

External Sector

India's external economic environment continued to be supportive of growth in output and trade in 2005-06 and 2006-07 so far. The continued expansion in world output growth for a record fourth year in a row in 2007 (Table 6.1), amidst rising concerns about continuing global macroeconomic imbalances, protracted Doha negotiations, volatile international crude oil prices, and inflation, testifies to the emergence of a new phase of the external economic scenario. This new phase has been

marked by robust and broad-based growth in emerging market economies, particularly with China and India together accounting for about 40 per cent of global growth measured in purchasing power parity terms. Increasingly, India is being recognized as an important player in the global economic scenario.

6.2 The robust phase of global output expansion in the recent past has been accompanied by stable growth in world trade volume; reasonable stability in world trade

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

	2004	2005	Projections	
			2006	2007
World output	5.3	4.9	5.1	4.9
Advanced economies	3.2	2.6	3.1	2.7
United States	3.9	3.2	3.4	2.9
Euro area	2.1	1.3	2.4	2.0
Japan	2.3	2.6	2.7	2.1
Other advanced economies	4.6	3.7	4.1	3.7
Newly industrialised Asian economies	5.9	4.5	4.9	4.4
Other emerging market and developing countries	7.7	7.4	7.3	7.2
Developing Asia	8.8	9.0	8.7	8.6
China	10.1	10.2	10.0	10.0
India	8.0	8.5	8.3	7.3
ASEAN-4*	5.8	5.1	5.0	5.6
Commonwealth of Independent States (CIS)	8.4	6.5	6.8	6.5
Russia	7.2	6.4	6.5	6.5
World consumer prices				
Advanced economies	2.0	2.3	2.6	2.3
Other emerging market and developing countries	5.6	5.3	5.2	5.0
World trade volume (goods & services)	10.6	7.4	8.9	7.6
World trade prices (in US dollar terms)				
Manufactures	9.4	3.6	2.2	2.3
Oil	30.7	41.3	29.7	9.1
Non-fuel primary commodities	18.5	10.3	22.1	-4.8
Capital flows				
Other emerging market and developing countries				
Private capital flows (net) in US\$ billion	213.4	261.7	205.6	188.3

* Includes Indonesia, Malaysia, Philippines and Thailand.

Source : World Economic Outlook, September 2006, IMF.

prices; and supportive growth in capital flows (net) to emerging market economies and developing countries. Despite persistence of high oil prices and the higher aggregate demand, inflation, both as measured by GDP deflator and consumer prices (2.3 per cent in 2005 and 2.6 per cent in 2006) for advanced economies and consumer prices (5.3 per cent in 2005 and 5.2 per cent in 2006) for emerging market economies and developing countries, has been low. While the key world economic indicators point to a virtuous phase of global economic activity that provides a conducive environment for deepening the process of development, some downside risks remain.

6.3 With a share of 20.1 per cent in global output in 2005, US continues to impact the world economy significantly. The current account deficit of the US after persisting around 5 per cent or more of GDP for five years is expected to be close to US\$1 trillion in 2007. Such a large current account deficit has been matched by similarly large surpluses in other countries and led to apprehensions about an abrupt unwinding of the global

macroeconomic imbalances and disruptive sudden changes in cross-currency rates with associated adverse implications for the world economy (Box 6.1).

6.4 The extended timeline of December 2006 of the Doha Round of negotiations under the World Trade Organisation (WTO) has been missed. Agricultural subsidies and non-agricultural market access are proving to be stumbling blocks. International crude oil prices, per barrel, which rose rapidly for Brent from an average of US\$42.1 in 2004-05 to US\$57.9 in 2005-06, reached an all-time high of US\$78.7 on August 8, 2006. While a warm winter, among other reasons, led to a decline in such prices to a low of US\$50.7 on January 17, 2007, considerable uncertainty remains about volatile oil prices. Some concerns have also been expressed about the sustainability of this phase of high growth momentum, particularly in China and India, without overheating and build up of inflationary pressures.

6.5 There appears to be some diminution of the downside risks over time. Initially, the

Box 6.1 : Global imbalances

Global imbalances in the form of two or more countries having large non-zero current account balances are not a new phenomenon. Even in the era of gold standard, with fixed exchange rates, there were current account deficits financed by large capital flows to fund investment overseas and/or finance expenditure in the settlements or colonies. But such imbalances used to adjust through gold movement across countries.

In the post-gold standard era, conventional economic theory envisions equilibrium in international transactions across nations to be established mainly through market determined exchange rates in the medium to long run. Global imbalances, in the current conjecture, refer to the persistence of large current account deficit in US which is financed mainly through corresponding surpluses in some other countries. US has been experiencing growing deficits in its external current account, particularly trade, while simultaneously, international financial system has been contracting dollar-denominated liabilities to offset such deficits. The US current account deficit grew from 4.8 per cent of GDP and 5.7 per cent of GDP in 2003 and 2004, respectively to US\$791.5 billion, equivalent of 6.4 per cent of GDP, in 2005. This, however, did not result in any appreciable decline in the external value of the US dollar primarily because East Asian and other economies were running huge current account surpluses and investing such surpluses in US financial assets, particularly bonds. This led some analysts to postulate that US dollar was the *de facto* international reserve currency, and the existing system of payment settlement could be sustained indefinitely. Such a view has been described as Bretton Woods 2 System.

The IMF, in its *World Economic Outlook* 2005 had cautioned that an abrupt decline in capital inflows to the US: "could engender a rapid dollar depreciation and a sharp increase in US interest rates, with potentially serious adverse consequences for global growth and international financial markets". In the event, the US dollar depreciated in nominal effective terms by 2.1 per cent in 2006 up to November.

Furthermore, the capital flows to finance the US current account deficit, it has been pointed out by many analysts, have been appropriated not for investment, but for consumption expenditure, particularly the US fiscal deficit. A cooling of asset prices in US (particularly housing) and rising bond yields together with tightening of monetary policy, it has been widely feared, may impact the global economy significantly. A sudden and sharp revision in the asset prices or US bond yields could affect global financial stability and through abrupt contraction in consumption, cause recessionary trends. It is in this context that the need to unwind the global imbalances in an orderly fashion assumes importance. The IMF has initiated a dialogue for this purpose with key stakeholders.

IMF in its bi-annual publication *World Economic Outlook* (WEO) April 2006 issue, had projected global output to grow by 4.9 per cent in 2006. With a pick up in growth in US, Euro Area and Japan and the continued momentum in the emerging market economies and developing countries in the first half, in the WEO September 2006, the IMF upped the growth forecast to 5.1 per cent.

Balance of Payments

6.6 The growing strength of India's Balance of Payments (BoP) observed in the post-reform period since the crisis of 1991 continued in 2005-06. This growing strength was in spite of a widening of the current account deficit from US\$2.5 billion in 2004-05 to US \$ 9.2 billion, equivalent to 1.1 per cent of GDP, in 2005-06 (Table 6.2). With a burgeoning trade deficit, primarily on account of rising oil prices, the reversal from current account surpluses witnessed between 2001-

02 and 2003-04 to a current account deficit in 2004-05 appears to be continuing into 2006-07 so far.

6.7 Rising foreign investment, both direct and portfolio, together with a sharp revival of inflows in non-resident (NR) deposits, in spite of the large repayment of India Millennium Deposits (IMD) under external commercial borrowing, maintained a strong balance in the capital account, and even after financing the current account deficit, resulted in a reserve accretion of US\$15.1 billion in 2005-06. While reserve accretion in 2005-06 was lower by US\$11.1 billion relative to 2004-05, because of a higher current account deficit (US\$6.7 billion) and a lower capital account balance (US\$4.4 billion), India continued to be among the top nations with high levels of reserves.

6.8 Given such robust external position, RBI had deemed it opportune to revisit the issue of fuller capital account convertibility and

Table 6.2 : Balance of Payments : Summary

(in US \$ million)

	1990-91	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	(April-Sept.)				
									R	R	PR	2005-06	2006-07
												PR	P
1. Exports	18477	37542	45452	44703	53774	66285	85206	105152	49255	60550			
2. Imports	27915	55383	57912	56277	64464	80003	118908	156993	76364	95691			
3. Trade balance	-9438	-17841	-12460	-11574	-10690	-13718	-33702	-51841	-27109	-35141			
4. Invisibles (net)	-242	13143	9794	14974	17035	27801	31232	42655	19949	23458			
Non-factor services	980	4064	1692	3324	3643	10144	15426	23881	11726	14298			
Income	-3752	-3559	-5004	-4206	-3446	-4505	-4979	-5510	-2278	-2051			
Pvt. transfers	2069	12256	12854	15398	16387	21608	20525	24102	10489	11157			
Official transfers	461	382	252	458	451	554	260	182	12	54			
5. Current account balance	-9680	-4698	-2666	3400	6345	14083	-2470	-9186	-7160	-11683			
6. External assistance (net)	2204	891	410	1117	-3128	-2858	1923	1682	409	358			
7. Commercial borrowing (net)@	2254	333	4303	-1585	-1692	-2925	5194	2723	2925	5093			
8. IMF (net)	1214	-260	-26	0	0	0	0	0	0	0			
9. Non-resident deposits (net)	1537	1540	2316	2754	2978	3642	-964	2789	233	2029			
10. Rupee debt service	-1193	-711	-617	-519	-474	-376	-417	-572	-142	-67			
11. Foreign investment (net)	103	5117	5862	6686	4161	13744	13000	17224	7542	5832			
Of which :													
(i) FDI (net)	97	2093	3272	4734	3217	2388	3713	4730	2129	4218			
(ii) FII	0	2135	1847	1505	377	10918	8662	9926	4529	-106			
(iii) Euro equities & others	6	889	743	447	567	438	625	2568	884	1720			
12. Other flows (net)+	2283	3930	-3740	-96	8795	6111	9893	392	2696	7084			
13. Capital account total (net)	8402	10840	8508	8357	10640	17338	28629	24238	13663	20329			
14. Reserve use (- increase)	1278	-6142	-5842	-11757	-16985	-31421	-26159	-15052	-6503	-8646			

R: Revised, PR : Partially Revised, P : Preliminary

@ Figures include receipts on account of India Development Bonds in 1991-92, 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.

