II THE PAYMENTS CRISIS

The first signs of the current payments crisis became evident in the second half of 1990-91 when the Gulf War led to a sharp increase in oil prices. Foreign exchange reserves began to decline from September 1990. They declined from a level of Rs.5480 crore ($3.11 billion) at the end of August 1990 to Rs.1666 crore ($896 million) on 16 January 1991. During this period the Government took recourse to the IMF by drawing Rs. 1177 crore (US$660 million) from the reserve tranche during July- September 1990. Again in January 1991 the Government made a drawing of Rs. 1884 crore ($1.025 billion) under the compensatory and contingency financing facility (CCFF) and a drawing of Rs. 1450 crore ($789 million) under a first credit tranche arrangement (FCT). When applying for a FCT drawing, the Government had indicated that it would be applying for an upper credit tranche (UCT) later in the year after presentation of the Budget. The purchases from the International Monetary Fund in January 1991 amounted to Rs.3334 crore ($1.814 billion). Nevertheless, the decline in reserves continued unabated (Figure 1).

Developments in 1990-91

The immediate cause of the loss of reserves beginning in September 1990

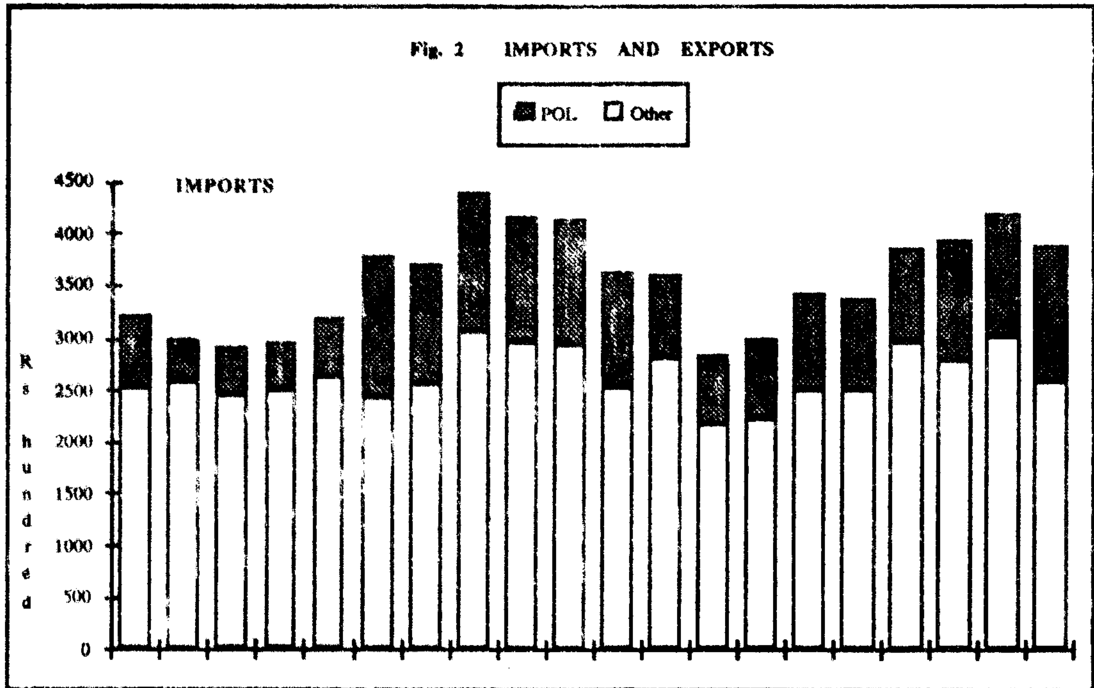
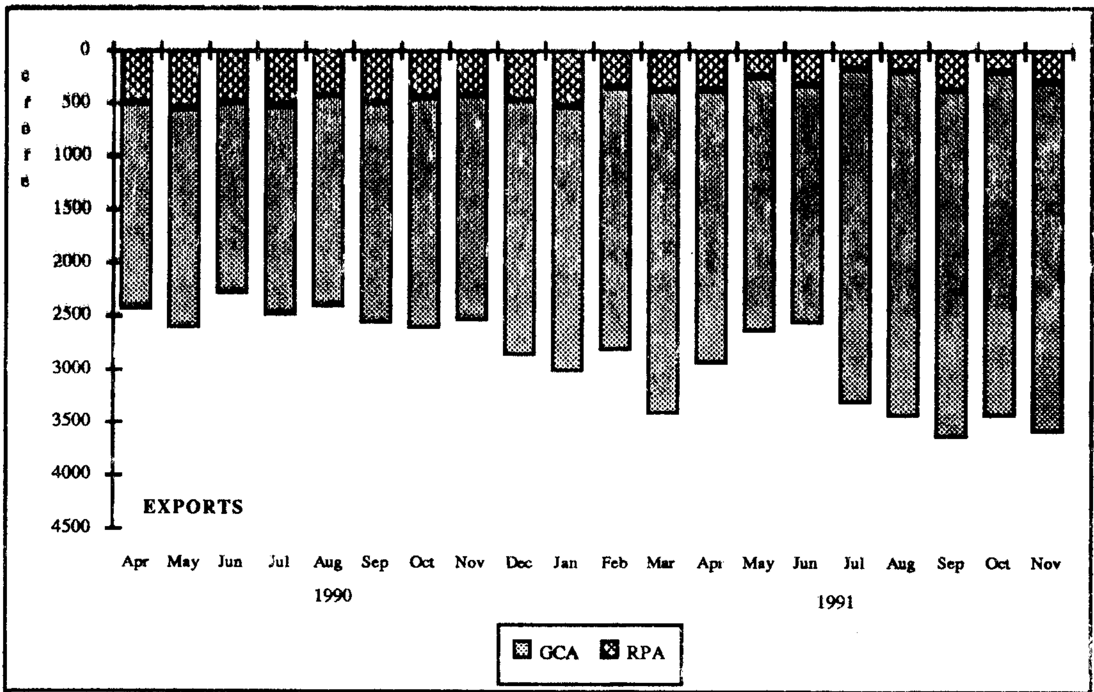


