6

External Sector

After a subdued performance for nearly three years, global economic activity is finally showing distinct signs of revival. The optimism about a buoyant global economy emanates largely from a turnaround in the US and the robust growth outlook for emerging Asia. The latest World Economic Outlook (WEO; April 2004) of the International Monetary Fund (IMF) projects world trade growth to rebound sharply in 2004 and maintain its upbeat trend in 2005 (Table 6.1). Despite high global energy prices, the WEO expects global output to grow by almost one additional percentage point in 2004 and sustain the momentum in 2005.

6.2 A much improved performance in 2003 suggests that the US economy is poised to bounce back on a high growth path in 2004. While the policy stimulus provided through fiscal and monetary measures appears to have paid dividend, concerns remain over the low employment growth despite strong productivity gains. As far as the rest of the G-3 (US, Euro area and Japan) are concerned, economic activity continues to remain

Table 6.1 : External environment
(Annual per cent change unless otherwise noted)

			Projections	
	2002	**2003**	**2004**	**2005**
A. World output	**3.0**	**3.9**	**4.6**	**4.4**
Advanced economies	**1.7**	**2.1**	**3.5**	**3.1**
United States	2.2	3.1	4.6	3.9
European Union	0.9	0.4	1.7	2.3
Japan	-0.3	2.7	3.4	1.9
Other advanced economies	2.8	1.9	3.2	3.5
Newly industrialized Asian economies	5.1	3.0	5.3	5.0
Other emerging market and developing economies	**4.6**	**6.1**	**6.0**	**5.9**
Developing Asia	6.4	7.8	7.4	7.0
China	8.0	9.1	8.5	8.0
India	4.7	7.4	6.8	6.0
ASEAN-4*	4.3	5.0	5.4	5.4
Commonwealth of Independent States (CIS)	**5.1**	**7.6**	**6.0**	**5.2**
Russia	4.7	7.3	6.0	5.3
B. World trade volume (goods & services)	**3.1**	**4.5**	**6.8**	**6.6**
C. World trade prices (in US$ terms)				
Manufactures	2.4	14.5	7.7	1.4
Oil	2.5	15.8	3.8	-10.0
Non-fuel primary commodities	0.5	7.1	7.6	-0.8
D. Emerging market and developing countries; Private capital flows (net) (in US $ billion)	47.0	131.3	162.9	100.9

* Includes Indonesia, Malaysia, Philippines and Thailand.

Source: World Economic Outlook; April 2004; The International Monetary Fund.

sluggish in the Euro area. The output gap, reflecting the difference between potential and actual output, is projected to widen from -2.1 per cent in 2003 (as a proportion of potential GDP) to -2.4 per cent in 2004 in the Euro area, underscoring the lack of adequate policy stimulus in the pipeline. Japan, however, appears to be out of the prolonged deflationary pressures. Buoyed by recoveries in both external and domestic demand, the Japanese economy is projected to achieve its highest growth since 1996 in the year 2004.

6.3 Growth prospects for emerging market economies are dominated by bright projections for developing Asia. The region is expected to post an overall growth of 7 per cent plus in 2004, the highest since the East Asian crisis in 1997. Like in the other years, China would continue to be the main driver of economic momentum in developing Asia, strongly supported by rising exports and domestic investment. India is also expected to contribute substantially to the robust outlook for developing Asia. The upbeat expectations about global trade growth are expected to positively impact the growth performances of most developing Asian economies in the current year.

6.4 Though the nascent recovery of the previous year appears to be gaining momentum, global economic activity continues to remain vulnerable to several downside risks. Structural imbalances in the US economy, notably in the form of large current account and fiscal deficits, remain serious concerns, in view of their impact on global financial and currency markets in the event of their disorderly resolution. The likelihood of an increase in the global interest rates, particularly in the US, may induce some reallocation of portfolio funds among regions, affecting particularly the emerging markets. Despite moderation of hostilities in Iraq, global crude prices continue to remain high, creating balance of payments pressures for many oil-importing developing economies. The timing and sequencing of the policy-induced slowdown of the 'over heated' Chinese economy is another short term downward risk faced in the present phase of global recovery. Finally, the optimism about global trade growth can translate into reality only if the roadblocks encountered at the failed talks in Cancun are negotiated successfully through meaningful efforts by the international community.

Balance of Payments

6.5 In recent years, India's balance of payments (BOP) has been characterized by surpluses in both the current and capital accounts. After recording current account surpluses for the past two years, the BOP estimates for the first nine months of 2003-04 (April-December) also indicate a current account surplus (Table 6.2). Given the trend, the country is expected to post a positive current account balance for the third successive year. The trend is consistent with that of most economies of developing Asia, which began showing surpluses in their current accounts from the later part of the 1990s, particularly the East Asian economies like Indonesia, Malaysia, Philippines and Thailand. However, as a proportion of GDP, India's current account surplus in 2003 (0.5 per cent) was much lower than those of Indonesia (3.9 per cent), Malaysia (11.1 per cent), Philippines (2.1 per cent), Thailand (5.6 per cent) and China (2.1 per cent).

6.6 The capital account has also continued to strengthen. The size of the capital account surplus during April-December 2003-04 was far more than that for the full year 2002-03. Earlier, the capital account surplus in India's balance of payments used to be partially offset by current account deficits, leading to lower overall surpluses. However, since 2001-02, surpluses in both, the current and capital accounts have resulted in larger overall surpluses, which have led to accumulation in the foreign exchange reserves of the country.

6.7 At a micro-level, the balance of payments profile reveals some interesting trends (Table 6.2). In recent years, the deficits in the trade account have been more than made up by large invisibles surpluses—sustained by large inflows of private transfers and non-factor services—resulting in positive current account balances. On the other hand,

Table 6.2 : Balance of Payments : Summary#

(in US $ million)

	1990-91	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	(April-Dec.) 2002-03	(April-Dec.) 2003-04
1. Exports	18477	34133	35680	34298	37542	44894	44915	52512	38437	43237
2. Imports	27915	48948	51187	47544	55383	59264	57618	65422	48200	58233
3. Trade balance	-9438	-14815	-15507	-13246	-17841	-14370	-12703	-12910	-9763	-14996
4. Invisibles (net)	-243	10196	10007	9208	13143	10780	13485	17047	12685	18222
Non-factor services	980	726	1319	2165	4064	2478	4577	6765	5090	8814
Income	-3752	-3307	-3521	-3544	-3559	-4832	-3601	-4935	-3664	-5195
Pvt. transfers	2069	12367	11830	10280	12256	12798	12125	14807	11003	14494
Official transfers	461	410	379	307	382	336	384	410	256	109
5. Current Account Balance	-9680	-4619	-5500	-4038	-4698	-3590	782	4137	2922	3226
6. External assistance (net)	2204	1109	885	799	891	410	1117	-2460	119	-1814
7. Commercial borrowing (net)@	2254	2848	4010	4367	333	3737	-1576	-2344	-2020	-3732
8. IMF (net)	1214	-975	-618	-393	-260	-26	0	0	0	0
9. NR deposits (net)	1537	3350	1125	960	1540	2317	2754	2976	2371	3502
10. Rupee debt service	-1193	-727	-767	-802	-711	-617	-519	-474	-358	-304
11. Foreign investment (net) of which :	103	5963	5353	2312	5117	5862	6693	4555	3119	10135
(i) FDI (net)*	97	2651	3525	2380	2093	3272	4741	3611	2768	2513
(ii) FIIs	0	1926	979	-390	2135	1677	1436	342	-186	7219
(iii) Euro equities & others	6	1386	849	322	889	913	516	602	537	403
12. Other flows (net)+	2283	-1131	-595	624	3930	-2263	2507	10590	6516	9776
13. Capital account(net)$	8402	10437	9393	7867	10840	9420	10976	12843	9747	17563
14. Reserve use (- increase)	1278	-5818	-3893	-3829	-6142	-5830	-11757	-16980	-12669	-20788

 # Actual $ Item no. 13 is sum of item nos. 6, 7, 8, 9 ,10, 11 and 12

@ Figures include receipts of Resurgent India Bonds in 1998-99 and India Millennium Deposits in 2000-01 and related repayments, if any, in the subsequent years.

+ Include, among others, delayed export receipts and errors & omissions.

*** These figures indicate FDI to India only. FDI to India figures from 2000-01 include reinvested earnings and other capital.**

Source : Reserve Bank of India.

the growing strength of the capital account has arisen largely from steady growth in non-debt creating foreign investment inflows. External commercial borrowings and external assistance have been showing net outflows in recent years. The trends indicate that fast-growing invisibles and non-debt creating foreign investment inflows are the main factors behind accumulation of foreign exchange reserves. A summary of key indicators for the external sector is given in Table 6.3.

Invisibles account

6.8 The current account surpluses in India's balance of payments in recent years are attributable to the expanding invisibles surpluses. In the first three quarters of 2003-04, the trade deficit estimated at around US$15 billion, was more than compensated by an invisibles surplus of US$ 18.2 billion, resulting in a positive current account balance of US$ 3.2 billion. The size of the invisibles surplus has increased by almost sixty per cent over the period 2000-01 to 2002-03 (from US$ 10.8 billion in 2000-01 to US$ 17 billion in 2002-03).

6.9 Buoyant inflows of private transfers have been one of the main factors contributing to the remarkable growth in invisibles. Net aggregate transfers at US$14.6 billion (mostly

Table 6.3 : Selected indicators of external sector

	Item\Years	1990-91	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04*
1.	Growth of Exports - BOP (%)	9.0	5.6	4.5	-3.9	9.5	19.6	0.0	16.9	12.5
2.	Growth of Imports - BOP (%)	14.4	12.1	4.6	-7.1	16.5	7.0	-2.8	13.5	20.8
3.	Exports/Imports - BOP (%)	66.2	69.7	69.7	72.1	67.8	75.8	78.0	80.3	74.2
4.	Import cover of FER (No. of months)	2.5	6.5	6.9	8.2	8.2	8.6	11.3	13.8	16.2
5.	External assistance (net)/TC (%)	26.3	10.6	9.7	10.4	8.3	4.3	10.2	-19.1	-10.3
6.	ECB (net)/TC (%)	26.8	27.3	42.6	55.4	2.9	39.7	-14.3	-18.2	-21.2
7.	NR deposits/TC (%)	18.3	32.1	12.0	12.2	14.2	24.6	25.1	23.2	19.9
8.	Short-term debt / FER (%)	146.5	25.5	17.2	13.2	10.3	8.6	5.1	6.0	5.7
9.	Debt service payments as % of current receipts	35.3	23.0	19.5	18.8	17.1	16.2	13.4	15.8	18.1
					As per cent of GDPmp					
10.	Exports	5.8	8.9	8.7	8.3	8.4	9.8	9.4	10.3	
11.	Imports	8.8	12.7	12.5	11.5	12.4	13.0	12.0	12.8	
12	Trade balance	-3.0	-3.8	-3.8	-3.2	-4.0	-3.2	-2.6	-2.5	
13.	Invisibles balance	-0.1	2.7	2.4	2.2	2.9	2.3	2.8	3.3	
14.	Current account balance	-3.1	-1.2	-1.4	-1.0	-1.1	-0.8	0.2	0.8	
15.	External Debt	28.7	24.6	24.3	23.6	22.1	22.6	21.1	20.2	
16.	Debt Service Payments	2.8	3.2	2.7	2.6	2.5	2.8	2.3	2.9	

* :Calculated on the basis of figures upto Apr.-Dec. 2003-04.

Notes :

(i) TC: Total capital flows (net).

(ii) ECB: External Commercial Borrowing.

(iii) FER: Foreign Exchange Reserves, including gold and SDRs.

(iv) GDPmp: Gross domestic product at current market prices.

(v) As total capital flows are netted after taking into account some capital outflows, the ratios against item no. 5, 6 and 7 may, in some years, add up to more than 100 per cent.

(vi) Rupee equivalents of BOP components are used to arrive at GDP ratios. All other percentages shown in the upper panel of the table are based on US dollar values.

private transfers of US$ 14.5 billion) during April-December 2003-04, far exceeded US$ 11.3 billion of such transfers in the corresponding period of the prievious year. It is worth noting that the magnitude of net private transfers during the first nine months of 2003-04 (US$ 14.5 billion) is almost equivalent to that of net private transfers for the full year 2002-03 (US$ 14.8 billion).

6.10 The current high level of private transfers, which comprise largely inflows of remittances from Indians working abroad, have made India the highest global recipient of remittances. The bulk of these remittances come in from expatriates in the US and the Middle East. The crucial role of private transfers in strengthening India's balance of payments is evident from the fact that the net private transfers exceeded the trade deficit in 2002-03 and almost fully financed it during April-December 2003-04.

6.11 In addition to transfers, the contribution of non-factor services to the invisibles account has been increasing steadily since 2001-02. This contribution was seen to have enhanced further in 2002-03. Among non-factor services, miscellaneous services have played the most significant role in enlarging the invisibles surplus on account of buoyant earnings from software services. Net inflows from software services increased from US$6.9 billion in 2001-02 to US$ 8.9 billion in 2002-03. In the year 2003-04, net inflows from software services have crossed US$ 9.0 billion during the first three quarters itself, compared with US$ 5.8 billion in the corresponding period of

2002-03. Apart from miscellaneous services, travel and transportation have recorded net positive inflows during April-December 2003-04, compared with net outflows in April-December 2002-03.