Source : Reserve Bank of India.

constituted a committee headed by Shri. S. S. Tarapore to bring out a roadmap for the purpose. The committee recommended a three-phase strategy for moving towards fuller capital account convertibility (Box 6.2). Though no final view has been taken on acceptance of the recommendations in totality, RBI has initiated measures on an on-going basis beginning with the announcements in its Mid-term Review of the Annual Policy Statement for 2006-07.

Current account

6.9 As a proportion of GDP, on BoP basis, exports, which had grown from 5.8 per cent in 1990-91 to 12.2 per cent in 2004-05, grew further to 13.1 per cent in 2005-06 (Table 6.3). The corresponding rise in imports was from 8.8 per cent in 1990-91 to 17.1 per cent in 2004-05 and further to 19.5 per cent in 2005-06. Trade deficit as a proportion of GDP, which had actually declined from 3.0 per cent in 1990-91 to 2.1 per cent in 2002-03, widened to 4.9 per cent in 2004-05 and further to 6.4 per cent in 2005-06. Imports grew rapidly and the trade

deficit widened sharply, particularly in 2004-05 and 2005-06, because of higher outgo on import of petroleum, oil and lubricants (POL) with large increases in international POL prices.

6.10 According to an IMF and International Energy Agency (IEA) estimate, an oil price increase of US\$10 per barrel results in a deterioration of the trade balance of oil importing developing countries by 1.2 per cent of GDP. Trade deficit in India ballooned from 2.3 per cent of GDP in 2003-04, when oil prices began their initial climb, to 4.9 per cent in 2004-05 and further 6.4 per cent in 2005-06. An estimate excluding the impact of the oil price rise, that is with the same headline price of Indian basket of crude as in 2002-03 but with the same quantities as actually imported in the relevant years, yields trade deficit of 3.4 per cent of GDP each in 2004-05 and 2005-06. The above estimate indicate an oil price impact of 1.47 per cent and 3.05 per cent in 2004-05 and 2005-06, respectively somewhat lower than the impact projected by the IMF-IEA estimate.

Table 6.3 : Selected indicators of external sector

	1990-91	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	(April-Sept.)	
								2005-06	2006-07
1. Growth of exports - BOP (%)	9.0	21.1	-1.6	20.3	23.3	28.5	23.4	34.2	22.9
2. Growth of imports - BOP (%)	14.4	4.6	-2.8	14.5	24.1	48.6	32.0	48.2	25.3
3. Exports/imports - BOP (%)	66.2	78.5	79.4	83.4	82.9	71.7	67.0	64.5	63.3
4. Import cover of FER (No. of months)	2.5	8.8	11.5	14.2	16.9	14.3	11.6	11.2	10.4
5. External assistance (net)/TC (%)	26.2	4.8	13.4	-29.4	-16.5	6.7	6.9	3.0	1.8
6. ECB (net)/TC (%)	26.8	50.6	-19.0	-15.9	-16.9	18.1	11.2	21.4	25.1
7. NR deposits/TC (%)	18.3	27.2	33.0	28.0	21.0	-3.4	11.5	1.7	10.0
As per cent of GDP at current market prices									
8. Exports	5.8	9.9	9.4	10.6	11.0	12.2	13.1		
9. Imports	8.8	12.6	11.8	12.7	13.3	17.1	19.5		
10. Trade balance	-3.0	-2.7	-2.4	-2.1	-2.3	-4.9	-6.4		
11. Invisibles balance	-0.1	2.1	3.1	3.4	4.6	4.5	5.3		
12. Current account balance	-3.1	-0.6	0.7	1.2	2.3	-0.4	-1.1		
13. External debt	28.7	22.5	21.1	20.3	17.8	17.3	15.8		
Notes :									
(i) TC: Total capital flows (net).									
(ii) ECB: External commercial borrowing.									
(iii) FER: Foreign exchange reserves, including gold, SDRs and IMF reserve tranche.									
(iv) 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 hundred per cent.									
(v) 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 volumes									

Box 6.2 : Towards fuller capital account convertibility

With growing strength of the balance of payments in the post-1991 reform period, in August 1994, by accepting obligations under Article VIII of the articles of agreement of the IMF, India made the Rupee convertible for current account transactions. A Committee headed by Shri S.S. Tarapore in 1997 had chalked out a phased road map for making the capital account convertible. The East Asian crisis intervened soon thereafter, leading to lack of popular enthusiasm for capital account convertibility. With external sector remaining robust and gaining strength every year and the relative macro economic stability with high growth providing a conducive environment for relaxation in capital controls, RBI, in pursuance of the announcement by the Prime Minister, constituted a Committee (Chairman: S.S. Tarapore) on March 20, 2006 for setting out a roadmap towards fuller capital account convertibility. The Committee submitted its Report to the RBI on July 31, 2006.

Conscious of the risks in the movement towards fuller convertibility of the Rupee as emanating from cross country experiences in this regard, the Committee calibrated the liberalization roadmap to the specific contexts of preparedness – namely, a strong macroeconomic framework, sound financial systems and markets, and prudential regulatory and supervisory architecture. After reviewing the existing capital controls, it detailed a broad five-year time frame for movement towards fuller convertibility in three phases: Phase I (2006-07); Phase II (2007-08 to 2008-09); and Phase III (2009-10 to 2010-11). It recommended the meeting of certain indicators/targets as a concomitant to the movement in: meeting FRBM targets; shifting from the present measure of fiscal deficit to a measure of the Public Sector Borrowing Requirement (PSBR); segregating Government debt management and monetary policy operations through the setting up of the Office of Public Debt independent of the RBI; imparting greater autonomy and transparency in the conduct of monetary policy; and slew of reforms in banking sector including a single banking legislation and reduction in the share of Government/RBI in the capital of public sector banks; keeping the current account deficit to GDP ratio under 3 per cent; and evolving appropriate indicators of adequacy of reserves to cover not only import requirements, but also liquidity risks associated with present types of capital flows, short-term debt obligations and broader measures including solvency.

Some of the significant measures, to be implemented in a sequenced manner as per the given roadmap include: raising the overall external commercial borrowing (ECB) ceiling as also the ceiling for automatic approval gradually; keeping ECBs of over 10-year maturity in Phase I and over 7-year maturity in Phase II outside the ceiling and removing end-use restriction in Phase I; monitoring import-linked short-term loans in a comprehensive manner and reviewing the per transaction limit of US\$20 million; raising the limits for outflows on account of corporate investment abroad in phases from 200 per cent of net worth to 400 per cent of net worth; providing Exchange Earners Foreign Currency Account holders access to foreign currency current/savings accounts with cheque facility and interest bearing term deposits; prohibiting FII's from investing fresh money raised through Participatory Notes (PN), after providing existing PN-holders an exit route so as to phase them out completely within one year; allowing non-resident corporates (and non-residents) to invest in the Indian stock markets through SEBI-registered entities including mutual funds and portfolio management schemes who will be individually responsible for fulfilling know your customer (KYC) and Financial Action Task Force (FATF) norms; allowing institutions/corporates other than multilateral ones to raise Rupee bonds (with an option to convert into foreign exchange) subject to an overall ceiling which should be gradually raised; linking the limits for borrowing overseas to paid-up capital and free reserves, and not to unimpaired Tier I capital, as at present, raising it substantially to 50 per cent in Phase-I, 75 per cent in Phase II and 100 per cent in Phase III; abolishing the various stipulations on individual fund limits and the proportion in relation to net asset value; raising the overall ceilings from the present level of US\$2 billion to US\$3 billion in Phase I, to US\$4 billion in Phase II and to US\$5 billion in Phase III; raising the annual limit of remittance abroad by individuals from existing US\$25,000 per calendar year to US\$50,000 in Phase I, US\$100,000 in Phase II and US\$200,000 in Phase III; allowing non-residents (other than NRIs) access to Foreign Currency Non-Resident (FCNR(B)) and Non-Resident (External) Rupee Account (NR(E)RA) schemes.

6.11 The invisibles (net), comprising of non-factor services (like travel, transportation, software services and business services), investment income, and transfers, have traditionally compensated to a large extent the trade deficit, and this trend continued in 2005-06 with a moderate current account deficit at 1.1 per cent of GDP. As a proportion of GDP, invisibles (receipts) at 11.5 per cent of GDP

in 2005-06 exhibited steady growth from a modest level of 2.4 per cent of GDP in 1990-91, with the most recent two years showing acceleration, particularly in software and business services. Simultaneously, invisible payments at 6.2 per cent of GDP in 2005-06 have grown, albeit at lower levels and somewhat unevenly, again with acceleration being noticed in the most recent two years.

6.12 The steady growth in invisibles (net) conceals divergent patterns and sharp changes in some of the components over a decade and a half. For instance, annual growth in travel receipts (gross), after remaining mostly in single digit during the 1990s, has shown rapid growth in the range of 18-52 per cent in the last three years ending in 2005-06. Nevertheless, with even faster growth in travel payments (gross), growth in travel receipts in net terms have been negative since 1997-98. Similarly growth in transportation receipts has varied in the range of (-) 11.3 per cent to 46.0 per cent between 1991-92 and 2005-06, with high growth in the latest 4 years. With growth in payments also varying from (-) 28.9 per cent to 95.0 per cent in the same period, and very high growth of 95.0 per cent and 72.8 per cent in the last two financial years (2004-05 and 2005-06), there were also outflows on a net basis under transportation. In the recent two years ending in 2005-06, with strong growth, miscellaneous (other than software services) payments have exceeded such receipts. Rapid growth of non-software miscellaneous services payments may indicate how business services payments have also risen in tandem with business services receipts in recent years, reflecting the ongoing technological transformation and modernization of the economy/industry.

6.13 Private transfers (net), which remained the single largest component of the invisibles (net) account till 2004-05, fell below miscellaneous (net) receipts in 2005-06. The ratio of net invisible receipts to private transfers (net) rose dramatically from 3/7 to more than 2 between 1991-92 and 2005-06. The growth in miscellaneous (net) receipts has been driven mostly by software services. On a net basis, in 2005-06, with rapid growth of 31.7 per cent and 209.8 per cent in receipts from software services and business services, respectively, non-factor services moved closer to private transfers in the invisibles account. In the invisible account, on a gross basis, both receipts and payments have grown at rapid rates of over 30 per cent in both 2004-05 and 2005-06.

