6

EXTERNAL SECTOR

The remarkable improvement in India's balance of payments witnessed in 1993-94 was sustained in 1994-95. According to the DGCI&S data exports continued to show buoyancy with a growth of 18.4 per cent in US dollar terms and private transfers were also buoyant. There was a large increase in imports by 22.9 per cent in line with the expansion in industrial growth and investment activities. Invisible payments also rose considerably, reflecting the liberal policy regime for current payments. As a result, the current account deficit widened from the abnormally low level of US $315 million in 1993-94 to US $2315 million in 1994-95. At this level, the current account deficit was about 0.8 per cent of GDP which is modest. The rise in the current account deficit in 1994-95 was anticipated as the economy recovered and did not pose any financing problems. In fact, total capital flows in 1994-95 were much in excess of financing needs, reflecting the continuing reserve build up of about US $4.76 billion during 1994-95. Foreign currency assets of the Reserve Bank of India (RBI) increased from US $15.07 billion at the end of March 1994 to a historical peak of US $20.81 billion at the end of March 1995. Total foreign exchange reserves, including gold and Special Drawing Rights (SDRs), amounted to US $25.19 billion at the end of March 1995, equivalent to about ten months of imports in 1994-95.

2. The trade and payments position remained reasonably comfortable during 1995-96. For the third year in succession, export growth was robust, supported by a congenial domestic policy environment. Import growth was also high, reflecting the continued good performance of the industrial sector. Net inflow of invisibles marked a sharp decline over the previous year, partly due to inflows of private transfers declining from the abnormally high level of 1993-94 to a level consistent with normal trends, and partly due to an increase in interest payments on foreign loans. Reflecting these developments on the trade and invisibles accounts, the current account deficit widened in 1995-96. But the level of the deficit was reasonable and sustainable. On the capital account, foreign investment flows were the major component, as in the two previous years. However, there was a significant deceleration in these flows, mainly because of the subdued trend in portfolio investments. Direct foreign investment flows, on the other hand, showed a considerable improvement. The residual financing need was met by drawing down foreign exchange reserves. Foreign currency assets of the RBI declined by US $4.48 billion, to a level of US $16.32 billion by the end of January 1996. The decline in reserves reflects the expansion in imports and greater investment absorption capacity of the economy in response to reform measures introduced since 1991.

3. The year 1995-96 saw an end to the prolonged stability of the rupee-dollar exchange rate from March 1993. This stability against the dollar had arisen because this period had seen buoyant inflows of portfolio capital which forced the Reserve Bank to intervene to prevent an appreciation. Although these flows slowed down in the last quarter of 1994-95, the exchange rate remained stable until August 1995 after which it depreciated against the US dollar. The second half of 1995-96 was characterised by periodic speculative pressure on the exchange rate which were actively countered by the Reserve Bank of India. On the whole, the adjustment in the exchange rate by the end of January 1996 has brought the real effective exchange rate of the rupee back to approximately the level that prevailed in March 1993.

4. India's external debt rose from US $92.70 billion at the end of March 1994 to US $99.04 billion at the end of March 1995. Of the US $6.34 billion increase in external debt during 1994-95, as much as US $5.61 billion, or 88% of the increase, was due to exchange rate changes alone. The increase in external debt at constant end March 1994 exchange rates was only US $794 million during 1994-95. Provisional estimates for the current

financial year show that India's external debt has declined by US $5.20 billion during the first six months to US $93.84 billion at the end of September 1995. Two-thirds of the decline in external debt is accounted for the appreciation of the US dollar against major world currencies since March 1995. The long term debt has declined by US $5.43 billion and the short term debt has increased marginally by US $0.23 billion since end March 1995. As a percentage of GDP, India's external debt has declined from the peak of 41.0 percent in 1991-92 to 33.0 percent in 1994-95. The external debt stock at the end of September 1995 works out to about 29.4 percent of the estimated GDP for 1995-96. Debt service payments as a percentage of current account receipts have also declined markedly from 35.3 percent in 1990-91 to 26.6 percent in 1994-95 and it is expected to decline further in 1995-96.

The Balance of Payments

5. Table 6.1 presents a summary view of India's balance of payments for the years 1990-91 through April-September of 1995-96. The developments in India's trade and payments over the past five years mark a noticeable structural change towards a more stable and sustainable balance of payments. During the post liberalization period, there has been a sharp improvement in the coverage of import payments through export earnings. The coverage ratio has averaged around 88 percent since 1992-93, compared with only 52.4 percent at the beginning of the 1980's and about 70 percent at the end of

TABLE 6.1
Balance of Payments: Key Indicators

(In US$ million)

	1990-91 (P)	1991-92 (P)	1992-93 (P)	1993-94 (Q.E.)	1994-95 (Q.E.)	Apr-Sep (Q.E.) 1994-95	Apr-Sep (Q.E.) 1995-96
1. Exports	18477	18266	18869	22700	26763	11853	14980
2. Imports	27914	21064	23237	23985	31269	13385	18165
Of which : POL	6028	5364	6100	5650	5882	2650	3113
3. Trade balance	-9437	-2798	-4368	-1285	-4506	-1532	-3185
4. Invisibles (net)	-243	1620	842	970	2191	1096	445
Non-factor services	979	1207	1128	777	-494	-659	-193
Investment income	-3752	-3830	-3422	-4002	-3905	-1938	-2112
Pvt. transfers	2069	3783	2773	3825	6200	3569	2600
Official Grants	461	460	363	370	390	124	150
5. Current Account Balance	-9680	-1178	-3526	-315	-2315	-436	-2740
6. External assistance (net)	2210	3037	1859	1700	1250	-55	-40
7. Commercial borrowings (net)[1]	2249	1456	-358	1252	1029	-73	25
8. IMF (net)	1214	786	1288	191	-1146	-1134	-839
9. NRI deposits (net)	1536	290	2001	940	847	621	59
10. Rupee debt service	-1193	-1240	-878	-745	-1050	-650	-300
11. Foreign investment	68	154	585	4110	4895	2586	1490
of which :							
(i) DFI	68	154	344	620	1314	466	856
(ii) FIIs	0	0	1	1665	1503	1017	533
(iii) Euro equities	0	0	240	1460	1839	903	46
12. Other flows[2]	2318	271	-243	1735	1247	2463	1056
13. Capital account total(net)	8402	4754	4254	9183	7072	3758	1451
14. Reserve use (-increase)	1278	-3576	-728	-8868	-4757	-3322	1289
Memo items:		*As per cent of GDP*					
Exports	6.2	7.3	7.8	8.9	8.9		
Imports	9.4	8.3	9.8	9.4	10.4		
Trade balance	-3.2	-1.1	-2.0	-0.5	-1.5		
Invisibles balance	-0.1	0.7	0.2	0.4	0.7		
Current account balance	-3.2	-0.4	-1.8	-0.1	-0.8		

(P): Preliminary Actuals; Q.E.: Quick estimates

1 Figures include receipt on account of India Development Bonds in 1991-92 and related repayments, if any, in the subsequent years.

2 Include delayed exports receipts and errors & omissions. For the year 1992-93, it also includes errors & omissions arising out of dual exchange rates applicable under the Liberalised Exchange Rate Management System (LERMS).

TABLE 6.2

Ratios of selected items of the Balance of Payments

Item\Years	1980-81	1985-86	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96[1]
1. Exports/Imports (%)	52.4	54.7	69.5	66.2	86.7	81.2	94.6	85.6	86.6[2]
2. Current account/GDP (%)	-1.6	-2.3	-2.5	-3.2	-0.4	-1.8	-0.1	-0.8	-1.5
3. Current account deficit (US$ million)	2095	4845	6837	9680	1178	3526	315	2315	4800
4. ECB/TC (%)	10.9	22.2	34.4	26.8	30.6	-8.4	12.4	14.6	NA
5. NRI deposits/TC (%)	9.7	33.6	28.4	18.3	6.1	47.0	10.2	12.0	NA
6. External assistance/TC (%)	60.9	31.9	35.9	26.3	63.9	43.7	18.5	17.7	NA
7. Debt service payments as a % of current receipts	10.2	18.7	30.9	35.3	30.2	28.6	25.1	26.6	26.5

[1] Projections [2] Based on DGCI&S trade data for April-December 1995.

Notes:
(i) TC: Total capital flows (net).
(ii) GDP: Gross domestic product at current market prices.
(iii) ECB: External Commercial Borrowings.
(iv) NA: Not Available
(v) As total capital flows are netted after taking into account some capital outflows, the ratios against item no. 4,5 and 6 may in some years add up to more than 100.
(vi) Debt service payments for the years 1980-81 and 1985-86 exclude defence debt.

the 1980's (Table 6.2). There has also been a marked improvement in the flow of invisible receipts. Together, these changes brought about a sharp reduction in the ratio of the current account deficit to GDP, from an unsustainable level of 3.2 percent in 1990-91 to 0.8 percent in 1994-95.

6. There has been a structural change in the capital account in terms of a sharp reduction in debt creating flows and an increased recourse to non-debt creating foreign investment flows. For example, debt creating flows, as a percentage of total capital flows in the balance of payments, averaged as much