6.12 The high skill-intensity of the Indian workforce has imparted a decisive comparative advantage to Indian software services exports and has helped the country in carving out a niche in the global market for software and IT-enabled services. Besides, in recent years, India has emerged as one of the most preferred destinations for offshoring of IT services from advanced economies. While software and services exports have more than trebled between 1998-99 to 2002-03, exports of IT-enabled and business process outsourcing (BPO) services have increased significantly in recent years.

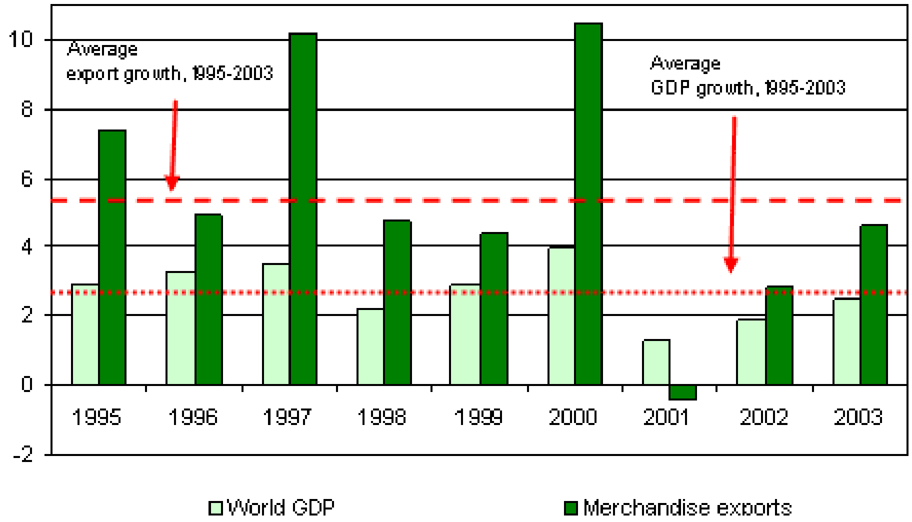
Merchandise trade

6.13 According to World Trade Organization (WTO), after a sharp downturn in 2001, the volume growth of world merchandise trade rebounded to 3.0 per cent in 2002 and grew somewhat faster at 4.5 per cent in 2003. The trade recovery in 2002 and 2003 benefited from strong import demand in developing Asia, the transition economies and the United States, with the sluggish economies of Western Europe and Latin America posting weak import growth. The most dynamic trading regions in 2003 were Asia and the transition economies, recording exports and imports expansion in real terms between 10 per cent and 12 per cent. United States' import growth at 5.7 per cent exceeded global trade expansion, thus contributing significantly to world trade growth. However, US import growth continued to exceed export growth, further widening its trade deficit. While the growth in world merchandise exports was stronger than expected especially in the wake of the outbreak of SARS, build up of tension in the Middle East and sluggish growth in Western Europe, trade expansion in real terms in 2003 remained below the average recorded since 1995 (Figure 6.1). World trade is projected to expand by 7.5 per cent in 2004, assuming the continued improvement in global economy.

6.14 The rebound in global trade was, however, stronger in nominal terms, with value of world merchandise exports registering a rise of around 16.0 per cent in 2003, two thirds of the rise being attributable to dollar price changes. The pick up in global

Fig. 6.1

Real GDP and merchandise exports, 1995-2003
(Annual percentage change)



Source : WTO

exports in 2003 was the strongest annual increase in nominal terms since 1995 and reflected, besides recovery in activity and demand, a recovery in global commodity prices. Commodity prices and exchange rate changes are estimated to have resulted in a 10.5 per cent strengthening of world merchandise trade prices in dollar terms, with prices in all the broad categories (viz. fuels, non fuel commodities and manufactured goods) rising in 2003. However, the impact of price and exchange rate developments on nominal trade flows differed sharply by region. While price changes accounted for most of the nominal increase in exports of Western Europe, due to strong appreciation of these currencies vis-à-vis the dollar, in Asia price changes accounted for less than one-third of the increase in the dollar value of the region's merchandise exports.

6.15 India's annual average merchandise export expansion at around 8 per cent in the latter half of the nineties was higher than the growth of overall world trade and expansion of trade of developing countries (Table 6.4), resulting in a rise in the share of India's exports in world exports from 0.6 per cent in 1995 to 0.7 per cent in 2000. Between 2000 and 2003, India's exports have increased by around 32 per cent as compared to a rise of around 17 per cent in world exports, suggesting some improvement in overall competitiveness of Indian exports. In 2002, India emerged amongst leading exporting nations as the world's fastest growing exporter after China, recording a robust growth of 13.8 per cent in dollar value. The growth in exports has been broadly maintained in 2003, resulting in retention of India's share in world exports at 0.8 per cent (Table 6.4). Currently India is 31st leading exporter and 24th leading importer in world merchandise trade.

6.16 Aided by recovery, *albeit slow*, in global demand and world trade, India's exports (in US dollar value), according to Directorate General of Commercial Intelligence and Statistics (DGCI&S), witnessed a sharp turnaround to 20.3 per cent in 2002-03 from a decline of 1.6 per cent in 2001-02. The vigorous revival was achieved notwithstanding an external environment dominated by rising uncertainties related to Iraq war, volatility in international crude oil prices and fallout of the decline in equity markets and internal factors like the drought and a sluggish domestic economy. Almost the entire increase was accounted for by higher volume of exports, with unit price of exports remaining sluggish (Table 6.5). The net terms of trade, which had been witnessing a continuously deteriorating trend since 1999-00, eroded further by 9.4 per cent in 2002-03. These terms of trade, which measure the relative changes in

Table 6.4 : Export growth and share in world exports of selected countries

	Percentage growth rate					Share in world exports			
Country	1995-99	2000	2001	2002	2003	2000	2001	2002	2003
1. China	10.4	27.7	6.8	22.4	34.5	3.9	4.3	5.1	5.9
2. Malaysia	8.1	16.3	-10.4	6.0	6.5	1.5	1.4	1.5	1.3
3. Indonesia	4.3	27.7	-9.1	3.0	7.8	1.0	0.9	0.9	0.8
4. Singapore	4.0	20.2	-11.6	2.8	16.1	2.2	2.0	2.0	2.0
5. Thailand	5.7	18.2	-5.7	5.6	17.1	1.1	1.1	1.1	1.1
6. India	**7.7**	**18.8**	**2.3**	**13.8**	**13.5**	**0.7**	**0.7**	**0.8**	**0.8**
7. Korea	8.9	19.9	-12.7	8.0	19.3	2.7	2.5	2.5	2.6
8. Developing countries	7.1	24.7	-4.5	7.7	19.1	37.1	36.8	37.8	38.8
9. World	5.9	12.9	-3.6	4.7	16.0	100.0	100.0	100.0	100.0

Source: Compiled from IFS statistics, IMF.

Table 6.5 : Performance of the foreign trade sector
(Annual percentage change)

Year	Export Growth		Import Growth		Terms of Trade	
	Volume	Unit value	Volume	Unit value	Net	Income
1997-98	-6.3	16.8	9.8	1.1	15.5	8.3
1998-99	3.4	3.8	14.6	0.9	2.9	6.4
1999-00	15.5	-1.2	9.4	10.5	-10.5	3.3
2000-01	23.9	3.3	-1.0	8.2	-4.5	18.3
2001-02	3.7	-1.0	5.0	1.1	-2.1	1.5
2002-03	21.7	0.3	9.5	10.7	-9.4	10.3

Source : DGCI&S.

import and export prices, seem to have been affected, inter alia, by the resurgence of international crude oil prices during the year. However, import purchasing power of exports, as measured by income terms of trade has consistently improved during the 1990s (except 1996-97), rising on an average by 11.7 per cent per annum, on account of the strong growth in exports in volume terms. This capacity to import based on exports alone increased further by 10.3 per cent in 2002-03. While export growth in 2002-03 might have been partly buoyed up by the low base of 2001-02, recovery in international commodity prices, movements in cross currency exchange rates, a faster repatriation of export proceeds and various policy initiatives for export promotion and market diversification contributed to the upsurge.

6.17 The growth in exports by 17.1 per cent in 2003-04 provided significant support to domestic demand during the year. In response to favourable policy mix, exports from Special Economic Zones (SEZs) grew faster by 46.1 per cent. Export growth which seemed to have been dampened in the first half of 2003-04 by weak demand, SARS related concerns and slower than anticipated pace of global economic recovery, recovered in the second half because of improved global growth and accompanying acceleration in world merchandise trade. The firming up of domestic manufacturing activity provided a supporting export base. The strong export performance is also a measure of India's growing export competitiveness, especially in view of the gradually appreciating nominal value of the rupee vis-à-vis the US dollar during this period. There are indications of productivity gains following the restructuring of domestic industry partly in response to opening up of the Indian economy. Export growth continues to be robust in the current fiscal, with exports growing by 24.9 per cent in April-May, 2004. However, with the increase in international dollar prices, growth in exports in real terms is likely to have decelerated between 2002-03 and 2003-04.

6.18 Macro and sector-specific policies were formulated in the Union Budget 2003-04, EXIM policy and various Departmental schemes to enhance manufacturing sector efficiency, including promotion of exports and further acceleration of the reform process (Box 6.1). This included provision of fiscal incentives to important designated industries like textile, pharmaceuticals, telecom, biotechnology, gems & jewelry and IT industry. Suitable thrust was also provided to areas of core competence in exports, like services and agro exports. Additional fiscal incentives and trade facilitation measures to help exports were announced in January 2004.

6.19 The export growth in 2003-04 has coincided with the strengthening of the Rupee vis-a-via the US dollar. The Indian rupee, which started strengthening from June 2002 onwards, on monthly average basis, had appreciated 8.8 per cent by March 2004. On annual average basis, vis-a-vis the US dolloar, the rupee after depreciating by 1.5 per cent in

Box : 6.1 Recent policy measures announced in the foreign trade sector

I. Measures announced in the Union Budget 2003-04 and reform package announced in January 2004

- Peak rate of customs duty reduced from 30 per cent to 25 per cent (excluding agricultural and dairy products) and duty structure on designated items rationalized. In a further reform package taking effect from January 9, 2004, the peak rate was further reduced to 20 per cent, Special Additional Duty of (SAD) of 4 per cent was abolished and customs duty on project imports, with investment of at least Rs 5 crore in plant and machinery, was reduced from 25 per cent to 10 per cent.
- The Budget announced a revival package (setting up of a Price Stabilization Fund and creation of separate Fund and Development Account for modernization and rehabilitation) for the plantation crops, and fiscal concessions for marine food industry which is likely to impact positively on exports of tea, coffee and marine products
- To improve the efficiency and competitiveness of the manufacturing sector, including promotion of exports, incentives have been provided for designated industries like the textile industry, pharmaceuticals, telecom and Information Technology (IT) industry, bio-technology and gems & jewelry. The reforms package of January 9, 2004 provided further incentives, in the shape of lower duties, for various sectors including power, IT/electronics, health, civil aviation and water supply.
- Trade facilitation measures announced in the Budget include: increasing the interest free period for warehoused goods (from 30 to 90 days) and reduction in the interest rate for the period beyond 90 days to reflect the market rate of interest; and the replacement of the existing system of concurrent audit of import documents by post-clearance audit. Other measures announced in January 2004 included extension (from 9 to 23 formations) of the round-the-clock electronic filing of customs documents for clearance of goods, customs clearance to be based on self-assessment and selective examination, liberalization of baggage rules and extension of electronic filing of service tax returns to all the 58 taxable services. These measures would contribute to further reduction in transaction costs of exports and imports.
- The share capital of ECGC has been increased to Rs 80 crore, to provide greater credit insurance cover to exports from the country.
- SSI reservations withdrawn from another 75 items of laboratory chemicals and reagents, leather and leather products, plastic products, chemicals and chemicals products and paper products.

II. Measures announced in the modified EXIM Policy 2003-04

- The policy provides a massive thrust to export of services by introducing duty free import facility for the service sector units having a minimum foreign exchange earning of Rs 10 lakhs. The scheme is likely to provide a major boost to export of services like health care, entertainment, professional services and tourism.
- Corporate sector with proven credentials would be encouraged to sponsor Agri-Export Zones for boosting farm exports. Another significant measure announced is the factoring in of the cost of pre-production of inputs (such as fertilizers, pesticides, seeds) in the fixation of DEPB rates for selected agro products.
- EPCG scheme made more flexible and attractive so that even the small scale sector could set up and expand its manufacturing base for exports. Major changes include allowing import of capital goods for pre-production and post-production facilities also, rationalization of export obligations by linking it to the duty saved, allowing import of spares to facilitate upgradation of existing plant and machinery, dispensing with the existing condition of imposing an additional export obligation of 50 per cent for products in the higher value chain, greater flexibility for fulfillment of export obligation under the scheme by allowing export of any other product manufactured by the exporter, allowing capital goods up to 10 years old under this scheme and counting royalty payments received from abroad etc. for discharge of export obligation under the EPCG scheme.
- Incentives for fast growing Status Holders include duty free entitlement for status holders having incremental growth of more than 25 per cent in exports in free foreign exchange, introduction of facility of Advance License to enable status holders plan their bulk imports, fixing of Input-Output norms for status holders on priority basis within a period of 60 days and permission to status holders in Software Technology Parks India (STPI) for free movement of professional equipments.