6.14 The four other main components of non-factor services, namely, travel, transportation, insurance and Government transactions (not included elsewhere), have exhibited mixed trends. Transportation (net), which had yielded modest positive inflows only in 2003-04 and 2004-05 in the preceding decade and a half, slipped back with an outflow of US\$1.6 billion in 2005-06. The pick up in international tourism observed in 2003-04 and 2004-05 continued in 2005-06 and resulted in a net inflow of US\$1.4 billion in 2005-06. With insurance receipts and payments more or less balancing each other and Government account yielding a modest net outflow of US\$197 million, the total invisibles (net) inflow amounted to US\$23.9 billion in 2005-06 for non-factor services.

6.15 Investment income (net) continued to be negative reflecting the servicing costs of capital inflows. While receipts on this account have grown rapidly at an average rate of 20.1 per cent in the last six years to reach US\$5.7 billion in 2005-06, payments on this account grew at a lower average rate of 13.6 per cent to reach US\$11.2 billion in 2005-06. Official transfers, a very small component in the invisibles account, continued to decline in 2004-05 and 2005-06.

6.16 Overall, in 2005-06, current receipts (including grants) grew by 27.6 per cent to US\$197.4 billion. But, such receipts fell short of current payments (including grants) which grew by 31.4 per cent to US\$206.6 billion. Current receipts covered 95.6 per cent of current payments in 2005-06.

6.17 As per the quarterly data on BoP for 2006-07 released by the RBI on December 29, 2006, both imports and exports have decelerated in the first half of the current year. With revisions to the first quarter data, trade deficit at US\$35.1 billion during April-September 2006 was considerably higher than US\$27.1 billion observed in the corresponding period of 2005. As per the quarterly data, export growth, which was 23.7 per cent in the first quarter of 2006-07, continued to be robust at 22.9 per cent in the first six months (34.2 per cent in April-

September 2005). Imports, which had grown by 23.6 per cent in the first quarter, also strengthened to 25.3 per cent growth in the first six months of the current year. There was, however, a deceleration of import growth from 48.4 per cent in the first half of 2005-06. However, as pointed out by the Economic Advisory Council to the Prime Minister in its outlook for BoP released on January 11, 2007, the provisional nature of the data, which can get revised sharply, needs to be taken into account in drawing any firm conclusions. The Council, in an earlier Report, had also expressed concern at the levels of divergence between customs (DGCI&S) trade data and RBI's trade data as per BoP accounts (Box 6.3).

6.18 In the first half of the current year, while invisibles receipts rose on account of growth in export of software and other professional and business services, invisible payments also

rose sharply, particularly in travel and transportation. Net invisible receipts at US\$23.5 billion, was up from US\$19.9 billion in the first half of 2005-06, but not enough to offset the rising trade deficit. Consequently, during April-September, the current account deficit widened from US\$7.2 billion in 2005 to US\$11.7 billion in 2006.

External Trade

6.19 India's total external trade, including goods and services, grew by 31.2 per cent to US\$361 billion in 2005-06. Growth was 27.5 per cent in the first half of 2006-07, with value of such trade at US\$212.5 billion. Trade in services has been growing faster than merchandise trade, and the share of services in total external trade increased from 25.8 per cent in 2004-05 to 27.4 per cent in 2005-06. In the first half of 2006-07, the share was 26.5 per cent.

Box 6.3 : Divergence in trade data

Periodically concerns have been expressed, since 1980s, as regards the divergence in the merchandise trade data compiled by the two agencies, namely, Reserve Bank of India (RBI) and Directorate General of Commercial Intelligence and Statistics (DGCI&S), Kolkata, Ministry of Commerce and Industry. This divergence is more pronounced in the case of imports. This divergence was examined by the High Level Committee on Balance of Payments (Chairman: Dr. C. Rangarajan, April 1993) and the Technical Group on Reconciling Balance of Payments and DGCI&S data on merchandise trade (Chairman: Shri O.P. Sodhani, September 1995). While the two agencies are recording the same transactions, the scope, time period, definition, method and coverage of items of trade differ considerably, besides inclusion and exclusion errors in trade items. While RBI relies on foreign exchange release/receipt returns, which are actual cash outgo and cover all flows, DGCI&S relies on customs data, which in turn are based on bills of entries (import document filed with the Customs), which might remain somewhat incomplete for a number of reasons in the short run. Defence imports are not reflected in the DGCI&S data. As such for a particular time period at any specific date, given the leads and lags in reporting, the two sets of data would never match.

The extent of the divergence has narrowed over the years, particularly for years prior to 2004-05 (Table below).

Divergence in import data

(in US\$ million)

Year	RBI-BoP	DGCI&S-Customs	Difference
1990-91	27,915	24,075	3,840
1995-96	43,670	36,678	6,992
2000-01	57,912	50,536	7,376
2001-02	56,277	51,413	4,864
2002-03	64,464	61,412	3,052
2003-04	80,003	78,150	1,853
2004-05	118,908	111,518	7,390
2005-06	156,993	149,166	7,827
2006-07(April-September)	95,691	83,927	11,764

As per the extant revision policy of the RBI, data on exports and imports are revised every quarter up to 24 months while DGCI&S finalise their trade data after 8 months. However, the extent of this level of divergence in the current conjecture makes it arduous for calibrating the policy responses to external sector developments in the short-run.

Merchandise Trade:

6.20 India's merchandise exports (in US dollar terms and on customs basis), which have been growing continuously at a high pace of more than 20 percent since 2002-03, continued its momentum and grew by 23.4 per cent to cross the US\$100 billion mark in 2005-06. Exports during 2006-07, which gained momentum after a slow start, reached US\$89.5 billion in April-December, 2006 with growth of 36.3 per cent on provisional to provisional (POP) basis (growth rates comparisons for April-December of the current year is on POP basis, unless stated otherwise).

6.21 Export performance was dominated by volume growth till 2002-03. There was a reversal of this trend in 2003-04, with increasing contribution of higher unit value in export performance. Subsequent years witnessed a surge both in terms of volume and unit value. During 2005-06, for exports, while volume increased by a record 45.4 percent (mainly in items like petroleum products, chemicals & related products and machinery & transport equipment), the unit value increased by 20.4 per cent (mainly in petroleum products, minerals & ores, machinery & transport equipment and footwear) (Table 6.4). However, notwithstanding these favourable developments on the export front, there was

a sharp deterioration in both net and income terms of trade. The net terms of trade, which measures the unit value index of exports as a proportion of unit value index of imports, deteriorated as the unit value index of imports rose by 49 per cent (mainly due to a sharp rise in the price of crude petroleum by over 40 per cent, and of gold and other metals). Even gross terms of trade, which measures the volume index of imports as a ratio of volume index of exports, fell with a decline in the quantum of imports (particularly gold) while quantum of exports increased.

6.22 India's share in world merchandise exports, after remaining unchanged at 0.8 per cent between 2003 and 2004, reached 1.0 per cent in 2005, and remained there in the first eight months of 2006 (Table 6.5). This increase was due to India's exports growing at more than double the rate of growth of world exports since 2005. China has been a stellar export performer for years; for the first time, in 2005 and the first eight months of 2006, India's export growth surpassed that of China.

6.23 India's significant export growth in recent years was on account of a host of favourable external developments and domestic policy initiatives. Improved global growth and recovery in world trade aided the growth of Indian exports. The opening up of the economy and corporate restructuring has enhanced the competitiveness of Indian

Table 6.4 : Performance of the foreign trade sector
(Annual percentage change)

Year	Export growth			Import growth			Terms of trade	
	Value (in US dollar terms)	Volume	Unit Value	Value (in US dollar terms)	Volume	Unit Value	Net	Income
1990-00	7.7	10.6	8.4	8.3	12.4	7.2	1.5	11.7
1990-95	8.1	10.9	12.6	4.6	12.9	7.6	5.0	16.5
1995-00	7.3	10.2	4.3	12.0	11.9	6.9	-2.0	7.0
2000-01	21.0	23.9	3.3	1.7	-1.0	8.2	-4.5	18.3
2001-02	-1.6	3.7	-1.0	1.7	5.0	1.1	-2.1	1.5
2002-03	20.3	21.7	0.3	19.4	9.5	10.7	-9.4	10.3
2003-04	21.1	6.0	8.5	27.3	20.9	-0.1	8.6	15.1
2004-05	30.8	17.6	8.9	42.7	14.7	21.6	0.5	5.0
2005-06	23.4	45.4	20.4	33.8	-1.6	49.0	-27.4	-33.2
2006-07*	36.3	-	-	36.3	-	-	-	-

*April-December, 2006

Source : DGCI&S, Kolkata

Table 6.5 : Export growth and share in world exports of selected countries

Country	Percentage growth rate				Share in world exports				Value (US \$ billion)
	1995-01	2004	2005	2006*	2001	2004	2005	2006*	2005
1. China	12.4	35.4	28.5	25.8	4.3	6.6	7.4	7.8	762.0
2. Hong Kong	3.6	15.6	11.6	8.6	3.1	2.9	2.8	2.6	289.0
3. Malaysia	6.6	26.5	12.1	15.1	1.4	1.4	1.4	1.4	140.9
4. Indonesia	5.7	11.2	18.2	17.4	0.9	0.8	0.8	0.9	84.6
5. Singapore	4.1	24.5	15.6	34.5	2.0	2.0	2.2	2.3	229.6
6. Thailand	5.9	20	14.6	20.0	1.1	1.1	1.1	1.1	110.0
6. India	8.5	25.7	30.0	40.4	0.7	0.8	1.0	1.0	99.5
8. Korea	7.4	30.9	11.8	13.7	2.5	2.8	2.7	2.7	284.0
9. Developing countries	7.9	27.1	21.8	23.1	36.8	40.7	43.8	44.8	4530.3
10. World	5.5	21.2	13.9	16.4	100.0	100.0	100.0	100.0	10355.3

Source : IFS statistics, IMF. * January-August, 2006

industry. There is a far greater export-orientation of domestic manufacturers, and corporate sector has been pursuing new growth strategies in response to economic reforms. Firming up of domestic economic activity, especially resurgence of the manufacturing sector, provided a supporting base for strong sector-specific exports. Trade policy reforms, continued trade promotion, market diversification and trade facilitation efforts seem to have paid good dividends. The nominal effective exchange rate (NEER) measuring the value of country's currency relative to the currencies of principal trading partners is a proximate indicator of its competitiveness in international trade. The NEER-5 (base 2000=100) which is a 5 currency export-weighted index, depreciated on a yearly basis till 2004-05, and after a bout of appreciation in 2005-06, depreciated steadily in 2006-07 till August 2006.