Fig. 6.1 **Exports as a Per cent of Imports**

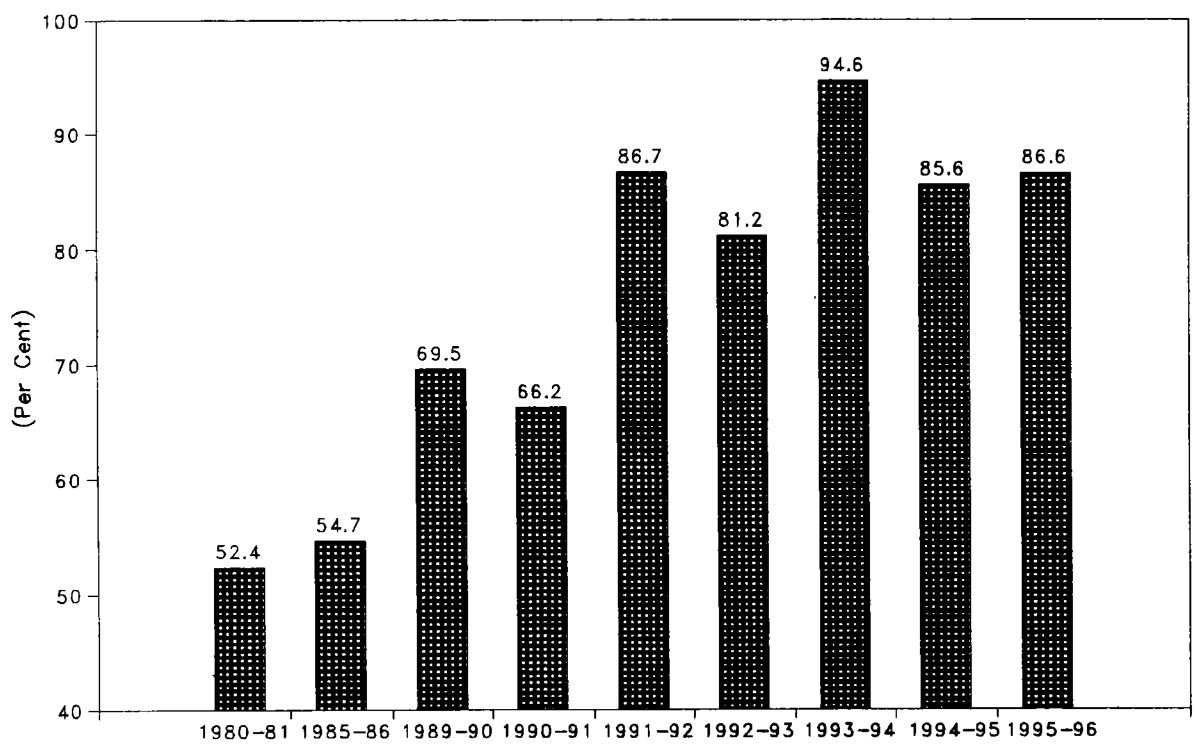


Fig. 6.2

Current Account Deficit 1980-81 to 1995-96

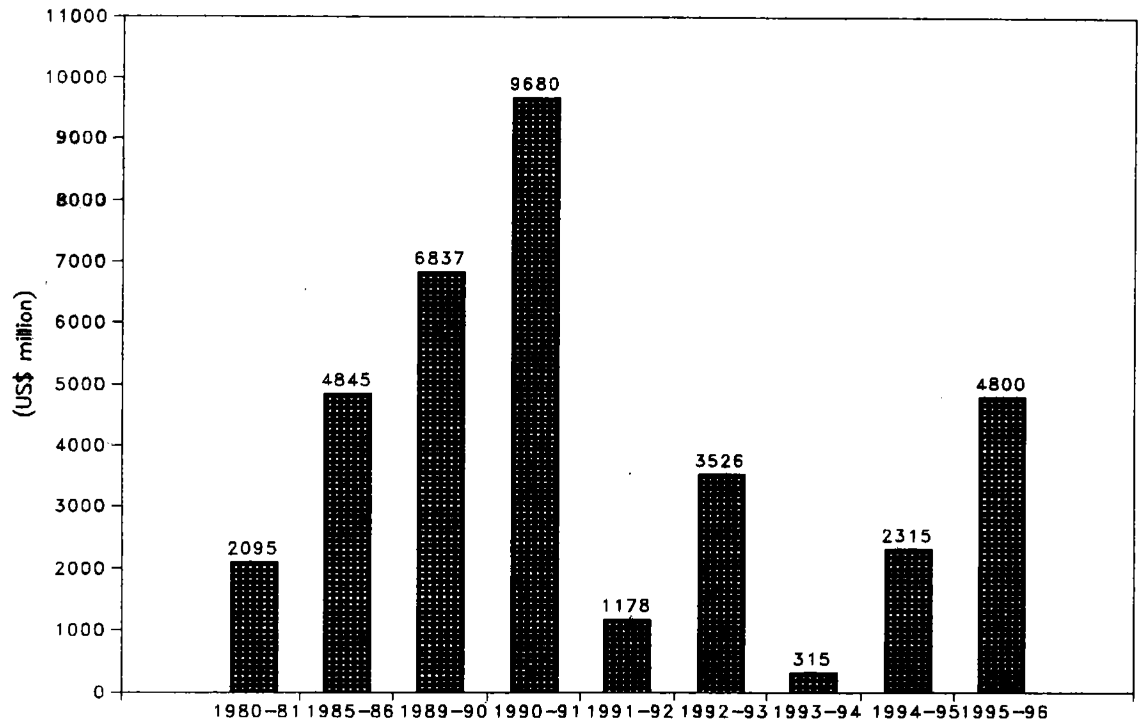
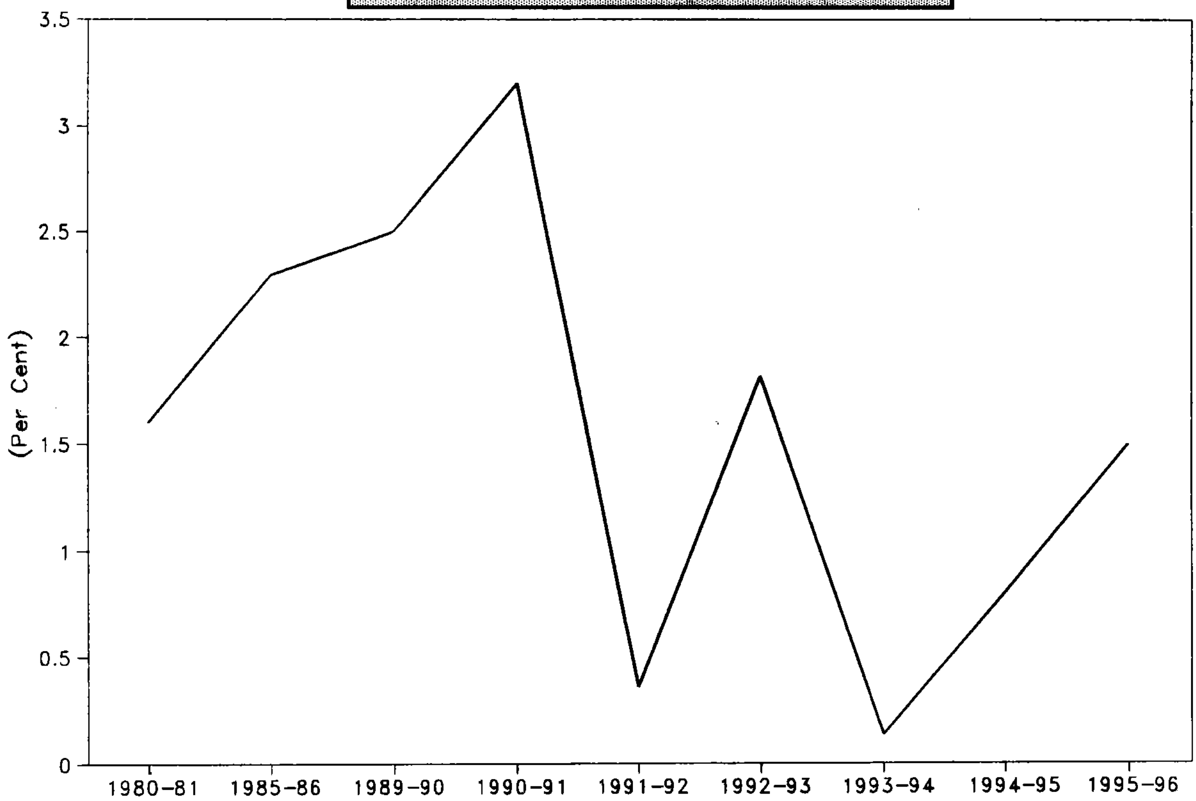


Fig. 6.3

Current Account Deficit as a Per cent of GDP, 1980-81 to 1995-96



as 97 percent during the Seventh Plan period (1985-86 to 1989-90). But the ratio declined very sharply to less than 18 percent in 1994-95. As shown in Table 6.2, this declining trend is shared by all the major components of debt flows, namely, external assistance, commercial borrowing, and non-resident deposits. This favourable shift, away from recourse to debt creating flows for financing the current account deficit, has obvious implications for moderating and reducing future debt service liabilities.

Current Account

7. The strength and resilience of India's balance of payments in recent years has been largely due to the robust export growth witnessed during the last three years. Compared to the negative growth of 1.5 percent in 1991-92 and a lacklustre growth of 3.8 percent in 1992-93, exports in US dollar terms, as per DGCI&S data, recorded a growth rate of 20.0 percent in 1993-94, 18.4 percent in 1994-95 and 24.2 percent during April-December of 1995-96. Imports remained subdued until the greater part of 1993-94, reflecting sluggish industrial activity. Towards the end of the year, however, imports began to pick up in line with the recovery in industrial activity. The growth in imports in US dollar terms, as measured by the DGCI&S data, increased from 6.5 per cent in 1993-94 to 22.9 percent in 1994-95, During April-December 1995, imports grew at a much faster rate of 29.3 percent. The trade deficit, measured on the basis of DGCI&S data, was US $1.07 billion in 1993-94 and rose to US $2.32 billion in 1994-95. It increased to US $3.53 billion during April-December 1995.

8. On the invisibles account, there was a turnaround from a net outflow of US $0.24 billion in 1990-91 to a net inflow of US $1.62 billion in 1991-92. This increased further to US $2.19 billion in 1994-95. The increase was supported by a significant improvement in tourism earnings and a major spurt in private transfer receipts in response to the incentives of a market determined exchange rate. Tourism earnings, in US dollar terms, have recorded a growth of 12 percent in 1994-95, largely reflecting an increase in per capita expenditure. The growth in tourist arrivals was only 1.9 percent. In 1995-96, it is estimated that tourism earnings will rise by about 20 percent, coupled with tourist arrivals increasing at about 12 percent. Similarly, the inflow of private transfers recorded a quantum jump from US $2.07 billion in 1990-91 to US $3.83 billion in 1993-94, with a further increase to US $6.20 billion in 1994-95. In 1995-96, private transfers are expected to decline somewhat compared to 1994-95, while maintaining the upward trend over 1993-94.

9. These developments moved the current account balance from an unsustainable deficit of US $9.68 billion in 1990-91 to a marginal deficit of US $315 million in 1993-94. With the revival on investment and industrial growth in 1994-95, the current account deficit widened to US $2.32 billion in 1994-95 in the wake of a surge in imports. As a percentage of gross domestic product (GDP), the current account deficit declined from 3.2 percent in 1990-91 to 0.12 per cent in 1993-94, before rising to 0.8 per cent in 1994-95. A further increase the current account deficit is expected in 1995-96 when the deficit is projected to reach around 1.5 per cent of GDP which is regarded as a sustainable level.

Capital Account

10. As noted above, there has been a major compositional shift, away from debt creating capital flows and in favour of non-debt creating foreign investment flows. On a net basis, the two major long term debt creating flows, namely, external assistance and commercial borrowing, have declined, when taken together, from an average of US $4.50 billion per annum during 1990-92, to US $2.84 billion in 1993-94 and US $2.28 billion in 1994-95.

External Assistance

11. Gross disbursements of loans under the external assistance head have shown a declining trend over the years. From a peak of US $4.37 billion in 1991-92, when special quick-disbursing assistance had been mobilised, disbursements under external assistance have slowed down to an average of about US $3.3 billion a year in the next two years, and to about US $3.1 billion during 1994-95. Disbursements during the current financial year have been distinctly sluggish. During April-December 1995, gross loan disbursements were only US $1706 million compared with US $1882 million in the same period of the previous year. Sluggish disbursements are attributed to the fact that much of aid is tied to projects where implementation is slow for a variety of reasons. As in previous years, aid disbursements are expected to pick up significantly in the last quarter of the financial year.

External Commercial Borrowing

12. After a sharp drop from US $4.25 billion in 1990-91 to US $1.17 billion in 1992-93, gross disbursements of external commercial borrowings (ECB), including disbursements of defence credits and self liquidating loans, rose markedly to US $3.84 billion in 1994-95. During the current financial year upto September 1995, gross disbursements of ECB amounted to about US $1.45 billion. External commercial borrowings are permitted by the Government as an important source of finance for Indian firms for the expansion of existing capacity and also for new investments. Utilization of borrowing is restricted to financing foreign currency

capital expenditures, except for power projects, where financing of capital equipment from domestic companies is also permitted. Borrowings are permitted within annual ceilings and they are monitored closely, in the light of the balance of payments and consistent with maintaining total external debt within prudent limits.

13. On account of a revival in investments in 1994-95 and demand for external commercial borrowing from investors in newly opened infrastructure sectors like power, there was a large demand for such borrowing during 1995-96. Hence, during the year, the minimum maturity requirements under ECB guidelines were revised upwards. ECBs upto US $15 million or its equivalent are required to have a minimum average tenor of 3 years and those above US $15 million or its equivalent require minimum average tenor of 7 years. Proposals relating to infrastructure projects like power, oil exploration and telecommunications and projects with a strong export orientation are accorded priority. The minimum maturity requirement for 100% export oriented units (EOUs) has been relaxed from 7 years to an average tenor of 3 years.

14. In view of the tight liquidity position prevailing in the domestic market in the latter half of the current financial year, it was decided that Development Financial Institutions, while adhering to the average minimum maturity criteria prescribed in the ECB guidelines, would be permitted to on-lend to borrowers at different maturities and such on-lending could be used for product related rupee expenditure. Further, the facility available to manufacturing companies to avail ECB upto US $1 million or its equivalent with a minimum 3 years simple maturity for meeting rupee expenditure, was extended to all corporates and institutions. External Commercial borrowings are allowed within an overall ECB approval cap of US $5 billion per year with marginal variation. This is consistent with the external debt management strategy which ensures that India's debt service ratio will gradually decline to comfortable levels. In addition, the Government recently made some relaxations of the requirements in regard to the issue of GDRs/FRNs/FCCBs, remittances into India of these proceeds and their utilization.

15. As a result of the clear improvement in overall economic performance and especially in the external sector, international credit rating agencies had upgraded India's credit rating to investment grade last year. In July 1995, the Japan Bond Research Institute (JBRI) affirmed the sovereign rating of investment grade for India during the current year as well. Moody's have similarly maintained an investment grade rating during the current year. Standard and Poor's affirmed its 'BB+' long term foreign currency rating with the outlook on the long term rating remaining stable.

IMF Borrowing

16. India drew from the International Monetary Fund (IMF), between January 1991 and June 1993, a total amount of SDR 3560 million under CCFF and Standby Arrangements. These loans have to be repaid by April 1999. During 1994-95, repayments to the IMF were of the order of US $1.15 billion. IMF repayments in 1995-96 are estimated at US $1.72 billion.

Non-Resident Deposits

17. The Economic Survey for the last two years detailed developments in the Government's policy regarding non-resident deposits. With a view to making deposits under certain schemes more attractive, additional measures were taken in the current financial year. The interest rate on NRE (nonresident external) term deposits, for maturities of 6 months to 3 years and more, was increased from 10 percent to 12 percent per annum.

18. The Cash Reserve Ratio (CRR) requirements on non-resident deposit schemes were raised at a time when capital inflows were very strong and the forward premia were small. Thus, with effect from January 21, 1995, banks were required to maintain CRR of 15 percent on Foreign Currency Non-Resident, Banks (FCNR(B)) deposits, 7.5 percent on Non-Resident Non-Repatriable (NRNR) deposits and 15 percent on Non-Resident (External) Rupee Account (NR(E)RA) deposits. On the basis of the latest exchange rate developments, both in the spot and forward markets, and the present regulations on reserve requirements, the non-resident deposit schemes are not attractive to banks. Therefore, the CRR norms in respect of non-resident deposits were relaxed in successive steps from October 1995. With effect from December 9, 1995, banks were exempted from maintaining the average CRR on additional deposits under NRE and NR(NR)D accounts over the level outstanding as on October 27, 1995 and over the level outstanding as on November 24, 1995 for deposits under FCNR(B) accounts. The CRR limit on the outstanding deposits on the above dates was also reduced to 7.5 percent for FCNR(B) and NR(NR) deposits and to 14 percent for NRE deposits. With effect from January 5, 1996, banks were fully exempted from CRR requirements in respect of FCNR(B) and NRNR deposits and the CRR on NRE deposits upto the level outstanding as on October 27, 1995 was reduced from 14 percent to 10 percent.

