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**India and Pacific Island Countries: Opportunities for
Trade, Investments and Lessons on Resilience**

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1. Introduction

India has achieved much in the last two decades of the reform period (since 1991). India is now \$1.8 trillion economy, the fourth largest in the world. However, a lot remains to be done for achieving all the economic, social and environmental goals of the nation. In the post-reform period since 1991, India has done well in some indicators such as economic growth, exports, balance of payments, resilience to external shocks, service sector growth, significant accumulation of foreign exchange, Information technology (IT) and stock market, improvements in telecommunications among others.

During the global financial crisis India showed resilience in many respects although there are many macro level challenges faced in the last two years. Although India is a large country with 1.2 billion population, the Pacific islands can have trade relations and learn lessons on resilience and inclusive growth from India.

Against this background, this paper examines the following:

- (1) Trade and investment linkages between India and Pacific island countries
- (2) India's experience in the global financial crisis and lessons learnt on resilience and inclusive growth

2. India's Trade with the Pacific Island Economies

The Pacific Island Economies (hereafter, PIEs) suffer from many development challenges arising from their small population, small size of markets, and geographical remoteness. Owing to their small domestic market and remoteness from major ports and export markets, these countries suffer from diseconomies of scale in production, distribution and trade. Further, due to their limited resource base and production facilities, the PIEs heavily concentrate on the production and export of few primary commodities.

In terms of population size and the value of output produced, by far the largest economy in the Pacific island region is Papua New Guinea followed by Fiji, Solomon Islands, Vanuatu and Samoa (See Table 1). In terms of per capita income, however, the positions of Papua New Guinea and Fiji are reversed, with Fiji's income per head nearly three times more than that of Papua New Guinea.

Foreign direct investment (FDI) has played an increasingly important role in many PIEs, particularly in some sectors such as minerals, petroleum exploration, processing industries (which include copra, palm oil, timber, fisheries etc) and services (which include telecommunications, tourism, banking, finance and real estate). Compared to the developing country average, FDI as a percentage of GDP is quite high in the PIEs though the absolute values are small. Most of the FDI to the region is attracted by four major countries – Fiji, Papua New Guinea, Solomon Islands and Vanuatu (Table 2).

The import to GDP ratios of the PIEs have been generally higher than their export to GDP ratios, reflecting their heavy import dependence for a large range of intermediate and finished goods (Table 1). The import tariff rate vary considerably among the countries in the region with the average tariff rate in Papua New Guinea (4.5%), the largest country in region, being significantly lower than that in Fiji (10.2%), the second largest country in the region (Table 3). Among all the countries in the region, Palau is most open to international trade (with the average tariff rate of 3%) followed by Papua New Guinea.

As of 2012, six PIEs – Fiji, Papua New Guinea, Solomon Islands, Tonga, Samoa and Vanuatu – are members of the World Trade Organization. The PIEs are also involved in some preferential trade agreements, which include the Pacific Island Countries Trade Agreement (PICTA) and the South-Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA)¹.

Though the combined size of PIEs (both in terms of GDP and population) is less than 1% of India's, the average per capita income for the PIEs as a whole (about US\$983) is higher than that of India (US \$ 795). All the individual PIEs, except Papua New Guinea and Kiribati, record significantly higher per capita income than that of India. Compared to India, most of the PIEs exhibit a much higher dependence on trade. With the exception of tiny islands such as Kiribati and Tonga, the export to GDP ratios of all the PIEs are significantly higher than that of India. In terms of import to GDP ratio, all the PIEs show higher values than India's. Further, the average import tariff rates in the PIEs are generally lower than that in India (Table 3). In particular, the Indian tariff rates in the basic agriculture and resource intensive commodity groups (SITC 0 – 4) are much higher than that in the PIEs. However, tariff rates in the manufactured commodity groups (SITC 5 – 8) are broadly comparable across India and the PIEs.

¹ PICTA is a reciprocal free trade agreement among 12 PIEs (Cook Islands, Fiji, Kiribati, Micronesia, Nauru, Niue, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu). SPARTECA is a long standing preferential agreement between 15 members of the Pacific Island Forum, which include 13 PIEs plus Australia and New Zealand. Under this agreement, the PIEs receive duty free access to the Australian and New Zealand markets. More details can be found in APTIAD Briefing Note (2012): <http://www.unescap.org/tid/aptiad/documents/APTIAD-Briefing-Note-4.pdf> (accessed on September 12, 2012)

Against this broad background, we now turn to examine the trends and patterns of India's merchandise trade with the selected 10 major PIEs². First, we discuss India's exports to the PIEs and then discuss India's imports from the PIEs.

2.1 Trends and Patterns of India's Exports to the PIEs

During the period 1990-97, the aggregate value of India's exports to the PIEs remained less than a paltry 5 million US dollar (Figure 1). However, from 1998 until the global crisis in 2008-09, India's exports to PIEs witnessed significant growth from US\$ 13 million in 1998 to US\$ 116 million in 2008³. As a consequence of the financial crisis, the value of India's exports to the PIEs declined significantly to about US\$ 50 million in 2009 and then increased gradually US\$ 75 million in 2011.

Consistent with the observed trends in the values of exports, India's share in the total world exports to the PIEs recorded a steady increase from the late 1990s until 2008 (see Figure 2 and Table 4). Between 1998 and 2008, India's market share in the PIEs recorded an increase in all commodity groups (disaggregated at the 1-digit SITC level), except in the cases of 'beverages and tobacco' (SITC 1) and 'animal & vegetable oils and fats' (SITC 4). In the aftermath of the financial crisis, India's market share declined sharply from nearly 2% in 2008 to 0.7% in 2011. This decline was reflected across all commodity groups, with the notable exception of 'chemicals' (SITC 5). In general, India enjoys a consistently high market share in two commodity categories: 'chemicals' (SITC 5) and 'miscellaneous manufactured articles' (SITC 8).

In addition to the world market shares, we also examine the commodity composition of India's exports to the PIEs – that is the percentage shares of different commodity groups in the country's total exports to the PIEs (Table 5). The analysis reveals that India's export basket is reasonable diversified. The major export categories include capital-intensive categories such as 'chemicals and 'machinery & transport equipments' as well as labor-intensive categories such as 'manufactured materials' and 'miscellaneous manufactured articles'.

The geographical direction of exports to the PIEs show that Fiji accounts for the largest share of India's exports followed by Papua New Guinea (Figure 3). In 2011, these two countries account for as much as 90% of India's total exports to the PIEs while the

² Based on the availability of data in the IMF's 'Direction of Trade Statistics', our analysis covers 10 major PIEs. These are: Fiji, Kiribati, Nauru, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.

