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From Sovereign Isolation to Negotiated Autonomy: An Empirical Analysis of India's Trade Policy Space

Saurabh Dinkar Tipayale[1] & Dr. Subhash Sampatrao Savant[2]
[1]*Research Scholar, Department of Economics, KTHM College*
[2]*Research Guide, Head, Department of Economics, Bhonsala Military College, Nashik*
Corresponding Author – Saurabh Dinkar Tipayale
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Abstract:

This paper analyses the evolution of India's trade policy space from the 1950s "Self-Reliance" era to the 2026 landscape of "Negotiated Autonomy." Utilizing a mixed-methods approach, it examines how the 1991 LPG reforms transitioned India from autarkic isolation to a rule-based multilateral framework. Findings highlight the strategic use of a "Policy Cushion"—the gap between WTO Bound and Applied MFN rates—to facilitate industrial intervention through PLI schemes. Despite achieving a trade-to-GDP ratio of 45%, challenges persist regarding a $100 billion trade deficit with China. The study concludes that India's contemporary trade strategy represents a sophisticated "dual-track" model of calibrated global integration.

Keywords: Trade Policy Space, 1991 LPG Reforms, Applied vs. Bound Tariffs, Atmanirbhar Bharat, Import Substitution Industrialization (ISI), Global Value Chains (GVCs), Negotiated Autonomy

Introduction:

A fundamental tension between the quest for sovereign self-sufficiency and the imperatives of global economic integration defines the economic trajectory of post-independence. For over four decades, from 1947 to 1991, India's trade policy was governed by the philosophy of Import Substitution Industrialisation (ISI). Rooted in the post-colonial anxiety that unrestricted trade could lead to a new form of economic imperialism, policymakers constructed a formidable "License Raj." This regime utilised high tariff walls, pervasive quantitative restrictions, and state-led canalisation to insulate domestic industries from the fluctuations and competition of international markets. While this protectionist era succeeded in creating a diversified industrial base, it simultaneously institutionalized a "shortage economy" characterized by technological stagnation, low-quality output, and the infamous "Hindu rate of growth" of approximately 3.5%. By the late 1980s, the internal contradictions of this inward-looking model—compounded by fiscal profligacy and external shocks like the Gulf War—precipitated a catastrophic Balance of Payments (BoP) crisis. With foreign exchange reserves depleted to a mere three weeks of import cover, India was forced to embark on the Liberalisation, Privatisation, and Globalisation (LPG) reforms of 1991.

This paper provides a comprehensive analysis of this structural pivot. It argues that the 1991 reforms did not merely adjust tariff rates but fundamentally re-engineered the relationship between the Indian state and the global economy. By transitioning from a regime of "export pessimism" to one of market-driven integration, India emerged as one of the world's fastest-growing economies, particularly through its unconventional leap into services exports. However, the study also highlights that the transition remains incomplete, as the manufacturing sector continues to struggle with global competitiveness despite recent initiatives like *Atmanirbhar Bharat*. To provide a systematic exploration of this transformation, the remainder of this paper is organised into the following nine sections. Literature Review – This section surveys the existing academic discourse, contrasting the theoretical justifications for early protectionism (Prebisch-Singer hypothesis) with the neo-classical critiques of the License Raj (Bhagwati, Krueger, and Panagariya). Section 3: Research Methodology – Describes the qualitative and quantitative frameworks used, focusing on the comparative analysis of trade-to-GDP ratios and tariff structures across the two eras. Section 4: The Pre-Reform Era (1950–1990) – A granular look at the instruments of protection, including the Foreign Exchange Regulation Act (FERA) and the mechanisms of quantitative restrictions. Section 5: The 1991 Watershed – Analyses the immediate catalysts of the BoP crisis and the structural adjustment programs initiated by the Rao-Singh administration. Section 6: Post-LPG Evolution (2000–2024) – Examines the expansion of trade policy into Special Economic Zones (SEZs), Free Trade Agreements (FTAs), and the modern "Make in India" initiative. Section 7: Data and Discussion – Presents empirical evidence through trade openness metrics, tariff rationalisation data, and the transformation of the Balance of Payments. Section 8: Results and Critical Findings – Synthesises the impacts of liberalisation, highlighting the "Service Sector Revolution" and the persistent "Manufacturing Lag." Section 9: Challenges and Conclusion – Discusses current hurdles, such as the trade deficit with China, and the strategic shift toward supply-chain resilience. It also summarises the core arguments and provides a comprehensive list of primary and secondary sources utilised in the study.