19. Net inflows, including accrued interest under non-resident deposits, recovered sharply to US $2.00 billion in 1992-93, from the crisis induced level of US $0.29 billion in 1991-92. Despite net

TABLE 6.3
Outstanding Balances and Net Flows under various Non-Resident Deposit Schemes

A. Outstanding Balances under Different Schemes[1]

(US$ million)

Schemes	As at the end of			
	March 93	March 94	March 95 (P.E.)	Nov 95 (P.E.)
FCNRA	10617	9300	7051	5218
FCNR(B)	—	1075	3054	4560
NR(E)RA	2862	3590	4590	3998
NR(NR)RD	610	1797	2479	2808
FC(B&O)D	1044	533	—	—
Total	15133	16295	17174	16584

B. Net flows under Non-Resident Deposits[1]

(US$ million)

Schemes	1992-93	1993-94	1994-95 (P.E.)	1995-96 (P.E.) Apr-Nov
Foreign Currency Non-Resident Accounts (FCNRA)	825	-1317	-2249	-1833
Foreign Currency Non-Resident(Banks) (FCNR(B))	—	1075	1979	1506
Non-Resident (External) Rupee Accounts (NR(E)RA)	335	728	1000	-101
Non-Resident (Non Repatriable) Rupee Deposits (NR(NR)RD)	610	1187	682	639
Foreign Currency (Banks & Others) Deposits (FC(B&O)D)	350	-576	-558	—
Total	2120	1097	854	211

P.E. Provisional Estimates.
[1] All figures are inclusive of accrued interest.
Note : The above inflows may not tally with those given in Balance of payments table 6.1 due to exclusion of accrued interest in NRNRD up to August 1994.

outflows under FCNRA (foreign currency non-resident accounts) and FC(B&O)D (foreign currency (banks & others) deposits), there was a total net inflow of US $0.94 billion in 1993-94 and US $0.85 billion in 1994-95. This was because of compensating inflows under the other schemes. There has been a net inflow of US $211 million (inclusive of accrued interest) in the non-resident accounts during the current financial year, upto the period ending with November 1995 (Table 6.3). The net inflows under FCNR(B) accounts (US $1.51 billion) and NR(NR)RD accounts (US $0.64 billion) have been partly offset by the outflows under FCNRA and NR(E)RA accounts. It may be recalled that fresh inflows into FCNRA deposits (in which Government bears the exchange risk) was discontinued with effect from August 15, 1994. The outstanding external debt liability on non-resident accounts, excluding deposits in NR(NR)RD, has declined by US $0.92 billion from US $14.70 billion at the end of March 1995 to US $13.78 billion at the end of November 1995 (Table 6.3).

Foreign Investments

20. The response of foreign investment flows to the liberalization measures has been very encouraging. Total foreign investment flows, direct and portfolio, rose sharply to US $4.11 billion in 1993-94, with a further increase to US $4.89 billion in 1994-95, compared to the average of about US $0.27 billion a year during the previous three years. During April-November 1995, foreign investment inflows were of the order of US $2.15 billion.

21. Table 6.4 gives the trends in foreign investment flows by categories. Portfolio investments by Foreign Institutional Investors (FIIs), which began with a sudden surge of US $1.67 billion in 1993-94, were maintained at a level of US $1.50 billion in 1994-95. These flows, however, slackened in the first part of 1995-96 in the wake of the December 1994 Mexican

TABLE 6.4
Foreign Investment Flows by Category

(US$ million)

	1991-92	1992-93	1993-94	1994-95[1]	1995-96[1] (Apr-Nov)
A. Direct investment	150	341	620	1314	1269
a. RBI automatic route		42	89	171	72
b. SIA/FIPB route	87	238	314	701	762
c. NRIs (40% & 100%)	63	61	217	442	435
B. Portfolio investment	8	92	3490	3581	879
a. FIIs	—	1	1665	1503	764
b. Euro equities	—	86	1460	1839	60
c. Offshore funds & others	8	5	365	239	55
Total (A+B)	158	433	4110	4895	2148

[1] Provisional.
Note : Figures shown in this table are based on actual inflows. These may differ from foreign investment flows given in Balance of Payments table 6.1 which are on accrual basis.

crisis. During April-November 1995, net portfolio investments by FIIs were only US $0.76 billion. From December 1995 there was a resurgence of portfolio investments by FIIs, with net flows in excess of $150 million in January 1996. These flows may become increasingly responsive to market conditions in India and abroad, the flexibility and resilience of the domestic financial sector in contending with these flows and the strength of macro-economic fundamentals.

22. Other types of portfolio investments, namely GDRs (global depository receipts) and FRNs which together amounted to US $1.46 billion in 1993-94 and US $1.84 billion in 1994-95, were also much lower in 1995-96.

23. The trend in foreign direct investments (FDI) flows has been encouraging. From US $620 million in 1993-94, foreign direct investments more than doubled to US $1.31 billion in 1994-95. During April-November 1995, foreign direct investments were US $1.27 billion.

24. Table 6.5 gives the trends in approvals of FDIs and actual inflows on a calendar year-wise basis. Approvals for FDI in 1991 were only US $325 million. In 1994, these rose to US $4.33 billion and further increased to about US $5 billion during the first nine months of 1995. This level of approvals highlights the prospect of a continued uptrend in these flows during the coming years.

25. Foreign investment flows supplement domestic efforts at augmenting investments in the economy. These inflows, direct and portfolio, are in the nature of non-debt creating flows and, therefore, they are a desirable form of capital flows to the country. Foreign direct investments are allowed in the priority areas like power, oil refinery, electronics and electronic equipments, chemicals, food processing industries, telecommunication, industrial machinery etc. Many of them also have export linkages. Foreign direct investments in consumer goods industry are selective. It needs to be noted that investments are coming in largely with Indian partners and only a small share of projects fall in the category of ventures exclusively by multinational corporations / foreign companies. This would ensure that the Indian companies would have the benefit of upgraded technology, marketing and management inputs apart from the additional capital injection and increased employment.

Foreign Exchange Reserves

26. The foreign exchange reserves of the country consist of foreign currency assets held by the RBI, gold holdings of the RBI and Special Drawing Rights (SDRs). Appendix Table 6.1 presents the trends in India's foreign exchange reserves, with disaggregation between the three components noted above. Total foreign exchange reserves rose from an abnormally low level (since mid 1970's) of US $3.96 billion at the end of 1989-90 to US $9.22 billion at the end of 1991-92, US $19.25 billion at the end of 1993-94 and a further increase to a historical peak of US $25.19 billion at the end of 1994-95. During the first ten months of the current financial year, total foreign exchange reserves have declined by US $4.30 billion to US $20.89 billion at the end of January 1996.

27. The foreign currency assets constitute the major component of India's foreign exchange reserves. As changes in the other two components, namely, gold and SDRs are few and far between, the movements in India's total foreign exchange reserves are mostly governed by the movements in foreign currency assets component of foreign exchange reserves. Table 6.6 gives the trends in foreign currency assets and some critical indicators of reserve management. As would be seen from the table, the foreign currency assets increased by

TABLE 6.5
Direct Foreign Investment: Actual Inflows vs Approvals

	1991	1992	1993	1994	1995[1]	Total (1991 to 1995[1])
Approvals						
Rs crore	739.1	5256.0	11189.3	13590.5	15805.2	46580.1
US$ million	324.8	1781.3	3558.5	4331.7	4999.0	14995.3
Actual Inflows						
Rs crore	351.4	675.2	1786.0	2971.7	4729.4	10513.7
US$ million	154.5	233.1	573.8	958.5	1517.4	3437.3
Actual inflows as % of Approvals	47.5	12.8	16.0	21.9	29.9	22.6

[1] Upto September, 1995.
Note : Approvals and inflows include NRI investments as well.

TABLE 6.6
Foreign Exchange Reserves[1]: Historical Perspective

(US$ million)

Years	Forex Reserves[2]	Import Cover (No of Months)[3]	Current Payments Cover[4] (No of Months)[3]
1950-51	1914	16.8	14.6
1955-56	1648	12.2	10.6
1960-61	390	2.0	1.7
1965-66	383	1.6	1.3
1970-71	584	2.9	2.2
1975-76	1657	3.3	2.9
1980-81	5850	4.5	4.0
1985-86	5972	4.2	3.5
1990-91	2236	1.0	0.8
1991-92	5631	3.2	2.3
1992-93	6434	3.3	2.5
1993-94	15068	7.5	5.4
1994-95	20809	8.0	5.7
1995-96	16317[5]	5.0[6]	3.8[6]

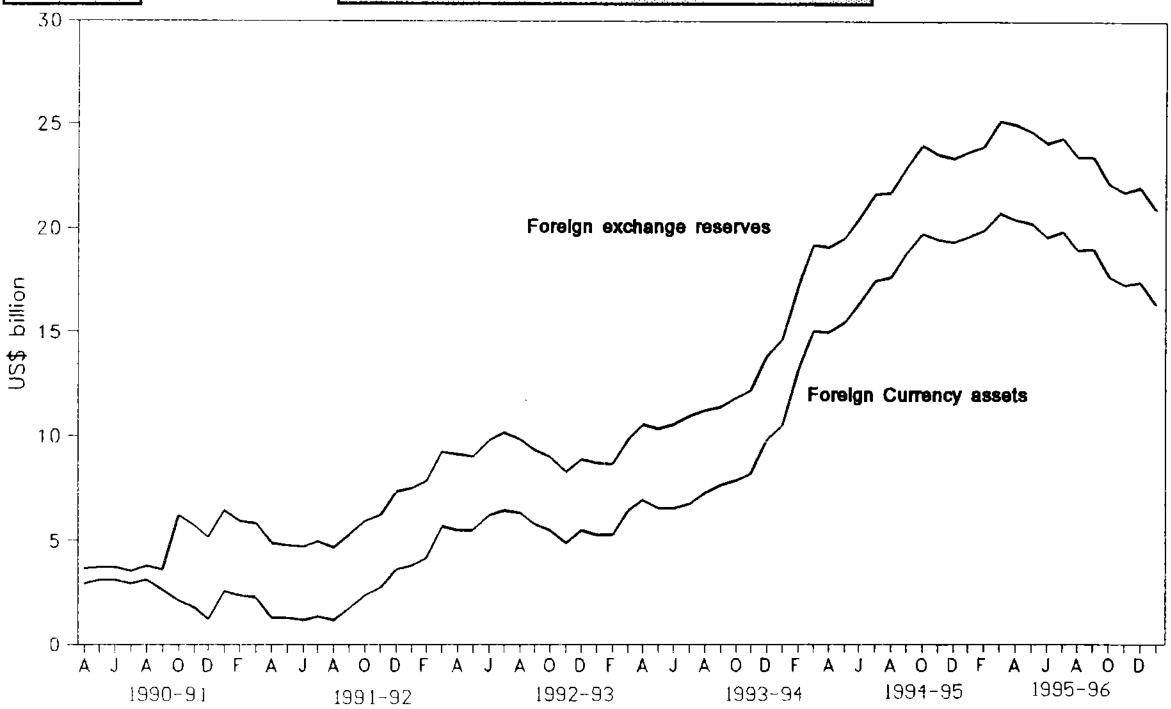
1 Excluding Gold and SDRs.
2 Year-end Level.
3 Based on foreign exchange reserves of respective year-end levels.
4 Current payments represent sum of merchandise imports and invisibles payments.
5 End-January 1996.
6 Estimates.

about 7 times during 1991-92 to 1993-94 from US $2.24 billion at the end of 1990-91 to US $15.07 billion at the end of 1993-94. These rose further to US $20.81 billion at the end of 1994-95. As noted earlier, the build up of reserves of this order was made possible largely due to the impressive performance of exports, buoyancy in invisible receipts and a surge in non-debt creating foreign investment flows, direct and portfolio. Corresponding to the increase in reserves, the import cover by foreign currency assets rose from 1.0 month of imports in 1990-91 to a very comfortable level of 8.0 months of imports in 1994-95. The cover of foreign currency assets to total payments in the current account of balance of payments also rose from 0.8 month in 1990-91 to 5.7 months in 1994-95.

28. The relatively high levels of reserve management indicators in 1993-94 and 1994-95 reflect, to some extent, the slack in capacity of the economy to absorb foreign savings. During 1995-96, however, the import and investments absorption capacity of the economy expanded rapidly resulting in use of foreign currency assets of the order of US $4.48 billion upto January 1996. As a result, foreign currency assets of the RBI declined to US $16.32 billion at the end of January 1996, equivalent to 5.0 months of imports and 3.8 month of current payments.

29. It needs to be recognised, however, that while the current level of foreign exchange reserves is

Fig. 6.4 **Foreign Exchange Reserves**



Foreign Exchange Reserves = Foreign Currency Assets + Gold + SDRs.

TABLE 6.7
Foreign Exchange Reserves in Selected Countries, 1990-95

($ million)

Country	1990	1991	1992	1993	1994	1995 (Latest)
India	1205	3580	5461	9807	19386	17467[3]
China[1]	28594	42664	19443	21199	51620	74496
Indonesia	7353	9151	10181	10988	11820	13306
Malaysia	9327	10421	16784	26814	24888	23513
South Korea	14459	13306	16639	19704	25032	31928
Thailand	13247	17287	20012	24078	28884	35463
Taiwan[2]	35790	40275	43534	44295	43380	39933
			Import Cover (Number of Months)			
India	0.6	2.1	2.8	5.2	8.7	5.5
China	6.5	8.2	3.1	2.5	5.4	7.8
Indonesia	4.0	4.2	4.5	4.7	4.4	5.0
Malaysia	3.8	3.4	5.1	7.0	5.0	4.7
South Korea	2.5	2.0	2.4	2.8	2.9	3.7
Thailand	4.8	5.5	5.9	6.3	6.4	7.8
Taiwan	7.8	7.7	7.2	6.9	6.1	5.6

1 Prior to 1992, foreign exchange included foreign exchange holdings of the Bank of China also and from 1992, figures include foreign exchange holdings of the People's Bank of China only.
2 Total Reserves minus Gold
3 Foreign currency assets at end-December, 1995.