³ This high growth coincided with the general acceleration in the growth rate of India's exports to the 'rest of the world' during the 2000s (Veeramani, 2012).

remaining eight countries for 10%. The high geographical concentration of India's exports is not surprising since Fiji and Papua New Guinea account for about 80% of the region's GDP. It is clear that the trend in India's aggregate exports, described above, is mainly driven by Fiji. An interesting contrast is that the financial crisis clearly caused a slump in India's export growth to Fiji, while no such adverse effect can be observed in the case of exports to Papua New Guinea.

In order to assess India's unexploited export potential in the PIEs, we estimate the values of India's export intensity indices with the region. The export intensity index is defined as: $EI = s_{jk} / s_{wk}$ where s_{jk} denotes the share of destination k in country j 's (India in our case) total exports and s_{wk} represents the share of destination k in the total exports from the rest of the world (w)⁴. Thus, the EI index is a ratio of two shares. The value of the index indicates whether or not India exports more to a given destination (region or country) than the world does on average. A value greater than one indicates an 'intense' trade relationship of India with the given destination while a value less than one would imply opportunities for trade expansion with the given destination. India's import intensity (MI) with the PIEs can be estimated in an analogous fashion.

The value of India's EI with the region as a whole remained significantly below 1 during 1990-97 (Figure 4). However, during 1999-2008, the value of EI remained above 1 reflecting India's success in exploiting the trade opportunities during this period. During the post-crisis period (2009-11), value of the EI index again fell below 1. Focusing on individual economies, it is evident that the values of India's EI with all the ten countries were below 1 during 1990-97 (Table 6). During 1998-2008, India's EI values with four countries were greater than 1, the highest value being recorded for Fiji (2.87) followed by Tuvalu (2.04), Solomon Islands (1.87) and Vanuatu (1.58). During 2009-11, however, all countries, except Fiji (1.33), recorded a value of EI less than 1.

Overall, based on the values of EI indices, we can infer that India holds a significant potential for intensifying its export relationships with the PIEs. India should take concerted efforts not only to regain its pre-crisis level of export intensity with Fiji, Tuvalu, Solomon Islands and Vanuatu but also to raise the EI value above 1 with other countries, particularly with Papua New Guinea and Samoa.

2.2. Trends and Patterns of India's Imports from the PIEs

At the aggregate level, India's imports from the PIEs show broadly similar trend to that of exports (Figure 1). During the period 1990-97, India's imports remained low in the

⁴ The trade intensity index has been used in a number of studies. See, for example, Drysdale and Garnaut (1982).

range of 3-6 US \$ million. The period 1998-2008, however, witnessed significant growth from US\$ 10 million in 1998 to US\$ 248 million in 2008. In the aftermath of the financial crisis, the value of imports declined to US\$ 122 million in 2009 and then recovered quickly to US\$ 232 million in 2011. The major increase in the value of India's imports from the PIEs since the early 2000s, however, did not lead to any discernible change in the share of the PIE's in India's total imports (Figure 2).

It can be seen that since the year 2004 the value of India's imports from the PIEs has been much higher than the value of India's exports to the PIEs. In 2011, the value of India's imports is about three times higher than the value of India's exports. The higher value of India's imports than exports is not surprising given the much larger size of India (leading to higher demand) in relation to the combined size of the PIEs.

What does the commodity composition of India's imports from the PIEs look like? The analysis reveals that India's import basket is extremely concentrated in that just a single commodity category, 'crude materials, inedible' (SITC 2), accounts for nearly 100% of India's imports (Table 5). This is in contrast to India's export basket, which shows a reasonably high degree of diversification. Examination of data at the 2-digit level reveals that the high share of SITC 2 in the import basket is accounted by two commodity groups: 'metalliferous ores and metal scrap' (SITC 28) and 'wood, lumber and cork' (SITC 24) (see Table 7). At a highly disaggregated level, India's major import items include gold, copper ores & concentrates, timber, copra, marine products, coffee, vanilla and cocoa. Most of these imports are sourced from Papua New Guinea.

We have seen that Fiji accounts for the largest share of India's exports to the PIEs, followed by Papua New Guinea. In terms of imports, however, the positions of Papua New Guinea and Fiji are reversed, with the former accounting for 88% of India's imports in 2011 while the share of the latter is just 1% (Figure 5). Overall, both in terms of commodity composition and geographical direction, India's import basket exhibit a much higher degree of concentration than its export basket.

Except for the year 2000, the value of India's import intensity (*MI*) index with PIEs as a whole stood below 1 for all the years during 1990-2003 (Figure 4). The value of the *MI* index recorded greater than 1 during 2004-08 before again falling to less than 1 during the more recent period of 2009 -11. Focusing on individual economies, it is evident that the values of India's *MI* with all the ten countries were below 1 during 1990-97 (Table 6). During 1998-2008, however, the *MI* values with five countries were greater than 1, the highest value being recorded for Nauru (11.5) followed by Vanuatu (8.47), Solomon Islands (2.17), Tuvalu (1.85), and Papua New Guinea (1.14). During 2009-11, however,

all countries, except Nauru (6.7) and Papua New Guinea (0.96), recorded a value of *MI* significantly less than 1.

Clearly, there exists scope for India to increase its current import intensity with the PIEs by extending the range of imported products as well by increasing the coverage of countries from which imports are sourced. The index of Revealed Comparative Advantage (RCA) is useful in indentifying the commodity groups where trade can be expanded. The RCA index can be defined as:

$$RCA_{ij} = \frac{X_{ij} / \sum_i X_{ij}}{\sum_j X_{ij} / \sum_j \sum_i X_{ij}}$$

The numerator represents the percentage share of a given sector (or product) in national exports – X_{ij} is exports of commodity group i from country j . The denominator represents the percentage share of a given commodity group in total world exports. The RCA index, thus, contains a comparison of national export structure (the numerator) with the world export structure (the denominator). When RCA equals 1 for a given commodity group in a given country, the percentage share of that commodity group is identical with the world average. Where RCA is above 1 the country is said to have a comparative advantage (and specialized) in that commodity group and vice versa where RCA is below 1.

We have computed the RCA index for individual PIEs and India across commodity groups (Table 8). It is evident that the PIEs generally hold comparative advantage (i.e., RCA values greater than 1) in the basic agricultural and natural resource intensive commodity groups, such as food & live animals' (SITC 0), 'beverages & tobacco' (SITC 1), 'crude materials, inedible' (SITC 2) and 'animal & vegetable oils, fats' (SITC 4). All countries in the region (except for Nauru) hold a comparative advantage (i.e., RCA values greater than 1) in 'food & live animals' while in the case of other primary commodity groups (SITC 1– 4) the RCA values show some heterogeneities across the individual countries. As expected, the PIEs generally have a comparative disadvantage in manufactured products (SITC 5–8) with exception of Fiji and Samoa, which hold some comparative advantage in some simple manufactured products grouped within 'miscellaneous manufactured articles' (SITC 8).