- Simplification and codification of rules, regulations and procedures applicable to SEZ and EOU units by putting all these rules and regulations in one place, thus greatly facilitating both potential investors and existing units. Sales from DTA to SEZs would be treated as exports thus entitling domestic suppliers to drawback/DEPB benefits etc. Further, SEZ units in agricultural/horticulture processing would be allowed to provide inputs and equipments to contract farmers in DTA to promote production of goods as per the requirements of importing countries. Other measures introduced include exemption from SAD for domestic sales by SEZ, removal of restriction of the one year period for remittance of export proceeds, permission for netting of exports, permission to take jobwork abroad and export goods from there only, permission to capitalize import payables, permission for duty-free import of goods required for operation and maintenance of SEZ units and uniform amortization over 10 years of the value of capital goods imported by SEZ units. The Policy also includes special measures to promote exports of gems and jewelry and electronic hardware from the SEZs.
- To increase the overall competitiveness of export clusters, a scheme for upgradation of infrastructure in existing clusters/industrial locations would be implemented. Efforts under the scheme would be supplemented by the Assistance to the States for Infrastructure Development of Exports (ASIDE) and other schemes. To begin with, 10 such clusters with high growth potential would be reinvigorated to bridge technology and productivity gaps in identified clusters.
- Other miscellaneous measures included in the EXIM Policy are: Extension of Duty Free Replenishment Certificate (DFRC) scheme to deemed exports and reduction in its value addition norms from 33 per cent to 25 per cent; introduction of facility of provisional DEPB rate to encourage diversification and promotion of new export products; anti dumping and safeguard duty exemption to advance license for deemed exports for supplies to EOU/SEZ/EHTP/STP; permission for extension of export obligation period for revival of sick units based on BIFR rehabilitation schemes; removal of Actual User condition for import of second hand capital goods up to 10 years old; reduction in penal interest rate from 24 per cent to 15 per cent for all old cases of default under EXIM Policy; permission to export free of cost goods for export promotion at 2 per cent of average annual exports in preceding three years; and removal of restrictions on export of warranty spares. Towards further reducing transaction cost, the policy continues with its thrust on placing high priority on EDI implementation programme.

III. Trade Facilitation Measures announced on January 28, 2004

- EPCG scheme made more attractive by providing flexibility in discharge of export obligations by extending the scope to include exports of products/services by group companies, refixation of export obligations of past EPCG licenses in line with existing policy, permitting clubbing of licenses, import of spares and doing away with “nexus certification for licenses upto designated ceiling.
- Imports of gold and silver liberalized
- Further liberalization of Duty Exemption scheme and procedural simplifications of deemed exports
- Introduction of major EDI initiatives like digital signature facility and electronic fund transfer facility with reduction in application fee by half for digitally signed online applications.

IV. Other measures

- Flexibility provided, beginning January 2004, to exporters in realization of export proceeds beyond 180 days and write off of outstanding export dues, up to 10 per cent of their export proceeds in a calendar year.
- Relaxation of labour and insurance laws for SEZ units by extending these units five year holiday from contribution to provident fund and employees’ insurance scheme, provided they have similar schemes of their own in operation.
- Duty exemption restored on goods procured for trading by EOU units that were in existence before March 31, 2002 and have been permitted to continue under the scheme.
- New foodgrain export policy announced enabling exporters to undertake direct grain purchase from the market instead of from the food corporation of India.

2002-03, appreciated by 5.3 per cent in 2003-04. These movements in the rupee value were smooth and orderly, avoiding any significant undue adjustment costs to industry. Furthermore, while the rupee appreciated against the US dollar in 2003-04, it depreciated against the currencies of major non dollar trading partners. While the appreciation of practically all major currencies vis-a-vis the US dollar was a general feature during 2003, the relative appreciation of the rupee was not high (Table 6.6). Moreover, given the inflation differential, the appreciation has been less pronounced in trade weighted effective terms, with the Real Effective Exchange Rate (REER) of the rupee, (5-country index with base 1993-94), appreciating by around 2 per cent on an annual basis in 2003-04.

6.20 Thus, while the profit margin of some exporters, especially of traditional goods with low import content and high value addition, may have been impacted adversely by the hardening of the rupee, such concerns in general need to be tempered by the fact that a strong rupee would have brought down the cost of imported inputs for other exporters with a high import-content in their exports. Other positive spin-offs of an appreciating rupee include gains to borrowers of foreign currency, benefits to consumers from softening of inflation and a fall in the rupee value of external debt. In any case, the impact of real appreciation of the rupee on exports also depends on productivity growth. Any attempt to simply relate the export growth deceleration to appreciation of the rupee misses out on the important issue of productivity growth and the benefits of a market determined exchange rate regime. Achieving such productivity gains may, however, necessitate a broad policy stance of further deepening of domestic reforms and reduction in tariff, which could also help check further strengthening of the rupee. Constraints on productivity like infrastructure bottlenecks, outdated/inflexible labour laws and SSI reservations need to be addressed. Exporters need to pay more attention to non-price factors such as product quality, brand image, packaging, delivery and after sales service. With the scope for sector-specific fiscal incentives getting reduced in a general atmosphere of declining tariff rates and fiscal reforms, export strategy needs to focus more on easing supply side constraints and providing infrastructure and institutional support to exporters.

6.21 Availability of adequate export credit at competitive rates continues to be accorded highest priority. Initiatives taken by the Government so far in this direction include export credit target of 12 per cent of net bank credit (NBC), rationalization of interest rates on export credit, reduction of Prime Lending Rate (PLR) linked ceiling rates and providing the option to exporters for availing pre-shipment and post-shipment credit either in rupees or in foreign currency from banks in India. At present banks are permitted to extend foreign currency loans to exporters with a ceiling of LIBOR plus 0.75 per cent so as to

Table 6.6: Appreciation (+)/Depreciation (-) of major currencies against the US Dollar

Country	1999	2000	2001	2002	2003
Indian Rupee	-4.17	-4.20	-4.76	-2.93	4.36
Euro	-	-13.52	-2.87	5.17	19.93
Pound Sterling	-2.31	-6.31	-5.02	4.26	8.87
Japanese Yen	14.92	5.70	-11.32	-3.08	8.16
Thailand Baht	9.37	-5.73	-9.72	3.43	3.56
Philippines Pesos	4.62	-11.55	-13.34	-1.18	-4.79
Korean Won	17.88	5.12	-12.40	3.19	4.99
Indonesian Rupiah	27.48	-6.73	-17.92	10.20	8.56
Singapore Dollar	-1.26	-1.68	-3.78	0.06	2.78

Source: Computed from International Financial Statistics, IMF, April, 2004.

cover cost of funds. Interest rates on rupee export credit have been deregulated with ceiling interest rate on pre-shipment credit up to 180 days and post-shipment credit up to 90 days being currently at benchmark PLR (BPLR) minus 2.5 percentage points. Banks are free to decide interest rates to be charged on pre-shipment credit beyond 180 days (and up to 270 days) and post shipment credit beyond 90 days (and upto 6 months) from the date of shipment. To provide greater flexibility to banks to source foreign currency funds for extending pre-shipment credit in foreign currency to exporters, banks have been permitted to use foreign currency funds borrowed from abroad, as also those generated through buy-sell swaps in the domestic foreign exchange market for granting such loans. Banks are also encouraged to utilize balances held under the Foreign Currency Non-Resident (FCNR) scheme for extending foreign currency loans to exporters. Other sources of funds that the banks can use to extend foreign currency loans to exporters include balances in Exchange Earners Foreign Currency (EEFC) Accounts, Resident Foreign Currency Accounts (RFC), Escrow Accounts, Exporters' Foreign Currency Accounts and overseas line of credit without any limit. As per latest available information, there has been an acceleration of export credit in 2003-04 (Table 6.7). Reserve Bank of India (RBI), in consultation with select banks and exporters announced a Gold Card scheme on May 27, 2004, to facilitate easy availability of export credit for credit worthy exporters. Better terms of credit including softer rates of interest than those extended to other borrowers by the banks, faster and simpler processing of applications for credit, sanction of 'in principle' limits for a period of three years with a provision of timely renewal, preference for grant of packing credit in foreign currency, are available for the Gold Card holders.

Table 6.7 : Export credit

Outstanding as on	Export credit (Rs crores)	Variations (Per cent)	Export credit as per cent of NBC
March 24, 2000	39118	9.0	9.8
March 23, 2001	43321	10.7	9.3
March 22, 2002	42978	-0.8	8.0
March 21, 2003	49202	14.5	7.3
March 19, 2004	57687	17.2	7.5

Source : Report on trends and progress of banking in India, RBI, various issues.

6.22 An increasing use of contingency trade policy and non tariff measures (NTMs) had its impact on the international trade environment. Growing use of unconventional NTMs like health and safety measures, technical regulations, environmental controls, customs valuation procedures and labour laws by developed countries has become a major barrier to market access to exports from developing countries. Such market barriers are considerably stiffer for products with lower value addition and technological content (agriculture products, textiles, leather products etc), products, which are of major interest to countries like India. According to one estimate, about 35 per cent of India's total exports to USA in value terms faced NTMs in 2002, with their incidence in other developed countries being more or less similar. Similarly, use of contingent protection measures like anti-dumping duties and countervailing duties has increased over time, with 98 anti-dumping cases and 39 subsidy cases having been initiated against India's exports so far. Major initiators of these cases against India include European Union, USA, South Africa, Canada and Brazil. India has also been a leading user of the anti-dumping instrument (Table 6.8), although there has been a significant decline in new investigations in 2003. The countries prominently figuring in these investigations include China, EU, Korea, Taiwan, Japan, USA, Singapore and Russia with chemicals petrochemicals, pharma-ceuticals, fibres/ yarn, steel and other metals as the major product categories of such investigations. As of March 2004, the Directorate of Safeguards had initiated 17 investigations so far, out of which safeguard duty had been imposed on 10.

6.23 Import growth, after stagnating for two years, accelerated in 2002-03, registering a growth of 19.4 per cent in US dollar value.

Table 6.8 : Top ten users of anti-dumping measures, 1995–2003

Country	1995	1996	1997	1998	1999	2000	2001	2002	2003	1995 -2003
India	**6**	**21**	**13**	**27**	**65**	**41**	**79**	**81**	**46**	**379**
United States	14	22	15	36	47	47	76	35	37	329
European Union	33	25	41	22	65	32	29	20	7	274
Argentina	27	22	14	8	23	45	26	14	1	180
South Africa	16	33	23	41	16	21	6	4	6	166
Australia	5	17	42	13	24	15	23	16	8	163
Canada	11	5	14	8	18	21	25	5	15	122
Brazil	5	18	11	18	16	11	17	9	4	109
Mexico	4	4	6	12	11	7	5	10	14	73
China, P.R	NA	NA	NA	NA	NA	6	14	30	22	72
All Countries	157	224	243	256	355	294	366	311	210	2416

Source : WTO

Both enhanced volume and higher unit prices contributed to this growth. While POL imports increased by 26.0 per cent, reflecting mainly the resurgence in international crude oil prices, non-POL imports rose by 17.0 per cent, indicating a recovery in the manufacturing sector. An important moderating influence on growth in non-POL imports was the decline by 6.4 per cent in imports of gold & silver on account of volatility in international gold prices. Excluding these imports, non -POL, non bullion imports increased by 20.3 per cent in 2002-03, as against a moderate rise of 8.8 per cent in the previous year. Benefiting from lower tariffs, a cheaper dollar and a buoyant domestic economy, imports continued to surge in 2003-04, rising faster than exports at 22.8 per cent (in dollar value). Bulk of the increase was contributed by growth in non-POL imports, which shot up from 17.0 per cent in 2002-03 to 26.2 per cent in 2003-04, reflecting higher domestic demand and industrial growth. The increase was powered in the most part by higher imports of capital goods, industrial raw materials and intermediate goods. Imports of 300 sensitive items, which constitute around 5 per cent of total imports and are being monitored separately, increased at a higher rate of 29.7 per cent in 2003-04, mainly because of higher imports of edible oil, cotton & silk, fruits & vegetables, automobiles, rubber, milk & milk products and alcoholic beverages. The accelerating trend in import growth continues in the current fiscal, with total imports rising by 25.8 per cent in April-May 2004.

6.24 The spurt in POL imports by 26.0 per cent in 2002-03 was contributed more by increase in international crude oil prices (around 20 per cent) than by enhanced volume of imports (3.2 per cent). By contrast, in 2003-04, the volume impact (11.3 per cent) dominated with average already high international crude oil prices rising further on an annual average basis by 5.4 per cent. In absolute terms, the average international crude oil prices increased from $23.0 per barrel in 2001-02 to $27.6 per barrel in 2002-03 and further to $29.0 per barrel in 2003-04. The price (Brent) increased to around $ 38 per barrel in May 2004 and peaked to $39 per barrel on June 1, 2004. Rising demand, lower than normal fuel inventories and rising concerns about the security of Middle East supplies contributed to this spike in prices. OPEC decision to increase production, by 2 million barrels a day in July, 2004 and add 50,000 barrels a day more in August 2004, calmed the market, resulting in a decline in crude oil prices to around $ 36 per barrel as on June 11, 2004. Increasing dependence on crude oil imports, in the face of rising domestic refining capacity, and a stagnant domestic crude production, has imparted a downside risk to the country's oil economy from volatility of such external shocks. Currently, almost two thirds of country's crude oil requirements are imported, with POL imports constituting around 27 per cent of India's total imports. Hence, an important feature of sourcing of POL imports in the recent past has been the diversification of India's POL imports away from the geo-politically sensitive regions like the Middle East. Another development has been the decision to build up strategic oil reserves, equivalent of about 15 days requirement, to minimize external shocks due to crude oil price volatility in the short term.