Fig. 2 IMPORTS AND EXPORTS
POL
Other
IMPORTS
4500
4000
3500
3000
2500
2000
1500
1000
500
0
Rs hundred


0
500
1000
1500
2000
2500
3000
3500
4000
4500
EXPORTS
Apr May Jun Jul Aug Sep Oct Nov Dec Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov
1990
1991
GCA
RPA

was a sharp rise in the imports of oil and refined products (POL) (Figure 2). From an average of Rs.499 crore ($287 million) per month in June-August 1990, POL imports rose sharply to Rs.1221 crore ($671 million) per month in the following six months. There was a sharp rise in world oil prices on the annexation of Kuwait, and spot purchases made to prevent the emergence of shortages in the domestic market were very costly. The rise in the cost of POL imports more than accounted for the rise in the trade deficit from an average of Rs.619 crore (($356 million) per month in June-August 1990 to Rs.1229 crore ($677 million) per month in the following six months (Figure 3). The effect of the rise in oil prices was aggravated by the events that followed. Indian workers employed in Kuwait had to be airlifted back to India, and their remittances ceased to flow in. Further, the consequent UN trade embargo on Iraq led to the cessation of exports to Iraq and Kuwait. The loss of exports to West Asia is estimated to have been about Rs.500 crore ($280 million).

The payments crisis of 1990-91 was not, however, due simply to a deterioration in the trade account; it was accompanied by other adverse developments on the capital account reflecting the loss of confidence in the Government's ability to manage the situation. Short-term credits began to dry up; this imposed a severe strain on the balance of payments position. In 1989-90, canalizing agencies had increased their recourse to short-term external credit by about $ 2 billion. Such increase had to be restricted to a level of $ 645 million in 1990-91. Short-term credits by way of bankers' acceptance lines and six-month credits were available at 0.25 per cent above LIBOR (the standard reference interest rate in international commercial borrowings) until November 1990. Thereafter the cost went up to 0.65 per cent above in March 1991; it rose to 1.25 per cent above by May that year. By June the overall cost of credit was far higher. More recently, margins over LIBOR have settled at 2 per cent above.

The volume of commercial borrowings abroad with maturity over a year (and going up to 12 years) approved in the past three years is shown in Table 2. Such medium-term loans are intended to be used by financial institutions and public sector enterprises to finance capital goods imports. They impart flexibility to the funding pattern, and facilitate cash management. They were also relatively cheap as long as India's credit rating was good. External commercial borrowings approved by the Government amounted to Rs.5479 crore in 1989-90. This came down to Rs.3414 crore in 1990-91. In the first half of 1991-92 the volume of commercial borrowings approved was only Rs.1559 crore (Table 2). The fall was entirely in bank loans and in the bonds placed abroad. These were replaced to some extent by export credits, which usually are guaranteed by the official export credit guarantee institutions of exporting countries.

The drying up of commercial loans in 1990-91 was accompanied by a net outflow of NRI deposits which began in October 1990 and continued in 1991 (Figure 4). NRI deposits, although ostensibly in the nature of time deposits for different periods, are in fact withdrawable on demand if the depositor is prepared to lose some interest. They are thus in effect a form of short-term debt. The outflow from NRI deposits was very substantial. In April-June 1991 it was $952 million. It continued at the monthly average rate of $120 million in July-September and then declined to $83 million in October-December. It was reversed only in January 1992.