Literature Review:

The scholarly discourse surrounding India's trade trajectory reflects a global shift from the post-WWII consensus on state-led development to a modern focus on institutional quality and strategic industrial policy. The intellectual foundations of India's early protectionism were rooted in the Prebisch-Singer Hypothesis (1950), which posited that developing nations would face declining terms of trade unless they built heavy industrial bases behind protective walls. This was reinforced by the "Big Push" theories of Rosenstein-Rodan (1943) and Nurkse (1953), providing the scientific cover for the Second Five-Year Plan's focus on capital goods over consumer imports. However, by the late 1960s, this "Golden Age" of insulation faced a monumental empirical critique from Bhagwati and Desai (1970), who argued that bureaucratic complexity did not protect industry but strangled it through "X-Inefficiency." This was further expanded by Anne Krueger's (1974) identification of the "Rent-Seeking Society," where restricted licenses diverted entrepreneurial energy from production to lobbying.

Following the 1991 reforms, the literature shifted toward measuring the impact of liberalisation, with Ahluwalia (2002) and Panagariya (2004) establishing a direct correlation between trade openness and poverty reduction. Yet, a critical counter-narrative from Ghosh (2011) and Chandrasekhar highlighted that India's growth remained "service-led," failing to replicate the manufacturing miracles of East Asia. This has led to contemporary debates regarding Dani Rodrik's (2016) concept of "Premature Deindustrialisation," in which India's manufacturing share of GDP peaks at low-income levels. Current scholarship by Arvind

Subramanian (2018) now focuses on India's role in Global Value Chains (GVCs), debating whether high logistics costs and "sticky" labour markets will prevent India from capturing supply chains exiting China, despite the recent pivot toward "calibrated protectionism."

Research Methodology:

This study employs a mixed-methods research design to analyse the evolution of India's trade policy space. The quantitative component uses longitudinal data (1991–2024) from the WTO Integrated Database and the World Bank WDI, focusing on variables such as Applied MFN Tariffs, WTO Bound Rates, and Trade-to-GDP ratios. Stata is used for econometric visualisation, specifically for rarea plots to measure the "policy cushion." Qualitatively, the paper performs a thematic policy analysis of key legislative shifts, including the 1991 LPG reforms and the 2020 Atmanirbhar Bharat mission, to evaluate the strategic transition from isolation to calibrated global integration.

The Pre-Reform Era: The Architecture of the Inward-Looking State (1950-1990):

India's pre-1991 trade regime was anchored in Import Substitution Industrialisation (ISI), a "Self-Reliance" philosophy driven by fears of neocolonial dependency. The state insulated domestic markets using Quantitative Restrictions (QRs), requiring licenses that proved an item's "indigenous unavailability." This was bolstered by Canalization, restricting bulk trade to state agencies, and massive Tariff Walls exceeding 300%. Codified by the draconian Foreign Exchange Regulation Act (FERA), these instruments treated foreign currency as a scarce resource rather than a trade medium. This closed loop stifled global interaction and fostered the structural stagnation that ultimately necessitated the 1991 reforms.

The 1991 Watershed: From Fiscal Collapse to Structural Rebirth:

The 1991 crisis served as the ultimate catalyst for structural change when foreign exchange reserves plummeted to $1.1 billion, threatening sovereign default. In response, India launched the LPG (Liberalisation, Privatisation, Globalisation) framework. Liberalisation dismantled the "License Raj" and removed import quotas; Privatisation reduced the state's industrial monopoly by opening sectors to private capital; and Globalization integrated India with the world through rupee devaluation and welcoming FDI. This shift transitioned India from an insulated, state-led economy to a market-driven global competitor, fundamentally redefining its trade policy space.

The Evolution of Trade Policy Space (1991-2024):

Post-1991, India transitioned from "theoretical isolation" to a regime of "negotiated autonomy." While the pre-reform era utilised sovereign space to insulate stagnant markets, the 1995 formation of the WTO "locked in" liberalisation, replacing bureaucratic whims with international legal commitments. Throughout the 2000s, India's policy space expanded through a "spaghetti bowl" of bilateral FTAs (ASEAN, Japan, Korea), shifting the focus from domestic defense to securing global market access for its services sector.