6.25 Gold and silver imports (excluding imports through passenger baggage) declined by 6.4 per cent in 2002-03 on account of volatility in international gold prices, decline in rural incomes on account of drought and a sluggish domestic economy. Despite continued rise in international bullion prices, imports picked up in 2003-04, rising sharply by 61.9 per cent in April-February 2003-04. These imports seem to have been buoyed up by recovery in domestic demand and strengthening of the rupee against the US dollar. The reduction in duty on imported gold from Rs 250 to Rs 100 per 10 gram announced in the Union Budget 2003-04 and liberalization of these imports as per trade facilitation measures announced in January 2004, may have also provided a fillip to demand for the metal. International gold prices, up almost by one third in last two years, had pierced the psychological barrier of $400 per troy ounce and stood at $425.5 per troy ounce on January 13, 2004. Much of the rise in prices reflected the dollar decline, spurring investors to turn to the metal as a safe heaven. International gold prices have moderated in April and May 2004 and currently (June 11, 2004) rule around $385 per troy ounce. A weak dollar, still recovering equity markets, low inflation and interest rates and ongoing geo-political tension may continue to provide support to the current level of international gold prices in the near future.

6.26 The trade deficit, which reflects changes in the relative growth rates of exports and imports, has showed a widening trend in the recent years and stood at $8.7 billion in 2002-03, notwithstanding the export acceleration. Given the surge in imports, the deficit widened further by around 57 per cent and stood at a record level of $13.7 billion in 2003-04. The deficit was higher by 28.5 per cent in April-May 2004 over corresponding previous period.

Composition of trade

6.27 Export growth in 2002-03 was broad based, with both commodity groups and manufacturing goods posting strong growth (Table 6.9). The major contributor to this increase was the manufacturing sector, accounting for around three-quarters of the incremental growth in exports. Major traditional exports like textiles (including garments), gems & jewelry, engineering goods (especially iron & steel, non-ferrous metals, transport

Table 6.9 : Commodity composition of exports, April-February 2003-04

Commodity Group	Percentage Share			Growth Rate*		
		April-February			April-February	
	2002-03	2002-03	2003-04	2002-03	2002-03	2003-04
I. Primary products	**16.6**	**16.7**	**15.2**	**22.0**	**22.1**	**7.2**
Agriculture & allied	12.8	12.9	11.7	14.1	13.9	7.1
Ores & minerals	3.8	3.8	3.5	58.7	61.0	7.8
II. Manufactured Goods	**76.6**	**76.7**	**75.8**	**21.0**	**19.9**	**16.8**
Textiles incl. RMG	21.1	21.0	19.0	14.9	12.0	7.0
Gems & jewelry	17.2	17.1	16.7	23.9	26.3	14.8
Engineering goods	17.1	17.1	19.4	29.8	27.9	34.7
Chemicals & related products	14.2	14.3	14.6	23.6	23.0	20.6
Leather & manufactures	3.5	3.6	3.3	-3.2	-3.7	7.2
III. Petroleum, crude & products	**4.9**	**4.7**	**5.8**	**22.0**	**15.9**	**44.6**
IV. Others	**2.0**	**1.8**	**3.2**	**-11.8**	**-20.5**	**107.5**
Total Exports (I+II+III+IV)	**100.0**	**100.0**	**100.0**	**20.3**	**19.0**	**18.2**

* In US Dollar terms

equipment and project goods), chemicals and related products and handicrafts contributed bulk of such increase in manufactured goods exports. Other important features of the export performance in 2002-03 included acceleration in exports of primary products, a turnaround in exports of agriculture and allied products and manufactured goods, a surge in exports of ores & minerals and continued robust growth in exports of petroleum products. Important exceptions to this broad-based growth, included exports of plantation sector, oil meals, poultry & dairy products and leather and manufactures, which registered declines during the year.

6.28 In spite of a drought, exports of agriculture & allied commodities recorded a sharp turnaround, contributed mainly by enhanced exports of cereals (mainly non-basmati rice), marine products, spices, tobacco, cashew nuts, processed foods, meat & meat preparations and floriculture products. Given lower unit price realizations, the declining trend in exports of plantation sector (tea, coffee) continued, with the sector recording a further decline of 6.9 per cent in 2002-03. The surge in exports of ores & minerals was contributed mainly by expansion in exports of iron ore (which more than doubled) and processed minerals, while rising domestic refining capacity enabled continued robust growth in exports of petroleum products. Export growth performance in 2003-04 (April-February 2003-04) was underpinned by strong growth in engineering goods (buoyed up by exports of iron & steel, machinery, non-ferrous metals, transport equipment and electronic goods), petroleum products, chemical and related products, gems and jewelry, oil meals and processed foods. While exports of engineering goods grew on the back of rising demand from countries in East Asia and China, increased refining capacity and domestic production contributed to higher exports of petroleum products. Exports of leather and manufactures also witnessed a turnaround in 2003-04 after two years of declining growth trend. However, the slowdown in overall export growth during this period was contributed by a deceleration in exports of both primary products and manufactured goods, contributed by slowdown/decline in major exports like textiles (including readymade garments), handicrafts, iron ore, cereals, marine products and cashew nuts. The decline in foodgrain exports was mainly due to policy change in prices, decline in stocks and infrastructural bottlenecks like non-availability of railway wagons.

6.29 The rise in imports in 2002-03 was also broad based, reflecting higher oil prices and oil imports and a pick up in domestic industrial activity. This growth was contributed by robust increases in imports of food & allied products (mainly edible oils), capital goods, raw materials and intermediate and consumer goods. Around 85 per cent of the increase in imports in absolute terms during the year was accounted for by higher imports of POL, electronic goods, pearl, precious and semi precious stones, capital goods and edible oils. A significant aspect of the import performance was the acceleration in imports of capital goods after the recovery in these imports in the preceding year. Imports of capital goods accelerated from 6.3 per cent in 2001-02 to 25.9 per cent in 2002-03, led by import of transport equipment, machinery and manufacture of metals. Such acceleration in imports, coupled with production trends in capital goods sector in 2002-03, point to some recovery in investment in the economy during the year. However, import of project goods, which reflect technological maturity and industrial capabilities of a country, continued to decline for the fourth successive year.

6.30 Imports of raw material and other intermediate imports also witnessed substantial growth in 2002-03, mainly on account of higher imports of items like electronics goods, chemicals, iron & steel, medicinal & pharmaceutical products, artificial resins, plastic material and computer software in physical form. The increase in imports of food and allied products (by 22.2 per cent) was contributed mainly by higher imports of edible oils and cashew nuts. Imports of gold & silver, fertilizers, newsprint, metalifers ores & metal scrap, leather, wood & wood products and raw cotton, however, recorded significant declines during the year. Imports continued to surge in the 2003-04, powered by strong import demand for capital goods, raw materials and intermediates goods, reinforcing the positive outlook for the domestic economy as a whole and manufacturing sector in particular. Overall, around 82 per cent of the incremental imports in absolute terms during this period were accounted for by higher imports of gold and silver, POL, electronic goods, capital goods, chemicals, pearls, precious stones & semi precious stones and edible oils (Table 6.10). While the increase in gold & silver imports was primarily due to the hardening of international prices, higher imports of edible oils could be attributed to lower domestic production following the drought in 2002-03. Given the rise in demand, fertilizers imports have witnessed a turnaround in 2003-04 after three years of declining trend. The robust growth in capital goods imports, along with a buoyant growth in domestic capital goods production mainly reflects a revival of investment demand.

Direction of trade

6.31 Exports to OECD, OPEC and other developing country regions increased in 2002-03 by 22.0 per cent, 31.9 per cent and 32.0 per cent, respectively, resulting in rise in their shares in total exports to 50.0 per cent, 13.1 per cent and 30.8 per cent, respectively. Exports to all the major countries in OECD region registered increases, reflecting some recovery in demand in this region. Prevalence of high international crude oil prices and the consequent gains in terms of trade have increased the share of India's trade with the OPEC region in India's total trade. Growth was strong in exports to Asia and Latin American regions, growing by 40.7 per cent and 35.9 per cent respectively. Exports to Eastern Europe, declined in 2002-03, mainly because of lower exports to Russia. The growth of exports to all these regions, however, slowed down in April-February 2003-04 (except for OPEC and Eastern Europe). While the share of exports to OECD countries declined to 46.6 per cent, the share of exports to European Union was broadly maintained by an increase of 17.8 per cent in exports to these countries, probably reflecting the exchange rate developments during this period. The sourcing of imports in 2002-03 showed lower shares

Table 6.10 : Imports of principal commodities, April-February 2003-04

	Commodity Group	Percentage Share			Growth Rate*		
			April-February			April-February	
		2002-03	2002-03	2003-04	2002-03	2002-03	2003-04
1.	POL	28.7	29.0	26.7	26.0	25.5	15.7
2.	Pearl, precious & semi precious stones	9.9	10.2	9.4	31.2	34.0	15.9
3.	Capital goods	12.1	11.1	12.0	25.9	27.6	35.7
4.	Electronic goods	9.1	9.1	9.7	48.0	46.5	33.7
5.	Gold & silver	7.0	6.8	8.7	-6.4	-6.4	61.9
6.	Chemicals **	6.9	7.0	7.5	8.7	8.2	33.9
7.	Edible oils	3.0	2.9	3.4	33.8	27.0	46.8
8.	Coke, coal & briquettes	2.0	2.1	1.8	8.4	7.1	12.3
9.	Metalifers ores & metal scrap	1.7	1.7	1.6	-9.3	-10.8	17.2
10.	Professional instruments & optical goods	1.8	1.9	1.6	8.8	8.7	7.2
11.	Others	17.8	18.1	15.8	-11.8	4.0	21.8
	Total Imports	**100.0**	**100.0**	**100.0**	**19.4**	**18.1**	**25.8**

In US Dollar terms** * Organic and Inorganic chemicals**

from regions like OECD, OPEC and Eastern Europe, with gains in the share of other developing countries, mainly from Asia. Given the robust growth in imports in 2003-04, share of imports from OPEC, Eastern Europe and other developing countries increased to 7.2 per cent, 1.5 per cent and 19.9 per cent respectively, while the share of OECD region declined to 37.7 per cent in April-February 2003-04.

6.32 ASEAN countries, with which India has a trade deficit, account for around 9 per cent of India's total trade. Exports to this region registered a rise of 33.7 per cent in 2002-03, with imports increasing by 17.4 per cent. While exports continued to grow by 22.0 per cent in April-February 2003-04, imports accelerated by 43.8 per cent, because of higher imports from Indonesia, Malaysia, Singapore and Thailand. Given the closer interaction of India's major trading partners like China, Japan and Korea with ASEAN and the immense trade potential of this region, India's stakes with ASEAN+3 block has been rising. In fact ASEAN +3 (China, Japan and Korea) countries have emerged as India's dominant trading partners, accounting for 19.7 per cent of India's total merchandise trade, compared to trade share of 19.0 per cent for EU and 12.8 per cent for North America in April-February 2003-04. The signing of India-ASEAN Framework Agreement on Comprehensive Economic Cooperation, consistent with the country's "Look East Policy", is likely to further facilitate growth in trade with this region. Trade with SAARC region countries, which currently constitutes around 3 per cent of India's total trade, was also buoyant with exports rising by 52.4 per cent and imports by 14.0 per cent in April-February 2003-04, due mainly to robust trade with Bangladesh, Nepal and Sri Lanka. The agreement on setting up of SAFTA by the SAARC members is expected to aid further growth of trade with this region.

6.33 Sino-India trade continued to be robust, with China acting as the driver of intra-regional trade in Asia. In 2002-03, while India's exports to China more than doubled (increasing by 107.5 per cent), imports sourced from China were higher by 37.1 per cent. The robust growth continued in 2003-04, with exports to China growing by 47.4 per cent and imports sourced from China rising by 42.9 per cent in the first eleven months of fiscal 2003-04. In 2003-04 (April-February), China's share in India's total trade has thus risen from 1.9 per cent in 2000-01 to 4.5 per cent for exports, and from 3.0 per cent to 5.2 per cent for imports. The recent increase in exports was accounted for mainly by Iron and steel, iron ore, plastic and linoleum products, and machinery and instruments. Imports from China were buoyed up mainly by higher imports of electronic goods, chemicals, medicinal & pharmaceuticals products, coal, coke and briquettes and silk yarn and fabrics. Thus, in 2003-04, overtaking countries like the UK and Belgium, China has emerged as India's highest trading partner, after the USA and UAE (Table 6.11). The recent granting of tariff concessions to India by China under the Bangkok Agreement is likely to provide a further boost to such bilateral trade. Another country whose share in India's trade increased significantly in 2003-04, contributed by strong growth in exports and imports, is UAE, which is now the second largest trade partner of India after USA.