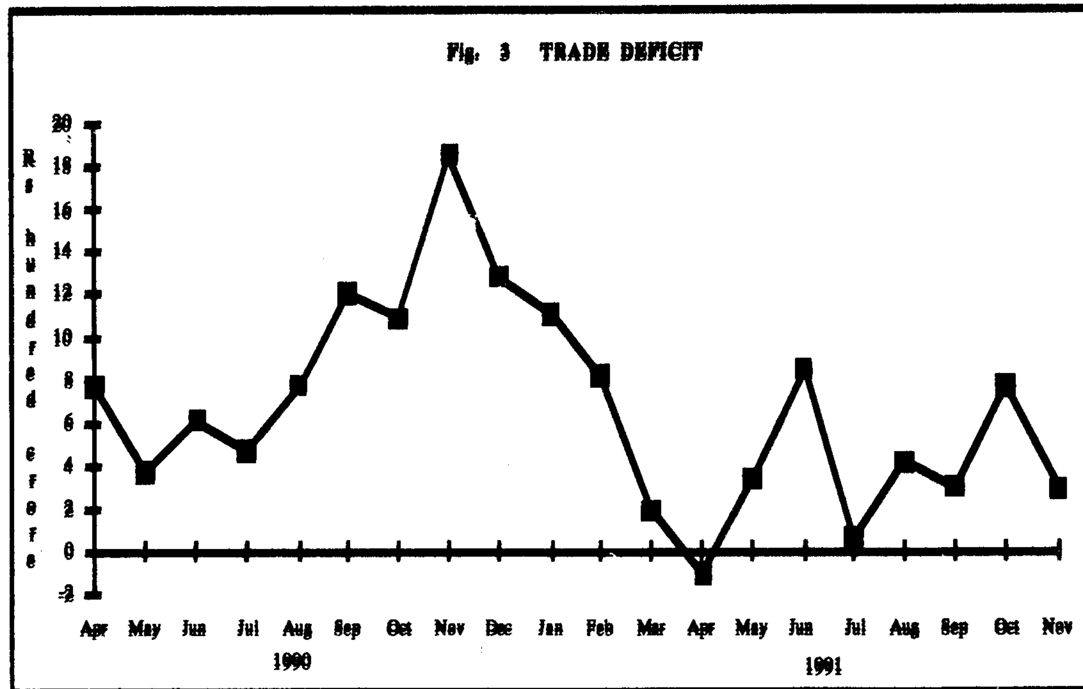


Fig. 3 TRADE DEFICIT
Rs hundred crore
20
18
16
14
12
10
8
6
4
2
0
-2
Apr May Jun Jul Aug Sep Oct Nov Dec Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov
1990
1991

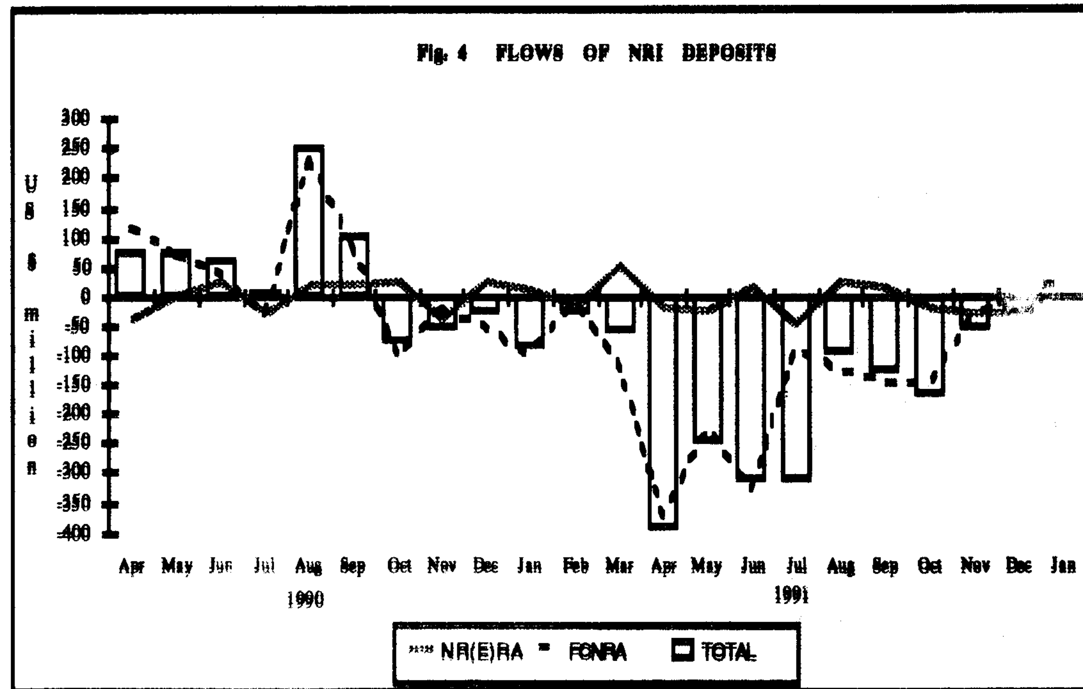


Fig. 4 FLOWS OF NRI DEPOSITS
US $ million
300
250
200
150
100
50
0
-50
-100
-150
-200
-250
-300
-350
-400
Apr May Jun Jul Aug Sep Oct Nov Dec Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec Jan
1990
1991
NR(E)RA
FCNRA
TOTAL

TABLE 2

Approvals of external commercial borrowings

1989-90 to 1991-92

Rs.crore

	1989-90	1990-91	April-Sept. 1991
Bank loans	2296	624	50
Bonds etc	1219	1155	-
Export credits	1963	1635	1509
Total	5479	3414	1559

The rapid loss of reserves had prompted the Government to take a number of counter-measures in the second half of 1990-91. In October 1990, Reserve Bank of India imposed a cash margin of 50 per cent on imports other than those of capital goods. Capital goods imports were allowed only against foreign sources of credit. In December 1990, the Government imposed a surcharge of 25 per cent on the prices of petroleum products except domestic gas. It also raised auxiliary customs duties. The cash margin imposed by Reserve Bank was raised to 133.3 per cent in March 1991 and 200 per cent in April 1991. In May, Reserve Bank of India imposed a 25 per cent surcharge on interest on bank credit for imports. These stringent measures had the expected effect of forcing a considerable degree of import compression. Non-oil imports in October-December 1990 were 16.8 per cent higher in dollar terms than a year earlier. In the next quarter, non-oil imports were 4.1 per cent below the level in the corresponding period of the previous year . In April-June 1991, they were 23.1 per cent lower in dollar terms.