Source : International Financial Statistics, IMF.

adequate, it is not in excess of the need of economy, keeping in view the expansion of industrial sector and the resulting future need for imports and investments at levels larger than in the past. Table 6.7 compares the foreign exchange reserves level of India with the position for some major developing countries. It is important to note that at the end of December 1995, all these developing countries, barring Indonesia, were holding foreign reserves much in excess of India.

External Debt

30. India's external debt at the end of March 1995 was estimated at US $99.04 billion showing a sharp increase from the level of US $92.70 billion at end March 1994 (revised estimate). The increase in debt by US $6.34 billion when measured in US dollar terms is partly a reflection of changes in the exchange rate of the US dollar vis-a-vis other currencies. In fact, of the total increase in debt, as much as US $5.61 billion (about 88 percent of the increase) was because the US dollar had depreciated against major currencies during this period, so that the dollar value of debt incurred in these currencies increased. Had the exchange rate of the US dollar against other major currencies remained unchanged, India's external debt would have increased by only US $794 million during 1994-95.

31. Although India's total debt is large in absolute terms, an important feature of debt is that a large part of it, especially debt to multilateral institutions excluding the IMF and bilateral debt, has a high degree of concessionality. The share of such debt in total debt stock went up from 44.4 percent (US $41.1 billion) in end March 1994 to 45.3 percent (US $44.8 billion) in end March 1995. A large part of the rise in external debt during 1994-95 was due to an increase in long term debt. This rose from US $89.07 billion in end March 1994 to US $94.78 billion in end March 1995. At both points in time, long term debt accounted for about 96 percent of total debt stock and this reflects the Government's policy of reducing the importance of short term debt. The share of short term debt (debt of maturity upto one year) in total debt stock was about 4 percent, indicating a sharp drop from the peak of 10.2 percent in March 1991.

32. India's external debt, as a percentage of GDP, rose sharply from 28.5 percent in 1989-90 to a peak of 41.0 percent in 1991-92. But the ratio declined to 36.3 percent in 1993-94 and there was a further drop to 33.0 percent in 1994-95.

33. Provisional estimates of external debt as at the end of September 1995 show that India's external debt has declined by US $5.20 billion during the first six months of 1995-96 to US $93.84 billion at the end of September 1995. A large part of this decline in foreign debt, in US dollar terms, is accounted for the appreciation in the exchange rate of the US dollar against other currencies between

end March 1995 and end September 1995. It is estimated that of the total decrease of US $5.20 billion during this period, as much as US $3.47 billion (or about two-thirds) was due to exchange rate variation. As a percentage of estimated GDP (at current market prices) for 1995-96, India's total external debt at the end of September 1995 shows further decline to about 29.4 percent.

34. Table 6.8 gives the debt service payments profile of India for the years 1989-90 to 1994-95. Total debt service payments rose from US $7.42 billion in 1989-90 to US $8.98 billion in 1990-91. This was due to a bunching of debt service payments on the external commercial borrowing account. In the following two years, total debt service payments declined, mostly reflecting declines in payments on external commercial borrowing. Subsequently, debt service payments increased, touching US $10.94 billion in 1994-95. The sharp rise in 1994-95 was due to higher repayments to the IMF, as well as higher repayments on account of external commercial borrowing. The ratio of debt service payments to current receipts peaked at 35.3 percent in 1990-91. There was a significant reduction to 25.1 percent in 1993-94, followed by an increase in the ratio to 26.6 percent in 1994-95, as repayments to the IMF rose. In 1995-96, the ratio of debt service payments to current receipts is expected to decline further.

35. Table 6.9 shows the debt and debt service indicators for India and the major developing countries and country groups. The debt and debt service indicators for India compare favourably with the levels in many developing countries. The debt to GDP ratio for India in 1993-94 is comparable with the levels in Thailand and Malaysia and is much lower than the ratios for Indonesia, Philippines, Turkey and all the individual country groupings.

36. The relatively higher grant element in India's external debt implies that the present value of the debt is much lower than the nominal value of the debt. According to the World Debt Tables, 1994-95, of the World Bank, the present value of India's external debt was only US $60.52 billion in end March 1994. The present value of Indian debt was thus only 24.6 percent of GDP. This is significantly lower than the nominal ratio of 36.3 percent and is in sharp contrast to other developing countries, where there is very little change in the ratio regardless of whether one uses present value or nominal figures.

37. India's debt service payments as a percentage of exports of goods and services was 25.1 percent in 1993-94. This is lower than the corresponding ratio for Argentina, Indonesia, Mexico, Turkey and the average ratio for Severely Indebted Middle Income Countries. But it is higher than the ratio for other developing countries and country groups. It needs to be also recognized that the debt service ratio for India remains high by international standards. Besides, India's exports of goods as a percentage of GDP works out to only a little over 9 percent and the ratio of current receipts to GDP was only about 14 percent in 1994-95. These ratios, which represent

TABLE 6.8
Debt Service Payments

(US$ million)

	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95[1]
1. External assistance[2]	2214	2315	2447	2541	3024	3202
Repayments	1193	1187	1329	1443	1618	1817
Interest payments	1021	1128	1118	1098	1406	1385
2. External commercial borrowing	2244	3414	2830	2707	3232	4273
Repayments	1158	2004	1677	1525	1978	2795
Interest payments	1086	1410	1153	1182	1254	1478
3. I.M.F.	1043	778	697	614	387	1368
Repayments	874	644	459	335	134	1146
Interest payments[3]	169	134	238	279	253	222
4. NRI Deposits						
Interest payments	936	1282	1036	918	905	1045
5. Rupee Debt Service	983	1193	1240	878	745	1060
Total Debt Service	7420	8982	8250	7658	8293	10938
Repayments	4208	5028	4705	4181	4475	6808
Interest payments	3212	3954	3545	3477	3818	4130
As per cent of current receipts	30.90	35.25	30.21	28.63	25.07	26.65

[1] Provisional. [2] Inclusive of Non-Government Account. [3] Excluding charges on net cumulative allocation.

Box 6.1
Structural Aspects of India's External Debt

- India's external debt amounted to US $92.70 billion at end March 94, US $99.04 billion at end March 95 and US $93.84 billion at end September 95. India's external debt increased by only $1.14 billion between end March 1994 and end September 1995.
- The growth of India's external debt has slowed down substantially to an average annual increase of only $2.2 billion between March 31, 1991 and September 30, 1995 compared to $4.9 billion (excluding defence and short term debts) between end March 1986 and end March 1991.
- As a per cent of GDP at current market prices, India's external debt declined from the peak of 41.0 per cent in 1991-92 to 33.0 per cent in 1994-95 and further to 29.4 per cent in end September 1995.
- Short term debt (debt of maturity upto one year) as a proportion of total external debt declined from 10.2 percent at end March 1991 to 4.3 per cent at end March 1995. It was 4.8 per cent at end September 1995.
- A large part of the external debt, especially debt to multilateral (excluding the IMF) and bilateral agencies has high degree of concessionality, ie grant element of at least 25 per cent. The share of concessional debt in total debt is about 45 per cent.
- Debt in rupees owed to the former Soviet Union, rupee denominated Non-Resident deposits and debt due to Foreign Currency Convertible Bonds, moderate the degree of concern about the current level of external debt because of their special characteristics.
- The relatively high grant element in India's external debt translates into downsizing the nominal value of the debt by about one-third in present value (PV) terms. The PV of India's external debt at end March 1994 is estimated at US $60.52 billion or 24.6 per cent of GDP.
- Debt service payments as a percent of current receipts declined from the peak of 35.3 per cent in 1990-91 to 26.6 per cent in 1994-95 and it is estimated to decline further in 1995-96.

TABLE 6.9
External Debt and Debt Indicators, 1993 - International Comparison

Countries/ Country Groups	Total Debt (EDT) (US$ Billion)	EDT/GNP (%)	PV of Debt (US$ Bn)	PV/GNP (%)	PV/XGS (%)	TDS/XGS (%)	Concessional/EDT (%)
Countries							
India	92.68	36.3	60.52[1]	24.6	183.0	25.1	46.7
Argentina	74.47	29.6	72.08	28.6	431.9	47.6	0.7
Brazil	132.75	24.0	130.08	23.5	295.8	24.4	1.9
China	83.80	21.4	76.59	19.6	81.3	10.7	16.1
Indonesia	89.54	65.9	81.50	60.0	199.7	32.6	27.9
South Korea	47.20	14.4	45.86	14.0	46.2	9.2	10.0
Malaysia	23.34	37.8	22.70	36.7	42.6	7.9	12.3
Mexico	118.03	35.5	116.46	35.0	182.1	32.7	1.2
Philippines	35.27	63.7	33.23	60.0	173.0	24.9	29.5
Thailand	45.82	37.7	44.70	36.7	91.0	18.6	13.0
Turkey	67.86	55.3	63.74[1]	52.0	209.9	28.3	10.3
Country Groups							
South Asia	146.12	43.3	93.88	27.9	185.4	24.7	56.0
SIMICs	445.37	42.2	370.31	35.1	305.5	26.9	17.0
SILICs	201.06	117.2	163.58	95.1	448.0	18.2	45.3
MILICs	185.20	49.0	124.33	32.9	188.0	23.1	49.8
All DCs	1811.78	39.7	1489.77	32.7	141.5	18.2	20.2

[1] Excludes Deposits of Non-Residents.

SIMIC — Severely Indebted Middle-Income Countries.
SILIC — Severely Indebted Low-Income Countries.
MILIC — Moderately Indebted Low-Income Countries.
DCs — Developing Countries

EDT — External Debt Total.
PV — Present Value of Debt.
GNP — Gross National Product.
XGS — Exports of Goods and Services.
TDS — Total Debt Service Payments.

Source: Compiled from data given in World Debt Tables, 1994-95, World Bank.

the potential capacity of the nation to service external debt, being relatively low, make India vulnerable to external shocks. This, therefore, underscores the need for sustaining the growth in exports and invisible receipts witnessed in the recent past.

38. The high level of external debt is a matter of continuous concern for the Government and the policy for the management of the external sector is consciously directed to keep the debt burden within prudent levels. The strategy for external debt management being followed by the Government ensures that India's debt service ratio will gradually decline to comfortable levels. In fact, the growth of India's external debt has decelerated sharply from 10.5 percent in 1990-91 to 2.9 percent in 1993-94, with a further decline to 0.9 percent (excluding the increase in debt in US dollar terms due to exchange rate variations) in 1994-95. During the first Six months of 1995-96, external debt, in US dollar terms, has declined by about 5.3 percent over the level at end March 1995.

Exchange Rate and Current Account Convertibility

39. In March 1993, India moved from the earlier dual exchange rate regime to a single, market determined exchange rate system. Under this system, there is no officially fixed exchange rate of the rupee. Instead, the rate is determined by the demand and supply conditions in the foreign exchange market, while the Reserve Bank of India stands ready to intervene to maintain orderly market conditions and to curb excessive speculation.

40. Despite the shift to a market determined system, the rupee-dollar rate remained steady at about Rs.31.4 for over two years after March 1993. This happened mainly because there was a large inflow of foreign portfolio investment in 1993 and most of 1994. If the rupee had been left to be determined solely by the market supply and demand for foreign exchange in this period, it would have appreciated sharply against the dollar. This would have hurt exports and encouraged imports. It was therefore decided to prevent appreciation and the Reserve Bank of India intervened by buying dollars in the market. Between end March 1993 and December 1994, about US $13 billion were added to the country's foreign currency reserves because of this process.

41. The reduction in net capital inflows and the widening of the current account deficit in 1995-96 ended the earlier period of surplus dollar availability. Against this background, the operation of normal supply and demand conditions in the foreign exchange markets gave rise to expectations of a depreciation of the exchange rate. Some depreciation was indeed appropriate.

42. During the prolonged period of stability of the rupee-dollar rate from March 1993 to July 1995, India's competitiveness in international markets was significantly eroded by the rate of inflation in India being higher than the rates of inflation in India's major trading partners. As a result, the index of the real effective exchange rate, which is obtained by adjusting the index of nominal effective exchange rate (using a basket of major currencies) by the differential rate of inflation (in India as compared to these major currencies) showed an appreciation of India's exchange rate in real terms in the order of 8 per cent between 1993-94 and August 1995. Had this erosion of India's competitiveness continued, it would have adversely affected exports, the foreign trade balance and the overall balance of payments.

Box 6.2

Recent Developments in the Exchange Rate of the Rupee

- In March 1993, India moved to a single, market-determined exchange rate system.
- The rupee-dollar rate remained steady at about Rs. 31.4 for over two years after March 1993.
- The stability vis-a-vis the US dollar resulted from buoyant inflows of capital which were sterilized by the Reserve Bank through intervention to prevent an appreciation that would have hurt the export recovery.
- These inflows slowed down in the last quarter of 1994-95, but the exchange rate of the rupee vis-a-vis the US dollar remained stable until August 1995 after which it depreciated against the US dollar to Rs. 37.0 as of February 9, 1996.
- The exchange rate developments need to be appropriately assessed with reference to rupee's movement against all the currencies of India's major trading partners and the inflation differential between India and her trading partners.
- The nominal effective exchange rate (NEER) of the rupee, which is a weighted average of exchange rates vis-a-vis the currencies of major trading partners, showed a depreciation of the rupee of about 8 per cent by August 1995 in nominal terms since 1993-94.
- However, the higher rate of inflation in India vis-a-vis the trading partners implied an appreciation of the rupee in real effective exchange rate (REER) terms by about 7 per cent during the period from 1993-94 to August 1995. The appreciation was 10.5 per cent as compared to March 1993.
- The period since the middle of September 1995 was characterised by periodic speculative pressures on the exchange rate which were actively countered by the RBI.
- The movement in the rupee's exchange rate in recent months has brought the current external value of the rupee, in REER terms, back to approximately the level that prevailed in March 1993.