6.24 Reaching the 1.5 per cent targeted share of world exports by 2009, and maintaining and further accelerating the current dynamism in exports on a long term basis require a deepening of domestic reforms: reducing constraints like infrastructure bottlenecks, outdated/inflexible labour laws, SSI reservations, and high transaction costs; and a calibrated policy of phasing out export incentive schemes coupled with lowering of basic customs duties. Exporters, in turn, need to place more emphasis on non-price factors like product quality, brand image, packaging, delivery and

after-sales service. A more aggressive push to foreign direct investment (FDI) in export industries will not only increase the rate of investment in the economy but also infuse new technologies and management practices in these industries, and thereby increase exports.

6.25 Indian banks, particularly the Export-Import Bank of India (Exim Bank), are financing different stages of exports (see Box 6.4). Availability of adequate export credit at competitive rates continues to be an important determinant of export performance. However, export credit as a proportion of net bank credit (NBC) has gone down steadily in the current decade (Table 6.6). While this may partly

Table 6.6 : 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	7.4
March 19, 2004	57687	17.2	7.6
March 18, 2005	69059	19.7	6.3
March 31, 2006	86207	24.8	5.7
December 22, 2006*	97763	13.4	5.6

Note : ¹ Data upto March 2004 relate to select banks accounting for 90 per cent of bank credit
² March 18, 2005 onwards, data pertain to all scheduled banks excluding RRBs availing export credit refinance from the RBI.
* Over the corresponding figure as on March 31, 2006 (variation)

Source : Reserve Bank of India (RBI)

Box 6.4 : Export finance

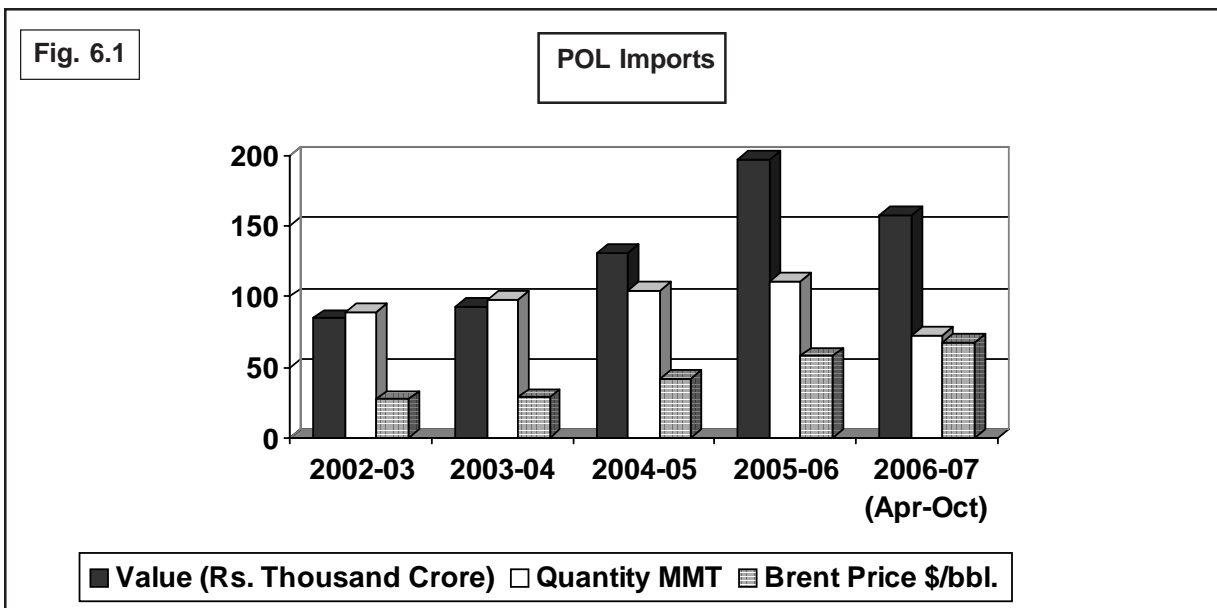
Pre-shipment and post-shipment credits are the customary banking credit facilities for exports. Traditional exports (such as tea), with foreign exchange from such exports realised typically within 180 days from shipment, require finance which is short-term in nature. Non-traditional exports, covering products such as capital goods, services, and project exports, however, require deferred credit over the medium (1-5 years) and long term (beyond 5 years and up to 10 years). Commercial banks, with their liability structure short-term in character, concentrate on traditional, short-term export finance. Export credit of scheduled commercial banks amounted to Rs. 65,914 crore at end-March 2005. Export-Import Bank of India (Exim Bank), with its medium/long term liability structure, concentrates primarily on medium to long-term export finance, besides working capital. Exim Bank also provides refinance and rediscounting facilities to commercial banks so that short-term exports are not affected by lack of finance. Exim Bank's lending has steadily increased over the years. In 2005-06, Exim Bank's approved loans increased by over 29 per cent to Rs. 20,489 crore.

Exim Bank provides finance at various stages of the export cycle — import finance, product development, production, marketing, pre-shipment and post-shipment — as well as for overseas investment. It has a range of export credit programmes, such as supplier's and buyer's credit, for Indian companies executing contracts overseas for projects, products, as well as services. The Exim Bank also extends guarantee facilities to facilitate Indian companies in executing export contracts and extends lines of credit, on its own or at the behest of the Government of India, to overseas governments, or to agencies nominated by them, or to financial institutions overseas for encouraging imports from India on deferred payment terms. Exim Bank's import lines of credit provide financing for import of capital goods and related services particularly for enhancing export production capabilities of small and medium sized export oriented units.

reflect the growing strength of the Indian export sector, which may be availing of less export credit, it may also be a reflection of the relatively higher cost of export credit in India compared to other countries.

6.26 Merchandise imports grew by 33.8 per cent to US\$149.2 billion in 2005-06. This high growth in imports in value terms was primarily due to the high POL prices. While volume growth of POL imports declined marginally from 6.4 per cent in the previous year to 6.1

per cent in 2005-06, with the price of Indian basket of crude oil increasing by 42.1 per cent (Figure 6.1), POL imports during 2005-2006 increased by 47.3 per cent to US\$44 billion. Growth of non-POL imports in 2005-06 was 28.8 per cent. With high international price of gold and silver, there was a rapid deceleration in growth of import of gold and silver from 62.6 per cent to 1.5 per cent between 2004-05 and 2005-06. Non-POL non-bullion import grew by 39.0 per cent in 2005-06. Apart from the high price of gold, subdued global demand for



gems & jewellery affected the import of items related to export of gems & jewellery i.e. pearls, precious & semi-precious stones, the import of which declined by 3.1 per cent.

6.27 In the current year, imports continued to grow, though at a slightly decelerated pace due to the fall in gold and silver imports. The 36.3 per cent growth in imports in April-December 2006 was substantially contributed by the growth in POL imports at 39.2 per cent due to high crude oil prices. While the trend of negative growth of gold and silver imports, which started in October 2005, continued even in the first few months of the current year, there has been a reversal in this trend from August 2006 with a very high growth of around 182 per cent in September 2006. This was due to the softening of international gold prices which fell from a high of \$675.4 per troy ounce in May 2006 to \$598.2 per troy ounce in September 2006, coupled with the festival demand both for domestic consumption and for exports. With gold and silver import growth at 15.5 per cent in April-December 2006, non-POL import growth also picked up to 18.7 per cent. Non-POL non-bullion import growth was at 19.1 per cent.

6.28 Trade deficit reached a record high of US\$46 billion (as per customs data) in 2005-06 and US\$41.7 billion in the first nine months of the current year. With rapid growth in non-POL imports, even the non-POL trade balance turned negative to US\$(-)5.3 billion in 2004-05, and more than doubled in 2005-06 to US\$(-)14.0 billion. Non-POL trade deficit in the first seven months of the current year at US\$ (-)9.6 billion was higher than such deficit of US\$ (-) 7.6 billion in the first seven months of the previous year.

Composition of merchandise trade

6.29 Export growth in 2005-06 was broad-based with good performance in most of the sectors (Table 6.7). Major drivers of export growth during 2005-06 were petroleum products, engineering goods and chemicals. Growth of 66.2 per cent in exports of petroleum products (over and above the 91.2 per cent growth in the previous year) and the perceptible increase in share of petroleum

products in total exports to 11.5 per cent in 2005-06 reflected not only the rise in POL prices, but also India's enhanced refining capacity. Induced by strong international demand and higher prices, exports of ores & minerals, after more than doubling in 2004-05, grew by another 17.4 per cent in 2005-06. Manufacturing growth was powered mainly by engineering goods (mainly manufactures of metals, machinery and instruments and transport equipment); chemicals and related products, and textiles. However, there was a marginal decline in the share of manufactured goods (other than POL) in total exports from 74.2 per cent in 2004-05 to 72.0 per cent. Agriculture and allied exports also registered reasonably good growth of 19.8 per cent.