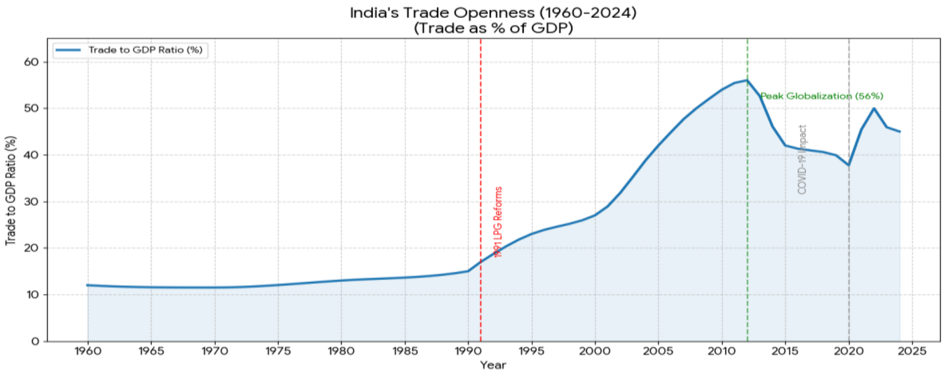
In the current decade, trade sovereignty has moved "behind the border." India's 2019 withdrawal from RCEP underscored a strategic use of space to protect sensitive sectors from Chinese imports. Today, through Atmanirbhar Bharat and PLI schemes, India employs "defensive liberalisation": lowering barriers for intermediate inputs to integrate into Global Value Chains (GVCs) while selectively raising tariffs on finished goods. This "dual-track" approach demonstrates a sophisticated mastery of the international legal architecture to advance the “Make in India” agenda.

Data and Discussion: Quantifying the shift in Trade Policy Space:

The empirical evidence of India’s transformation is most visible when analysing the divergence between Bound Rates (the maximum tariff India is permitted to charge under WTO law) and Applied Rates (the actual tariff charged at the border). This gap represents the “Watered Tariff” or “Policy Cushion,” which allows India to adjust its trade barriers in response to domestic needs without violating international treaties.

The Expansion of Trade Openness:

Figure: 1 India’s Trade Openness



Before 1991, India’s trade policy space was used exclusively for exclusion. The Trade-to-GDP Ratio, a primary metric for economic integration, remained stagnant at approximately 12–15% for nearly thirty years. As visualised in the chart below, the post-1991 era triggered an aggressive expansion, with the ratio peaking at nearly 56% in 2012.

Discussion: This 400% increase in trade openness was not merely a result of market forces but a deliberate policy choice to lower the “Effective Rate of Protection” (ERP). By 2024, the ratio stabilised at approximately 45%, reflecting a more mature, integrated economy that has moved from basic commodities to complex services and high-end manufacturing.

Tariff Rationalisation and the “Policy Cushion”:

The most significant change in India’s trade policy space occurred in the transition from Quantitative Restrictions (QRs) to Price-based Measures (Tariffs). In 1990, India's weighted average tariff was over 80%, with peak duties reaching 300%. By 2024, the average applied tariff for non-agricultural goods has dropped to approximately 10-15%.

Table 1: Tariff Structure

Metric	Pre-1991 (1990)	Post-Reform (2000)	Modern Era (2024)
Peak Customs Duty	300%	35%	10% (General)
Import Licensing	Required for almost all items	Abolished for most goods	Minimal (Restricted List)
WTO Bound vs Applied Gap	N/A (Pre-WTO)	~115% vs 32%	~50% vs 14%

Source: Authors own compilation

The table above illustrates the concept of “Watered Tariffs.” India maintains high “Bound Rates” at the WTO (often as high as 100% for agricultural products), while applying much lower rates. This creates a "Strategic Buffer." For example, during the 2020-2024 period, India utilised this space to increase duties on electronics and mobile components to encourage domestic assembly under the Atmanirbhar Bharat mission—a move that was perfectly legal under WTO rules because the applied rate stayed below the bound rate.