2.3. Business Opportunities and Cooperation Possibilities

The pacific island countries are one of the least explored nations - both for natural resources and the potential it offers in the range of investment sectors. There are different areas where the PIEs and India can mutually benefit by fostering a liberal trade and investment relationship. India should provide greater market access to the PIEs in commodity groups (mostly agricultural and resource-intensive commodities) where the

latter have a comparative advantage. As noted earlier, the Indian tariff rates in these commodity groups are very high. In order to achieve a closer economic integration, India will have to provide duty free access to PIEs in the Indian market especially in agriculture and resource intensive commodities where the former have a comparative advantage. Similarly, the PIEs should utilize India's technological capabilities in a wide range of manufacturing and services by attracting investment by Indian companies in these areas.

Recently, India has emerged as significant provider of development assistance to the developing countries and has started the Regional Assistance Initiative for Pacific Island Countries. Government of India announced annual grant of US\$100,000 Grant-in-aid to all Pacific Island countries in 2006 (this was increased to US\$125,000 since 2009). The assistance offered by India covers a wide spectrum of economic and social needs as determined by the Pacific countries themselves. During 2008-12, India had offered grants-in-aid totaling US\$ 0.5 million each to Papua New Guinea, Solomon Islands and Vanuatu⁵. Under the Indian Technical & Economic Cooperation programme (ITEC), India has been engaging with the countries in the Pacific Island region to provide development assistance in the form of training, capacity building and aid.

Indian businesses have also been investing in the PIEs. The Asian Paints, a major Indian chemicals company has built a subsidiary company (Apco Coatings) in the South Pacific Island and operates in Australia, Fiji, Tonga, Solomon Islands and Vanuatu. Under an MOU that was signed in 2005, and reactivated in 2008, India had made a commitment to assist Fiji in developing its ICT industry. Recently, the Fijian Cabinet has accepted a reform plan for its sugar industry, dubbed the 'Indian Experts' plan', which was prepared by a visiting Indian government technical mission⁶. This plan, which carries a price tag of Fijian Dollar 86 Million, would see significant infrastructure upgrades and changes in the techniques used to grow sugar in Fiji. Negotiations on India –Fiji Double Taxation Avoidance Agreement were completed in October 2011. Indian companies are now increasingly looking at the various projects coming up in Papua New Guinea, consequent to the discovery of natural gas in Southern Highland Province. Indian Companies are interested in investment opportunities in gas, non ferrous metals/ores, and infrastructure development.

⁵ See the document from the Ministry of External Affairs, Government of India (<http://www.mea.gov.in/mystart.php?id=50044510>) (accessed on 13 September 2012)

⁶ See Oxfam Briefing Paper 77 "The Fijian Sugar Industry: Investing in Sustainable Technology", September 2005. <http://archives.pireport.org/archive/2005/October/FIJI%20SUGAR%20INDUSTRY%20REPORT%20-%20OXFAM.pdf> (accessed on 12 September, 2012).

3. India's Experience during Global Financial Crisis and Lessons on Resilience and Inclusive Growth

3. 1. Economic Growth

The trend rate of GDP growth in the last twenty year period was more than 6 per cent per annum. The growth rate was nearly 9 per cent per annum during 2003-04 to 2007-08 and 9.3 per cent per annum during 2005-08. All the three sectors (agriculture, industry and services) contributed to growth. The acceleration in growth was more due to the performance of manufacturing and agriculture during this period. For example, manufacturing sector showed a growth rate of 14.3 per cent and 10.3 per cent respectively in 2006-07 and 2007-08 (Table 1.1).

For about five years, starting from 2003-04, one observes a structural break regarding investments in the country. Savings and investments increased significantly in the period 2004-05 to 2007-08. During the 1990s, savings and investments hovered in the range of 21-24 per cent of GDP. Domestic savings rate rose from 23.7 per cent in 2000-01 to 32.2 per cent in 2004-05 to 36.4 per cent in 2007-08. Similarly, investment rate increased from 24.3 per cent to 32.7 per cent and to 37.7 per cent during the same period.

The pre global financial crisis period was characterised by high GDP growth of more than 9 per cent per annum, low inflation, low fiscal deficit, higher trade and capital flows. In other words, all the macroeconomic fundamentals were in good shape and the economy was buoyant.

The global financial crisis that originated in the US in 2008 transmitted to other countries. India is globally integrated more now as compared to 1991 when reforms started. Due to a slowdown in external and domestic demand, the GDP growth in India declined from 9.3 per cent in 2007-08 to 6.7 per cent in 2008-09. To address the negative fallout of the global slowdown on the Indian economy, the government responded by adopting policy measures such as fiscal stimulus and easy monetary policy. It may be noted that India's counter-cyclical fiscal stimulus began much before the dramatic deterioration of the global financial markets. In fact, it started in February 2008, six months before the start of the crisis. These included the payout of a part of the arrears to government employees, following the Sixth Pay Commission Report and the debt relief (farm loan waiver) package to alleviate the debt burden of the distressed farmers. The vote on account budget has not announced further fiscal stimulus but increased expenditure on Mahatma Gandhi National rural employment Guarantee scheme (MGNREGS).

The Indian economy recovered quickly after 2008-09 crisis period. The GDP growth rate increased significantly from 6.7 per cent in 2008-09 to 8.4 per cent in 2009-10 in spite of the drought. Despite global integration, GDP growth in India largely depends on domestic economy (on domestic consumption). It gives some resilience to external factors although one does not subscribe to decoupling theory. Monetary policy, fiscal policy, export policies and some of structural advantages including a calibrated approach to capital convertibility etc. helped for quick recovery and resilience. The manufacturing sector growth rate was 9.7 per cent in 2009-10 as compared to 4.4 per cent in 2007-08. The GDP growth rate was 8.4 per cent in 2010-11 with growth of 7 per cent and 7.6 per cent respectively in agriculture and manufacturing sector.

Global factors like the Euro zone debt crisis and the rise in oil prices have affected Indian economy in 2011-12 and 2012-13. High interest rates due to increase in inflation has also reduced the investment rate and GDP growth declined from 8.4 per cent in 2010-11 to 6.5 per cent in 2011-12. The manufacturing sector recorded only 2.5 per cent growth rate in 2011-12 (Table 9). According to the projections of Prime Minister's Economic Advisory Council, GDP growth is expected to be around 6.7 per cent in 2012-13 while Reserve Bank of India indicates that growth would be around 6.5 per cent in the same year.⁷ Agriculture growth would be affected due to drought in some parts of the country. Growth in manufacturing sector is expected to rise in 2012-13 compared to that of 2011-12.