Fig. 6.5A

Nominal and Real Effective Exchange Rate of Rupee (5 Country Index)

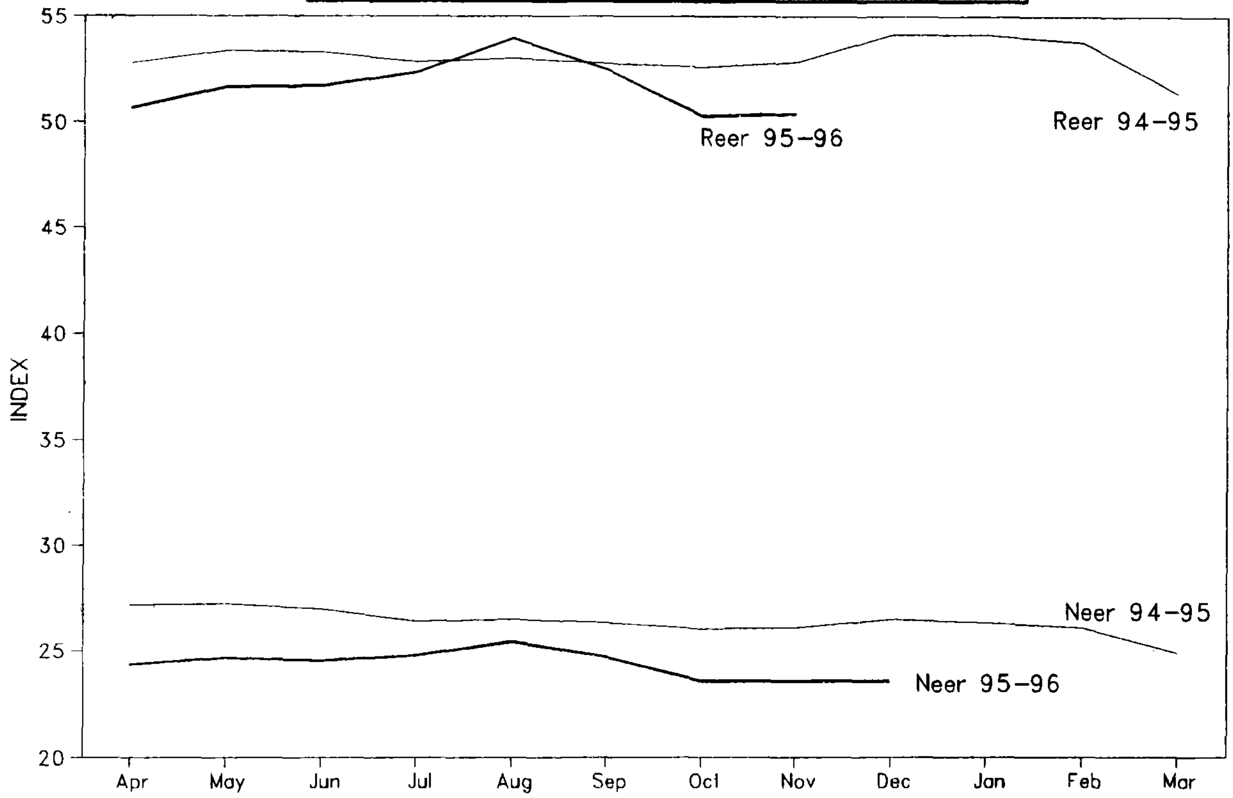
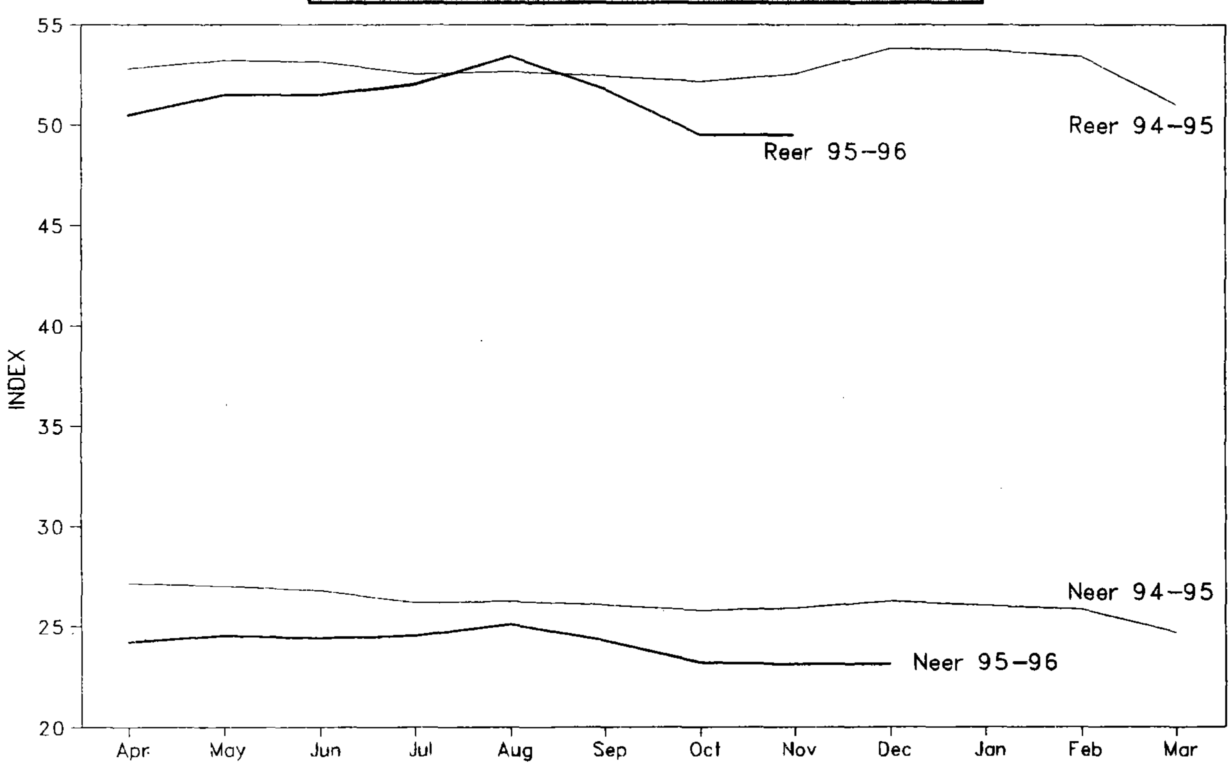


Fig. 6.5 B

Nominal and Real Effective Exchange Rate of Rupee (10 Country Index)



43. The market-triggered adjustment in the exchange rate which occurred after August 1995 led to an exchange rate of Rs. 37 per US dollar as of February 9, 1996. This brings the real effective exchange rate of the rupee back to approximately the level that prevailed in March 1993. In other words, the recent change in the exchange rate has corrected the erosion in competitiveness and will help ensure that export growth remains strong and import growth is contained. Both factors will help to contain the trade deficit to manageable levels. Since October 1995, the Reserve Bank has intervened in the foreign exchange market to curb excessive volatility.

44. Taking into account the development in the exchange markets as well as the overall monetary and credit situation, the RBI announced on February 7, 1996, the termination of the Scheme of Post-Shipment Export Credit denominated in US dollars, freeing of interest rate on Post-Shipment Export Rupee Credit for over 90 days, increase in the interest rate surcharge on import finance from 15 percent to 25 percent and monitoring of cancellation of forward contracts and intra-day trading transactions of authorised dealers. These measures came into effect from February 8, 1996.

45. The process of current account convertibility was carried forward with further relaxation in release of foreign exchange for various purposes like foreign travel, medical treatment, gifts, services etc... Release of foreign exchange by authorised dealers for the above purposes was earlier governed by indicative limits. Accordingly, authorised dealers were required to seek prior approval of the RBI where their customers required exchange facility in excess of the indicative limits. It has been observed that the cases in excess of indicative limits being referred to the RBI for approval were very few. With effect from July 5, 1995, the RBI has permitted authorised dealers to provide exchange facility for the above mentioned purposes beyond the indicative limits, provided they are satisfied about the bonafides of the application and the need for releasing exchange at a higher rate. Authorised dealers will, in such cases, release exchange on their own without prior approval of the RBI. They are only required to report such transactions to the Reserve Bank.

Merchandise Trade

Exports

46. During April-December 1995, exports at $ 22.8 billion show a growth of 24.2 per cent over the corresponding period of 1994.

47. The growth in exports during the first half of 1995-96 is well spread over the commodity groups (Table 6.10). The April-September 1995 growth in agriculture and allied group of exports at 26.8 per cent in dollar terms, over the corresponding period of 1994 is almost equal to the growth of exports in manufactured goods at 26.1 per cent. Within the agriculture and allied products, there are clear indications of a revival in the growth of exports of tea ,unmanufactured tobacco, spices and fruits & vegetables, when compared to the growth rates registered during 1994-95. Exports of cashew, oil-meals, marine products, and raw cotton have been lower in dollar value terms during April-September 1995, as compared to the corresponding period of 1994. An important contributory item in the growth of exports of agriculture items has been cereals. The exports of cereals during April-September 1995 was more than three times the values over the level during April-September 1994. Amongst items in the manufactured goods category, which have shown a spurt in export growth during April-September 1995, are electronic goods (71.9 per cent), readymade garments (32.6 per cent), drugs, pharmaceutical & fine chemicals (29.3 per cent), primary & semi-finished iron & steel (27.6 per cent) machinery and instruments (23.9 per cent), and leather footwear (21.4 per cent). Exports of gems & jewellery and handicrafts have shown a revival in growth rates during April-September 1995.

48. Notwithstanding the different growth rates in exports registered by a large number of commodities, the composition of India's exports during April-September 1995 has not shown any significant change as compared to the corresponding period in 1994. This shows up in the percentage shares of various commodity groups in total exports (Table 6.11). The share of manufactured goods in total exports remained at around 78 per cent during April-September 1995, after increasing to this level last year from 75.5 per cent in 1993-94. Similarly, the share of the agriculture and allied group of commodities remained at 16 per cent during April-September 1995, after having declined to this level in 1994-95 from 18 per cent in 1993-94. The share of ores and minerals in total exports remained unchanged at 4.0 per cent in April-September 1995. This was also the share in the year 1993-94. (Figure 6.6).

Imports

49. The import surge on account of the buoyancy on the industrial sector, which was noted in Economic Survey for 1994-95, gained momentum during April-September 1995, particularly for capital goods . Total imports as per DGCI & S records during the year 1994-95 were $ 28,654 million, thus registering an increase of 22.9 per cent over the level of imports during 1993-94. During April-September 1995, the import bill at $ 17065 million

TABLE 6.10
India's Exports by Commodity Group

(US$ million)

Commodity Group	1993-94	1994-95	Apr-Sept 1994-95	Apr-Sept 1995-96	Apr-Mar. 1994-95 (% Change)	Apr-Sept 1995-96 (% Change)
I. Agriculture & allied, of which	3995.9	4210.5	1853.2	2349.7	5.4	26.8
1. Tea	337.7	310.7	141.5	164.1	-8.0	15.9
2. Coffee	174.0	335.3	187.8	230.2	92.7	22.6
3. Cereals	421.1	406.4	163.4	504.9	-3.5	208.9
4. Unmanufactured tobacco	117.4	58.6	34.3	58.5	-50.1	70.7
5. Spices	181.4	194.9	78.5	103.2	7.5	31.4
6. Cashew	333.3	396.4	204.9	184.2	18.9	-10.1
7. Oil meals	709.0	572.6	253.1	213.2	-19.2	-15.8
8. Fruits & vegetables	144.5	171.6	73.1	96.9	18.7	32.6
9. Marine products	813.6	1126.4	437.7	409.4	38.4	-6.5
10. Raw cotton	208.4	44.5	30.4	21.6	-78.6	-28.9
II. Ores and minerals, of which	888.2	987.9	422.7	591.6	11.2	40.0
11. Iron ore	438.0	413.3	184.7	262.0	-5.6	41.9
12. Processed minerals	212.1	263.8	108.4	144.0	24.3	32.9
13. Other ores and minerals	208.5	275.7	121.6	171.9	32.2	41.3
III. Manufactured goods, of which	16797.5	20567.3	9050.2	11412.8	22.4	26.1
14. Leather & manufactures	841.8	1061.2	472.4	549.5	26.1	16.3
15. Leather footwear	482.1	549.5	246.5	299.2	14.0	21.4
16. Gems & jewellary	3995.8	4500.4	2014.0	2473.7	12.6	22.8
17. Drugs,pharmaceticals & fine chemicals	637.5	800.2	344.9	446.0	25.5	29.3
18. Dyes\intmdtes & Coal tar chemicals	367.1	479.7	217.4	234.4	30.7	7.8
19. Manufactures of metals	623.7	706.1	304.2	386.7	13.2	27.1
20. Machinery and instruments	637.5	726.6	319.0	395.3	14.0	23.9
21. Transport equipment	591.9	771.3	339.4	432.5	30.3	27.4
22. Primary & semi-finished iron & steel	492.2	420.8	190.6	243.3	-14.5	27.6
23. Electronic goods	304.9	412.3	170.7	293.4	35.2	71.9
24. Cotton yarn, fabrics, madeups etc..	1551.2	2233.8	1014.1	1199.4	44.0	18.3
25. Ready made garments	2586.2	3281.9	1326.8	1759.4	26.9	32.6
26. Handicrafts	937.7	1033.4	482.6	554.0	10.2	14.8
IV. Crude & petroleum products	397.8	416.9	217.4	233.3	4.8	7.3
V. Others & unclassified items	158.8	147.9	58.9	97.3	-6.9	65.2
Grand Total	22238.3	26330.5	11602.5	14684.6	18.4	26.6

Source:DGCI&S, Calcutta

was higher by 33.1 per cent than the level in corresponding period of 1994.