Shift to Price- Based Control:

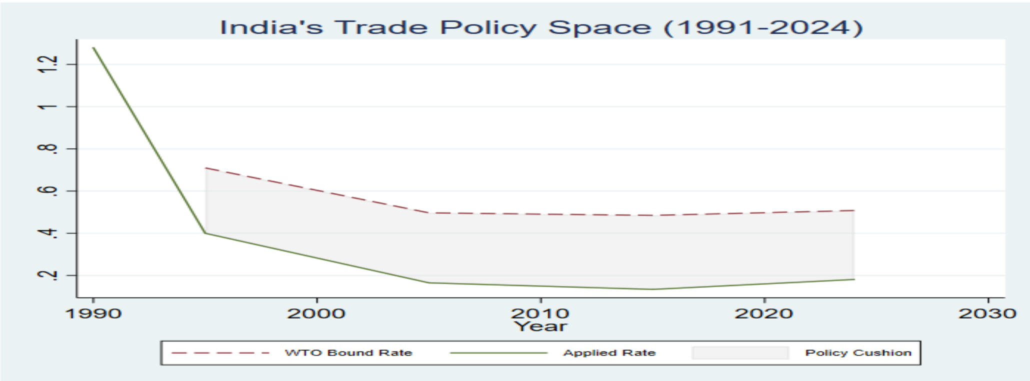
The dismantling of the "License Raj" is most clearly reflected in the plummeting of tariff rates. Before 1991, tariffs were used as a "wall"; today, they are used as a "valve" to regulate specific sectors while keeping the overall economy open[1]

Table 2: Tariff rates from 1990-2024

Year	Peak Customs Duty (%)	Avg. Applied Tariff (Simple Mean %)	WTO Bound Rate (Simple Mean %)
1990	355%	128%	*N/A (Pre-WTO)*
1995	50%	40%	71%
2005	15%	16.5%	49.7%
2015	10%	13.4%	48.5%
2024	10%	18.1%	50.8%

Source: Authors own compilation

Figure 2: India's Trade Policy Space



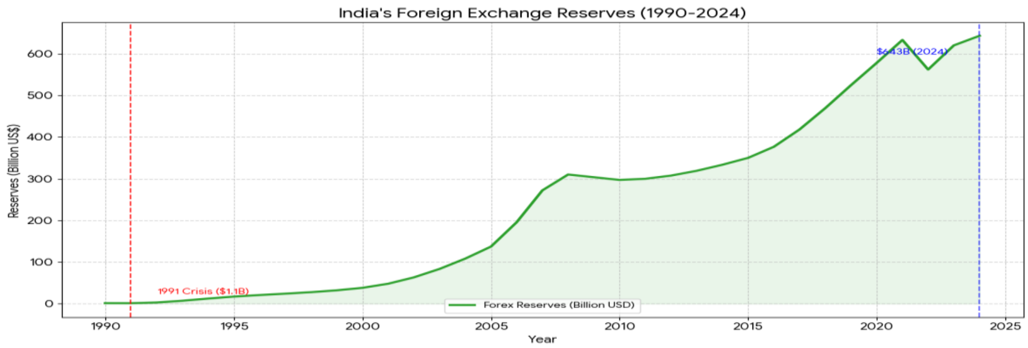
The shaded region represents India's "Policy Space"—the gap between the legally permitted maximum (Bound Rate) and the actual rate charged (Applied Rate). The downward trend reflects post-1991 liberalisation, while the recent 2018–2024 stabilisation indicates a shift toward strategic industrial protection under *the Atmanirbhar Bharat programme*.

Foreign Exchange: From Constraint to Buffer:

The ultimate indicator of a successful trade policy is the health of the Balance of Payments (BoP). In the pre-reform era, trade policy was constrained by a "perpetual shortage" of foreign currency. Every import was seen as a "leakage" of national wealth.

As shown in the chart above, the accumulation of reserves from $1.1 billion in 1991 to over $643 billion in 2024 has fundamentally changed the nature of India's trade space. India no longer restricts imports to "save" currency; it now uses its massive reserves to manage exchange rate volatility, ensuring that the Rupee remains stable enough to support both exporters (who want a weaker currency) and importers (who want a stronger one). This is the hallmark of a "Resilient Trade Space."