The Crisis in 1991-92

By June 1991, it had become clear that import compression was proving counter-productive as an instrument for management of the balance of payments. The drastic effect of import compression is illustrated by comparing the import figures for April-September 1990-91 with those for 1991-92 (Table 3). Merchandise imports (in terms of US dollars) fell 17.5 per cent between April-September 1990 and April-September 1991. Essential imports consisting of oil and refined products, foodgrains, edible oils, fertilisers and non-ferrous metals fell 7.5 per cent. Capital goods imports fell 17.2 per cent. Mainly export-related imports fell 14.8 per cent. Of the rest, bulk imports - steel, coal, ores, paper and pulses - fell 25.4 per cent, mostly because of deliberate policy, and the rest fell 32.8 per cent. The proportion of these residual goods in total imports had fallen to 13.5 per cent by April-September 1991; there was not much room left for their compression. Hence further import reduction would have had to fall on essential inputs into industry and transport, petroleum products and fertilizers. As Table 4 shows, the adverse effect of import compression was already being felt in terms of a decline in the index of industrial production during 1991-92. Further compression would have entailed an even sharper fall in industrial production, disruption of transport and a fall in exports as imports of inputs for them were reduced. Import compression had reached a stage when it threatened widespread loss of production and employment, and verged on economic chaos.

TABLE 3

Imports by major commodity groups

(Million Dollars)

				April-Sept (P)		Percentage change		
	1988-89	1989-90	1990-91	1990-91	1991-92	1989-90	1990-91	Apr-Sep'91
1	2	3	4	5	6	7	8	9
I. Bulk imports	8058.0	8848.6	11156.6	4728.6	4115.3	9.8	26.1	-13.0
(a) Essential imports	5227.7	5941.6	7909.7	3288.5	3040.8	13.7	33.1	-7.5
1. POL	3009.0	3768.1	6028.1	2279.1	2334.6	25.2	60.0	2.4
2. Cereals & cereal preparations	534.2	227.1	101.6	48.6	29.4	-57.5	-55.3	-39.6
3. Edible oils	503.9	126.6	181.6	104.6	26.5	-74.9	43.4	-74.6
4. Fertilizers	644.7	1067.0	984.3	556.3	504.4	65.5	-7.8	-9.3
5. Non-ferrous metals	535.8	752.8	614.1	299.9	145.9	40.5	-18.4	-51.3
(b) Other bulk imports	2830.3	2907.0	3246.9	1440.1	1074.5	2.7	11.7	-25.4
6. Pulses	265.8	136.9	268.2	126.0	58.7	-48.5	95.9	-53.4
7. Coal	290.0	337.5	440.0	194.0	181.7	16.4	30.3	-6.3
8. Iron and steel	1335.0	1384.2	1177.6	523.7	472.6	3.7	-14.9	-9.8
9. Paper, paperboard & pulp	390.2	397.4	509.4	247.9	179.6	1.8	28.2	-27.6
10. Ores & metal scrap	549.4	651.0	851.7	348.5	181.9	18.5	30.8	-47.8
II. Non-bulk imports	10028.5	11004.9	11340.7	5435.2	4424.3	9.7	3.1	-18.6
(a) Capital goods	4803.0	5303.9	5832.7	2547.7	2110.6	10.4	10.0	-17.2
(b) Mainly export related imports	3729.0	4085.9	3680.0	1966.7	1676.3	9.6	-9.9	-14.8
(1) Pearls and precious stones	2192.8	2547.6	2083.1	966.7	941.1	16.2	-18.2	-2.6
(2) Chemicals	1307.9	1282.5	1275.6	819.3	622.3	-1.9	-0.5	-24.1
(3) Textile yarn, fabrics etc	185.9	209.7	246.7	133.5	79.4	12.8	17.6	-40.5
(4) Raw cashewnuts	42.4	46.0	74.7	47.2	33.5	8.7	62.2	-28.9
(c) Other non-bulk items	1496.4	1615.2	1828.0	920.8	637.4	7.9	13.2	-30.8
(1) Instruments etc.	469.1	532.0	590.6	327.1	199.0	13.4	11.0	-39.2
(2) Chemical materials and products	355.6	384.0	514.4	222.6	109.5	8.0	34.0	-50.8
(3) Plastic materials& artificial resins	558.3	598.3	610.0	297.6	284.5	7.2	2.0	-4.4
(4) Non-metallic minerals	113.4	100.9	113.1	73.5	44.4	-11.0	12.1	-39.6
III. Unclassified	1410.7	1418.3	1575.2	915.4	595.1	0.5	11.1	-35.0
IV. Total	19497.2	21271.8	24072.5	11079.1	9134.8	9.1	13.2	-17.5

(P) Provisional.

Notes: 1. Item (4) includes fertilizer crude, manufactured & fertiliser material.

2. Item (13) includes organic, inorganic, pharmaceutical & dyeing & colouring materials.

TABLE 4

Industrial Production and Non-oil Imports: Annual Rates of Change

(per cent)

Month	Index of industrial production		Non-oil imports (in dollar terms)	
	1990-91	1991-92	1990-91	1991-92
April	11.1	-0.9	20.39	-25.93
May	14.7	-2.9	3.21	-27.04
June	12.1	-3.0	2.46	-15.95
July	13.1	1.7	21.09	-32.27
August	10.9	-0.9	23.24	-23.89
September	8.0	0.7	3.46	-20.77
October	7.7	-0.4	7.62	-17.69
November	3.0	-1.5	31.54	-41.25
December	5.9		12.14	
January	4.8		6.57	
February	6.8		-9.98	
March	6.8		-8.68	

By the beginning of 1991-92 it had become clear that the payments crisis was no longer primarily due to the trade deficit, which had come down from Rs.1412 crore ($781 million) per month in October-December 1990 to Rs.710 crore ($382 million) per month in January-March 1991 and further to Rs.361 crore ($172 million) per month in April-June 1991. The outflow of Foreign Currency Non-Resident (FCNR) deposits, however, had accelerated from $59 million a month in October-December 1990 to $76 million in January-March 1991 and $310 million in April-June 1991. There was also evidence that expectations of default, and therefore of devaluation, were creating longer leads in the payments for imports and lags in the realisation of export proceeds which had the effect of exacerbating the foreign exchange shortage.