6.30 Data on commodity composition of trade are available only up to October 2006. During April-October 2006, the major drivers of export growth were petroleum products and engineering goods while exports of primary products decelerated. Between the first seven months of 2004-05 and 2006-07, exports of petroleum products went up more than three-fold while that of engineering goods almost doubled. The deceleration in exports of primary products during April-October 2006 was mainly due to the negative growth in export of ores & minerals due to a fall in demand from China and Japan. Manufactured products export growth decelerated during April-October 2006, mainly due to the decline in exports of gems and jewellery with the fall in off-take in major markets like Hong Kong, Singapore, Israel, Belgium, Japan, Switzerland and Germany and a possible shift in consumer spending in US. The sustained growth of engineering goods exports was supported by machinery & instruments, primary & semi-finished iron & steel, non-ferrous metals and manufacturers of metals in particular. There was a deceleration in export growth in textiles across most of the product groups including readymade garments (RMG). With the sudden rise in share of POL products in exports to 16.3 per cent, the share of manufactures fell drastically to 69 per cent despite reasonable growth.

Table 6.7 : Commodity composition of exports

Commodity Group	Percentage share				Growth rate*			
	2004-05	2005-06	April-October		2004-05	2005-06	April-October	
			2005-06	2006-07			2005-06	2006-07
I. Primary products	16.0	15.4	14.9	13.9	36.2	18.9	38.6	17.3
Agriculture & allied	10.5	10.2	9.9	9.9	11.7	19.8	28.9	25.4
Ores & minerals	5.5	5.2	5.0	4.0	136.5	17.4	63.2	1.1
II. Manufactured goods	74.2	72.0	73.5	69.0	24.9	19.6	30.1	17.6
Textile incl. RMG	14.9	14.5	11.0	9.8	5.3	20.4	20.2	11.7
Gems & jewellery	16.5	15.1	16.8	12.9	30.2	12.8	29.6	-4.4
Engineering goods	20.7	20.7	20.6	22.5	40.2	23.4	36.8	37.0
Chemical & related pdcts.	12.2	11.6	11.3	10.4	33.9	17.3	27.9	14.8
Leather & manufactures	2.9	2.6	2.1	1.8	12.0	11.1	21.9	5.7
Handicrafts (incl. carpet handmade)	1.2	1.2	1.3	1.0	-7.0	30.2	37.4	-7.3
III. Petroleum, crude & products (incl. Coal)	8.5	11.5	11.0	16.3	91.2	66.2	67.7	85.3
Total exports	100.0	100.0	100.0	100.0	30.8	23.4	33.9	25.3

* In US \$ terms
Source : DGCI&S, Kolkata

6.31 Prospects for export of textiles and clothing (T&C) including RMG, an important sector in India in terms of both output and employment, improved after dismantling of the quota system in 2005. Export of textiles including RMG grew by 20.4 per cent to reach US\$14.8 billion in 2005-06. But, in the second year of the quota free regime, growth of such exports by India moderated to 11.7 per cent in April-October, 2006, while that of China grew by 28.9 per cent in April-November 2006. Furthermore, during April-October 2006, while T&C exports to US from India grew by only 6.2 per cent, that from China grew by 16.8 per cent. Even though India improved its share of the global T&C trade from 2.9 per cent in 2004 to 3.4 per cent in 2005, China registered major gains to garner a 24 per cent share of such global trade. China's trade surplus in T&C increased by US\$ 20 billion to US\$100 billion in 2005.

6.32 With a share of 23 per cent of India's merchandise exports, engineering sector is the largest contributor to such exports well ahead of gems & jewellery. There has also been a spurt in Engineering Process Outsourcing (EPO) from giant automotive and aerospace companies like Ford Motor Company, General Motors, Boeing and Airbus. Similarly, a number of semi-conductor

manufacturing companies, electronic goods manufacturers, and mobile handset vendors have been outsourcing some of their work to India. EPO has grown at a compound annual rate of 37 per cent between 2003 and 2006, and has the potential to reach a level of US\$10-20 billion in the next five years from the present level of US\$3.5 billion. Such EPOs have a beneficial impact on engineering goods exports in the medium term. India, with its low cost labour and talented manpower, has the potential of being the major hub of engineering goods both for direct exports and development of engineering process outsourcing services.

6.33 Gems & jewellery, contributing about 15 per cent of India's total commodity exports, is an important item in India's export basket. While India has emerged as one of the key players in gems & jewellery exports on the basis of its traditional strength in craftsmanship and its share in the US\$146 billion global business in 2005 was around 11 per cent, of late, there has been a deceleration in export growth in this sector.

6.34 India had a share of 2.3 per cent of world exports of marine products (Table 6.8). Exports of marine products, which after a decline in 2003-04 had picked up in subsequent years, grew by 6.3 per cent in

Table 6.8 : Share of major exports of India in World exports

(Items with one per cent share and above in 2005)

HS rev.1	Product	2000	2005
03	Fish, crustaceans, molluscs, aquatic invertebrates, nes	3.4	2.3
05	Products of animal origin, nes	1.2	1.1
08	Edible fruit, nuts, peel of citrus fruit, melons	2.1	1.2
09	Coffee, tea, mate and spices	5.8	3.7
10	Cereals	2.3	1.3
12	Oil seed, oleagic fruits, grain, seed, fruit, etc, nes	1.7	1.1
13	Lac, gums, resins, vegetable saps and extracts nes	11.9	10.0
14	Vegetable plaiting materials, vegetable products nes	4.4	4.9
23	Residues, wastes of food industry, animal fodder	2.4	2.1
25	Salt, sulphur, earth, stone, plaster, lime and cement	2.7	3.4
26	Ores, slag and ash	1.9	9.1
29	Organic chemicals	1.2	1.6
32	Tanning, dyeing extracts, tannins, derivatives, pigments etc	1.5	1.5
41	Raw hides and skins (other than furskins) and leather	1.8	2.6
42	Articles of leather, animal gut, harness, travel goods	4.1	3.2
46	Manufactures of plaiting material, basketwork, etc.	0.1	1.9
50	Silk	11.3	10.0
52	Cotton	6.6	3.6
53	Vegetable textile fibres nes, paper yarn, woven fabric	4.5	3.4
55	Manmade staple fibres	2.0	1.3
57	Carpets and other textile floor coverings	7.5	10.8
58	Special woven or tufted fabric, lace, tapestry etc	2.4	1.6
61	Articles of apparel, accessories, knit or crochet	2.1	2.6
62	Articles of apparel, accessories, not knit or crochet	3.6	3.5
63	Other made textile articles, sets, worn clothing etc	6.3	6.6
64	Footwear, gaiters and the like, parts thereof	1.4	1.6
67	Bird skin, feathers, artificial flowers, human hair	1.7	3.1
68	Stone, plaster, cement, asbestos, mica, etc articles	1.9	2.7
71	Pearls, precious stones, metals, coins, etc	6.5	8.1
72	Iron and steel	0.9	1.2
73	Articles of iron or steel	1.2	1.1
74	Copper & Articles there of	0.4	1.0

Source : NCTI based on UN-ITC Trade Map data.

April-October 2006. In terms of export earnings, among marine products, frozen shrimp continued to be the largest export item, followed by frozen fish, cuttlefish, squid, and dried items. European Union accounted for the largest share of India's export of marine products, followed by US and Japan. This sector, however, faced a number of hurdles in the major export destinations. Indian shrimp imports to US have been subject to anti-dumping duty of 10.17 per cent from August 2004. In European markets, India's marine products have been facing problems due to multiplicity of standards – in addition to the EU's own standards, the standards of each of the member states.

6.35 While efforts at export diversification has continued, in 2005, India had a share of one per cent or more of world exports in only 32 out of a total of 99 commodity chapters at the two digit (Harmonised System (HS) Revision 1) level (Table 6.8). In these 32 items, India had a significant world export share of 5 per cent or more only in six items: carpets and other textile floor coverings; silk; lac, gums, resins, vegetable saps and extracts not elsewhere specified; ores, slag and ash; pearls, precious stones, etc.; and other made textile articles, sets, worn clothing, etc.

6.36 With a sudden spurt in world trade in 2005 and domestic constraints, two items of India's exports have moved out of the one per

Table 6.9 : Imports of principal commodities

Commodity	Percentage Share				Growth Rate*			
	2004-05	2005-06	April-October		2004-05	2005-06	April-October	
			2005-06	2006-07			2005-06	2006-07
POL	26.8	29.5	29.6	33.7	45.1	47.3	41.4	44.0
Pearls, precious & semi-precious stones	8.4	6.1	7.5	4.1	32.2	-3.1	36.8	-31.3
Capital goods	12.4	15.0	10.7	12.1	39.5	62.0	53.8	43.1
Electronic goods	9.6	9.5	9.1	9.4	35.1	32.7	33.2	29.2
Gold & silver	10.0	7.6	9.0	8.6	62.6	1.5	43.4	20.8
Chemicals	6.2	5.7	6.1	5.5	38.3	23.2	42.2	12.9
Edible Oil	2.2	1.4	1.7	1.3	-3.0	-17.9	-6.1	-1.1
Coke, coal and briquettes	2.9	2.6	2.6	2.4	126.7	21.0	30.6	21.1
Metaliferrous ores & metal scrap	2.2	2.6	2.7	3.9	90.5	57.3	75.3	85.5
Professional instruments and optical goods	1.4	1.3	1.4	1.3	24.4	28.9	43.8	18.5
Total Imports**	100.0	100.0	100.0	100.0	42.7	33.8	44.4	26.4
* In US \$ terms								
** Columns do not add up to a hundred because of other items not included in the Table								
Source : DGCI&S, Kolkata								

cent share in world exports. They are code 07: 'Edible vegetables and certain roots and tubers' due to fall in India's exports in 2005, and code 28: 'inorganic chemicals, precious metal compound, isotopes' due to rise in world exports. With the rise in copper prices, code 74: 'copper and articles thereof' has made an entry into the one per cent share category. In new items like office and telecom equipment and scientific instruments, which have registered high growth rates in world trade in recent years, India's share continued to be negligible. The items with large potential, in which India has not yet made a mark while China has already established itself, include many electronic and electrical items, processed food items, scientific instruments and apparatus, toilet papers and handkerchiefs, electro-medical appliances, furniture and toys.

6.37 With hefty rise in crude oil prices, POL continued to be the most important item of India's imports, accounting for a little over a third of total imports in April-October 2006 (Table 6.9). Following POL, capital goods was the second most important item of import.

