PAPER I - INDIAN ECONOMY & INDIAN FINANCIAL SYSTEM

Module A: INDIAN ECONOMIC ARCHITECTURE

Chapter 8: Foreign Trade Policy, Foreign Investments and Economic Development

Topics in this chapter

- Foreign Trade Policy
- FTP - Structural Changes during 1990s,
- FTP policy - 2015-2020 & Beyond
- Challenges to be addressed in upcoming FTP,
- FDIs, FIIs and Recent trends,
- Economic development vs economic growth,
- Importance of economic development as a dimension etc.

8.1 FOREIGN TRADE POLICY (FTP)

A Foreign Trade Policy is a government's master plan that sets the rules for buying (imports) and selling (exports) goods and services with other countries. It is designed to boost the nation's economy by promoting exports and managing imports effectively. This policy acts as a roadmap for all international trade activities.

8.2 FTP - STRUCTURAL CHANGES DURING 1990S

Prior to 1991, the Indian economy was highly protected. It had high tariffs (taxes on imports) and other taxes that made it difficult for foreign goods to enter the market. Foreign investment was not permitted in many sectors, and there were significant quantitative restrictions (limits on the quantity of goods that could be imported).

Following the economic crisis of 1991, the Indian government implemented a **liberalized international trade strategy**. This marked a significant break from the protectionist trade policies of the past. These changes were made for two main reasons:

1. To make the domestic market more competitive in international markets.
2. Due to pressure from international agencies like the IMF and World Bank as part of the economic reform program.

The main goals of these trade policy reforms were to integrate the Indian economy with the global economy, strengthen the competitiveness of Indian industries, and solve the country's adverse balance of payments problem.

8.3 FOREIGN TRADE POLICY: 2015-2020 & BEYOND

On April 1, 2015, the Indian government launched its **Foreign Trade Policy (FTP) for 2015-2020**. This policy was aligned with the **'Make in India'** initiative and provided a framework for promoting the export of goods and services, as well as generating employment and increasing value addition in the economy.

Key Aims of FTP 2015-20:

- **Export Target:** To nearly double India's merchandise and services exports to USD 900 billion by 2020 (Not achieved). For the fiscal year 2019-2020 (the target period), India's combined exports of merchandise and services were approximately **USD 528.5 billion**.

- **National Alignment:** To support and integrate with national initiatives like "Make in India" and "Digital India".
- **Ease of Business:** To simplify trade procedures and reduce transaction costs, making the process faster and more efficient.
- **Diversification:** To encourage a wider variety of export products and expand into new global markets.
- **SEZs & E-Commerce:** To revive Special Economic Zones (SEZs) and promote the growth of e-commerce exports.
- **Domestic Manufacturing:** To promote higher value addition and encourage the use of domestically manufactured goods in export production.

The policy introduced two new schemes:

1. **Merchandise Exports from India Scheme (MEIS):** For rewarding the export of specified goods to specified markets.
2. **Services Exports from India Scheme (SEIS):** For promoting the export of notified services.

Major steps Taken in the Foreign Trade Policy 2015-20

- **Simplification & Merger of Reward Schemes:**
    - Five different schemes for rewarding merchandise exports were merged into a single scheme, the **MEIS**.
    - The Served from India Scheme (SFIS) was replaced with the **SEIS**.
    - The duty credit scrips (rewards) issued under MEIS and SEIS were made fully transferable. These scrips could be used to pay customs duty, excise duty, and service tax.
- **Boost to "Make in India":**
    - To support domestic manufacturing, the specific export obligation under the **Export Promotion Capital Goods (EPCG)** scheme

was reduced to 75% if the capital goods were purchased from domestic producers.
- Products with high domestic content received higher rewards under MEIS.

Trade Facilitation & Ease of Doing Business:

- The need to submit hard copies of applications and documents was eliminated.
- An online, paperless system was promoted, with dedicated email addresses for faster communication with the Directorate General of Foreign Trade (DGFT).

The Foreign Trade Policy 2015-2020, after multiple extensions due to pandemic, concluded on March 31, 2023. It has been replaced by the new Foreign Trade Policy 2023, which became effective on April 1, 2023. Unlike its predecessor, this new policy is dynamic and has no fixed end date, allowing it to be updated as required to respond to the evolving global trade environment.