By June 1991, the balance of payments crisis had become owerwhelmingly a crisis of confidence - of confidence in the Government's ability to manage the balance of payments. The loss of confidence had itself undermined the Government's capability to deal with the crisis by closing off all recourse to external credit. A default on payments, for the first time in our history had become a serious possibility in June 1991.

A default is essentially a failure to repay debts, but its ramifications are never confined to debt. All trade requires credit, even if it is for a short period - at least for the period between the shipment of goods and their receipt. A default in payments inevitably leads to a breakdown in credit availability and in normal payments arrangements. Suppliers become reluctant to sell goods and services and insist on advance payments through banks of their own country. Typically, this leads to severe trade disruption which in turn forces severe and prolonged import compression, and results in shortages, industrial

dislocation, severe unemployment and inevitably, in very high inflation.

Policy Response

The new Government which assumed office in June 1991 had to act swiftly to deal with the situation and bring the economy back from the brink of default. It became necessary to take emergency action to prevent a default in payments. The Government leased 20 tonnes of gold out of its stock to the State Bank India to enable it to sell the gold abroad with an option to repurchase it at the end of six months. This export took place in May 1991. In addition, the Government allowed Reserve Bank of India to ship 47 tonnes of gold to the Bank of England in July. This helped to raise about $ 600 million. The exchange rate of the Rupee was also adjusted in July 1991 to bring it to a credible level which could be defended.

It was evident that the economy needed substantial reforms if the crisis was to be fully overcome. The new Government moved urgently to implement a programme of macro-economic stabilization through fiscal correction. Moreover, to impart inherent competitive strength to the industrial economy, a programme of structural reforms of trade, industrial and public sector policies was also initiated. The objective is to evolve an industrial and trade policy framework which would promote efficiency, reduce the bias in favour of excessive capital-intensity and encourage an employment-oriented pattern of industrialization. The four major policy initiatives taken by the Government to fundamentally address the balance of payments problem and the structural rigidities are discussed below.

Fiscal Correction

A key element in the stabilization effort was the effort to restore fiscal discipline. Both the balance of payments problems which were building up over the past few years and the persistent inflationary pressure were the result of large budgetary fiscal deficits which characterized the economy year after year. The budget deficit reached Rs. 10,992 crore in 1989-90, and Rs.10,772 crore in the Revised Estimates in 1990-91. A reversal of the trend of fiscal expansionism was essential to restore macro-economic balance in the economy.

The signal was given in the Budget for 1991-92 which was presented on 24 July. The Budget projected a sharp decline in the budget deficit to Rs.7719 crore in 1991-92. Similarly, the fiscal deficit, which represents the overall resource gap of the Government, was projected to decline from Rs.43,331 crore in 1990-91 to Rs.37,772 crore in 1991-92. These improvements in fiscal performance were made possible by the decision to abolish export subsidies, to increase fertilizer prices, as well as the steps taken to keep non-plan expenditures (including defence expenditure) in check.

Trade Policy Reforms

New initiatives were taken in trade policy to create an environment which would provide a stimulus to export while at the same time reducing the degree of regulation and licensing control on foreign trade. The exchange rate adjustment of 18 per cent in the value of the rupee was designed to provide a substantial stimulus to exports.

This change was accompanied by several other changes in trade policy. The more important trade policy reforms introduced in 1991-92 are as follows:

(i) A large part of administered licensing of imports was replaced by import entitlements linked to export earnings. These import entitlements, renamed Eximscrips, are freely tradeable and attract a premium in the market. For

most exports a uniform rate of 30 per cent of Eximscrips was made applicable, though some exports were entitled to higher rates.

(ii) Eximscrips could be used to import any item in the limited permissible list, the non-sensitive canalized list, all OGL items for actual users and non-OGL capital goods which were not in the restricted list.

(iii) The Advance Licensing system for exports was simplified so as to improve exporters' access to imported inputs at duty-free rates.

(iv) Permission to import capital goods was given without clearance from the indigenous availability angle provided this import was fully covered by foreign equity or was up to 25 per cent of the value of plant and machinery, subject to a maximum of Rs.2 crore.

(v) Export and Trading Houses and Star Trading Houses were permitted a larger range of imports. 51 per cent foreign equity is also now allowed in Trading Houses.

(vi) The scope of canalization for both exports and imports was narrowed.

(vii) Actual user requirements for the import of capital goods, raw materials and components under OGL was removed; and

(viii) Established exporters are now permitted to maintain foreign currency accounts and to raise external credits to finance their trade transactions.

The effect of these reforms was to reduce the degree of licensing in import trade, to broaden, to enhance and harmonize export incentives and to introduce a self-balancing mechanism where imports would be automatically regulated by the availability of Eximscrips through export earnings.

Industrial Policy Reforms

In order to consolidate the gains already achieved during the 1980s, and to provide greater competitive stimulus to the domestic industry, a series of reforms were introduced in Industrial Policy. The new industrial policy of 24 July 1991 sought substantially to deregulate industry so as to promote the growth of a more efficient and competitive industrial economy. Industrial policy reforms announced in July 1991 should be seen as being complementary to those undertaken in trade and fiscal policies and in the management of the exchange rate and the financial sector. The central elements of these reforms were as follows :

(i) Industrial licensing was abolished for all projects except in 18 industries where strategic or environmental concerns are paramount or where industries produce goods with exceptionally high import content. With this, 80 per cent of industry has been taken out of the licensing framework.