Capital goods imports have been growing rapidly, reflecting higher domestic investment, resurgence of manufacturing, and rising needs of export sector. Import of industrial inputs like chemicals and metaliferrous ores & metal scrap also increased substantially to support high growth in manufacturing sector, while a rise in international metal prices was also a contributory factor for the latter.

6.38 Machinery including both electrical and non-electrical, transport equipment and project goods were the main contributors to the rise in capital goods imports. Project goods imports, which reflect the technological maturity and industrial capabilities of a country, increased by 48 per cent with the growth further accelerating in the current year. This augurs well for the industrial and infrastructure sectors of the economy.

Direction of Trade

6.39 The share of 11 major trading partners of India, accounting for nearly a half of India's trade, has not changed much since 2000-01 (Table 6.10). US continues to be the single largest trading partner of India, but with a

Table 6.10 : India's major trading partners, 2000-2006

Percentage share in total trade (exports+imports)

Country	2000-01	2002-03	2003-04	2004-05	2005-06	April-October	
						2005-06	2006-07
1. US	13.0	13.4	11.6	10.7	10.6	10.3	9.7
2. U.K	5.7	4.6	4.4	3.7	3.6	3.7	3.1
3. Belgium	4.6	4.7	4.1	3.6	3.0	3.3	2.4
4. Germany	3.9	4.0	3.8	3.5	3.8	3.7	3.7
5. Japan	3.8	3.2	3.1	2.8	2.6	2.4	2.3
6. Switzerland	3.8	2.4	2.6	3.3	2.8	3.3	3.2
7. Hong Kong	3.7	3.1	3.3	2.8	2.7	2.9	2.3
8. UAE	3.4	3.8	5.1	6.2	5.1	5.3	6.9
9. China	2.5	4.2	4.9	6.5	7.0	6.8	7.7
10. Singapore	2.5	2.5	3.0	3.4	3.5	3.7	4.0
11. Malaysia	1.9	1.9	2.1	1.7	1.4	1.4	2.2
Total (1 to 11)	48.6	47.9	48.1	48.2	46.1	46.8	47.5

Source : DGCI&S, Kolkata

declining trend. China, on the other hand, has increased its share almost threefold to become the second largest trading partner of India. With rising POL prices, and India not only importing crude oil from but also exporting refined POL products to the United Arab Emirates (UAE), UAE has emerged as the third largest trading partner of India. There is a perceptible change in the share of India's trade with Singapore after the signing of the Comprehensive Economic Cooperation Agreement (CECA) with growth of gems & jewellery, petroleum products and ships and boats on the export side, and machinery and organic chemicals on the import side. In the two most recent years, there is a slight fall in the shares of countries like Belgium and Hong Kong, reflecting the slowdown in both exports and imports of gems & jewellery and related items.

6.40 In terms of export destination, US continued to be the principal destination accounting for 16.8 per cent of India's total exports in 2005-06, followed by UAE (8.4 per cent), China (6.5 per cent), Singapore (5.4 per cent) and U.K. (5.0 per cent). Region wise, Asia and ASEAN countries have emerged as major export destinations. From a level of around 40 per cent in 2001-02, the share of Asia & ASEAN countries (including West Asia

& North Africa (WANA) with a share of 19 per cent and the three China's: China Peoples Republic, Hong Kong and Taiwan with 10 per cent) accounts for half of India's total exports in April-October 2006. During this period, destination-wise, India's exports to Africa, Asia & ASEAN posted strong growth, while exports to Europe and America registered moderate growth. Among the major markets, while growth in exports to UAE, China and Singapore was very high, growth in exports to US and UK was moderate.

6.41 India's merchandise exports to South Asian countries increased by an impressive 19.3 per cent in 2005-06 compared to the 7.3 per cent growth in 2004-05. The major items of India's exports to South Asian countries include: engineering goods, chemicals and related products, petroleum, crude and products, cotton yarn fabrics and made ups, and rice. Similarly, imports from South Asian countries increased by 40.1 per cent in 2005-06 over and above an equally impressive growth of 40.6 per cent posted during a year ago. Major imports include non-ferrous metals, textile yarn fabrics and made ups, iron and steel, spices, organic and inorganic chemicals, artificial resins and plastic material, essential oil and cosmetic preparation and fruits and nuts. This trend is likely to be further

strengthened with South Asian Free Trade Area (SAFTA) coming into force from January 1, 2006. India has already notified the reduction in tariffs as per SAFTA Agreement on July 1, 2006.

6.42 In 2005-06, for India's imports, Asia & ASEAN continued to be the major – and rapidly growing – source accounting for 35.2 per cent of total imports. Country-wise, imports from China recorded high growth of 51.3 per cent over and above the 75 per cent growth in the previous year. Growth of imports from EU25 (with a share of 16.0 per cent) was 19.5 per cent and that from America (with a share of 7.8 per cent) 12.7 per cent. In America, US was the major source of imports; Germany, Belgium and the UK were the major import sources in EU25. In South East Asia, import growth from major sources like Singapore and Thailand and in South Asia, growth in imports from Sri Lanka, Bangladesh and Pakistan and even Maldives were high. In April-October, 2006 very high growth was registered in the case of imports from Africa, mainly due to dramatic growth rates in five digits in imports from Nigeria (mainly crude oil) which also raised its share in India's imports to 4.4 per cent. Among the other regions, growth was high in the case of imports from Latin America and Asia & ASEAN. Imports from major oil exporters like Saudi Arabia, UAE and other WANA countries recorded rapid growth. China, the top import source of India with 9.1 per cent share, recorded growth of 58.1 per cent, while imports from US (with 5.7 per cent share) was also buoyant at 30.2 per cent.

Services Trade

6.43 India has been recording high growth in the export of services during the last few years. Such exports have increased threefold during the last three years; in 2005-06, with a growth of 42.0 per cent, it reached US\$ 61.4 billion. Growth has been particularly rapid in the miscellaneous service category, which comprises of software services, business services, financial services and communication services. In 2005, while India's share and ranking in world merchandise exports were 1 per cent and 29, respectively,

its share and ranking in world commercial services' exports was 2.3 per cent and 11, respectively. By growing faster than merchandise exports, services exports constituted almost 60 per cent of merchandise exports in 2005-06.

Trade Policy

6.44 In the Union Budget 2006-07, the peak rate of basic customs duties was reduced from 15 per cent to 12.5 per cent. RBI, in its Mid-Term Review of Annual Policy 2006-07 of October 2006, has also come out with policies related to exports which include allowing all categories of foreign exchange earners to retain up to 100 per cent of their foreign exchange earnings in their Exchange Earners' Foreign Currency accounts; allowing large turnkey/project exporters/service exporters with satisfactory track record to operate one foreign currency account with inter-project transferability of funds/machinery in any country, subject to specified reporting requirements; and allowing large turnkey/project exporters/service exporters with good track record to deploy their temporary cash surpluses in either short-term bank deposits or AAA-rated short-term paper abroad, subject to monitoring by the authorized dealer bank(s).

6.45 The Annual Supplement of Foreign Trade Policy (FTP) 2004-09, in April 2006, announced the twin schemes of Focus Product and Focus Market. Further, to meet the objective of employment generation (Box 6.5) in rural and semi urban areas, export of village and cottage industry products were included in the Vishesh Krishi Upaj Yojana, renamed as Vishesh Krishi and Gram Udyog Yojana . A number of measures announced to achieve the objective of making India a gems and jewellery hub of the world include: allowing import of precious metal scrap and used jewellery for melting, refining and re-export; permission for export of jewellery on consignment basis; permission to export polished precious and semi precious stones for treatment abroad and re-import in order to enhance the quality and afford higher value in the international market. The value addition norms have been reduced due to the increase

Box 6.5 : Exports and employment

One of the objectives of the FTP was to make trade an instrument for employment generation. A study was also commissioned by the Department of Commerce to find out the employment potential in the export sector.

In 2004-05, against an export of US\$80 billion, the total employment generation in the export sector was 16 million (9 million direct and 7 million indirect). In 2009-10, it is estimated that overall exports of US\$165 billion will result in total employment of 37 million. Thus, exports are likely to generate incremental employment of 21 million between 2004-05 and 2009-10.

In 2004-05, in the export sector, the maximum employment was in agricultural products (6.2 million) followed by mineral products (1.7 million), textile and textile articles (1.7 million) and prepared foodstuff and beverages, etc. (1.6 million). While export has recorded robust growth in recent years, the corresponding growth of export of labour-intensive goods has slowed down. Between 1995 and 2003, while *labour-intensive exports* (rice, tea, spices, horticulture and floriculture products, marine products, processed food, textiles, gems and jewellery, handicrafts, sports goods) grew by 7.2 per cent per year, the growth of *resource-intensive exports* (iron ore), *medium-technology-intensive exports* (manufactures of metals, primary & semi-finished iron and steel, manmade yarns, petroleum products) and *knowledge-intensive exports* (chemicals, drugs and pharma, plastics and linoleum, machinery and transport equipment, machinery, electronic goods) were of the order of 12 per cent, 19 per cent and 14 per cent, respectively. India's relatively small share of global exports of labour-intensive goods relative to China's indicate how the potential for such exports remain unutilized.

Since certain industrial products can generate large employment per unit of investment compared to other products, and promoting their export would in turn give a thrust to their manufacture and resulting employment, in the 2006-07 annual revision of FTP the 'Focus Product Scheme' was formulated. The Scheme allows duty-credit facility at 2.5 per cent of the FOB value of exports on fifty per cent of the export turnover of notified products, such as value added fish and leather products, stationery items, fireworks, sports goods, and handloom & handicraft items. The Vishesh Krishi Upaj Yojana was also launched to promote labour-intensive and value added products such as fruits, vegetables, and flowers. To take the benefits of foreign trade further to rural areas, the Vishesh Krishi Upaj Yojana has been expanded to include village industries based products for export benefits, and it is therefore renamed as Vishesh Krishi Upaj aur Gram Udyog Yojana.

in prices of gold and silver in international markets.