Major steps taken in the Foreign Trade Policy 2023

- **Dynamic & Open-Ended Policy:** Unlike previous five-year plans, this policy has no fixed end date and will be updated as required.
- **Shift from Incentives to Remission:** Moves from direct subsidies to a WTO-compliant system of refunding duties and taxes paid by exporters (e.g., RoDTEP scheme).
- **Districts as Export Hubs (DEH):** A key initiative to identify and promote unique products from every district, boosting grassroots-level exports.
- **Focus on E-Commerce Exports:** A dedicated policy framework to support online exporters, including raising the per-consignment value limit for courier exports from ₹5 lakh to ₹10 lakh.
- **Enhanced Ease of Doing Business:**

a) Promotes automated, online approvals to reduce processing times.
b) Significantly lowers application fees for MSMEs.
c) Introduces a one-time Amnesty Scheme to settle old compliance issues.

For the fiscal year **2024-2025 (April 2024 - March 2025)**, India's total exports (including both merchandise and services) were estimated at **$820.93 billion**.

This comprises:

- **Merchandise Exports:** $437.42 billion
- **Services Exports:** $383.51 billion

Current Export Targets

- **Long-Term Target (FTP 2023):** The Foreign Trade Policy 2023 has set an ambitious long-term target of reaching **$2 trillion in total exports by the year 2030**. This includes $1 trillion from merchandise exports and $1 trillion from services exports.
- **Near-Term Projections:** For the current fiscal year **2025-2026**, apex export bodies like the Federation of Indian Export Organisations (FIEO) are projecting that India's total exports could cross the **$1 trillion** mark, driven by robust global demand and benefits from recent Free Trade Agreements (FTAs).

8.4 CHALLENGES TO BE ADDRESSED IN UPCOMING FTP

Recent events have shown that India’s overdependence on a few products and a few markets has had a negative impact on its international trade earnings.

The new FTP needs to address the following issues:

- **Diversification:** India needs to diversify its trading partners, both for exports and imports. This means exploring new markets in Africa, South-East Asia, and Latin America, and finding alternate suppliers for products that are currently sourced heavily from a few countries, especially China.
- **Simplification of Processes:** Further simplification of processes will greatly enhance the competitiveness of Indian exports.
- **Responding to Deglobalisation:** The policy needs to consider the strategic retreat from globalisation and the rise of inward-looking economic policies as a potential threat.
- **Post-COVID Reforms:** The new FTP must explore significant reforms, including land and labor law reforms, speedy environmental clearances, and setting up alternative payment mechanisms to adapt to the new world order.

8.5 FDIs, FIIs AND RECENT TRENDS

Foreign Direct Investment (FDI)

Foreign Direct Investment (FDI) is an investment made in a country by a foreign investor (often a company) to control the ownership of an entity in that country. FDI is a key engine of economic growth as it helps in maintaining high growth rates, enhancing productivity, and generating employment.

The Indian government has been implementing a series of changes to liberalize and simplify its FDI policy to improve the ease of doing business.

Routes of FDI in India

1. **Automatic Route of RBI:** FDI is permitted through the automatic route without any prior approval from the Government or the RBI in most

sectors. The Indian company receiving the FDI simply has to report the transaction to the RBI.

2. **Government Route:** Foreign investment in activities that are not covered by the automatic route requires prior permission from the government. These proposals are reviewed by the relevant administrative ministry or department.

The table below shows the FDI limits for various sectors:

Sector	**FDI Limit**	**Entry Route**
Agriculture & Animal Husbandry	100%	Automatic
Plantation Sector	100%	Automatic
Mining	100%	Automatic
Defence Manufacturing	100%	Automatic up to 74%; Government route above 74%
Broadcasting Content Services	49%	Government
Print Media	26%	Government
Civil Aviation - Airports	100%	Automatic
Civil Aviation - Air Transport	100%	Automatic up to 49%; Government route above 49%
Private Security Agencies	74%	Automatic up to 49%; Government route above 49%
Telecom Services	100%	Automatic
E-commerce activities	100%	Automatic
Single Brand Retail Trading	100%	Automatic
Multi Brand Retail Trading	51%	Government