6.34 Greater diversification of markets has been an important factor in sustaining export growth. Recent measures taken in this direction included the expansion of the "Focus Africa" programme to include the remaining 11 countries of the region and the launching of "Focus CIS" Programme from April 1, 2003. The enlargement of EU from May 1, 2004 is likely to facilitate greater market access for Indian exports to the ten accession countries (Box 6.2). A significant development to diversify trade and economic cooperation was the impetus provided to the movement towards free trade/regional trading arrangements by signing of Framework Agreement for Economic Cooperation between India and the ASEAN and bilateral agreement between India and Thailand, with similar agreement with Singapore being currently under negotiation. These Framework Agreements include provisions relating to free trade agreements in goods, services and investments and are aimed at strengthening India's trade and

Table 6.11: India's major trading partners, 2000-2004
(Percentage share in total trade (exports+imports)

	Country	2000-01	2001-02	2002-03	2002-03	2003-04
					April-February	
1.	USA	13.0	12.2	13.4	13.4	11.6
2.	UK	5.7	5.0	4.6	4.7	4.4
3.	Belgium	4.6	4.4	4.7	4.7	4.1
4.	Germany	3.9	4.0	4.0	3.9	3.9
5.	Japan	3.8	3.8	3.2	3.3	3.1
6.	Switzerland	3.8	3.4	2.4	2.3	2.7
7.	Hong Kong	3.7	3.2	3.1	3.1	3.4
8.	UAE	3.4	3.6	3.8	3.8	5.0
9.	China	2.5	3.1	4.2	4.1	4.9
10.	Singapore	2.5	2.4	2.5	2.5	2.9
11.	Malaysia	1.9	2.0	1.9	2.0	2.1
	Total (1 to 11)	**48.6**	**47.2**	**47.9**	**47.8**	**48.1**

economic cooperation with its Southeast Asian neighbours. Bilateral agreements with Bangladesh, Afghanistan, Myanmar, South Africa and Mercosur (Argentina, Brazil, Paraguay and Uruguay) are currently under consideration. Joint study Groups (JSG) have been formed to work out the modalities for Framework Agreements with Mauritius and China. The January 2004 agreement on setting up of a SAFTA (South Asian Free Trade Area) by the SAARC member countries, is also likely to provide a fillip to trade growth with this region. Further, India along with Bhutan, Myanmar, Sri Lanka, Thailand and Nepal have signed the Framework Agreement on the BIMST-EC Free Trade Area in February 2004, with the objective to strengthen and enhance economic, trade and investment cooperation among the member countries and to progressively liberalize and promote trade in goods, services and investment cooperation. Such regional arrangements can help integrate developing countries like India into the world economy by providing immediate gains in trade and investment, particularly for geographically contiguous regions. These may also underline the need for expediting internal reforms if the benefits are to be maximized. However, if such arrangements are to act as building blocks to the multilateral trading system, coherence and compatibility of such agreements with the multilateral trading system also needs to be ensured.

World Trade Organization (WTO) related issues

6.35 The Doha Declaration, which had launched a new round of trade negotiations in November 2001, is a large, complex and ambitious agenda with a number of subjects/ issues involving negotiations. Given the widespread slippages in the timeline on these negotiations and the current stalemate, progress under the Doha round so far has been slow, putting a question mark on the feasibility of a timely completion of the Round ("not later than" January 1, 2005). The fifth WTO Ministerial meeting, held at Cancun, Mexico during September 10-14, 2003, which was expected to take stock of progress in the on-going negotiations under the work programme adopted at Doha and to provide necessary political guidance including decisions on launching negotiations on Singapore issues, ended without any agreement, reflecting serious polarization of views and positions. While the draft ministerial text of August 24, 2003 had formed the basis for deliberations by the ministers at Cancun, a revised draft circulated on September 13, 2003 after initial consultations, evoked sharp

Box 6.2 : European Union Enlargement – Impact on India

The European Union has been enlarged from its present membership of 15 to 25 with the accession of ten countries from May 1, 2004. The ten acceding countries (ACs) are Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic and Slovenia. These ten countries account for 15 per cent of the EU population and 19 per cent of the EU area, and will add 5 per cent to the EU's GDP, reflecting both the small size of most of the ACs as well as low income per capita.

The enlargement is not expected to increase sharply the shares of trade between the EU(15) countries and the ACs, as most of the trade re-orientation has already taken place under the umbrella of the Europe Agreements – extended free trade agreements – which preceded the enlargement. Under those agreements, the ACs have enjoyed virtually duty free access to the European market for industrial products since 1994. According to the WTO World Trade Report 2003, the share of EU (15) in total imports of ACs remained constant at 58 per cent between 1995 and 2001. The share of ACs exports going to EU (15) increased from 60 per cent to 68 per cent during the same period. The share of new entrants in total EU trade remained very small and stable over this period, at between 4 per cent and 5 per cent. The Enlargement will increase the share of intra-EU trade in the EU's total trade from nearly 62 per cent to 67 per cent, while the share of EU in world merchandise exports (including intra-EU flows) will reach 41 per cent. The degree of integration of ACs is also apparent from the sharp increase in FDI flows from the EU. The latter increased from 1.5 per cent of GDP of the ACs in 1996 to 3.2 per cent of GDP in 2000, with the EU accounting for 80 per cent of the ACs FDI inflows in 2000.

Given such a degree of trade integration of ACs with the EU (15), a significant trade diversion for India following the enlargement of EU is unlikely. Such an impact may be further eroded given the low volume of India's trade with the ACs, with the ACs accounting for only around $550 million worth of trade (exports plus imports), with Hungary, Poland and Czech Republic being the main trading partners. India's main exports to ACs include gems and jewelry, drugs and pharmaceuticals, leather and leather products, textiles, plastics and linoleum products and agricultural commodities. A significant advantage of enlargement on the trade front will be the standardization and harmonization of trade policy regimes and rules, resulting in lowering of transaction cost of Indian exports, to the EU. Adoption of single tariff by the ACs may also facilitate easier market access to Indian exports, as average tariff rates in these countries at around 9 per cent is currently higher than the EU average of about 3.6 per cent. Since all the ACs are WTO members, for any deterioration over the existing WTO commitments for various areas/sectors, the affected members have the right to negotiate for compensation. Also, availability of new ports in the larger EU may see a significant saving in transportation costs. The removal of quota restrictions for textiles and clothing from January 2005 may also work to India's advantage, since it will reduce the protection presently available to ACs exports in the EU market. The enlarged EU may also spur joint ventures with Indian companies looking forward to setting up manufacturing bases in the low cost ACs.

However, the relative competitive advantage of many of India's exports to the EU (15) may be impacted by the enlargement of EU, as countries like Poland and Czech Republic compete with India in selling textiles and apparel, footwear and leather, chemical compounds, iron and steel, automotive parts etc. in the EU (15) market. According to one estimate, India and Poland compete in EU market for 46 of the top 100 exports from India to the EU. Exports of textiles may be adversely affected with low cost production in Central and Eastern European countries (CEECs) eating into India's EU (15) markets under the outward processing traffic (OPT) programme, even as Indian suppliers grapple with customs duties and procedures. The OPT arrangement is a specific customs regime that grants preferential trade access to CEECs exports to the EU, which are actually re-exports (preceded by imports of material from the EU in order to be processed in CEECs). Further, strict non-tariff barriers like azo dyes certification for textile and leather and quality standards for agricultural goods will now apply to exports to ACs also. The enlargement may have implications for India's trade with rest of the world also, as after their accession, the ACs will become part of the EU (15) FTAs with rest of the world, thus competing with Indian exports in the third country markets. In agriculture, higher tariffs and non-tariff and defence measures applicable in EU may impact Indian exports. As the ACs are labour abundant and low income countries, India may also face stiffer competition on account of temporary movement of its natural persons to EU and business process outsourcing by EU to India. As regards impact on FDI, three ACs - Poland, Hungary and Czech Republic - compete with India in top ten most attractive destinations for FDI.

The enlargement of the EU establishes that the EU is a growing market which needs to be explored further. Government may have to ease up its policy framework and the Indian business may have to reposition themselves to take full advantage of the opportunities posed by the expansion of the world's largest economic block.

criticism from a number of countries, including India, as unrepresentative of their views. Given such wide divergence of views and lack of convergence amongst the developed and developing countries, especially on Agriculture and the Singapore issues, the Ministerial concluded on September 14, 2003 without reaching a consensus or a detailed Ministerial declaration. India emerged as a key player in this Ministerial (Box 6.3). State of play on various issues under the Doha round is summarized below.

6.36 In **agriculture** negotiations, Members remain sharply divided over further reforms and liberalization of agriculture, particularly on the nature and extent of reduction in trade-distorting domestic support and improvements in market access, while Members that grant export subsidies have also been resisting phasing out such subsidies across all products. The engagements between the US and the EC mid-August 2003 accommodated each others' concerns by drawing up a framework on further negotiations envisaging marginal reduction in domestic support and elimination of export subsidies in some products only. The formula for tariff reductions developed by them required minimal market access commitments in their sensitive products, but projected them as demanders of substantial improvements in market access in developing countries particularly large and relatively more advanced among them. The subsequent formation and consolidation of the G-20 on agriculture, of which India is a founder Member, as a powerful negotiating group of developing countries with offensive and defensive interests in agriculture emerged as the most significant development with regard to the agriculture negotiations.

6.37 The G-20 has succeeded in bringing back the focus in the negotiation on substantial reductions in distortions in agriculture due to high levels of subsidies provided by some developed countries as well as their resistance to reduce border protection in import sensitive products. The G-20 has emphasized that any new market access commitments on developing countries must not cast a disproportionately higher burden on them as compared to developed countries and that sufficient safeguards must be available to safeguard their food and livelihood security and rural development concerns. The G-20 has maintained an inclusive approach to accommodate the concerns and specific interests of other developing countries, in particular including small economies, and net food importing countries. India's position in these negotiations continues to be underpinned by the fact that a vast majority of people are dependent on agriculture characterized by subsistence and small-scale farming. The farming community constitutes an economically weak and exceptionally vulnerable section of the population with a large number of them either below or close to the poverty line, and that providing opportunities for livelihood in agriculture, and availability of food at affordable prices are, therefore, of crucial importance. India accordingly emphasizes that flexibility in domestic policies for agriculture aimed at enhancing food and livelihood security and for rural development should be incorporated in the rules and disciplines on trade in agricultural products through special and differential treatment for developing countries.

6.38 Divergences among the Members, which had earlier resulted in missing the deadline of March 31, 2003 for establishing "modalities" for agricultural liberalization, could not be bridged at the Cancun Ministerial also. Negotiation since then have been energized through a process of developing a broader understanding on the general principles that would guide negotiators in their subsequent work in agriculture.

6.39 Similarly, the negotiations on market access for non-agricultural products **(NAMA)** have lacked a convergence on establishing modalities and formulae for actual tariff cutting negotiations so far, resulting in the missed deadline of May 31, 2003. While many members appeared to favour a combination of a formula–based approach with bilateral request/offer, starting from bound tariffs, phased in stages and with less than full reciprocity for developing countries, others like US favoured scrapping all tariffs by 2015. The

Box : 6.3 Cancun WTO Ministerial Conference

India participated in the Ministerial proactively, forging very useful and effective coalitions, bringing the concerns of developing countries centre-stage. It played a key role in forming two important coalitions, viz. G-20 on agriculture and G-16 on Singapore issues, undertaking initiative in organizing regular meetings of these groups at Cancun. At the meeting, flagging agriculture as the key concern, India sought elimination of distortions in world agriculture, created through high level of subsidies in the developed countries. According to estimates, protection in the developed countries faced by developing countries exporters in agriculture is four to seven times higher than in manufactures, stimulating over-production in high cost rich countries and shutting out potentially more competitive products from developing countries. The net effect of subsidizing agriculture in developed countries at the expense of products of the relatively poor in developing countries was to aggravate global income inequalities. Urgent need to bring down the high tariffs and non-tariff barriers on products of export interest to developing countries was also underlined, to secure for these countries sufficient gains from globalization. Further, to effectively take account of their development needs, including rural development, food security and livelihood concerns, ensuring special and differential treatment for developing countries and policy space to deal with sensitive products remained an integral part of all elements of negotiations. India reiterated its opposition to any form of harmonization of tariffs in agriculture. These suggestions formed part of joint proposals on agriculture put forward by India and other (G-20) members offering constructive and meaningful alternative to agricultural negotiations.

It supported the tariff reduction formula devised by the Chairman of the negotiating Group on market access negotiations on non-agricultural products, opposing any amendment in the formula on the grounds that it would negate the entire work done so far. The suggestion for mandatory tariff harmonization and elimination would be most iniquitous to developing countries because substantial, if not the entire, contribution would then be made by developing countries. India was also opposed to any mandatory binding (zero-for zero) of tariff in suggested seven sectors (auto components, fish & fish products, textiles, gems & jewelry, leather products, and electric and electronic goods), as countries, being in various stages of development, lacked the capacity to undertake such binding commitments in all the proposed sectors.

On Singapore issues, it was reiterated that WTO is not the right forum for these issues, that traditional WTO principles of non-discrimination particularly national treatment are not appropriate for a development policy-related issue like investment and that trade negotiators are not the right people to deal with the movement of capital that have dynamics of their own. Moreover, the need for a multilateral agreement on investment itself is not clear as it can neither promise additional investment flows nor reduce transaction costs for investors significantly. However, an agreement will certainly curtail the policy space of developing countries. Similarly, competition issues are viewed differently by countries at different stages of development, based on the effects they have on their economies. The WTO membership is too diverse to admit a framework that suits all. Further, multilateral rules, binding in nature, in respect of trade facilitation and transparency in government procurement would entail high costs for developing countries. As the process of clarification of issues has revealed a wide divergence in views on various elements, any decision on modalities would be inappropriate at this stage, as it does not provide any idea of the substance and direction of obligations that agreements in this area may require India to undertake.