3.2. Inflation

Inflation in India before the financial crisis was low at 4 to 5 per cent. Inflation increased to 8.1 per cent in 2008-09 but declined to 3.8 per cent in 2009-10 (Table 10). The high inflation started in the last quarter of 2009-10 persisted and became generalized over two consecutive years. Inflation was high in the first 8 months of 2011-12 before softening moderately in December. It has since remained in the range of 6.9 to 7.7 per cent. The inflation was 9.6%, 8.9% respectively in the years 2010-11 and 2011-12.

Food inflation has been one of the concerns for the country. India did well during the 2006-08 global cereal food inflation. However, since 2009-10, food inflation has been very high. Food inflation was around 15 to 16% in 2009-10 and 2010-11. It was around 10% in 2011-12 and persisted at that level in 2012-13. The fuel and power inflation was high at 12.3% and 14% respectively in 2010-11 and 2011-12. But, India managed to contain the adverse effects of inflation with appropriate policies (more on this below).

⁷ Credit rating agencies and international organizations put the growth rate around 5.5 to 6.0 per cent in 2012-13.

3.3. Fiscal Deficit

The Centre's fiscal deficit which was 2.6 percent in 2007-08 increased to 6 percent in 2008-09 and to 6.5 percent in 2009-10 and declined to 4.9 per cent in 2010-11 and 5.9 percent in 2011-12 (Table 11). The combined (centre and states) in 2011-12 was 7.7 percent. Fiscal space to support any counter-cyclical policies is limited now. More enduring fiscal consolidation strategy is required by restraining subsidies, implementation of Direct Tax Code (DTC) and Goods and Services Tax (GST) need to be put in place. There is a need for medium term fiscal framework by undertaking reforms in revenue side and expenditure front.

3.4. Current Account Balance

On the external front, the current account deficit which was -0.3 during the five year period 2003-8 increased to -2.3, -2.8, -2.7 per cent respectively in 2008-09, 2009-10, 2010-11. It reached an all time high of -4.2 per cent of GDP. This is unsustainable and matter of concern. "The year 2011-12, especially the second half was characterized by a burgeoning current account deficit, subdued equity inflows, depletion of foreign exchange reserves, rising external debt and deteriorating investment position. These indicators reflect the weakening external sector resilience and thus, present a formidable challenge for policy makers" (p.66, RBI, 2012).

3.5. Main Factors Responsible for Resilience in Indian Economy and Lessons

The Indian economy recovered quickly after 2008-09 crisis period. One expected much more adverse impacts on India during the present crisis as compared to the late 1990s East Asian crisis. India's growth rate increased significantly from 6.8 percent in 2008-09 to 8 percent in 2009-10. Exports growth in 2010-11 was 37.5 percent.

Despite global integration, GDP growth in India largely depends on domestic economy (on domestic consumption). It gives some resilience to external factors although one does not subscribe to decoupling theory. Monetary policy, fiscal policy, export policies and some of structural advantages including a calibrated approach to capital convertibility etc. helped for quick recovery and resilience. The details of monetary policy indicated that RBI targeted three objectives: (a) to maintain comfortable rupee liquidity (b) augment foreign exchange liquidity; (c) a policy that would keep credit delivery on track. Like any central bank, the RBI used both conventional and unconventional measures. Taken together, the measures put in place since mid-September 2008 have ensured that the Indian financial markets continue to function in an orderly manner. Liquidity injection was about 7 percent of GDP.

There are also several structural factors that have come to India's aid. (Subbarao, 2009). First, in spite of adverse shocks, India's financial markets have shown admirable resilience. This is in large part due to India's sound and healthy banking system well-capitalised and prudently regulated. Second, our comfortable reserve position provided

confidence to overseas investors. Third, the majority of Indians did not participate in equity and asset markets and hence the negative impact of the wealth loss effect was muted. Consumption demand was not affected. Fourth, because of India's mandatory priority sector lending, institutional credit for agriculture remained unaffected. Fifth, India had many safety net programmes including the Mahatma Gandhi NREGS. Thus, India had unique version of automatic stabilisers which have also protected the poor from the extreme impact of the global crisis.

3.5. Recent problems and Summary of Current macro challenges

Because of resilience, India recorded more than 8% growth in 2009-10 and 2010-11. However, GDP growth decelerated sharply to a nine-year low of 6.5 per cent during 2011-12 and the growth projections for 2012-13 varies from 5.5 to 6.5 per cent. Both monetary and non-monetary factors were responsible for decline in investment rate and growth. Persistence of inflation led to tightening of monetary policy. However, research suggests that real interest (lending) rates explain only about one third of GDP growth. This indicates that non-monetary factors played a bigger role in the decline of GDP growth. External demand was affected due to Euro zone crisis and global uncertainty. "Domestic policy uncertainties, governance and corruption issues amidst lack of political consensus on reforms led to a sharp deterioration in investment climate. Structural constraints emerged in key investment drivers in the infrastructure space – telecom, roads and power – which increased the disinflationary costs. High inflation kept aggregate demand and business confidence subdued" (p.16, RBI, 2012).

Currently, particularly in the short run, India has many macroeconomic challenges as given below

- Nearly 7 per cent overall inflation and 10 per cent food inflation in July 2012
- Current account deficit of 4.2 per cent in 2011-12
- Depreciation of rupee of about 19 per cent in nominal terms between June 2011 and June 2012
- Fiscal deficit of nearly 6 per cent for Central Government (including off-budget liabilities) and 8.2 per cent for Centre and states together in 2011-12
- Decline in gross domestic capital formation (GDCF) from 38 per cent in 2007-08 to 35.5 per cent in 2011-12. If we look at GDCF without valuables (like gold), the decline is large from 37 per cent to 32.7 per cent or 4.3 percentage points of GDP (EAC, 2012).
- Decline in exports in the first quarter (April-July) of 2012 to \$ 75.2 billion compared to \$76.5 billion in first quarter of 2011 – a decline of 1.7 per cent.
- The index of industrial production was 0.8 per cent during April-May 2012 as compared to 5.7 per cent during April-May 2011

In spite of the short run problems, our medium term prospects of achieving more than 8 per cent GDP growth are still high. As pointed out by Subbarao (2012), India in 2012 is different from that of 1991 as the country is more resilient now. India also have undertaken reforms such as increase in diesel prices, allowing FDI in multi-brand retail, FDI in aviation and power sector reforms etc.