(ii) The MRTP Act was amended to eliminate the need for prior approval by large companies for capacity expansion or diversification. This will enable Indian firms to become large enough to compete effectively in global markets.

(iii) The requirement of phased manufacturing programmes was discontinued for all new projects.

(iv) Areas reserved for the public sector were narrowed down, and greater participation by private sector was permitted in core and basic industries. In the place of the 17 areas earlier reserved for investment by the public sector, only 8 such areas are now reserved. These eight are mainly those involving strategic and security concerns.

(v) Government clearance for the location of projects was dispensed with except in the case of 23 cities with a population of more than one million.

(vi) Small-scale enterprises were given the option to offer up to 24 per cent of their share-holding to large-scale and other industrial undertakings. This will provide them with greater access to capital and technology.

(vii) Loan agreements of the financial institutions with privately managed firms were earlier required to provide for the right of the financial institutions to convert the loans into equity. In August 1991, the institutions were permitted not to insist on this provision in future loans unless they felt it necessary for commercial reasons. In December 1991, the institutions were permitted to delete the provision from past loans also subject to a revision of the interest rate where appropriate.

(viii) A National Renewal Fund has been set up with a corpus of Rs. 200 crore to ensure that the costs of technological change and modernization of industry would not be borne by workers. It will be used to provide a safety net to workers in sick and non-viable enterprises, and to finance their retraining and redeployment.

Along with a reform of industrial policies, steps were also taken to facilitate the inflow of direct foreign investment. These non-debt-creating inflows will reduce reliance on fixed-interest debt and also bring in new technology, marketing expertise and modern managerial practices. The following measures were taken in this context :

(i) The limit of foreign equity holdings was raised from 40 to 51 per cent in a wide range of priority industries. However, foreign exchange outflow on account of dividends on additional equity will be balanced by export earnings. Such foreign equity participation now has automatic approval and is cleared by Reserve Bank of India.

(ii) The procedures for investment in non-priority industries have been streamlined. The Foreign Investment Promotion Board has been established to negotiate with large international firms and to expedite the clearances required. The FIPB also considers individual cases involving foreign equity participation over 51 per cent.

(iii) Technology imports for priority industries are automatically approved for royalty payments up to 5 per cent of domestic sales and 8 per cent of export sales or for lumpsum payments of Rs.1 crore.

Deregulation will reduce the role of Government regulatory agencies. They will be reorganized and their staff redeployed. For the economy as a whole, delays in project implementation will be greatly reduced. Increased competition will lead to enhanced pressure on enterprises to reduce their costs and to improve quality.

The full outcome of the industrial policy changes will materialize after some time; but the early results are already visible. The response to the new industrial policy has been very encouraging. The number of investment approvals given in 1991 has risen to 5538 from 3335 in 1990. The figure for 1991 includes 3095 Industrial Entrepreneurs' Memoranda filed under the new policy, which would have earlier required letters of intent or industrial licences. 3897 investment proposals were cleared between the announcement of the new policy on 24 July 1991 and 31 January

1992. During the same period, 505 foreign technology import agreements were also approved. The effects of this increased domestic investment activity in terms of higher capacity and output will emerge after a lag when these investment plans fructify.

Changes brought about in policies towards direct foreign investment have also evoked a strong positive response from foreign companies. In 1991, a total of 244 cases of foreign equity participation with a proposed equity investment of $504 million was approved. In the previous three years, 1988, 1989 and 1990 the total inflow of private foreign equity was $95 million, $120 million and $50 million respectively. The increase in domestic investment activity and inflow of foreign capital will strengthen our industrial capabilities and contribute to exports.

Public Sector Reforms

The public sector was originally conceived as holding the commanding heights of the economy and leading technological advance. It was also intended to generate investible surpluses and become an engine for self-reliant growth. The public sector has contributed significantly to the diversification of India's industrial structure. But its contribution in terms of generating internal resources for further expansion has fallen short of expectations, and its inability to do so has now become a major constraint on economic growth.

The performance of the public sector deteriorated sharply in 1990-91 when the net profit (after tax) of all non-departmental central public sector enterprises declined to Rs. 2368 crore from the level of Rs. 3789 crore reached in 1989-90. The poor performance has continued in 1991-92. It is imperative that the public sector attains the objectives originally set for it. This will require a sustained improvement in productivity and profitability. The budgetary support to public sector enterprises will need to be scaled down and they will be expected to maintain financial discipline in their operation. The sector should be exposed to competitive pressures wherever possible. Some of the enterprises can be restructured so as to improve their capital base and access to the market.

To enable the public sector to work efficiently, the public sector units have to be given the greatest autonomy in their operations. A system of full responsibility and complete accountability will have to be enforced on public sector managements. In 1991-92 the Government undertook a limited disinvestment of a part of public sector equity to the public through public financial institutions and mutual funds in order to raise non-inflationary finance for development. The disinvestment will also bring in greater public accountability and help to create a new culture in their working which would improve efficiency. The objective of public sector policy is to improve the operational efficiency of these units and return them to their original goals. Recognizing that sickness is a serious problem in many public sector units, the government amended the Sick Industrial Companies Act to bring public sector undertakings also within its purview. This makes sick public sector units subject to the same discipline as private sector units including reference to the BIFR for identification of a viable restructuring package or closure as the case may be.

Balance of Payments Financing

The measures of fiscal correction and structural reform described above were expected to bring about an improvement in the balance of payments in the medium term. However, for the immediate future substantial financing of balance of payments was unavoidable if

import compression was to be relaxed. Accordingly, the Government attempted to mobilize support for the balance of payments from multilateral financial institutions -- the International Monetary Fund, the World Bank and the Asian Development Bank -- as well as from bilateral donors.