6.46 In order to enable the country to offer supply of fuel and other stores to foreign going vessels and aircrafts at international rates thereby making India an attractive destination for refueling, the Annual Supplement 2006 of FTP, 2004-09 also announced that such supplies would be treated as exports for extending the benefits under various export promotion schemes. To promote development and export of auto sector, import of new vehicles by auto manufacturers has been allowed for R&D purposes, without homologation. A number of procedural changes have been effected to streamline the existing provisions like enabling ITES to avail refund of Central Sales Tax and interest payments on delayed refunds. Through the introduction of duty-free import authorization, a window has been introduced to offer the facility to import required inputs for export

production with the facility of transferability of inputs or the scrip. In order to promote services exports, some new features have been added to the 'Served from India Scheme'. The scheme now allows transfer of both the scrip and the imported input to the Group Service Company while, earlier, transfer of imported material only was allowed. Some policies aimed at simplification include filing of applications for obtaining authorization under duty exemption/remission schemes like Advance authorization/EPCG/DEPB on line with digital signature and payment of fee through Electronic Fund Transfer (EFT) mode.

6.47 A major development related to trade policy was the operationalization of the Special Economic Zone (SEZ) Act 2005. SEZ Act and SEZ Rules were notified on February 10, 2006 to give transparency and stability to the policy. The SEZ Rules provide for differentiated minimum land requirements for different classes of SEZs. Every SEZ is divided into a

Box 6.6 : Special Economic Zones (SEZs)

India was one of the first in Asia to recognize the effectiveness of the Export Processing Zone (EPZ) model in promoting exports, with Asia's first EPZ set up in Kandla in 1965. However, the EPZs were not able to emerge as effective instruments for export promotion on account of multiplicity of controls and clearances, absence of world-class infrastructure and an unstable fiscal regime.

With a view to overcome these shortcomings and attract larger foreign investments in India, the Special Economic Zones (SEZs) Policy was announced in April 2000. This policy was intended to make SEZs an engine for economic growth supported by quality infrastructure complemented by an attractive fiscal package, both at the Centre and the State level, with minimum possible regulations. To instill confidence in investors and signal the Government's commitment to a stable SEZ policy regime and with a view to impart stability to the SEZ regime thereby generating greater economic activity and employment through the establishment of SEZs, the Special Economic Zones Act, 2005, was passed by Parliament in May, 2005. The SEZ Act, 2005, supported by SEZ Rules, came into effect on February 10, 2006. The main objectives of the SEZ Act are generation of additional economic activity, promotion of exports of goods and services, promotion of investment from domestic and foreign sources, creation of employment opportunities and development of infrastructure facilities. Various incentives and facilities are offered to both units in SEZs for attracting investments into SEZs (including foreign investment) as well as for SEZ developers. It is expected that these incentives and facilities will trigger a large flow of foreign and domestic investment in SEZs, in infrastructure and productive capacity, leading to generation of additional economic activity and creation of employment opportunities.

During 2005-06, exports from functioning SEZs, which are mainly the former EPZs were around US\$5 billion. At present 1,016 units are in operation in these SEZs providing direct employment to over 1.79 lakh persons (about 40 per cent of whom are women). Private investment by entrepreneurs for establishing units in these SEZs is of the order of about Rs.3163 crore.

After the SEZ Act and SEZ Rules came into effect on February 10, 2006, formal approval has so far been granted to 237 SEZ proposals and in-principle approval has been granted to 164 SEZ proposals. Out of the 237 formal approvals, notifications have already been issued in respect of 63 SEZs. In these 63 new generation SEZs which have come up after February 10, 2006, investment of the order of Rs.11,194 crore has already been made in less than one year. These SEZs have so far provided direct employment to 15,097 persons. It is expected that total investment in these SEZs would be around Rs.58,459 crore and 8,90,700 additional jobs will be created by December 2009. It is also expected that if all the 237 SEZs become operational, investment of the order of Rs.3,00,000 crore may take place and 4 million additional jobs may be created.

Concerns have been expressed regarding acquisition of agricultural land for setting up SEZs. The State Governments have been advised that in land acquisition for SEZs, first priority should be for acquisition of waste and barren land and if necessary single crop agricultural land could be acquired for the SEZs. If perforce a portion of double cropped agricultural land has to be acquired to meet the minimum area requirements, especially for multi-product SEZ, the same should not exceed 10 per cent of the total land required for the SEZ. Various issues relating to setting up of SEZs in the country including issues raised by various political parties are being addressed by the Empowered Group of Ministers.

processing area where alone the SEZ units would come up and the non-processing area where supporting infrastructure is to be created. The SEZ Rules also provide for simplified procedures for development, operation and maintenance of the SEZ, setting up units in SEZs, single window clearance both relating to Central as well as State Governments for setting up of an SEZ and units in a SEZ, and simplified compliance procedures/documentation with emphasis on self-certification. A Board of Approval has been constituted by Government in exercise of the powers conferred under the SEZ Act (Box 6.6).

6.48 Contingency trade policy and non-tariff measures (NTMs) continued to act as

significant barriers to exports from developing countries, but with somewhat reduced intensity (Table 6.11). Such barriers are considerably stiffer for products with lower value addition and lower technological content (e.g. agriculture, textiles, and leather products), which are of major interest to developing countries like India. With its diversified manufacturing and export base, India has been one of the major users as well as one of the major targets of anti-dumping measures in the world. During January-June 2006, 20 WTO members reported initiating a total of 87 new investigations, down from the 105 initiations in the corresponding period of 2005. India reported the highest anti-dumping

Table 6.11 : Investigations initiated by top ten users of anti-dumping measures, 1995–2006

Country	1995	2000	2001	2002	2003	2004	2005	2006 Jan- June	1995- June 2006
India	6	41	79	81	46	21	28	20	448
United States	14	47	75	35	37	26	12	0	366
European Community	33	32	28	20	7	30	25	17	345
Argentina	27	45	26	14	1	12	12	5	209
South Africa	16	21	6	4	8	6	23	2	199
Australia	5	15	23	16	8	9	7	9	188
Canada	11	21	25	5	15	11	1	4	138
Brazil	5	11	17	8	4	8	6	3	125
Mexico	4	6	5	10	14	6	7	3	89
China, P.R.	0	6	14	30	22	27	24	3	126
All countries	157	292	364	312	232	213	201	87	2938
Source : WTO									

initiations with 20 new initiations (taking each country as one case) followed by European Communities (17) and Australia (9). As far as imposition of new final anti-dumping measures during the first half of 2006 is concerned, China reported applying the largest number (15) followed by Turkey (11), India (8) and Egypt (7).

WTO related issues

6.49 At Hong Kong, in December 2005, WTO Ministers had agreed to establish modalities for agriculture and Non-Agricultural Market Access (NAMA) by April 30, 2006, submit the draft Schedules by July 31, 2006 and conclude the negotiations across all areas of the Doha Round by the end of 2006. In respect of services, all Members were to file their revised offers by July 31, 2006 and submit the draft Schedules by October 31, 2006. These deadlines were missed despite intensive negotiations.

6.50 The intensive discussions through January to July 2006 had focused mainly on the triangular issues of Domestic Support, Agricultural Market Access (AMA), and NAMA. At the informal meeting of the Trade Negotiations Committee (TNC) held on July 24, 2006, the Director General, WTO, who is its Chairman, reported that "it remained clear that the gaps remain too wide", and

recommended that the only course of action would be to suspend the negotiations across the Round as a whole to enable serious reflection by participants. In the light of the impasse particularly in agriculture (Box 6.7), and ruling out the possibility of finishing the Round by the end of 2006, Members agreed to suspend the negotiations across all areas of the Doha Work Programme, and to resume them when the negotiating environment was right.

6.51 For India, the suspension has been a disappointment. It is an avoidable delay on the delivery of the development promises of the Round. India has welcomed the soft resumption of negotiations on November 16, 2006 and subsequently the full-scale resumption on February 7, 2007 on the principles that it preserves the architecture of the negotiations, inclusiveness, and the progress made so far, and leads to an outcome that is balanced, ambitious and pro-development.

India's Regional Trading Arrangements

6.52 India views Regional Trading Arrangements (RTAs) as 'building blocks' towards the overall objective of trade liberalization complementing the multilateral trading system. In the past, India had adopted a very cautious and guarded approach to

Box 6.7 : Agri-exports and India's stand on agricultural issues in WTO

India's total exports of agricultural and allied products including plantations at US \$ 10.5 billion in 2005-06 constitute 10.2 per cent of its export share. Developed country markets continued to account for nearly 35 per cent of India's agri-exports. However, its contribution to national economy is significant in terms of sustaining livelihood of a significant proportion of the population, including a large number of producers and landless agricultural labourers (characterized as low-income and resource-poor). This section of population lack skills and are not covered under any safety nets, which are essential for ensuring a minimal cross-sector labour mobility. Like India, most developing countries are in a similar situation in sharp contrast to the reality of the agriculture sector in developed countries. Apart from a number of agricultural crops, a number of other products, including livestock products, are produced in hilly/mountainous or other disadvantaged regions, or by tribal communities and women. India, and other developing countries, have, therefore, been insisting that special and differential treatment for developing countries must be integral to all aspects, including the negotiated outcome, on agriculture under the Doha Round in the WTO.

Mitigating the risks facing the low-income, resource-poor and subsistence farmers associated with price declines, price volatility and predatory competition and other market imperfections, including the huge amounts of production and trade-distorting subsidies provided by some developed countries to their agriculture sector, remains paramount. Therefore, along with other developing countries, particularly its alliance partners in the G-20 and G-33, India has been emphasizing that the Doha agricultural outcome must include at its core:

- removal of distorting subsidies and protection by developed countries to level the playing field, and
- appropriate provisions designed to safeguard food and/or livelihood security, and to meet the rural development needs in developing countries.