50. The growth in non-POL imports was even higher than the growth rate in aggregate imports. This was due to sharp increases in imports of edible oils (370 per cent), paper board manufactures and newsprint (128 per cent), fertilizers (109 per cent), and capital goods (45 per cent) (Table 6.12). It is important to note that the growth in imports of non-electrical machinery and machine tools by 55 per cent during April-September 1995, and a growth of about 45 per cent during the full year 1994-95, of electrical machinery by 76 per cent during April-September, 1995 and 33 per cent over the full year 1994-95, and that of project goods by 40 per cent in April- September, 1995, and 14 per cent over the full year 1994-95 has basically reflected the buoyancy in the investment climate and industrial production during the current year. Moreover, the growth in imports of a large number of items in the nature of inputs, particularly for manufactured goods exports like chemicals, iron and steel, non-ferrous metals, pearls, precious and semi-precious stones has also been high partly because of the buoyancy of export growth.

Figure 6.6

COMPOSITION OF INDIA'S EXPORTS

(PER CENT)

A AGRICULTURE AND ALLIED PRODUCTS
B ORES AND MINERALS
C MANUFACTURED GOODS
D CRUDE AND PETROLEUM PRODUCTS
E OTHERS

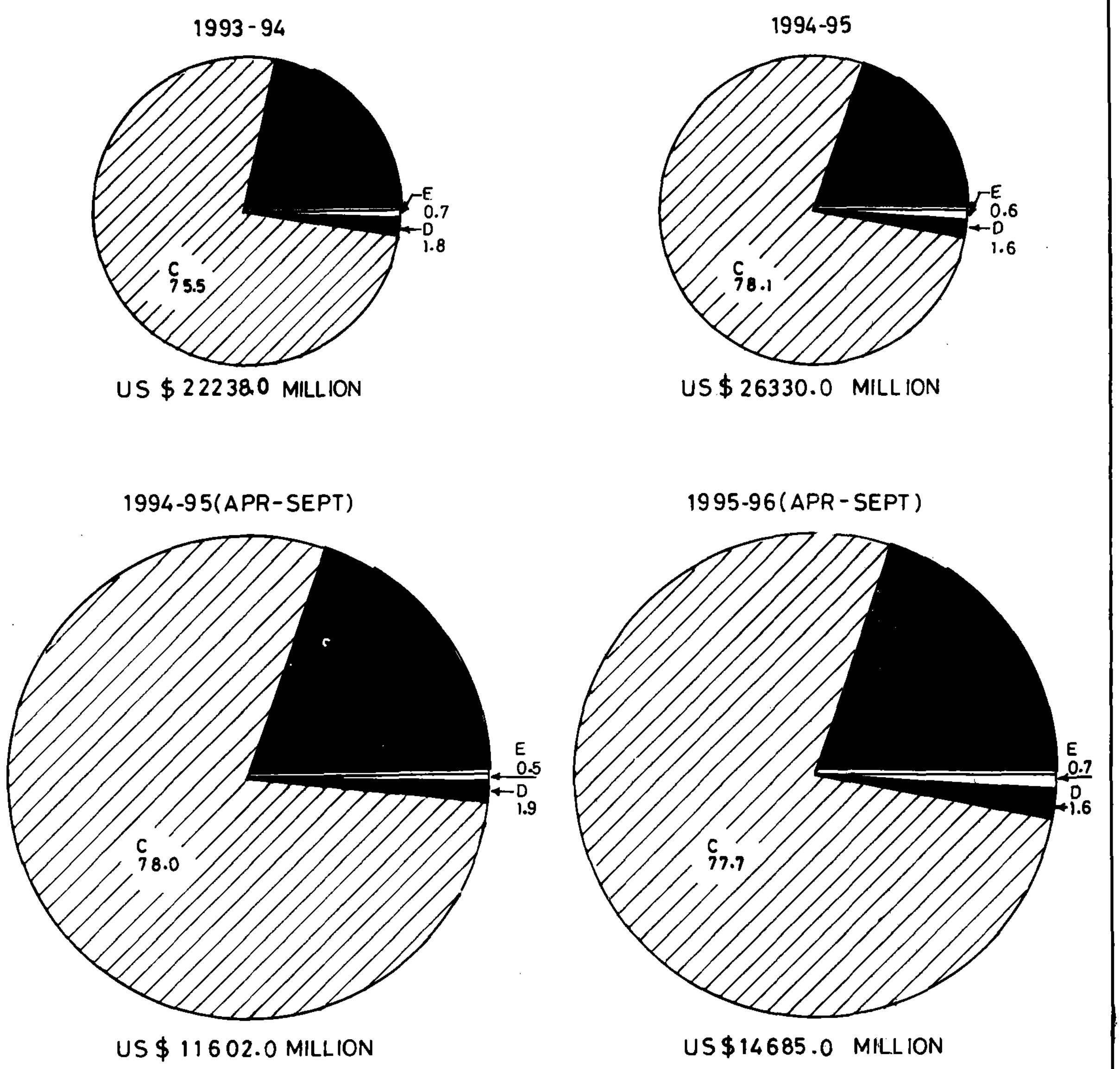


Figure 6.7

COMPOSITION OF INDIA'S IMPORTS

(PER CENT)

A – FOOD AND ALLIED PRODUCTS
B – FUEL
C – FERTILIZERS
D – PAPER BOARD, MANUF. AND NEWS PRINT
E – CAPITAL GOODS
F – OTHER BULK ITEMS
G – OTHERS

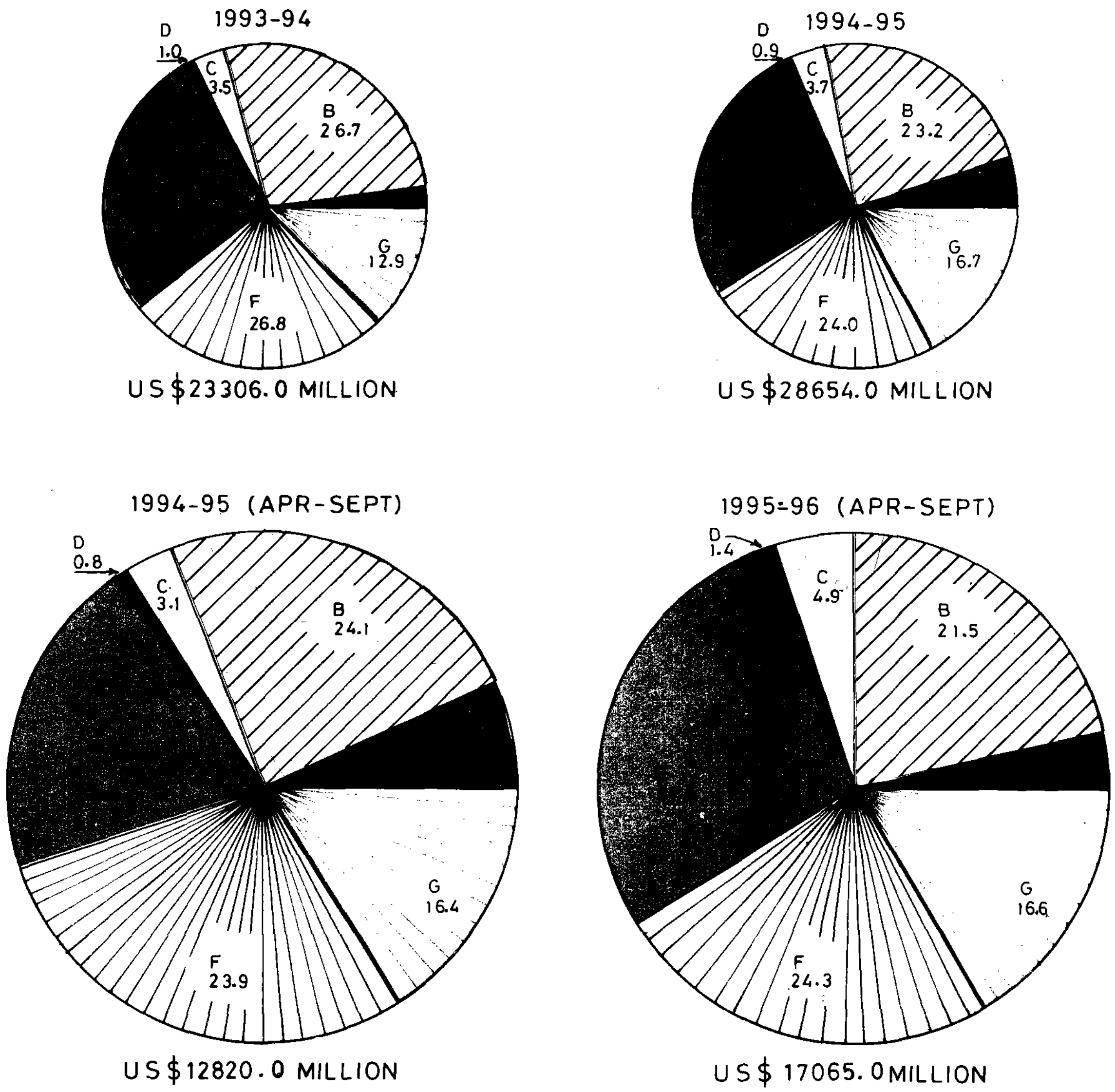


TABLE 6.11
Composition Of India's Exports

(Percentage Shares)

Commodity Group	1993-94	1994-95	Apr-Sept 1994-95	Apr-Sept 1995-96
I. Agriculture & allied, of which	18.0	16.0	16.0	16.0
1. Tea	1.5	1.2	1.2	1.1
2. Coffee	0.8	1.3	1.6	1.6
3. Cereals	1.9	1.5	1.4	3.4
4. Unmanufactured tobacco	0.5	0.2	0.3	0.4
5. Spices	0.8	0.7	0.7	0.7
6. Cashew	1.5	1.5	1.8	1.3
7. Oil meals	3.2	2.2	2.2	1.5
8. Fruits & vegetables	0.6	0.7	0.6	0.7
9. Marine products	3.7	4.3	3.8	2.8
10. Raw cotton	0.9	0.2	0.3	0.1
II. Ores and minerals, of which	4.0	3.8	3.6	4.0
11. Iron ore	2.0	1.6	1.6	1.8
12. Processed minerals	1.0	1.0	0.9	1.0
13. Other ores and minerals	0.9	1.0	1.0	1.2
III. Manufactured goods, of which	75.5	78.1	78.0	77.7
14. Leather & manufactures	3.8	4.0	4.1	3.7
15. Leather footwear	2.2	2.1	2.1	2.0
16. Gems & jewellary	18.0	17.1	17.4	16.8
17. Drugs,phrmcutes & fine chemicals	2.9	3.0	3.0	3.0
18. Dyes intmdtes & Coal tar chemicals	1.7	1.8	1.9	1.6
19. Manufactures of metals	2.8	2.7	2.6	2.6
20. Machinery and instruments	2.9	2.8	2.7	2.7
21. Transport equipment	2.7	2.9	2.9	2.9
22. Primary & semi-fnished iron & steel	2.2	1.6	1.6	1.7
23. Electronic goods	1.4	1.6	1.5	2.0
24. Cotton yarn, fabrics, madeups etc..	7.0	8.5	8.7	8.2
25. Ready made garments	11.6	12.5	11.4	12.0
26. Handicrafts	4.2	3.9	4.2	3.8
IV. Crude & petroleum products	1.8	1.6	1.9	1.6
V. Others & unclassified items	0.7	0.6	0.5	0.7
Grand Total	100.0	100.0	100.0	100.0

Source: DGCI&S, Calcutta

51. The composition of imports has shown some change during April-September 1995. The share of capital goods imports increased to 27.5 per cent from 25.3 per cent during the corresponding period of 1994. (Table 6.13) The share of food and allied products in total imports declined from 6.4 per cent in April-September 1994 to 3.7 per cent in April-September 1995. Fuel imports constituted 21.5 per cent of the import basket during April-September 1995, compared to 24.1 per cent in April-September 1995. The share of fertilizer imports in total imports increased during April-September 1995. (Figure 6.7).

