, at least in a supervisory role, and the latter is not destined to be corrupt or subject to politicisation, as the examples of Canada and Sweden illustrate.

Ironically, that is what Prime Minister Nehru sought – a third way between American capitalism and Soviet communism that would yield sustainable GDP *per capita* growth rates with distributional equity and social justice. Renowned Indian economist Jagdish Bhagwati (1934-) remarked that India is cursed by the affliction of having brilliant economists.<sup>107</sup> They have debated endlessly about trade and other economic policies, yet few appreciate the legal dimensions of their various proposals, and none has yet devised a third way that is theoretically robust and practically appealing. That may take a grand lawyer-*cum*-politician, as Nehru was, updated to the new millennium.

A simple example adduces the point. Tariff collections account for nearly 30 percent of all central government tax revenues.<sup>108</sup> Free trade oriented economists clamour for a reduction in applied duties, but that cannot happen without structural change in the composition of government funding. In turn, that cannot occur without fundamental tax reform, especially in respect of income tax rules and enforcement. All such changes are far beyond the narrow ken of economists. Good lawyers and skilful politicians, guided by sound economic thinking, are indispensable.

#### D. *Getting Politics and Law Straight*

At bottom, however, India's challenges are not economic. They are legal and political. Why did the first generation reforms peter out? Why has growth slowed? Why is the export sector an underachiever? Why do hundreds of millions of Indians remain poor? A typical answer is population, but the one word answer is: "government," or "governance." It is the government, by its obstructionist action, maddening paralysis, and rampant corruption that has held, and continues to hold, India back from achieving the successes enjoyed by other developing countries, particularly in East Asia. It is not the lack of rule of law on statute books or in cases, but in implementation in villages, towns, and cities that holds India back from these successes.

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<sup>107</sup> See THAROOR, *supra* note 6, at 244.

<sup>108</sup> See Acharya, *supra* note 37, at 57-58.

As regards political and legal reform, Communist or other extremist parties in India have blocked or impeded change or implementation, partly out of understandable concerns the changes benefit the rich and widen income disparities. Yet, reform-minded governments, such as the Congress Party-led coalition headed by Prime Minister Singh, sometimes rely on the Communist parties for support. Conversely, with a monopoly on political power, the Communist Party of China can push through necessary reforms – albeit after internal consultations, negotiations, and debate. Yet, as has been widely reported for several years, large and growing socioeconomic disparities in China, plus many cases of cadres and their families benefitting corruptly from their Party positions, are frequent sources of protest (sometimes violent) against Party rule and policies.<sup>109</sup>

As modern India is a young country atop an ancient civilisation, as is modern China, debates about their relative systems and performance are only just beginning. Born in 1947 and 1949 respectively, their economic records are short as against a timeline many Americans can hardly understand. But, in the end, it is hard not to be sanguine about India, its economic future, and its status in the global trading system. Over 40 percent of Indians were not born in 1991, when the first generation of reforms transpired.<sup>110</sup> As any traveller to India knows, the young are full of optimism and hope. Besides, Indians are survivors – and joyful ones at that.

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<sup>109</sup> Such stories are covered (*inter alia*) by the BBC (and posted on its website), and in the pages of the *Financial Times* and *Economist*. Indeed, Wikipedia has an entire Category, “Protests in China”. See *Category: Protests in China*, WIKIPEDIA.COM, [http://en.wikipedia.org/wiki/Category:Protests\\_in\\_China](http://en.wikipedia.org/wiki/Category:Protests_in_China) (last visited Aug. 26, 2013) .

<sup>110</sup> See *What a Waste*, *supra* note 88, at 12.