3.7. Inclusive Growth

The 11th five year plan of India suggested faster and more inclusive growth for the country. The 12th Five Year Plan aspires for 'Faster, More Inclusive and Sustainable Growth'. Since 2004-05, Indian government followed inclusive growth policies which are given below.

(a) Agriculture: The growth rate of agriculture was only around 2 per cent per annum from mid-1990s to mid-2000s. The government since 2004-05 focused on increasing agricultural growth. The investment in agriculture has increased from 14% of agricultural GDP in 2004-05 to 21% in 2008-09.

(b) Increase in Social Sector Expenditure: There has been significant increase in expenditures on health and education rose significantly. The expenditure on social services and rural development as per cent of total expenditures increased from 13.4% in 2006-07 to 18.5% in 2011-12. The expenditures on social services as per cent of GDP rose from 5.6% to 7.3% during the same period.

(c) Flagship programs: In the 11th five year plan, government introduced several programs to provide social services and building rural and urban infrastructure. There are 13 such flagship programmes. One of the important programs is Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS)

National Rural Employment Guarantee Act (NREGA) was notified in September, 2005. The objective is to enhance livelihood security in rural areas by providing at least 100 days of guaranteed wage employment in a financial year to every household. The primary objective is employment creation. The auxiliary objective is regenerating natural resource base and creating productive assets. Third one which is process objective is to strengthen grass root democracy by infusing transparency and accountability in governance. First time, a rights based approach for employment throughout India is introduced. This is the largest ever public employment programme visualised in human history. One of the important things in the programme is to have transparency and accountability. Gram Sabhas conduct social audits of all works taken up within Gram Panchayat. Social audit includes scrutinizing and

verifying the authenticity of all records and procedures of the programme and expenditure. Social audit of all works in gram panchayat area is conducted by the Gram Sabha.

Most evaluations-official and non-official show that implementation has been more effective than any of its predecessor schemes. In particular, the leakages have been reduced significantly in many places. Significant rise in agricultural wage shows its success. In some places, migration has reduced. It created much needed relief during financial crisis even for the urban poor returning to rural areas. The 11th Five Year Plan indicates that NREGS is going to be one of the important programs for poverty reduction in India. NREGS can transform livelihoods of the poor but can also lead to revolution in rural governance.

(d) Rights based approach: India has adopted rights based approach since 2004-05. Right to food, right to health and right to education, right to employment and right to information. Rights approach plays an important role in improving implementation for development programmes and puts pressures on governments to deliver the services to citizens. Right to information is a landmark measure which improved transparency in government activities. Similarly right to employment in the form of NREGS has helped the rural unskilled workers. Government is planning to introduce National Food Security Act to provide right to food.

Has there been progress in inclusive growth? There have been some improvements in agricultural growth and poverty reduction since the mid 2000s. Agriculture growth was around 3.3 per cent per annum during 11th Plan period. This was due to increase in investment in agriculture and other policies.

Poverty declined by 1.5 percentage points per annum between 2004-05 to 2009-10. It is the fastest decline of poverty compared to earlier period. The provisional estimates for 2011-12 (68th Round of NSS) also reveal significant growth in average monthly per capita expenditure (MPCE). The average MPCE grew at the annual rate of 3.7 per cent in rural areas and 4 per cent in urban areas. This growth is much higher than earlier periods. Both higher GDP growth and public intervention in schemes like NREGS could be responsible for rise in average MPCE and faster decline in poverty in both rural and urban areas. Real wages of agricultural labourers also increased significantly partly due to MGNREGS.

3.8. Measures for tackling food inflation

India has done well in containing inflation during the 2006-08 global food price crisis. Global rice and wheat prices increased by 80 to 100 per cent. The inflation for rice and

wheat prices was only around 10 per cent. This is because of India's foograin policies such as procurement, buffer stock and public distribution policies.

However, since the drought year of 2009-10, food inflation in India increased significantly. The inflation for food items rose from around 7 percent in 2007–08 to 9 percent in 2008–09, 15 percent in 2009–10, and 16 percent in 2010–11 before declining to 7.3 per cent in 2011-12. But, even now food inflation is around 10 per cent. Food consumption patterns have diversified in recent years. The predominance of cereals in the typical household diet has given way to greater balance, with a consequent increase in the demand for proteins—pulses, milk, meat, fish, and eggs—and for vegetables and fruit. Thus, it is no surprise that these items have been the primary causes of food inflation in the recent past. Inflation for three major pulses was nearly 50 percent, although they showed negative inflation in recent months. Similarly, inflation for milk, eggs, meat, fish, fruits, and vegetables was very high.

In the past three years, what have been the drivers of higher food inflation in India? Both global factors and domestic factors are involved, but domestic factors—including supply shortages—play a greater role than do global factors (RBI 2011). Food inflation does not seem to be a transitory phenomenon; in fact, it appears to be becoming a structural problem, especially in *protein inflation* (that is, for pulses, milk, eggs, meat, and fish) (RBI 2011).

Developing countries in Asian region have adopted different short term responses in dealing with price rise in agricultural commodities. ESCAP (2011) provides some of the responses of the countries in the region. ADB (2011) had done a survey among developing member countries about the domestic policies to deal with the rising food prices. The policies were classified as “(i) food price stabilization (such as through removal or cuts in import taxes or value-added taxes, increases in buffer food grain stocks, export restrictions, or price controls and consumer subsidies; (ii) self sufficiency programmes (largely producer subsidies); and (iii) safety nets (such as targeted or conditional cash transfers, food-for-work programs, food-aid programs, or feeding programs) (p.16, ADB, 2011). The survey results of ADB indicate that the countries in the region have largely taken self-sufficiency measures rather than imposed trade restrictions to tackle the recent increases in international food prices.

For example, Bangladesh has taken several measures to tackle food price inflation during 2007-08. These include active participation and intervention in the food grain market, expanded operation of existing safety net programs, and provision of increasing rice production (Hossain, 2010).

Several countries have used food based safety net programmes to address rising food prices. Some of these are : food support targeted at vulnerable population (Afghanistan), targeted family benefit program (Armenia), targeted social assistance program for 145,000 households and untargeted food coupons from March 2011 (Georgia), food benefits targeted at single, old persons, and irregularly distributed through Makhalla system and effective child and maternity malnutrition program in place (Uzbekistan), food stamps targeted at 25,000 vulnerable civilians (Mongolia), upto 1 milion tones of rice to be imported for food based program (Bangladesh), rice for the poor (Raskin) for 17.5 million households (Indonesia) and rice subsidy program (Philippines)⁸

With the increase in population and incomes, demand for commodities particularly food is going to increase significantly in the developing countries of the region. Although prices may come down in the near future, there is likelihood of rise in food commodity prices again. Increase in agricultural productivity is the major solution for addressing the effects of commodity boom in the medium to long term.