Underlining India's interests in the services negotiations, it was pointed out that while liberalization of certain sectors was essential to accelerate growth in developing countries, there was need to tread with caution in other sensitive sectors. For developing countries like India, the balance of benefit in the negotiations will accrue to the extent to which their service providers are allowed to supply services in important overseas markets either from remote locations or through temporary movement of natural persons. Expressing deep disappointment over the short shrift given to the development dimension envisaged in the Doha work programme, India emphasized the need to restore the priority accorded to resolving the outstanding implementation issues. Similarly, the need for expediting making of all SDT provisions precise, operational and effective and non mandatory provisions being converted into mandatory ones within a specified time-frame was also stressed.

The issue of transparency and participation in decision-making process in WTO was further raised, suggesting the Ministerial Conference move towards a more inclusive decision making process, responsive to the needs of the developing countries. The need for decisive progress in areas of great importance to developing countries, such as transfer of technology and trade, debt and finance, was also underlined. India also supported the initiative taken by certain countries regarding cotton subsidies and commodity price stabilization, which are areas of critical significance to developing countries.

Indian proposal suggested a simple percentage cut on bound tariff of each Member, with higher reduction percentage for developed countries relative to developing countries (developing countries reduction in tariffs being two thirds of the corresponding reduction in tariffs by developed countries), removal of tariff peaks (in excess of three times the average tariff) and flexibility for developing countries both for unbound and bound tariff lines. Finally, the chairman of NAMA, on his own responsibility, in May 2003, submitted a set of modalities which reflected the ambitions and concerns of various members. The draft, apart from proposing zero-for –zero tariff commitments on seven major sectors (including auto components, fish and fish products, textiles, gems & jewelry, leather products, and electric and electronic goods), also proposed special & differential treatment and less than full reciprocity for developing and least developed countries. Developing countries were allowed to keep up to 5 per cent of their tariff lines unbound provided they do not exceed 5 per cent of their total value of imports. India and some other developing countries were, however, opposed to any such mandated zero-for zero import duty commitment. The draft presented for the Cancun Ministerial, however, provided certain flexibility for developing countries by proposing that up to 10 per cent of tariff lines could have less than the formula-based levels of cuts and further left the scope of mandatory participation in sectoral initiative more open.

6.40 The process of exchanging initial bilateral requests and offers proceeded broadly on schedule under negotiations in trade in **services**. India has formulated and submitted requests to various countries in architectural services, audio visual services, computer and related services, health services, maritime services, tourism and travel related services, financial services, construction and related engineering services, and accounting and book keeping services. At the horizontal level, India's major interest lies in liberalization of movement of natural persons (Mode 4), where the Uruguay round liberalization was extremely unsatisfactory. India and developing countries have targeted a range of restrictions in developed country markets related to economic needs test, the processing of visa applications, residency requirements, recognition of educational qualifications and social security contributions. Another area of key interest is the cross-border supply of services (Mode 1), especially through electronic mode of delivery in a large number of service sectors. On the other hand, the core interest of most of India's trading partners seem to be in Mode 3 (commercial presence), in which the request is either for binding the presently applicable FDI policy or to offer a more liberal policy than currently prevailing. India has tabled its initial conditional offer in services covering both horizontal access under mode 4 (movement of natural persons) and sectoral access in various sectors. The process of negotiation on the basis of offers tabled so far is underway at the bilateral and multilateral level. Negotiations towards developing Rules in various areas are also continuing.

6.41 An important area of negotiations in the Doha round relate to trade rules "aimed at clarifying and improving disciplines under the Agreements on Implementation of Article VI of the GATT 1994 and on subsidies and countervailing measures". In addition, it was agreed to "clarifying and improving" disciplines on fisheries subsidies and regional trade agreements (RTAs) and for "improvements and clarifications" of the Dispute Settlement Undertaking. The scope of these negotiations is, however, hedged about with the caveat that they should preserve "the basic principles and effectiveness of these agreements and their instruments and objectives". India has made two submissions to the Negotiating Group on Rules; the first seeking special and differential treatment for developing countries during anti-dumping and countervailing duty investigations, and the second suggesting identification of specific provisions of the Anti-dumping Agreement that require amendments. The push for sector-specific rules on **fisheries subsidies** proposes a substantial cut in allowable fisheries subsidies of types which lead to overexploitation of fishery resources, and damage competition on the plea that the heterogeneous nature of the products in this sector precludes a meaningful application of existing provisions of the subsidies agreement. The opponents, on the other hand, insist on a cross-sectoral approach to subsidies on the grounds that heterogeneous nature of products is not unique to the fisheries sector and it is a generic issue. The negotiations on **regional trade agreements (RTAs)** so far have focused on the issue of transparency. Given the potential of proliferating bilateral and regional agreements to undermine the multilateral system, the importance of clearly defining the criteria of RTAs needs to be underlined. Negotiations under **Dispute Settlement Undertaking** (DSU), which are placed on a separate track (not part of single Undertaking), were required to be concluded by May, 31, 2003. The deadline being missed, the time frame for negotiations was extended to May 31, 2004.

6.42 Progress on "**implementation agenda**", which had risen to the top of the WTO priority list in the Doha Ministerial, has been slow so far, relegating the issues to a lower order of priority**.** India hopes that all the outstanding implementation issues would be satisfactorily resolved within the framework set in the Doha Ministerial Declaration and the Decision on Implementation Related Issues. The Doha declaration had also spelled out the hope of an "early harvest" of **special & differential treatment** (SDT) for developing countries. However, the deadline had to be shifted to the end of December 2002 due to lack of agreement and even this second deadline passed without agreement. The main roadblock in the **TRIPS and public health** negotiations was the scope of diseases for compulsory licensing provisions for developing countries without domestic production capacity. India continued to maintain its position that the Doha mandate should not be diluted to restrict the scope and the definition of diseases to just infectious diseases as desired by countries like the USA. The General Council finally took a decision in August 2003, under paragraph 6 of the Doha Ministerial Declaration on TRIPS agreement and Public Health, which would enable manufacture and export of pharmaceutical products under compulsory license to countries with limited or no manufacturing capacity in pharmaceutical sector. Other aspects of negotiations under TRIPS included establishing a system of notification and registration of "geographical indications" for wines and spirits, extension of geographical indications (place names used to identify products with characteristics associated with specific locations) to products other than wines and spirits, examining, inter alia, the relationship between the TRIPS agreement and the Convention on Biological Diversity and the protection of "traditional knowledge and folklore". India has proposed that the multilateral register should be extended for products other than wines and spirits.

6.43 The **Singapore issues** were included in the Doha agenda in a two step procedure. Preparatory work commenced at the beginning of the round and actual negotiations were to start after the Cancun ministerial meeting, "on the basis of a decision to be taken, by explicit consensus, at that session on the modalities of the negotiations". India, while continuing with the clarification process, has been reiterating its stand that many of these issues desired to be treated outside the framework of WTO. The lack of explicit consensus on modalities was also emphasized by India. A core group of 16 countries (G-16), including India, took a strong and effective stand at the Cancun Ministerial, highlighting the problems and lack of explicit consensus on modalities. Nevertheless, the draft Ministerial text of September 13, 2003 ignored the position taken by over 90 countries, including India, and suggested commencement of negotiations on three of the four Singapore issues, viz. Investment, Transparency in Government procurement and Trade facilitation. As such a position was unacceptable to these developing and least developed countries, the Ministerial ended in a deadlock over Singapore issues.

6.44 As mandated by the Cancun Ministerial Conference, the General Council at senior capital based officials level met on December 15-16, 2003. In this meeting members agreed on the need to take forward the process of negotiations. The process received some momentum when the United States Trade Representative (USTR) circulated a letter to all Trade Ministers in January, 2004 giving a broad outline of the goals he felt should be achieved and suggested that a 'framework' may be agreed by mid July, 2004. This was followed by a letter from the EC Trade Commissioner in May, 2004 addressed to Trade Ministers showing flexibility in the area of domestic support and export subsidy in relation to the Agricultural negotaitions. The current efforts are to conclude a package agreement by July, 2004. This could include frame work agreements on Agriculture and Non-Agricultural market Access which could expand on the Doha Mandate and lay down broad principles for future negotiations of detailed modalities. On Singapore issues, the emerging consensus appears to be in the direction of finalization of modalities for negotiations on trade facilitation by 'explicit consensus' where as the other three issues of Investment, Competition and Transparency in Government procurement would cease to be part of the Doha agenda. The proposed July package is also expected to cover Implementation issues and issues relating to Special and Differential Treatment.

Capital account

6.45 Net capital flows to emerging market and developing countries improved rapidly in 2003. Though still short of the pre-East Asian crisis levels, total private capital flows in emerging markets experienced an increase of around US$ 84 billion in 2003. Emerging Asia, comprising developing Asia, and the newly industrialised Asian economies, accounted for more than 60 per cent of the total private capital flows to emerging markets. An encouraging feature of these private capital flows has been the significant share of direct foreign investment in total inflows (58.5 per cent). Despite net outflows of portfolio investment from the region, buoyant direct investment inflows, along with robust other private capital flows, resulted in a large augmentation of the volume of capital flows.

6.46 In line with the trends observed for developing Asia, the capital account of India's balance of payments strengthened further in the year 2002-03. The size of the surplus in the capital account increased by almost US$1.8 billion in 2002-03 to US$12.8 billion compared with US$11.0 billion in 2001-02. Banking capital inflows were the largest contributors to the capital surplus, followed by foreign investment and 'other capital' inflows. Robust inflows under these three categories helped in overcoming the negative impact of net outflows under loans, leading to a sizeable surplus in the capital account.

6.47 BOP statistics for the first three quarters of 2003-04 point to the possibility of achieving an even larger surplus in the capital account for the full year. Compared to 2002-03, capital inflows in 2003-04 have been spearheaded by foreign investment inflows, followed by banking capital and other capital flows. Net inflows under loans continue to reflect a negative balance, principally on account of higher outflows under external commercial borrowings.

Foreign Investment

6.48 Net aggregate foreign investment inflows during 2002-03 were lower compared to the net aggregate inflows in 2001-02 (Table 6.2). The decline in foreign investment in 2002-03 is attributable largely to reduction in portfolio investment inflows. During 2003-04, however, the trends have been much more encouraging. Aggregate foreign investment inflows (net) were estimated at US$10.1 billion during the first three quarters of 2003-04, which is more than three times the level of US$ 3.1 billion recorded during the corresponding period of 2002-03. The higher foreign investment during 2003-04 is attributable to a sharp rise in net portfolio investment inflows.

6.49 The year 2003-04 indicates a significant departure from the trend observed in the contribution of direct and portfolio inflows to total foreign investment. The share of FDI inflows in total foreign investment rose sharply from 55.8 per cent in 2000-01 to almost 80 per cent in 2002-03. The shares indicate that longer-term FDI inflows have been the main contributors to foreign investment in recent years. However, during the first three quarters of 2003-04, FDI inflows accounted for less than 25 per cent of total foreign investment, while portfolio flows were responsible for more than 75 per cent. The change in the trend pattern becomes more evident in view of FDI inflows having accounted for almost 90 per cent of total foreign investment inflows during the corresponding period of 2002-03.

Foreign Direct Investment (FDI)

6.50 Aggregate FDI inflows declined by more than US$ 1 billion in 2002-03 to US$ 3.6 billion from US$ 4.7 billion in 2001-02. Net FDI inflows are sum total of FDI inflows into India and FDI outflows from India. A category-wise analysis reveals that net FDI inflows into India were lower by US$1.5 billion in 2002-03, compared with 2001-02 (Table 6.2). According to the revised system of data reporting for FDI inflows adopted recently by the RBI in line with the international best practices (Box 6.4), FDI inflows comprise equity inflows, reinvested earnings and other capital. The overall decline in 2002-03 was principally on account of a sharp drop in net equity inflows. The analysis points to a slackening of fresh equity injected through FDI in the year 2002-03, which might be indicative of a commensurate decline in new investment projects. FDI outflows from

Box 6.4 : Revised FDI definition

A Committee was constituted by the DIPP in May, 2002 to bring the reporting system of FDI data in India into alignment with international best practices. Accordingly, the RBI has recently revised data on FDI flows from the year 2000-01 onward by adopting a new definition of FDI. The revised definition includes three categories of capital flows under FDI: equity capital, reinvested earnings and other direct capital. Previously, the data on FDI reported in the balance of payments statistics used to include only equity capital.

Conceptually, the main difference between FDI and portfolio investment is in the **lasting interest** expressed by a non-resident direct investor in a resident enterprise of the domestic economy. The **lasting interest** underlines a firm desire on part of the non-resident investor to be associated with the long-term business activities of the resident enterprise by exerting significant influence on the management of the enterprise. Accordingly, the international best practice systems have focused on recording of FDI data in balance of payments statistics in terms of three main categories as mentioned below:

1. equity flows (equity in branches, shares in subsidiaries and other capital contributions),
2. reinvested earnings (retained earnings of foreign subsidiaries and affiliates), and
3. inter-company debt transactions (inter-corporate debt transactions between associated corporate entities).