Sector	FDI Limit	Entry Route
Railway Infrastructure	100%	Automatic
Banking - Private Sector	74%	Automatic up to 49%; Government route above 49%
Banking - Public Sector	20%	Government
Insurance	74%	Automatic
Pension Sector	74%	Automatic
Pharmaceuticals (Greenfield)	100%	Automatic
Pharmaceuticals (Brownfield)	100%	Automatic up to 74%; Government route above 74%

Types of FDI

- **Greenfield FDI:** When a parent company establishes a brand new subsidiary in the destination country and builds its operations from scratch. (e.g., McDonald's, Hyundai India).
- **Brownfield FDI:** When a company buys a stake in an already existing firm in the host country. (e.g., acquisition of Flipkart by Walmart).
- **Joint Venture:** When a foreign company and a local company join up to share investment, technology, and profits. (e.g., Vistara Airline).

FDI Prohibited Sectors

FDI is prohibited in the following sectors in India:

- Lottery Business
- Gambling and Betting,
- Chit funds
- Nidhi company
- Real Estate Business (except for development of townships, etc.)

- Manufacturing of cigars, cigarettes, and other tobacco products
- Sectors not open to private sector investment (e.g., Atomic Energy).

Foreign Institutional Investment (FII)

Foreign Institutional Investment (FII), now more commonly known as Foreign Portfolio Investment (FPI), refers to short-term capital invested in a country's financial assets, like stocks or hedge funds. It is generally **volatile** and is often called **"hot money"** because there is always a possibility of capital flight (investors quickly pulling their money out) in the case of an economic slowdown or political turmoil.

FIIs/FPIs are registered with SEBI and play an essential part in a country's capital market performance.

Difference Between FDI and FII

Basis of Difference	Foreign Direct Investment (FDI)	Foreign Institutional Investment (FII/FPI)
Nature of Investment	Goes directly into production (machines, factories).	Goes into financial markets (stocks, bonds).
Time Perspective	Long-term perspective.	Short-term perspective.
Stability	Stable in nature; low threat of capital flight.	Volatile in nature ("hot money"); high threat of capital flight.
Type	Can be Greenfield, Brownfield, or Joint Venture.	Takes the form of hedge funds, etc.

8.6 ECONOMIC DEVELOPMENT VS ECONOMIC GROWTH

Economic Development

Economic development is defined as a sustained improvement in a society's **material well-being**. It is a wider concept than economic growth. In addition to the growth of national income, it includes positive social, cultural, political, and economic changes that contribute to material progress. It includes changes like more equitable income distribution, more employment, and poverty reduction.

Economic Growth

Economic growth is defined as the process by which an economy's **actual national and per capita income grows** over time. It is a narrower term compared to economic development and focuses on the quantitative increase in output.

Difference Between Economic Growth and Economic Development

Basis of Difference	Economic Growth	Economic Development
Meaning	An increase in the amount of goods and services produced (national income/output).	A reduction in poverty, unemployment, and inequality, along with an improvement in the quality of life.
Focus	Focuses on the **production** of goods and services.	Focuses on the **distribution** of resources and the improvement of living standards.
Nature	**Single-dimensional** (focuses only on income).	**Multi-dimensional** (focuses on income and the overall improvement of living standards).
Relationship	It is the precursor and a prerequisite for economic development.	It comes after economic growth and is a positive impact of it.

Basis of Difference	Economic Growth	Economic Development
Indicators	GDP, GNI, Per Capita Income.	Human Development Index (HDI), Human Poverty Index (HPI), literacy rates, life expectancy.
Scope	A relatively **narrow** concept.	A **broader** concept.

8.7 IMPORTANCE OF ECONOMIC DEVELOPMENT AS A DIMENSION, ETC.

Economic development is a persistent increase in the material well-being of society. It is a much larger set of ideas than economic growth.

Economic development includes:

- The growth of human capital.
- The elimination of socioeconomic inequalities.
- Structural changes that improve the public's quality of life.

To assess economic development, we use **qualitative indicators** such as the **HDI (Human Development Index)**, gender-related indexes, the **Human Poverty Index (HPI)**, infant mortality rates, and literacy rates.