Inspite of food inflation, India managed to contain social tensions because of increase in purchasing power of rural population with social protection programs like National Rural Employment Guarantee Scheme.

3.9. Energy Policies

India's energy policy is based on demand management and supply augmentation. India imports 70 to 80 per cent of its petroleum products. It is relevant for demand management, because energy users have no incentive to economize if energy is under-priced. It is also relevant for expansion of domestic supply, because under-pricing of energy imposes a large burden on the energy producers reducing the resources that should accrue to them for financing new investments in these areas. In the longer term, we must move beyond fossil fuels to non-conventional energy. However, these new energy sources are significantly more expensive at present than fossil fuels and increased dependence on these fuels will mean higher per unit energy costs (GOI, 2012).

The Integrated Energy Policy, which was approved in 2009, had enunciated principles of energy pricing that equalize domestic energy prices with the prices of imported energy, while allowing for targeted subsidy to the needy and poor.

3.9. Conclusion

This paper examines : (a) Trade and investment linkages between India and Pacific island countries (b) India's experience in the global financial crisis and lessons learnt on resilience and inclusive growth. There are some opportunities for trade and investments

⁸ For more on this see ADB (2011)

between pacific island countries and India. Some lessons can be learnt on the resilience shown by India during the global financial crisis and inclusive growth. India also offers lessons on resilience on food inflation. Integrated energy policies also offers some lessons.

Tables and Figures

Table 1: GDP, Population, Per capita income and Trade openness for the PIEs and India, 2010

	GDP (constant 2000 US\$ Million)	Population	GDP per capita (constant 2000 US\$)	Exports of goods and services (% of GDP)*	Imports of goods and services (% of GDP)*
Fiji	1908	860623	2218	52.7	64.7
Kiribati	76	99546	764	9.4	76.5
Palau	128	20472	6244	80.8	100.2
Papua New Guinea	5104	6858266	744	55.9	53.1
Samoa	328	183081	1793	32.0	58.8
Solomon Islands	616	538148	1144	31.1	61.5
Tonga	211	104058	2024	13.2	59.1
Tuvalu	17	9827	1687	n.a	n.a
Vanuatu	371	239651	1546	48.0	54.4
India	973325	1224614327	795	22.8	26.9

Note: (i) * The values for 2010 are not available for Kiribati and Palau. Therefore, values for the closest year (2004 for Kiribati and 2008 for Palau) are used. Data for Tuvalu is not available for any year during the 2000s.

(ii) World Development Indicators does not provide data for Nauru.

Source: World Development Indicators

Table 2: Average inward FDI in US \$ million and as percentage of GDP

Country	1990-97		1998-2008		2008-2011	
	US \$ Million	% of GDP	US \$ Million	% of GDP	US \$ Million	% of GDP
Fiji	45.1	2.7	168.0	6.0	178.6	5.6
Kiribati	0.6	1.1	1.3	1.3	3.6	2.4
Nauru	0.004	0.1	0.6	2.5	0.9	1.5
Palau	10.0	9.0	4.3	3.4	2.1	1.0
Papua New Guinea	136.2	3.1	73.2	2.0	47.7	1.0
Samoa	5.9	3.6	7.9	1.6	7.6	1.3
Solomon Islands	13.3	4.5	21.6	4.2	168.0	25.1
Tonga	1.0	0.5	6.3	2.3	6.5	1.6
Tuvalu	0.04	0.3	2.8	17.7	1.8	6.1
Vanuatu	26.9	11.2	30.3	8.0	43.7	6.1

Source: UNCTAD

Table 3: Import Tariff Rates, Simple Averages, 2010

SITC		Fiji	Papua New Guinea	Palau	Solomon Islands	Tonga	Tuvalu	Vanuatu*	India*
0	Food & live animals	14.0	17.7	0.3	9.3	13.5	8.2	21.4	32.5
1	Beverages & tobacco	29.8	3.9	103.1	10.0	1.1	30.8	30.0	93.6
2	Crude materials, inedible	5.6	2.3	2.9	9.7	12.0	0.8	8.3	10.9
3	Mineral fuels & lubricants	5.0	0.0	3.0	10.0	7.6	2.2	1.9	6.0
4	Animal & vegetable oils and fats	7.2	3.7	1.9	10.0	17.7	13.6	5.0	15.1
5	Chemicals	6.5	0.5	3.3	7.8	13.5	2.4	10.8	8.8
6	Manufactured goods classified chiefly by material	9.5	2.2	3.0	9.2	13.8	10.4	12.3	8.9
7	Machinery & transport equipment	8.2	0.2	3.0	9.4	3.8	4.1	11.8	9.5
8	Miscellaneous manufactured articles	17.0	10.3	3.0	9.8	14.0	14.2	19.0	9.6
9	Commodities & transacts not classified according to kind	20.3	0.0	3.0	8.0	10.9	18.0	83.0	16.8
Total	Total Trade	10.2	4.5	3.0	9.2	11.8	7.7	14.0	12.4

Note: * data for 2009 used since the 2010 values are not available

Tariff data are not available for Kiribati, Samoa, and Nauru.

Source: TRAINS – WITS

Table 4: India's Shares in the World Exports to Pacific

		1998	2008	2011
0	Food & live animals	0.14	2.57	0.30
1	Beverages & tobacco	0.32	0.22	0.00
2	Crude materials, inedible	0.12	1.40	0.91
3	Mineral fuels & lubricants	0.00	1.96	0.02
4	Animal & vegetable oils and fats	0.04	0.00	0.02
5	Chemicals	2.30	3.34	4.13
6	Manufactured goods classified chiefly by material	0.93	1.66	1.20
7	Machinery & transport equipment	0.20	1.49	0.51
8	Miscellaneous manufactured articles	3.52	4.45	3.62
9	Commodities & transacts not classified according to kind	0.12	13.99	0.04

Source: Estimated using COMTRADE-WITS database

Table 5: Composition of India's Trade with the PIEs (% shares)