Direction of Trade

52. The direction of India's foreign trade, as shown in summary form in Table No. 6.14 and Figures 6.8, 6.9, has undergone some perceptible diversification during April-September 1995, when compared to the corresponding period last year. Thus the proportion of our total exports destined for other LDCs (less developed countries) has increased to 25 per cent during April-September

TABLE 6.12
India's Imports by Commodity Group

(US$ million)

Commodities	1993-94	1994-95	Apr-Sept 1994-95	Apr-Sept 1995-96	(Apr-Mar) 1994-95 (% Change)	(Apr-Sept) 1995-96 (% Change)
I. Food and allied products, of which	557.6	1467.6	822.3	632.0	163.2	-23.1
1. Cereals	92.6	29.4	17.4	12.3	-68.3	-29.2
2. Pulses	180.7	188.8	87.9	92.5	4.5	5.3
3. Cashew nuts	153.9	220.1	112.5	79.2	43.0	-29.6
4. Edible oils	53.1	198.8	77.0	361.9	274.2	369.9
II. Fuel, of which	6220.1	6636.2	3094.7	3667.8	6.7	18.5
5. Coal	466.5	708.4	338.7	393.8	51.8	16.3
6. POL	5753.5	5927.8	2756.0	3274.0	3.0	18.8
III. Fertilizers	825.9	1052.4	401.6	841.0	27.4	109.4
IV. Paper board,manufactures & newsprint	221.9	246.2	102.9	234.8	11.0	128.3
V. Capital goods, of which	6224.4	7594.6	3239.2	4701.2	22.0	45.1
7. Machinery except elec & machine tools	1881.9	2727.8	1145.9	1776.9	45.0	55.1
8. Electrical machinery	1116.1	1479.7	539.0	946.5	32.6	75.6
9. Transport equipment	1270.4	1113.6	514.6	496.4	-12.3	-3.5
10. Project goods	1623.1	1853.6	849.2	1189.7	14.2	40.1
VI. Others, of which	6255.2	6866.6	3057.9	4148.8	9.8	35.7
11. Chemicals	1972.1	2945.3	1300.3	1793.3	49.3	37.9
12. Pearls precious semi precious stones	2634.5	1629.5	782.4	978.0	-38.1	25.0
13. Iron & steel	755.3	1082.1	462.1	604.4	43.3	30.8
14. Non-ferrous metals	471.0	717.9	312.6	440.9	52.4	41.1
15. Professonal instruments,optical goods etc.	422.3	491.8	200.5	332.2	16.5	65.7
VII. Unclassified items	3001.1	4790.8	2101.8	2839.7	59.6	35.1
Grand Total	23306.2	28654.4	12820.4	17065.3	22.9	33.1

Source: DGCI&S Calcutta

TABLE 6.13
Composition Of India's Imports

(Percentage Share)

	1993-94	1994-95	Apr-Sept 1994-95	Apr-Sept 1995-96
I. Food and allied products, of which	2.4	5.1	6.4	3.7
1. Cereals	0.4	0.1	0.1	0.1
2. Pulses	0.8	0.7	0.7	0.5
3. Cashew nuts	0.7	0.8	0.9	0.5
4. Edible oils	0.7	0.8	0.9	0.5
II. Fuel, of which	26.7	23.2	24.1	21.5
5. Coal	2.0	2.5	2.6	2.3
6. POL	24.7	20.7	21.5	19.2
III. Fertilizers	3.5	3.7	3.1	4.9
IV. Paper board,manufactures & newsprint	1.0	0.9	0.8	1.4
V. Capital goods, of which	26.7	26.5	25.3	27.5
7. Machinery except elec & machine tools	8.1	9.5	8.9	10.4
8. Electrical machinery	4.8	5.2	4.2	5.5
9. Transport equipment	5.5	3.9	4.0	2.9
10. Project goods	7.0	6.5	6.6	7.0
VI. Others, of which	26.8	24.0	23.9	24.3
11. Chemicals	8.5	10.3	10.1	10.5
12. Pearls precious semi precious stones	11.3	5.7	6.1	5.7
13. Iron & steel	3.2	3.8	3.6	3.5
14. Non-ferrous metals	2.0	2.5	2.4	2.6
15. Professonal instruments, optical goods etc.	1.8	1.7	1.6	1.9
VII. Unclassified items	12.9	16.7	16.4	16.6
Grand Total	100.0	100.0	100.0	100.0

Source: DGCI&S Calcutta

Figure 6.8

DESTINATION OF INDIA'S EXPORTS

(PER CENT)

A. U.K.
B. GERMANY
C. OTHER E.U.
D. U.S.A.
E. JAPAN
F. RUSSIA
G. EAST EUROPE
H. OPEC
I. L.D.Cs
J. OTHERS

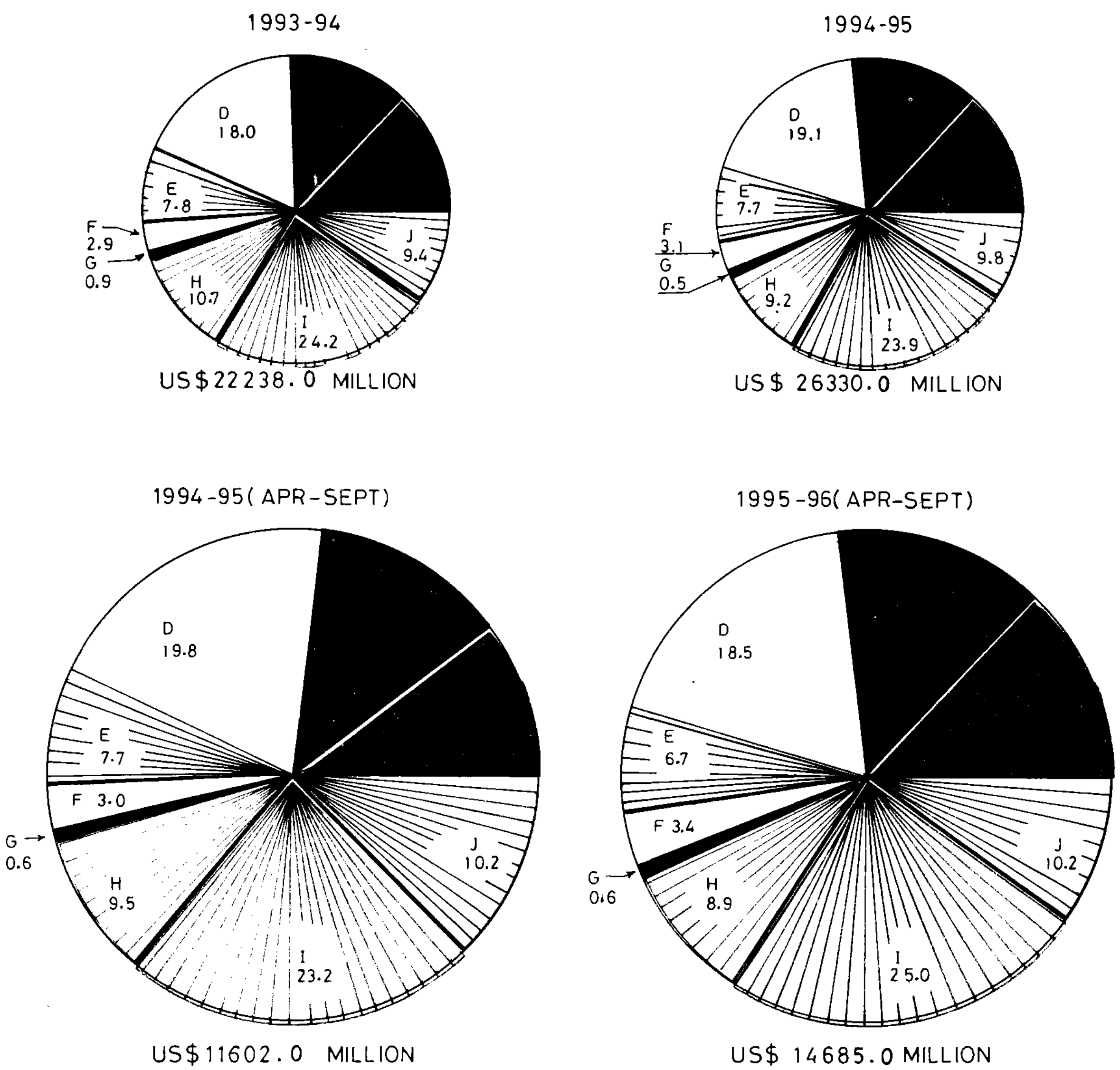


Figure 6.9

SOURCES OF INDIA'S IMPORTS

(PER CENT)

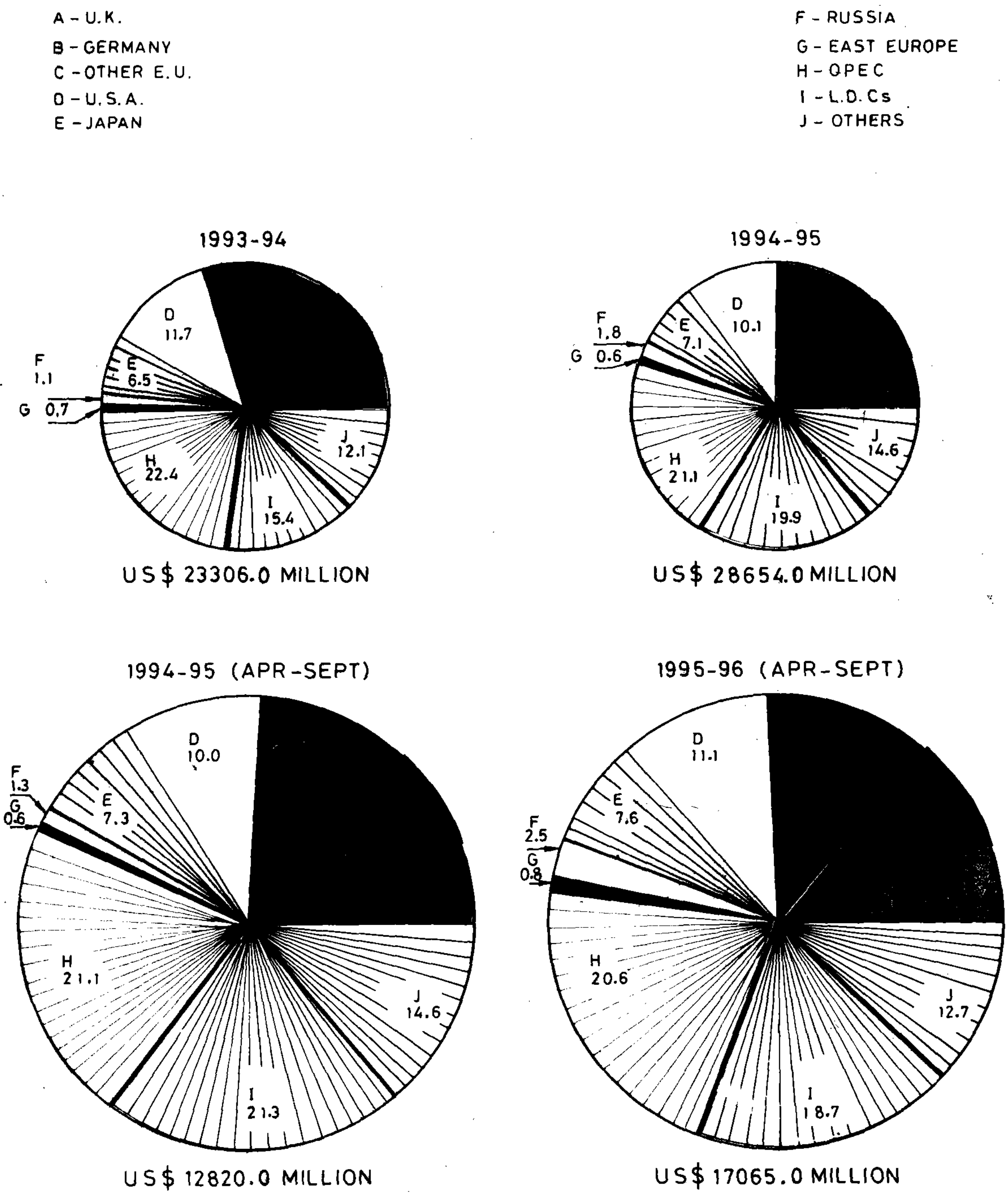


TABLE 6.14
Direction Of India's Trade

(Percentage Share)

Country	Exports 1993-94	Exports 1994-95 (Apr-March)	Exports 1994-95	Exports 1995-96 (Apr-Sept)	Imports 1993-94	Imports 1994-95 (Apr-March)	Imports 1994-95	Imports 1995-96 (Apr-Sept)
1 U.K	6.2	6.4	6.5	6.5	6.6	5.4	5.6	5.1
2 Germany	6.9	6.6	6.7	6.5	7.7	7.6	7.3	8.6
3 Oth EC	12.9	13.6	12.8	13.9	15.8	11.8	11.1	12.2
4 U.S.A	18.0	19.1	19.8	18.5	11.7	10.1	10.0	11.1
5 Japan	7.8	7.7	7.7	6.7	6.5	7.1	7.3	7.6
6 Russia	2.9	3.1	3.0	3.4	1.1	1.8	1.3	2.5
7 Oth East Europe	0.9	0.5	0.6	0.6	0.7	0.6	0.6	0.8
8 OPEC	10.7	9.2	9.5	8.9	22.4	21.1	21.1	20.6
9 Oth LDCs	24.2	23.9	23.2	25.0	15.4	19.9	21.3	18.7
10 Others	9.4	9.8	10.2	10.2	12.1	14.6	14.6	12.7
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: DGCI&S, Calcutta

1995, up from 23.2 per cent in the corresponding period last year. This appears to be a diversion from the developed countries, as the shares of USA and Japan have fallen by about one percentage point each during the same period. In contrast, the share of LDCs in our total imports has declined from 21.3 per cent in April-September 1994 to 18.7 per cent in 1995 with an increase in the shares of some developed countries like USA and Germany.