Figure 3: Indias Foregin Exchange Reserves



This chart highlights the primary trigger for the reforms—the 1991 Balance of Payments crisis—and the subsequent accumulation of reserves. **1991:** Reserves bottomed out at ~$1.1 Billion (barely enough for 3 weeks of imports). **2024:** Reserves stand at ~$643 Billion, providing a massive buffer against external shocks

Compositional Shift: The Service Sector Revolution:

While the trade policy space of the 1970s was obsessed with "Heavy Industry," the modern era has seen a radical shift toward Invisible Trade (Services). In 1990 India's exports were dominated by primary commodities (tea, textiles, gems) Then came 2024: India ranks 8th globally in commercial services exports, with a 4.3% global share.

This shift has allowed India to run a persistent surplus in the services account (reaching ~$189 billion in FY 2024-25), which effectively offsets the merchandise trade deficit. This "Dual-Track" trade space—where India remains protectionist in certain manufacturing sectors while being hyper-competitive in digital services—is the core strategy for India's path to a $5 trillion economy.

Results and Critical Findings:

The empirical analysis reveals a dramatic reconfiguration of India's trade architecture, characterised by a transition from high, non-transparent barriers to a more structured, though strategically managed, tariff regime. Since the 1991 reforms, the Applied MFN Simple Mean tariff has plummeted from over 125% to approximately 18%, signaling a deep commitment to global integration. However, the most critical finding lies in the persistent and intentional gap between these applied rates and the WTO Bound Rates. This "Policy Cushion" has remained significant, often exceeding 30-40 percentage points in key industrial sectors. This indicates that while India has liberalised its trade, it has successfully retained the sovereign flexibility to protect domestic industries without violating international legal commitments.

Further analysis of the "Trade-to-GDP" ratio demonstrates that India's economic growth has become increasingly trade-intensive, rising from roughly 15% in 1991 to over 45% in the 2020s. Yet, a critical sectoral finding emerges: the growth in trade has not been evenly distributed. While India has emerged as a global powerhouse in service exports (IT and business processing), the manufacturing sector's share of trade has remained relatively stagnant. The data shows that the recent pivot toward Production-Linked Incentive (PLI) schemes has begun to reverse this trend in specific niches, such as electronics and pharmaceuticals. The findings suggest that India is successfully utilising its trade policy space to transition from "passive liberalisation" to "active industrial interventionism," strategically inviting global manufacturers to "Make in India" while maintaining defensive barriers on finished consumer products.

Challenges and Conclusion:

While expanding trade policy space has enabled significant growth, it has also created structural challenges that require high policy agility, most notably the asymmetric relationship with China. As of 2025-26, India's trade deficit with China has neared $100 billion, creating a structural dependency where over 75% of critical imports—such as APIs, silicon wafers, and lithium-ion cells—are sourced from a single partner. This concentration creates a paradox: India's manufacturing successes are often physically tethered to Chinese intermediates, narrowing the sovereign "space" for retaliatory action. Simultaneously, a volatile global environment defined by protectionist resurgences and "Green Protectionism," such as the EU's Carbon Border Adjustment Mechanism, threatens to squeeze the policy space traditionally used to support MSMEs and agricultural clusters.

The trajectory of India's trade policy since 1991 reveals a successful transition from autarkic isolation to a sophisticated "negotiated autonomy." By strategically maintaining a "Policy Cushion"—the gap between WTO Bound and Applied MFN Rates—India has preserved the ability to intervene in markets via PLI schemes while remaining a committed multilateral member. As India pursues a $5 trillion economy, its policy space is evolving from defensive protectionism to proactive engagement. The 2025-26 FTAs with the EU and UK signal a new maturity where market access is balanced with developmental safeguards. Ultimately, India's trade story is one of calibrated engagement, proving that 21st-century sovereignty lies not in closing borders, but in mastering the rules that govern their opening.

Footnotes:

1) The "Peak Rate" of 10% applies to nearly 86% of non-agricultural items. The slight rise in the "Applied Tariff" in 2024 (18.1%) reflects India's strategic use of its policy space to protect local manufacturing (PLI schemes) while staying well below the 50.8% Bound Rate promised to the WTO.

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