There are, however, considerable variations among countries as far as their reporting systems of FDI flows are concerned. China and India are good examples in this regard. The Chinese system of reporting FDI is much more broad-based. Apart from equity capital, reinvested earnings, inter-corporate debt transactions, China includes short-term and long-term loans, trade credits, bonds, grants, financial leasing, investment by foreign venture capital funds, earnings of indirectly held enterprises, non-cash equity acquisition, control premium and non-competition fee within FDI. It also includes project imports as FDI flows, which, in India, are recorded as imports. As compared to China, it is clear that till some time back, the reporting of FDI in India's balance of payments statistics, which was confined only to equity capital, represented a much narrower coverage of FDI flows.

It is interesting to note that adoption of a broader coverage system for FDI flows has resulted in upward revision of annual FDI inflows into India for the years 2000-01 and 2001-02 by US$1.7 billion and US$2.2 billion respectively, representing on average, a 70 per cent increase over previously reported data. While this is not to suggest that the difference between volume of FDI inflows into China and India is attributable only to the disparities in coverage of data, comparisons between the two nations in terms of their abilities to attract FDI, should take note of this point.

India, which reflect the long term investment commitments of Indian multinationals in foreign markets, showed a decline of US$ 0.34 billion in 2002-03, reflecting lower interests on part of Indian companies in direct investment abroad.

6.51 Net FDI inflows maintained their subdued trend in the first nine months of 2003-04, registering a marginal decline of US$ 0.25 billion compared to the corresponding period of the previous year. Equity FDI inflows into India recorded a lower volume of US$ 3.2 billion in April-December 2003, compared with US$ 3.6 billion in April-December 2002. FDI outflows from India were also recorded at a reduced level during April-December 2003-04. According to the data on monthly inflows of foreign investment compiled by the RBI, FDI inflows for the full year of 2003-04 have been estimated at US$ 4.5 billion, which are slightly lower than US$ 4.7 billion recorded during 2002-03.

Portfolio investment

6.52 Aggregate portfolio investment inflows exhibited a declining trend between 2000-01 and 2002-03. From a net inflow of US$ 2.6 billion in 2000-01, such inflows declined to US$ 2.0 billion in 2001-02, and dropped further to US$0.9 billion in 2002-03. The decline is attributable to a steady fall in portfolio inflows into India, as a result of which the difference between portfolio inflows into India and outflows from India have gradually become smaller, leading to lower levels of aggregate portfolio investment.

6.53 The declining trend of portfolio investment observed during 2000-01 to 2002-03, however, witnessed a sharp reversal in 2003-04. During the first three quarters of 2003-04, net portfolio investment stood at US$ 7.6 billion with aggregate portfolio inflows at US$ 17.3 billion. The turnaround from the corresponding period of the previous year (April-December 2002-03), when net portfolio investment was only US$ 0.4 billion, and aggregate inflows were around US$5.2 billion, is indeed remarkable. The month-wise statistics compiled by RBI on foreign investment indicates that total portfolio investment inflows during the year 2003-04 amounted to around US$ 11.4 billion, which is far higher than around US$ 1 billion recorded during 2002-03.

6.54 A quarter-wise examination of the BOP data indicates that the first half of 2002-03 witnessed net outflows of portfolio investment. Portfolio inflows began exceeding outflows from the third quarter (i.e. October-December) of 2002-03. The turnaround gained momentum through the remaining three months of 2003-04. The rapid rise in portfolio inflows during 2003-04 has much to do with the buoyant state of domestic capital markets and greater FII participation. FII inflows have been found to be significantly related to the contemporaneous returns from country-specific domestic stock markets vis-à-vis the risks prevailing in other international equity markets. A sharp improvement in domestic market sentiments positively influenced the risk-return payoffs envisaged by portfolio investors about India, leading to an unprecedented expansion of portfolio inflows.

External Commercial Borrowings

6.55 External commercial borrowing outflows exceeded inflows during 2002-03, resulting in net negative inflows of US$2.3 billion. At this level, net outflows exceeded the previous year's level of US$ 1.6 billion. While outflows increased by almost US$1 billion to US$ 5.2 billion in 2002-03 from US$ 4.3 billion in 2001-02, inflows increased only marginally to US$ 2.8 billion from US$ 2.7 billion in 2001-02. The proportionally larger increase in outflows resulted in a much larger volume of net negative inflows for external commercial borrowings during 2002-03.

6.56 During the year 2003-04, external commercial borrowings recorded net negative inflows for the first three-quarters, reflecting the trend observed during the previous two years. Net inflows during the first three-quarters were estimated at US$-3.7 billion. This was far higher than the net inflow of US$-2.0 billion observed during the corresponding period of 2002-03. While outflows during April-December 2003 were estimated at US$6.7 billion, far higher than

US$3.9 billion during the corresponding period of 2002-03, aggregate inflows at US$3 billion during April-December 2003 were also higher than US$1.8 billion recorded during April-December 2002. However, the increase in outflows has been more than double than that of inflows (April-December 2003 vis-à-vis April-December 2002) leading to a larger increase in net negative inflows.

6.57 The increasing volume of net negative inflows under external commercial borrowings during 2001-02 and 2002-03 is largely attributable to a gradually widening differential between disbursements on one hand and amortisation payments on the other. The differential has been widening largely on account of lower disbursements, which underlie lower demand for ECBs during 2001-02 and 2002-03, presumably due to weak domestic investment demand. The trend for the current year indicates that the differential is showing signs of increasing further. However, an increase in the number of ECB approvals during 2003-04 may indicate a future reversal in the offing (Table 6.12).

6.58 In order to further improve the access of Indian corporates to global capital markets, the existing ECB policy was comprehensively liberalised in January 2004. Presently, ECBs are permitted for investment in all sectors except capital markets and real estate. The eligible list of ECB borrowers now includes all corporates, except banks, financial institutions and NBFCs. ECBs upto US$ 20 million and minimum average maturity of three years are now eligible under the automatic route. ECBs above US$ 20 million and upto US$ 500 million are also permissible under the automatic route of the RBI for loans with minimum average maturity of five years. An Empowered Committee set up by the RBI considers ECB proposals falling outside the purview of the automatic route limits and for maturity periods exceeding the permissible time period allowed under the automatic route.

Non-resident deposits

6.59 Information on aggregate outstanding balances and net inflows/outflows for various non-resident deposit accounts are available till March 2004. The trends of accumulation in different non-resident accounts and the pattern of month-wise inflows/outflows under various deposit schemes are given in Table 6.13 (Panels A and B).

6.60 In terms of outstanding balances for various schemes, there has been a steady increase in the outstanding stocks held in NR (E)RA accounts. Fresh inflows under this

Table 6.12 : ECB approvals

(in US $ million)

Sector	2001-02	2002-03	2003-04
Power	270.11	375.00	700.00
Telecom	0.00	341.00	1166.00
Shipping	0.00	0.00	0.00
Civil aviation	0.00	0.00	0.00
Petroleum & natural gas	750.00	0.00	0.00
Railways	0.00	0.00	0.00
Financial institutions	150.00	225.00	1015.00
Ports, roads, etc.	0.00	829.00	0.00
Other (including Exporters)	750.00	156.76	0.00
Approval given by RBI	243.00	1044.46	1108.47
Amount raised under auto-route facility	489.40	1263.74	4186.03
Total	**2652.64**	**4234.96**	**8175.50**

Source: RBI

scheme have also been much higher than those for the other two schemes. The main reason behind the higher stocks and flows in the NR(E)RA account is the progressive crediting of maturity proceeds from the NR (NR)RD scheme, which has been discontinued from April 1, 2002.

6.61 Despite constituting an important source of external finance, non-resident deposits are liabilities for the banking system. There are fiscal costs involved in terms of the interest outgo on these deposits, which tend to increase along with the increase in the volume of the deposits. Since 1990s therefore, the policy towards non-resident deposits has aimed to achieve the twin objectives of retaining the attraction of the schemes, while simultaneously reducing their effective costs.

6.62 The policy focus with regard to non-resident deposits in the recent past has been on rationalisation of interest rates on these deposits. Traditionally, the interest rates on FCNR(B) deposits have been linked to the LIBOR rates since October 1997 with the spread kept at 25 basis points. Beginning from July 2003, interest rates on fresh NR(E)RA deposits for one to three years have also been linked to the US Dollar LIBOR/SWAP rates. The spread on these deposits was reduced from 250 basis points (July 16, 2003) to 100 basis points (September 19, 2003), further to 25 basis points (October 30, 2003), and were

TABLE 6.13- PANEL A: NRI DEPOSITS – OUTSTANDING@

(in US $ million)

2003-04 (P) (end month)

SCHEME	APR.	MAY	JUN.	JUL.	AUG.	SEP.	OCT.	NOV.	DEC.	JAN.	FEB.	MAR.
1	2	3	4	5	6	7	8	9	10	11	12	13
1 FCNR(B)	10,099	9,994	10,080	9,880	9,924	9,952	10,547	10,668	10,845	10,928	11,002	10,979
2. NR (E) RA	15,933	16,673	17,745	18,451	18,765	19,023	19,983	19,772	20,233	20,261	20,495	20,496
3. NR (NR) RD	3,274	3,063	2,965	2,796	2,646	2,496	2,397	2,209	2,111	2,027	1,912	1,773
TOTAL	**29,306**	**29,730**	**30,790**	**31,127**	**31,335**	**31,471**	**32,927**	**32,649**	**33,189**	**33,216**	**33,409**	**33,248**

TABLE 6.13-PANEL B : INFLOWS (+)/ OUTFLOWS (-) UNDER VARIOUS NRI DEPOSIT SCHEMES

(in US $ million)

2003-04 (P) (end month)

SCHEME	APR.	MAY	JUN.	JUL.	AUG.	SEP.	OCT.	NOV.	DEC.	JAN.	FEB.	MAR.	APR.-MAR.
1	2	3	4	5	6	7	8	9	10	11	12	13	**14**
1. FCNR (B)	-100	-105	86	-200	44	28	595	121	177	82	74	-22	**780**
	(126)	(90)	(102)	(171)	(-42)	(66)	(68)	(-40)	(44)	(2)	(-21)	(-40)	**(526)**
2. NR (E)RA@@	901	627	876	580	193	287	699	60	304	-67	191	-17	**4634**
	(592)	(377)	(466)	(607)	(484)	(501)	(767)	(474)	(435)	(498)	(521)	(473)	**(6195)**
3. NR (NR) RD	-158	-233	-133	-189	-168	-146	-133	-158	-116	-94	-119	-141	**-1788**
	(-191)	(-361)	(-336)	(-390)	(-402)	(-367)	(-383)	(-243)	(-245)	(-285)	(-296)	(-246)	**(-3745)**
TOTAL	**643**	**289**	**829**	**191**	**69**	**169**	**1,161**	**23**	**365**	**-79**	**146**	**-180**	**3626**
	(527)	**(106)**	**(232)**	**(388)**	**(40)**	**(200)**	**(452)**	**(191)**	**(234)**	**(215)**	**(204)**	**(187)**	**(2976)**

P : Provisional
@ : All figures are inclusive of accrued interest
@@ : The inflows into NR(E)RA deposits during the years 2002-03 & 2003-04 may partly be due to crediting of maturity proceeds of the NR(NR)RD deposits which were discontinued with effect from April 1, 2002.

Notes:

1. **FCNR(B): Foreign Currency Non-Resident(Banks)**
2. **NR(E) RA: Non-Resident (External) Rupee Accounts**
3. **NR(NR)RD: Non-Resident (Non-Repatriable) Rupee Deposits**
4. **Figures in the bracket represent inflows (+) /outflows (-) during the corresponding month/period of the previous year. Inflows/outflows have been calculated by taking the monthly variation in rupee denominated deposits and converting those by monthly average exchange rate. All figures are inclusive of interest and valuation changes arising on account of fluctuation in non-dollar currencies against US Dollar.**

finally brought on par with LIBOR/SWAP rates for US Dollar of corresponding maturity with effect from April 17, 2004. Moreover, the interest rate on NR (E) savings deposits have been fixed so as to not exceed the LIBOR/ SWAP rates of six months maturity on US Dollar deposits and are to be fixed quarterly on the basis of the LIBOR/SWAP rate of US dollar on the last working day of the preceding quarter.

6.63 The rationalisation of interest rates on the various non-resident deposit schemes through thinning of spreads and eventual linkage with LIBOR/SWAP rates has led to a perceptible reduction in fresh NR(E)RA inflows, as can be seen from the sharp drop in the volume of inflows during the later half of 2003-04.

Foreign Exchange Reserves

6.64 A strong balance of payments position in recent years has led to a steady accumulation of India's foreign exchange reserves. During 2003-04, India's total foreign exchange reserves (including gold, SDRs and reserve position in the IMF) amounted to US$ 113.0 billion. The annual accretion for the year was US$ 36.9 billion. At present, India is the sixth largest reserve-holder in the world.

6.65 A rapid growth in India's foreign exchange reserves has been consistent with the trend of reserves growth seen in developing Asia. As a group, economies of developing Asia have been the largest contributors to the reserves held by emerging market and developing countries, for almost a decade. During 2003, developing Asia, with total reserves of US$ 666 billion, accounted for almost half of the total reserves held by all emerging markets and developing countries (US$ 1,378 billion). Within developing Asia, China holds the largest volume of reserves. Taiwan, Korea, and India, are the other high reserve-holding economies in the region.