53. Another major feature of the direction of India's foreign trade, as was noticed in Economic Survey 1994-95 as well, is that the volume of our trade with selected East Asian countries has been steadily increasing (Table 6.15). During April-September 1995, the share of these select East Asian countries in India's total export basket has increased to 15 per cent, as compared to 14.2 per cent during the corresponding period last year. For imports, the increase was from 10.8 per cent to 11.7 per cent during the same period.

Policy Developments since March 31, 1995

54. With the objectives of accelerating the pace of reforms, sustained export growth and enhancement of opportunities for the domestic sector's participation in the dynamics of foreign trade, the Export-Import Policy (1992-97) was reviewed and revised in several ways since end March 1995. The revisions included measures for trade promotion, as well as further simplification of procedures. The following are the major changes that have been introduced:

- Under zero duty import of capital goods scheme, which is available for imports of capital goods of at least Rs 20 crore, there are now two

TABLE 6.15
Direction Of India's Trade With Selected East Asian Countries

(Percentage Shares)

Country	Exports 1991-92	Exports 1992-93	Exports 1993-94	Exports 1994-95 (Aplrl - March)	Exports 1994-95	Exports 1995-96 (Apr-Sep.)	Imports 1991-92	Imports 1992-93	Imports 1993-94	Imports 1994-95 (Aplrl - March)	Imports 1994-95	Imports 1995-96 (Apr-Sep.)
1 Indonesia	0.8	0.7	1.1	1.1	0.9	1.6	0.3	0.3	0.5	1.1	1.1	1.2
2 Malaysia	1.1	1.0	1.1	1.1	1.0	1.2	2.0	1.9	1.1	1.7	2.2	2.6
3 Hongkong	3.4	4.1	5.6	5.8	5.4	6.0	0.6	0.8	0.8	1.0	0.8	1.0
4 South Korea	1.4	0.9	0.9	1.3	1.2	1.3	1.7	1.6	2.4	2.2	2.1	2.1
5 Singapore	2.2	3.2	3.4	2.9	2.9	2.6	3.6	2.9	2.7	3.1	2.8	3.2
6 Thailand	1.1	1.4	1.6	1.5	1.5	1.5	0.3	0.3	0.2	0.6	0.8	0.5
7 Chinese Taipei	1.0	1.0	1.2	1.0	1.1	1.0	1.5	1.0	0.8	1.0	0.9	1.0
Total (SEASC)	11.1	12.3	14.9	14.6	14.2	15.0	9.9	8.7	8.6	10.8	10.8	11.7

Source: DGCI&S, Calcutta

Box 6.3

Trade Policy Reforms

It is now widely acknowledged that major reforms in trade policy and procedures since the announcement in March 1992 of the EXIM Policy for 1992-97, have accelerated India's transition towards a globally oriented economy by stimulating exports and facilitating imports of essential inputs as well as capital goods.

One of the main objectives of the EXIM Policy-1992-97 and changes therein during the last four years was to phase out quantitative restrictions in the form of licensing and other discretionary controls. Thus:

- In 1991 imports were regulated by means of a positive list of freely importable items. Since 1992 imports are regulated through a limited negative list.
- Quantitative restrictions on imports of most intermediate inputs and capital goods have been eliminated.
- In July 1991 out of 5,021 Harmonised System (H.S.) tariff lines (6 digits), 80 per cent i.e., 4,000 lines were subject to import licensing restrictions. As of December, 1995 more than 3000 tariff lines covering raw materials, intermediates and caiptal goods are free of import licensing requirements.
- A large number of items covering 1,487 tariff lines whose import is otherwise restricted, are now allowed to be imported under freely tradable Special Import Licences, which are granted to the export houses/trading houses/star trading houses and super star trading houses.
- Through continuous review and revisions during the last four years, control on exports has been liberalised to the extent that now all goods may be exported without any restriction except the few items mentioned in the negative list of exports. The items in the negative list are regulated because of strategic considerations, environmental and ecological grounds, essential domestic requirements, employment generation, and on grounds of socio-cultural heritage.

windows to fulfill export obligation on FOB (free on board) or NFE (net foreign exchange earnings) basis.

- Advance licences have been made transferable after the export obligation has been fulfilled and the Bank Guarantee/LUT (letter of undertaking) redeemed.

- The concept of a back to back inland letter of credit has been introduced to enable an advance licence holder to source his inputs from domestic suppliers.

- The list of sensitive items has been pruned after taking into account the reduction in customs duties and excise duties. Besides, flexibility has been provided to the exporter for using unutilised c.i.f. (cost-insurance-freight) value of sensitive items for importing non-sensitive items.

- Realisation of export proceeds is no longer a condition for availing of facilities, including transferability of the duty exemption licences or the goods imported under such licences.

- The Software Technology Park (STP) scheme and the Electronic Hardware Technology Park (EHTP) scheme have been amended in several respects, including value addition norms and DTA (domestic tariff area) sales.

- The definition of consumer goods has been changed to suit the needs of importers, so as to allow them to freely import parts, components and spares of consumer goods as well. These were earlier restricted to the extent that these could be imported without a licence only by actual users. With the changes made, any person can import parts or components of consumer durables freely, without a licence and without actual user condition.

- The list of freely importable consumer goods has been further expanded to include 78 items. Some of the new items included are natural essential oils, instant coffee, refrigerated trucks, cranes and other utility vehicles. In addition, import of 90 consumer items is permitted by all persons against the freely transferable Special Import Licences which are granted to the export houses/trading houses/ star trading houses/super star trading houses etc. and are tradeable in the open market at a premium to be determined by market forces. These items cover within them a large variety of consumer goods.

- The list of goods permitted to be imported against the freely transferable import licences which are granted to the export houses/trading houses/star trading houses and supar star trading houses, has been expanded to include items, *interalia,* electric drilling machine, blank 8 mm video tapes/cassettes, bar code readers, electronic diaries, ropeway systems, cable cars, electric shavers, powered mowers for lawns, parks or sports grounds, marine containers, video monitors and certain types of hand tools.

- Newsprint including glazed newsprint, has been made freely importable, by all persons.

- Import of mandatory spares upto 5 per cent of the c.i.f. value of the licence has been allowed.

- An alternative route of the Pass Book scheme, for some categories of exporters, has been opened. Basic customs duty credit is allowed to be given upon exports. These credits may be utilised for payment of customs duty against import of goods of non-negative nature.

International Economic Environment

55. Some of the encouraging signs in the World economy, noted in Economic Survey last year, gained further momentum during 1995 . New challenges, however, have emerged, for industrial, as well as for developing countries. World output, having increased by 3.6 per cent during 1994 after a growth of 2.5 per cent in 1993, is now projected to grow further by about 4 per cent per year in 1995 and 1995. The growth in output in developing countries is likely to be sustained at around the 6 per cent, a rate also achieved during 1993 and 1994. The growth rate in industrial countries may remain at around 2.5 per cent. There are signs of improvement for the countries in transition. The growth in World trade volume (goods and services) by 8.7 per cent during 1994, as against 3.9 per cent during 1993, has been quite impressive. Even though projections indicate a modest slow down in the growth of merchandise trade during 1995 and 1996, the growth rate is likely to remain above the average of the past decade.

56. Despite a robust growth in trade and recovery in output levels, the world economy, and in particular the developing countries, continue to face significant risks and challenges. High levels of structural unemployment in the developed countries, excessive budget deficits notwithstanding the subdued inflation rates, financial market volatility and exchange rate instability are the major risk factors for the developing countries. Sharp movements in the foreign exchange values of the major currencies have significant repercussions on several developing countries depending on their openness, liability structure and trade pattern. Strengthening of domestic financial markets and macro-economic fundamentals thus remain a challanging priority for the developing countries.

57. The General Agreement on Trade in Services (GATS) has been one of the major achievements of the Uruguay Round of negotiations and now forms an integral part of the WTO's (World Trade Organisation) legal framework. GATS covers all service sectors, including financial services, and is based on two elements. The first is the set of rules and disciplines which apply to all WTO members; the second is the "schedules of specific commitments." The "Schedules" are analogous to the tariff schedules which govern market access commitments of each WTO member with respect to merchandise goods. The services schedules, each of which amounts to a legally enforceable and binding undertaking on the part of the Member concerned, contain commitments on individual service sectors and service activities which define the conditions for access to the market. India's schedule of commitments in financial services are made in accordance with the General Agreement on Trade in Services and the Annexe on Financial Services. All the commitments are subject to entry requirements, domestic laws, rules and regulations. Our objective in the negotiation under GATS was to offer entry to foreign services providers in services sectors in which such entry was considered to be most advantageous for us in terms of capital inflows, technology and employment. In return, we sought greater access for our skilled personnel to the markets of our major trading partners. Broadly our commitments cover a limited offer in the insurance sector as per existing practice. In the Banking sector, India has permitted entry of eight new licences per year both for new entrants and existing banks, subject to a maximum share of assets in India both on and off balance sheet of foreign banks not exceeding 15 per cent of the banking system as a whole. As far as commitments in other financial services, such as merchant banking, financial leasing, factoring, venture capital, financial consultancy etc., all envisage locally incorporated joint venture companies with foreign equity not exceeding 51 per cent except for stock broking where the limit is 49 per cent.

58. Net capital flows to developing countries have shown a significant decline, particularly after the Mexican financial crisis. However, the various components of such flows, including direct

Box 6.4

EXIM Policy Aligned on ITC(HS) Classification

The Harmonised System (HS) of commodity classification, developed by the CCC (Customs Co-operation Council), Brussels has been in use the world over since the late eighties. India has adopted the system for Customs, Excise, Drawback and compilation of foreign trade statistics purposes.The first attempt to introduce the same system in the Trade sector was made with the publication of "Import Licensing Policy" in two volumes in October, 1991. However, the sweeping changes which took place with the liberalisation in the EXIM Policy, 1992-97, reduced the utility of the document. The entire exercise was thereafter taken up afresh at the eight digit extended HS level, and the new Indian Trade Classification (ITC) has now been brought out with the objectives of:

i) Greater transparency in the import and export licensing policy.

ii) Compatibility with the system of classification followed by Customs, Central Excise and the DGCI & S, on Harmonised System (HS) of Commodity Classification.

iii) Reduction in discretionary controls and areas of ambiguity and disputes on import policy matters.

iv) Development of the basic module for computerisation and Electronic Data Interchange (EDI) investments, portfolio investments, official and private borrowing, have behaved in different ways. Foreign direct investments, which remained stable through 1994, declined marginally during 1995. Portfolio flows, on the other hand, dropped sharply during the first half of 1995, in continuation of a significant slowdown during the second half of 1994. Recent trends in aggregate official development assistance indicate a continuing slowdown, leading to tightening of external financing constraints for some developing countries. Overall, trends in capital flows indicate the growing importance of private, non official flows and this highlights the importance of sound economic management policies in the success or failure of individual developing countries in attracting such flows.

Outlook

59. The balance of payments situation in 1995-96 remained reasonably comfortable. The situation will, however, need close monitoring in the successive years. External sector viability in the medium term will crucially depend on sustaining the growth momentum in exports. While import growth is likely to slow down somewhat as the initial impact effect of trade liberalisation is absorbed, export growth in future must ensure import financing without excessive reliance on foreign borrowings. Many of the policy measures necessary to provide appropriate incentives for exports have already been put in place over the last five years, but further efforts will be needed to strengthen export efforts in the light of the emerging international trading environment.

60. Maintenance of external sector competitiveness will depend critically upon improvements in the power, transportation, communication and banking sectors. While some major initiatives have been taken by the Centre for bringing about the appropriate changes in organization and delivery of our infrastructural services, it needs to be emphasized that many of the necessary reforms in the provision of infrastructure would have to be undertaken by concerned State governments and agencies.

61. An important factor affecting our external sector viability is the performance of the petroleum sector. Domestic production of crude oil has declined after 1989-90. In spite of some recovery in 1994-95 and 1995-96, oil production is still below the level reached in 1989-90. Maximum efforts must be made to increase domestic oil production to reduce our dependence on oil imports. The growth in non-oil imports during the last two years has been very high. This is largely a reflection of sharp revival of industrial and investment activities, and a catch up for the low level of imports in 1992-93 and 1993-94. The high rates of growth in imports witnessed over the last two years is likely to moderate over the course of the next few years. In the years to come, non-oil imports is expected to record a growth rate more in line with the rate of expansion of the economic activity and also show a greater degree of price sensitivity.

62. Foreign investment flows can supplement our efforts at mobilizing investible resources in a non-debt creating way. The response of direct foreign investment and portfolio investment to liberalization has been highly encouraging. Therefore, it is important to ensure that there is no reversal of our foreign investment policy in the years to come, and foreign investment flows accelerate further over the medium run.

63. The exchange rate of the rupee, which now reflects market conditions, has corrected the real appreciation that took place since March 1993 and is now at a more realistic level. It has displayed volatility in recent months because of speculative factors, but these can be handled through appropriate corrective measures. The economic fundamentals are strong as evidenced by the foreign currency reserve position, growth of industrial and agricultural production, deceleration in the rate of inflation and the rise in employment. Maintenance of a viable balance of payments and a stable exchange rate depend on the pursuit of sound fiscal and monetary policies. Prudent macro policies, together with structural reform to enhance productivity growth in the future, are the best guarantees against the recurrence of exchange rate volatility observed in the recent past. The Government's continued commitment to sound policies must be established beyond reasonable doubt.

64. Finally, the Government has been following an external debt management strategy to ensure that India's debt service ratio will gradually decline to comfortable levels. The gains are evident from the sharp decline in the debt service ratio over the years. This trend can be sustained if the economic reforms in the key areas noted above continue.