TABLE 5

Drawals from International Monetary Fund, 1990-1992

Date	Facility	SDR million	US $ million	Rs crore
July-Sept 1990	RT	490	660	1177
23.01.1991	FCT	552	789	1450
23.01.1991	CCFF	717	1025	1884
22.07.1991	CCFF	166	221	570
12.09.1991	CCFF	469	639	1654
15.11.1991	UCT	85	117	305
02.01.1992	UCT	185	265	683
Expected till March 1992	UCT	461	650	1700

As pressure on the reserves mounted, the Government availed itself of the facilities available from International Monetary Fund. In July-September 1990 it withdrew the reserve tranche (RT) of SDR 490 million (Table 5). In December 1990 it applied for the first credit tranche (FCT) of SDR 552 million, and negotiated drawals under the contingency compensatory finance facility (CCFF) which totalled SDR 1.352 billion between January and September 1991. In addition, the Government has drawn a total of SDR 270 million under the upper credit tranche standby arrangement and a further SDR 461 million is due to be disbursed in April 1992. A Structural Adjustment Loan of $500 million has been negotiated with the World Bank, of which $300 million has been drawn. Additional fast disbursing assistance was tied up with the Asian Development Bank and with some of the bilateral donors.

Another important initiative taken by the Government to meet the urgent need for balance of payments financing was the announcement of two schemes designed to encourage the inflow of capital funds from abroad. The India Development Bond Scheme and the Immunity Scheme for repatriation of funds held abroad were introduced in October 1991. The schemes have proved to be highly successful. India Development Bonds mobilised $1.605 billion, and the Immunity Scheme, $793 million.

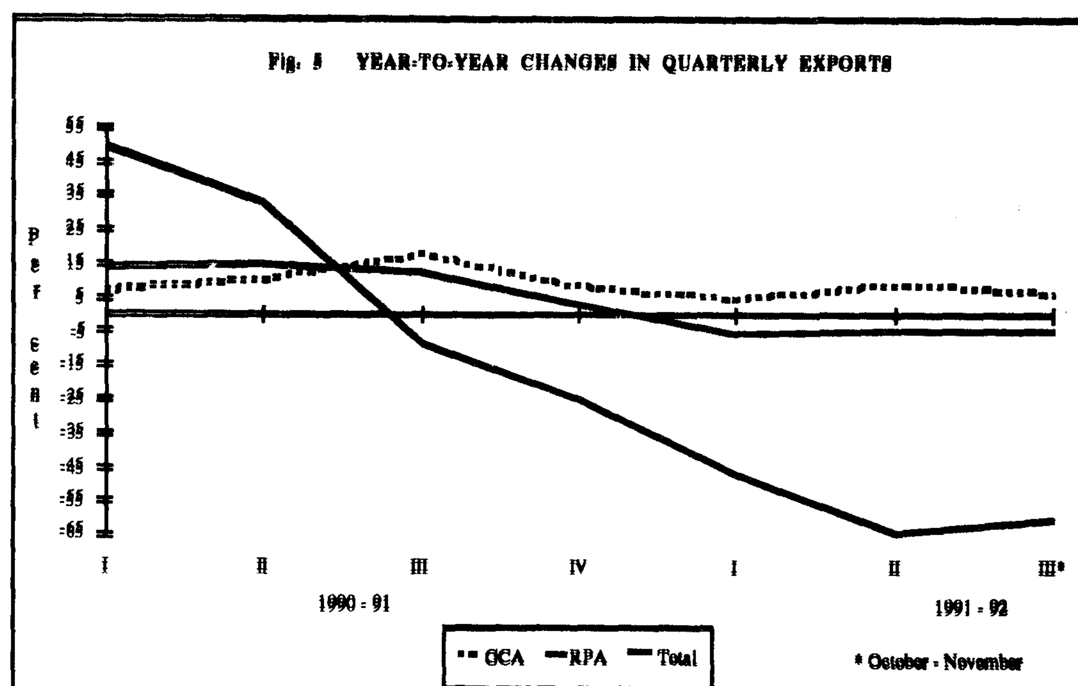
The Outcome

The early results of the crisis management effort in 1991-92 have been encouraging: foreign currency assets, which had declined to $1.1 billion at their lowest point in June 1991, had risen to about $4.4 billion by 19 February 1992. In addition to the buildup of foreign exchange reserves, the Government was able to bring back the gold pledged to the Bank of England and the Bank of Japan in July. The value of this gold was approximately $600 million. $1.605 billion was received on India Development Bonds, which is held by the State Bank of India. Thus there was an increase in external assets of about $4.6

billion, against which must be placed an increase in foreign liabilities of about $3.2 billion. (These figures are preliminary and are given only to indicate orders of magnitude.)

The buildup of reserves in the course of 1991-92 was necessary to restore confidence in the system, but it also meant that the additional resources mobilized from the multilateral financial institutions and the IDB and Immunity Schemes were primarily used for building up reserves and not to liberalize imports, which remained severely constrained in 1991-92 as is evident from Table 4. With the buildup of reserves, a gradual relaxation of import restrictions was introduced in the second half of 1991-92, specially in December 1991 and January 1992. The restrictions on imports of raw materials and components imposed by Reserve Bank of India have now been removed, and on imports of capital goods substantially relaxed.