6.66 The fast accumulation of reserves in the Indian economy has drawn attention to the sources of reserve accretion. A recent study conducted by the RBI identifies capital flows as the largest contributor to growth of reserves during the period 1991-92 to end-December 2003-04 (Table 6.14). In recent times, valuation gains, arising from a steady appreciation of the major non-US dollar global currencies (Euro and Pound Sterling in particular) against the US Dollar, have contributed significantly to growth of reserves.

6.67 The high growth of reserves has also raised questions about an 'optimum' level of reserves and the possible implications of the reserve build-up on overall macroeconomic management. Issues relating to an 'optimum' or adequate level of reserves have been addressed in Box 6.5. Regarding the impact

Table 6.14: Sources of accretion to foreign exchange reserves since 1991-92

(in US$ billion)

	Categories	1991-92 to 2003-04 (upto December 2003)
1.	Reserve outstanding as on end-March 1991	5.8
2.	Current account balance	-28.4
3.	Capital account (net)	119.0
	a. Foreign investment	60.3
	b. NRI deposits	23.3
	c. External assistance	11.8
	d. External commercial borrowings (including short term credit)	12.1
	e. Other items in capital account	11.5
4.	Valuation change	4.4
5.	Gold valuation	1.0
	Total (2+3+4+5)	**96.0**

Source: RBI.

Note: Totals may not tally due to rounding off of decimal points.

of reserves on macroeconomic management, one of the concerns relates to a concomitant growth in money supply and its impact on domestic price levels.To strengthen the monetary authority's ability to conduct exchange rate and monetary management operations, the Market Stabilisation Scheme (MSS) was introduced in April 2004. The MSS intends to absorb liquidity of a more enduring nature through the issue of Treasury Bills/ dated Governemnt securities. The ceiling on issuance of such bills/securities under MSS is initially placed at Rs. 60,000 crore for 2004-05.

Exchange rate movements

6.68 The management of the Indian Rupee continues to remain broadly market-determined with the RBI intervening only in the event of smoothening excessive volatilities in the foreign exchange market. Trends in the monthly average exchange rate of the Indian Rupee against the US Dollar during the years 2002-03 and 2003-04 indicates that the Rupee dropped to a low of 48.90 against the US Dollar in May 2002. It began strengthening thereafter to reach a monthly average rate of Rs 45.02 against the US Dollar in March 2004. The sharpest month-over-month appreciation in the value of the Rupee vis-à-vis the US Dollar was observed in the months of July and October 2003 respectively. But while the Rupee has almost consistently gained against the US Dollar since May 2002, it has simultaneously weakened against other major currencies like the Euro, Pound and the Yen.

Box 6.5 : Reserve adequacy

India's total foreign exchange reserves (including gold, Special Drawing Rights (SDR) and reserve with the IMF) have increased from US$ 5.8 billion at the end of March 1991 to US$ 118.5 billion at the end of April 2004. The rate of accretion to total reserves has been particularly remarkable during the last three financial years. In the three years since 2001-02, annual addition to total reserves has been US$ 11.8 billion, US$21.3 billion and US$36.9 billion. The spectacular rise in reserves has drawn attention to the issue of what is an 'adequate' level of reserves for the country.

There are certain common indicators for determining the adequate level of reserves for an economy. These indicators aim to determine the extent of external vulnerability of a country and the capability of reserves in minimizing these vulnerabilities. These indicators are:

1. **Import adequacy:** The number of months of imports that can be financed by the reserves held by the country.
2. **Debt adequacy:** The ability of reserves to cover external payment obligations, particularly short-term debt liabilities. This is measured by the ratios of reserves to total external debt and short-term debt.
3. **Monetary adequacy:** The extent of capital flight that can occur in the event of a financial crisis. This is measured by the ratio of reserves to broad money and reserve money.

Since 1991-92, India has made significant progress in all the reserve adequacy indicators. The import cover of reserves has increased from just over five months in 1991-92 to almost 14 months in 2002-03. The reserves to external debt ratio has shot up from 10.8 per cent in 1991-92 to 72 per cent in 2002-03. Over the same period, the reserves to short term debt ratio has gone up from 130.4 per cent to 1650.9 per cent. The ratios of reserves to reserve money and broad money have improved from 24 per cent and 7.5 per cent respectively in 1991-92, to 97.1 per cent and 20.8 per cent respectively in 2002-03.

While the level of foreign exchange reserves held by India at present can be termed comfortable in terms of all the commonly applied adequacy indicators, it is also important to reflect upon the costs of holding reserves. Two issues are significant in this regard. These are the returns earned from deploying the reserves in various securities (according to the guidelines laid down by the RBI Act, 1934) vis-à-vis the interest paid on external debt and the costs of building up reserves through sustained open market operations. While the first issue entails the direct economic cost of holding reserves, the second, apart from involving costs of intermediation for the banking system, includes the consequences of prolonged sterilization on domestic money supply and price levels. Given the trends of sustained accretion, the issue of reserve adequacy requires to be addressed in the light of the costs and benefits likely to manifest from holding on to the current high level of reserves.

6.69 One of the major reasons behind the strengthening of the Indian Rupee against the US Dollar over the last two years is the sustained increase in the volume of foreign exchange inflows, resulting in a gradual strengthening of the Rupee against the US Dollar. Besides, a gradual weakening of the US Dollar against other major currencies of the world, has also influenced the Rupee-Dollar rate through cross-currency volatility.

6.70 The effect of the cross-currency movements can be best judged by Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER) indices. The 5-country export weighted NEER index (base 1995=100) is seen to have decreased from 75.18 in 2002-03 to 75.01 in 2003-04. The 5-country REER (base 1995=100), however, is seen to have increased from 99.79 in 2002-03 to 103.03 in 2003-04. A marginal increase in REER despite a slight decline in NEER indicates that the decline in NEER has been more than offset by the higher inflation in the country vis-a-vis that in major export destinations. The finding is consistent with the generally subdued consumer price levels prevailing in advanced economies during 2003-04.

External Debt

6.71 India's external debt stock, which was US $ 83.8 billion at end-March 1991, increased over the years to reach US $ 112.1 billion as at the end of December 2003. In 2003, the external debt outstanding increased by 6.47 per cent from US $ 105.3 billion at the end of December, 2002.

6.72 Most of the external debt indicators have shown improvements since 1991 (Table 6.15). The total external debt to GDP ratio improved from 28.7 per cent from end March 1991 to 20.2 per cent at end March 2003. In the same period the short-term debt to total external debt ratio declined from 10.2 per cent to 4.4 per cent. However, this ratio increased marginally to 5.1 per cent by the

Table 6.15 : India's external debt outstanding

	End-March						End-Dec.	
Items	**1991**	**1999**	**2000**	**2001**	**2002**	**2003**	**2002R**	**2003 P**
(US $ million)								
Long-term Debt	75,257	92,612	94,327	97,504	96,012	100,301	101,476	106,357
Short-term Debt	8,544	4,274	3,936	3,628	2,745	4,569	3,837	5,773
Total External Debt	83,801	96,886	98,263	101,132	98,757	104,870	105,313	112,130
(Rupees crore)								
Long-term Debt	1,46,226	3,93,160	4,11,388	4,54,805	4,68,512	4,76,888	4,87,536	4,85,533
Short-term Debt	16,775	18,137	17,162	16,919	13,396	21,705	18,429	26,328
Total External Debt	1,63,001	4,11,297	4,28,550	4,71,724	4,81,908	4,98,593	5,05,965	5,11,861
(Ratio as per cent)								
External Debt to GDP	28.7	23.6	22.1	22.6	21.1	20.2	—	—
Short-term debt to Total External Debt	10.2	4.4	4.0	3.6	2.8	4.4	3.6	5.1
Short-term debt to Foreign Currency Assets	382.1	14.5	11.2	9.2	5.4	6.4	5.7	5.9
Debt Service to current receipts *	35.3	18.8	17.1	16.2	13.4	15.8	13.4	18.1
Concessional debt to total debt	45.9	38.5	38.9	35.5	36.0	36.8	36.1	36.4

R : Revised; P: Provisional ; * Figures for end-December relate to the period April-December only.

end of December 2003. The short-term debt to foreign currency assets ratio too improved significantly from 382.1 per cent at end-March 1991 to 5.9 per cent at end December 2003. The debt service to current receipts ratio, which indicates capacity of the country to meet its debt service obligations, improved from 35.3 per cent at end March 1991 to 15.8 per cent at end March 2003, rising thereafter to 18.1 per cent by the end of December 2003. This increase is mainly on account of redemption of Resurgent India Bonds (RIBs).

6.73 The share of concessional debt in the total external debt stock of the country remained more or less constant between 35 per cent to 37 per cent after 2001. However, by international standards, India's share of concessional debt continues to be high, particularly among the top 15 debtor countries; India's share of concessional debt is the highest.

International Comparisons

6.74 In terms of indebtedness classification, the World Bank, in its Global Development Finance 2004, has categorised India as a less indebted country for the year 2002. This categorisation is continuing since 1999. In 1998, India was considered a moderately indebted country. Among the top fifteen debtor countries of the world in the last decade, India improved its position from being *third* after Brazil and Mexico in 1991 to eighth in 2002. In terms of external debt indicators like short-term debt to total external debt ratio and short-term debt to foreign exchange reserves ratio, India's position is quite encouraging among the top 15 debtor countries. The short-term debt to total external debt ratio for India is lowest at 4.4 per cent whereas China and Thailand have higher ratios at 28.5 per cent and 20.1 per cent respectively. Again, the ratio of short-term debt to foreign exchange reserves is lowest for India at 6.4 per cent as compared to 141.4 per cent for Argentina and 72.8 per cent for Indonesia.

6.75 A prudent external debt management policy pursued over the last decade has improved the country's external debt position to a comfortable level. The policy focus has been on concessional and less expensive sources of fund, preference for longer maturity profiles, a constant vigil on build-up of short-term debt, focus on non-debt creating capital flows and prepayment of high cost external loans. Alongside, efforts have also been made to improve coverage, classification and computerisation of external debt statistics.

Outlook

6.76 With the strengthening of global recovery, prospects for growth in global output and trade in 2004 have brightened. The expected robust pick up in global trade is likely to contribute to the overall growth of Indian economy. However, significant downside risks to this growth persist. These include continuing firmness of global oil prices, volatility among major currencies and the danger of interest rate hikes in developed countries. Efficacy of macro policies in carefully managing the impact of a potential global transition from low interest rate and currency imbalances to a more sustainable regime, therefore, gains relevance.

6.77 External sector continues to be a source of strength, providing comfort to the conduct of such public policies. The sector has strengthened over the years with fragility of balance of payments being no longer a policy concern. While trade deficit has increased, the current account has been in surplus for the last three years, largely because of remittances from non-resident Indians. The large capital flows in 2003-04 have resulted in a further accumulation of reserves, rendering reserve position comfortable as per various indicators of reserve adequacy. These reserves provide an opportunity towards deepening of trade reforms and other administrative measures. India is already being seen as a new hub for exports of auto parts and other engineering goods and opportunities are expected to open in the textile sector after the phasing out of ATC next year. Micro strategies for export growth based on various policy pronouncements need to be designed to put export growth on a higher and sustainable growth trajectory. A reduction in tariffs towards the already announced alignment of tariff structure with ASEAN countries is likely to have beneficial effect on the competitiveness of the economy. Export promotion policies also need to utilize the natural complementarity of FDI with export activity, as the global reach and marketing ability of FDI could be effectively utilized to provide a cutting edge to the export effort. The impressive increase in imports of capital goods bolsters the hope of accelerated investment activity in 2004-05. Efforts towards strengthening of the services sector to promote services exports, in which India has a competitive advantage, need to be sustained and intensified. A further simplification of the domestic policy regime, rules and procedures is likely to attract higher foreign investment, thus supporting the investment needs of the economy for higher growth.

6.78 Trade liberalization is likely to counter some of the upward pressure on the exchange rate of the rupee. Current exchange rate policy of focusing on managing volatility with no fixed rate target, while allowing the underlying demand and supply conditions to determine the exchange rate movements in an orderly way, has stood the test of time. This broad approach of watchfulness, caution and flexibility in the foreign exchange market needs to be continued. Exchange rate management policy needs to balance build up of reserves and domestic liquidity on the one hand and maintaining external competitiveness with low inflation and interest rates on the other. This may entail some moderation in the exchange rate appreciation on account of concerns about the competitiveness of exports and maintaining a stimulative macroeconomic environment. Hence, the policy of flexibility in exchange rate together with ability to intervene, if and when necessary, needs to be continued.

6.79 Prudent reserve management has emerged as an important macroeconomic policy challenge. Suitable policy measures to facilitate greater productive absorption of capital flows for growth promoting purposes are likely to facilitate higher investment in the economy. The improvement in external debt position has been consolidated through recourse to pre-payment by Government as well as the corporates. The debt management policy sould continue with its focus on concessional and less expensive sources of funds, preference for longer maturity profiles, a constant vigil on build up of short term debt, focus on non debt creating capital flows and prepayment of high cost external loans.

6.80 An immediate challenge for the global community is to achieve further multilateral trade liberalization under the Doha round of trade negotiations. Given need for such liberalization, recent protectionist measures by some countries against BPO misses out not only the efficiency gains from such outsourcing but also the employment gains from the resources saved in the process and deployed in other employment generating sectors. There is, thus, an urgent need to revive the trade negotiations under the WTO, as a successful conclusion to the Doha Development Agenda could contribute to a stronger and more even expansion of world trade and sustained global economic growth.