		Exports			Imports		
		1998	2008	2011	1998	2008	2011
0	Food & live animals	2.4	11.7	3.5	0.0	0.2	0.1
1	Beverages & tobacco	0.6	0.1	0.0	0.0	0.0	0
2	Crude materials, inedible	0.2	0.5	1.0	99.4	95.8	97.3
3	Mineral fuels & lubricants	0.0	16.2	0.5	0.0	0.1	0
4	Animal & vegetable oils and fats	0.0	0.0	0.0	0.0	0.0	0
5	Chemicals	19.2	8.4	27.3	0.0	0.1	0.2
6	Manufactured goods classified chiefly by material	25.1	8.7	23.3	0.5	0.8	1.8
7	Machinery & transport equipment	9.7	17.5	21.2	0.0	2.8	0.4
8	Miscellaneous manufactured articles	41.3	9.6	22.8	0.0	0.2	0.1
9	Commodities & transacts not classified according to kind	1.4	27.4	0.2	0.0	0.0	0.1

Source: Estimated using COMTRADE-WITS database

Table 6: India's Average Trade Intensity with Pacific

	Export Intensity (EI)			Import Intensity (MI)		
	1990-97	1998-2008	2009-2011	1990-97	1998-2008	2009-2011
Fiji	0.03	2.87	1.33	0.00	0.18	0.09
Kiribati	0.10	0.89	0.14	0.05	0.10	0.24
Nauru	0.86	0.81	0.19	0.39	11.50	6.70
Palau						
Papua New Guinea	0.11	0.60	0.32	0.25	1.14	0.96
Samoa	0.64	0.36	0.26	0.06	0.21	0.03
Solomon Islands	0.41	1.87	0.20	0.89	2.17	0.39
Tonga	0.51	0.55	0.21	0.00	0.70	0.20
Tuvalu	0.17	2.04	0.07	0.00	1.85	0.65
Vanuatu	0.51	1.58	0.44	0.00	8.47	0.00

Source: Estimated using data from the IMF's 'Direction of Trade Statistics'

Table 7: Composition of India's Imports within 'crude materials, inedible' (SITC 2)

SITC		1998	2008	2011
24	Wood, lumber and cork	82.8	14.9	34.5
25	Pulp and paper	0	0	0
27	Crude fertilizers and crude minerals	17.2	8.2	4.2

28	Metalliferous ores and metal scrap	0	76.6	61.3
29	Crude animal and vegetable material	0	0.2	0
	Total	100	100	100

Source: Estimated using COMTRADE-WITS database

Table 8: Index of Revealed Comparative Advantage across Commodity Groups, 2011

SITC	Fiji	Kiribati	Nauru	Palau	Papua New Guinea	Samoa	Solomon Islands	Tonga	Tuvalu	Vanuatu	India
0	10.70	15.63	0.35	17.67	2.85	1.25	3.23	10.40	16.22	7.84	1.13
1	18.96	0.00	0.00	1.44	0.01	0.86	0.00	3.12	0.00	0.00	0.46
2	1.42	0.08	19.18	0.72	7.65	0.40	14.89	5.05	0.25	0.50	1.53
3	0.11	0.00	0.00	0.00	1.17	0.00	0.00	0.00	0.00	0.00	0.89
4	0.98	14.89	0.03	0.00	31.98	3.20	16.10	0.00	4.41	3.53	1.10
5	0.18	0.01	0.02	0.01	0.00	0.21	0.00	0.14	0.06	0.01	1.24
6	0.44	0.07	0.04	0.01	0.51	0.28	0.06	0.50	0.17	0.01	2.10
7	0.03	0.20	0.10	0.03	0.03	2.07	0.01	0.14	0.20	1.67	0.43
8	1.03	0.12	0.08	0.00	0.02	1.46	0.02	0.11	0.15	0.01	1.24
9	0.48	0.19	0.01	0.53	0.04	0.24	0.23	2.02	0.01	0.07	0.45

Source: Estimated using COMTRADE-WITS database

Note: Description of the SITC codes are as given in other tables

Table 9. GDP Growth Rates by Sectors: 2003-04 to 2012-13 (% per annum)

Annual Rates	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
						P	QE	Rev	Proj	Proj
Agriculture & Allied Activities	10.0	0.0	5.1	4.2	5.8	0.1	1.0	7.0	2.8	0.5
Manufacturing	6.6	8.7	10.1	14.3	10.3	4.3	9.7	7.6	2.5	4.5
Industry	7.4	10.3	9.7	12.2	9.7	4.4	8.4	7.2	3.4	5.3
Services	8.5	9.1	10.9	10.1	10.3	10.0	10.5	9.3	8.9	8.9
Non-Agriculture	8.1	9.5	10.5	10.8	10.1	8.1	9.8	8.6	7.1	7.7
GDP (factor cost)	8.5	7.5	9.5	9.6	9.3	6.7	8.4	8.4	6.5	6.7

Source: Reports of the Economic Advisory Council to the Prime Minister, July 2008, October 2009, August 2012, New Delhi

Table 10. Inflation for Commodity groups

Commodities	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012 August
All	5.42	4.66	8.1	3.8	9.6	8.9	7.56
Primary	7.85	7.61	11.0	12.7	17.7	9.8	10.1
Food Articles	7.78	7.78	9.1	15.3	15.6	7.3	9.1
Fuel and power	5.61	0.93	11.6	-2.1	12.3	14.0	8.3
Manufacture	4.43	4.97	6.2	2.2	5.7	7.3	6.1
--Food products	3.22	4.27	8.7	13.5	3.7	7.1	9.0

Source: Ministry of Finance, Government of India

Table 11. Fiscal Deficit

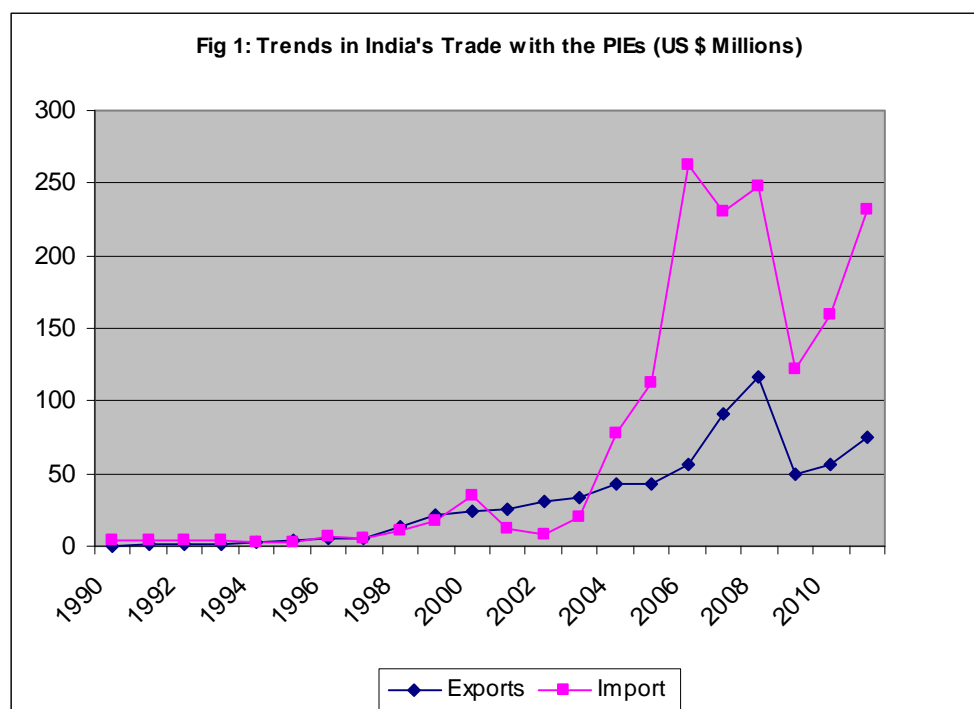
Year	Gross Fiscal Deficit		
	Centre	State	Combined
2007-08	2.5	1.5	4.0
2008-09	6.0	2.4	8.5
2009-10	6.5	2.9	9.4
2010-11	4.9	2.1	6.9
2011-12 RE	5.9	2.3	8.2
2012-13 BE	5.1	2.1	7.1