A lasting solution to our payments problem can only be found in a substantial improvement in the country's export performance. Exports performed extremely well in the four-year period from 1986-87 to 1989-90 when they grew at an average rate of 19 per cent per year in dollar terms. The momentum was lost in 1990-91 when export growth decelerated to 9 per cent. Conditions worsened further in 1991-92 as the full effect of import compression began to be felt in the industrial sector (Figure 5). The disruption in our Rupee trade with the erstwhile Soviet Union has also hurt exports. Exports to Rupee Payment area have declined by more than 50 per cent. The full positive effects of trade policy reforms have yet to emerge. Exporting firms are still adjusting to the changed regime. The lag in performance of exports consequent upon policy changes is understandable. Some of the positive effects of the trade policy changes would perhaps be reflected in the performance during the last quarter of 1991-92, the data for which are not yet available. But, the full impact on export expansion, of trade reforms already undertaken will be visible only during 1992-93. It is essential to restore to India's exports the momentum that was evident only two years ago.



Four types of adjustments are called for a broad-based, rapid and sustained growth of exports in the next four years.

(a) *Reduction in domestic excess demand:* The balance of payments deficit represents the excess of domestic demand for goods and services over domestic supply. In order to correct it domestic demand will have to be restrained and supply increased. Since the macro-economic imbalance is also the basic cause of inflation, this is dealt with more fully in the next section. It will be necessary to restrain the degree of excess spending by the Government to correct the balance of payments. At the same time it will be necessary to ensure that any reduction in aggregate demand is brought about without hurting production and that it is shared equitably by different sections of the population.

(b) *Enhanced Competitiveness:* By mid-1991 domestic prices had become seriously misaligned with international prices. This required two changes: a change in the exchange rate of the Rupee, and a reduction in the relative prices of those products which were costly vis-a-vis competing goods abroad. The first step was taken by means of a downward adjustment of about 18 per cent in the external value of the Rupee on 1 and 3 July 1991. The second step would require a phasing down of import restrictions and a reduction in the high levels of protection which characterize Indian industries. Progress in this regard is at present constrained by the grave balance of payments position as well as by the importance of import duties as a source of government revenue; however, it will be necessary to bring down trade restrictions as payments and fiscal conditions permit.

(c) *Deregulation:* One of the obstacles to exports lies in the cumbersome administrative procedures involved, arising from controls over imports (and on inputs required for exports) and exports, exchange control and also customs procedures. The Eximscrip scheme was designed partly to reduce the rigours of import control. Trade and customs classifications of goods were harmonized in October 1991, and new, simplified documentation of import control and customs was introduced. Simultaneously with the devaluation of the Rupee, Cash Compensatory Support for exports was withdrawn, thereby eliminating the work involved in its administration. Simplification of trade-related procedures must continue; the aim should be to make international trade as easy as domestic trade in respect of procedures.

(d) *Capability for self-improvement:* World markets are more competitive than some hitherto sheltered domestic markets. If our agricultural and industrial products are to compete internationally, their producers will have to improve their own competitive position continuously through technological and managerial improvements and adapt themselves rapidly to changes in international market conditions. This capacity for unceasing adaptation and innovation would need to be developed.

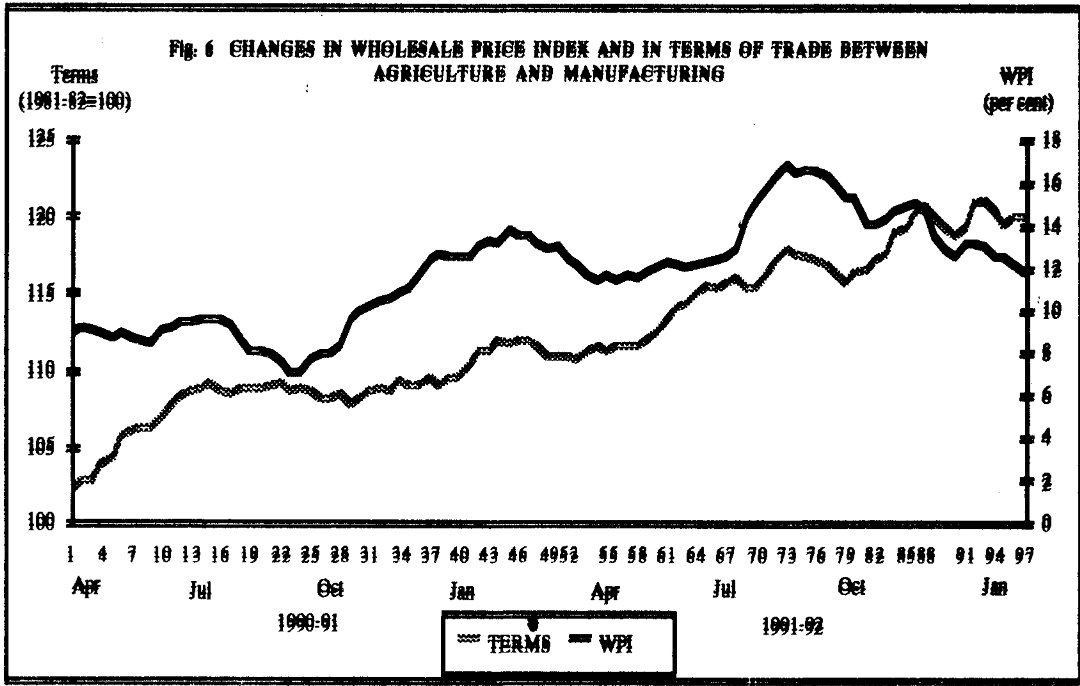


Fig. 6 CHANGES IN WHOLESALE PRICE INDEX AND IN TERMS OF TRADE BETWEEN AGRICULTURE AND MANUFACTURING