RE= Revised Estimates BE= budget estimates.

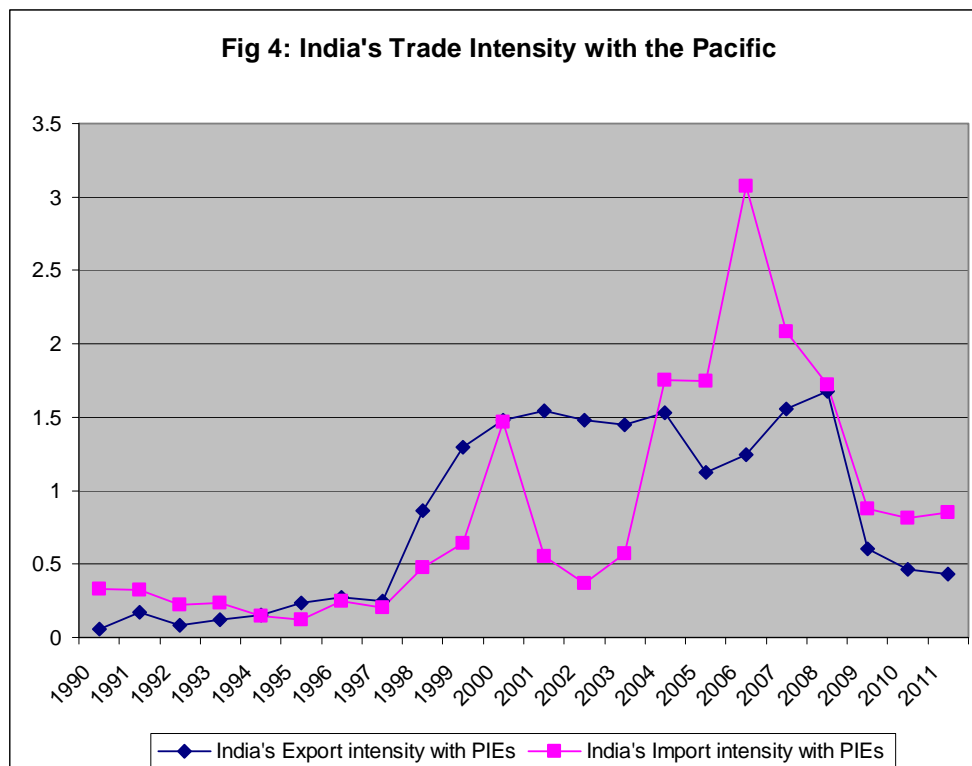
Source: RBI Annual Report 2011-12, Government of India

Table 12. Current Account Balance as per cent of GDP

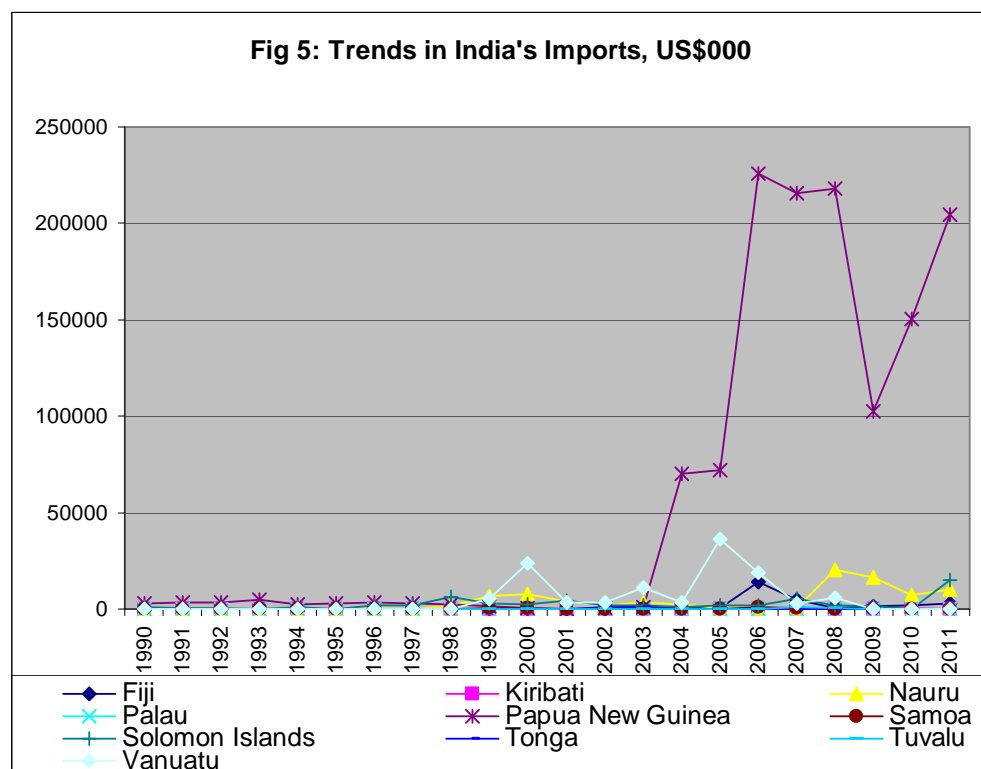
Year	Current account deficit as % of GDP
Average of 2003-04 to 2007-08 (5years)	-0.3
2008-09	-2.3
2009-10	-2.8
2010-11	-2.7
2011-12	-4.2



Source: Direction of Trade Statistics, IMF



Source: Estimated using data from the IMF's 'Direction of Trade Statistics'



Source: Direction of Trade Statistics, IMF

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