Apart from appropriate policy flexibilities to enable developing country governments to help the low-income and vulnerable producers absorb or insure themselves against risks, India has also taken the stand that governments must also be able to foster stable and remunerative prices for domestic producers in order to increase productivity and gradually move away from dependence on low-productivity agriculture. To these ends, meaningful and effective instruments (Special Products and the Special Safeguard Mechanism) are important for developing countries like India. At Hong Kong, it has been agreed that Special Products and the Special Safeguard Mechanism shall be an integral part of the modalities and the outcome of negotiations in agriculture. Moreover, developing countries shall have the right to self-designate an appropriate number of Special Products, guided by indicators based on the three fundamental criteria of food security, livelihood security and/or rural development needs. These designated products will attract more flexible treatment. Developing country Members will also have the right to have recourse to a Special Safeguard Mechanism based on import quantity and price triggers, with precise arrangements to be further defined.

regionalism. Recognizing that RTAs would continue to feature prominently in world trade, India engaged with its trading partners/blocks with the intention of expanding its export market and began concluding in principle agreements and moving in some cases even towards Comprehensive Economic Cooperation Agreements (CECAs) which covers Free Trade Agreement (FTA) in goods, services, investments and identified areas of economic cooperation. Framework agreements have already been entered into with a number of trading partners with specific road maps to be followed and specified time frames by which the negotiations are to be completed (Box 6.8). Joint Study Groups have also been set up for examining feasibility of CECA between India-Japan, India-Brazil-South Africa and India-Russia. The reports are at various stages of completion. India and

European Commission have also set up a High Level Trade Group (HLTG) as mandated by the India-EU Summit held in New Delhi on September 7, 2005. The mandate of the HLTG is to explore ways and means to increase bilateral economic flows including the possible launching of negotiations on a comprehensive trade and investment agreement.

Capital account

6.53 In 2005-06 and 2006-07 so far, capital flows into India remained strong on an overall basis with capital account surplus rising simultaneously with current account deficit, albeit with varying movements in the different components. Debt creating flows, particularly external assistance and external commercial borrowings (ECBs), which had turned into net outflows in 2002-03 and 2003-04, became positive inflows in 2005-06. Non-resident

Box 6.8: India — Status of FTAs/ RTAs

India-Sri Lanka Free Trade Agreement (ISLFTA)

India-Sri Lanka Free Trade Agreement, signed in December, 1998 and in operation since March, 2000, provided for tariff reduction/elimination in a phased manner on all items except the negative list and tariff rate quota (TRQ) items. While India has already completed the tariff elimination programme in March 2003, Sri Lanka is scheduled to reach zero duty by 2008. The two countries have since initiated negotiations in August 2004 on Comprehensive Economic Partnership Agreement (CEPA) which covers trade in services and investment.

Agreement on SAFTA

The Agreement on South Asia Free Trade Area (SAFTA) was signed during the 12th SAARC Summit on January 6, 2004 in Islamabad. Since then, negotiations on four annexes — Rules of origin, Sensitive lists, Revenue compensation for LDCs, and Technical assistance to LDCs — have been completed. The tariff liberalization programme under the Agreement has been implemented from July 1, 2006.

Framework Agreement on Comprehensive Economic Cooperation between ASEAN and India

Framework Agreement on Comprehensive Economic Cooperation was signed on October 8, 2003 in Bali. The Trade Negotiating Committee (TNC) is negotiating FTA in goods.

Framework Agreement for establishing Free Trade Area between India and Thailand

The Framework Agreement for establishing Free Trade Area between India and Thailand was signed on October 9, 2003 in Bangkok. The Early Harvest Scheme covering 82 items for exchange of concessions between India and Thailand has been implemented with effect from September 1, 2004. The TNC is already negotiating FTA in goods; and negotiations on services and investment are at a preliminary stage.

Framework Agreement on the BIMSTEC FTA

The Framework Agreement on the BIMSTEC (Bay of Bengal initiative for Multi-sectoral Technical & Economic Cooperation) Free Trade Area was signed in February, 2004 at Phuket by Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand. The Framework Agreement provides for implementing FTA on Goods with effect from July 1, 2006. Negotiations are being held by the TNC on FTA in goods, services and investment.

Comprehensive Economic Cooperation Agreement (CECA) between India and Singapore

India-Singapore CECA, signed on June 29, 2005, came into force on August 1, 2005. The Agreement provides for Early Harvest Scheme, phased reduction/elimination of duties on products other than those in the negative list by India by April 1, 2009, whereas Singapore eliminated duties on all products originating from India from August 1, 2005. CECA also covers investment, services, Mutual Recognition Agreement, and customs cooperation.

India-Afghanistan Preferential Trade Agreement

A Preferential Trade Agreement (PTA) between India and Afghanistan was signed on March 6, 2003. India has granted concessions on 38 products, mainly fresh and dry fruits, in return for concessions on 8 items for exports to Afghanistan.

India – MERCOSUR Preferential Trade Agreement (PTA)

A PTA was signed between India and MERCOSUR (Brazil, Argentina, Uruguay and Paraguay) on January 25, 2004 in New Delhi. The annexes to the PTA were signed on March 19, 2005 in New Delhi. The PTA will be operational after its ratification by the legislatures of MERCOSUR countries.

Bangkok Agreement

Bangkok Agreement is a PTA signed in July 1975 among Bangladesh, Republic of Korea, Sri Lanka and India. China acceded to this Agreement in 2001. This Agreement has been renamed as Asia Pacific Trade Agreement (APTA) from November 2, 2005. Three rounds of negotiations have been concluded under this Agreement. The Third Round concessions have been implemented from September 1, 2006.

Global System of Trade Preferences (GSTP)

Two rounds of negotiations have been held under GSTP signed in April 1998. 44 developing countries have acceded to this Agreement. Third round of negotiations, launched in June 2004, are expected to be concluded by the end of 2007.

SAARC Preferential Trade Area (SAPTA)

Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka are participants in the Agreement signed in April, 1993. Four rounds of negotiations have been concluded under SAPTA. Concessions exchanged during the four rounds of SAPTA have already been implemented.

India-Chile Framework Agreement on Economic Cooperation

A Framework Agreement on Economic Cooperation was signed between India and Chile on January 20, 2005. The Agreement envisages a PTA between two sides. The negotiations on PTA have been concluded, and the Agreement was signed on March 8, 2006.

India-Korea Joint Task Force (JTF)

Based on the recommendations of the Joint Study Group (JSG), India and Korea constituted a Joint Task Force for having negotiations on FTA in goods, services and investment. Four Rounds of Negotiations have been held so far.

India-China Joint Task Force (JTF)

A Joint Task Force between India and China has been set up to study in detail the feasibility of, and the benefits that may derive from the possible China-India Regional Trading Arrangement and also give its recommendations regarding its content.

India-Gulf Cooperation Council (GCC) FTA

A Framework Agreement on Economic Cooperation was signed between India and GCC on August 25, 2004. The first round of negotiations on India-GCC FTA was held in Riyadh on March 21-22, 2006 wherein the GCC side agreed to include services as well as investment and General Economic Cooperation, along with goods, in the proposed FTA.

PTA/CECPA between India & Mauritius

A Preferential Trade Agreement (PTA)/Comprehensive Economic Cooperation & Partnership Agreement (CECPA) is being negotiated with Mauritius which is likely to be finalized shortly.

Framework Agreement with South Africa Customs Union (SACU)

A decision has been taken to enter into a Framework Agreement with the South African Customs Union (SACU). The Agreement will aim to promote expansion of trade and provide a mechanism to negotiate and conclude a comprehensive Free Trade Agreement within a reasonable time.

India-Israel Preferential Trade Agreement

Negotiation process for India-Israel Preferential Trade Agreement has commenced.

deposits (net) rebounded after an outflow of about US\$1 billion in 2004-05 to an inflow of US\$2.8 billion in 2005-06. The developments in the first half of 2006-07 indicate some deviation from 2005-06, particularly in FII flows.

6.54 For 2006, the WEO, in both April and September 2006, had projected a moderation of private net capital flows to emerging market economies and developing countries from their torrid pace of 2005, and with overall net surpluses in their current account to result in continuation of the process of reserve accumulation in such countries. For emerging Asian economies, WEO 2006 (both April and September issues) had projected FDI to remain stable but portfolio flows to remain negative (outflows) as in 2005. These projections for 2006 followed the increased volatility observed in stock market crashes and exchange rates pressures in the first half of 2006, after a period of relative calm. The Indian experience in the first half of 2006-07

was more or less in conformity with the WEO projection.

Foreign investment

6.55 Foreign investment (net) receipts, as a proportion of total capital flows, rose steadily from 1.2 per cent in 1990-91 to reach a peak of 155.2 per cent in 1995-96 (all data for the capital account are on BoP basis unless stated otherwise). Thereafter, it declined to reach a low of 29.4 per cent in 1998-99. After some fluctuations in the interim, such investment (US\$17.2 billion) in 2005-06, as a proportion of total capital flows, stood at 71.1 per cent. As a proportion of GDP, foreign investment remained at 0.2 per cent or less till 1992-93. It picked up with reforms to reach 1.6 per cent of GDP in 1996-97, and after some fluctuations in the interim, has remained at about 2 per cent in the latest three years. In the first half of 2006-07, foreign investment (net) declined to US\$5.8 billion from US\$7.5 billion in the first half of 2005-06. Foreign

investment has two components: FDI, and portfolio, with the latter having two sub-components — FII, and Euro equities and others.

Foreign direct investment (FDI)

6.56 FDI inflows (net), which had declined from US\$ 4.7 billion in 2001-02 to US\$ 2.4 billion in 2003-04, continued its growth for the second consecutive year in 2005-06 to climb back to US\$ 4.7 billion again. The overall FDI reported is inward FDI netted for outward FDI. FDI on a comparative net basis, year-on-year, exhibited a growth of 27.4 per cent in 2005-06 reflecting the improved investment climate. Outward investment also simultaneously showed signs of a pick up with domestic companies making deeper forays for acquisitions abroad. FDI inflows were mainly in the form of equity accounting for about 75.2 per cent of the total FDI into India during 2005-06. FDI abroad (outward investment) grew sharply to reach US\$3.2 billion in 2005-06.

6.57 The rising trend in FDI observed in 2005-06 accelerated further in 2006-07. As per provisional data available, FDI (net) in April-September 2006 at US\$4.2 billion was almost twice its level in April-September 2005. As per the latest data on foreign direct investment inflows, there has been a 98.4 per cent jump in the equity investment into India in April-September 2006-07 over April-September 2005-06 levels.

Foreign institutional investment (FII)

6.58 Portfolio flows into India consist of FII flows and resources mobilised by Indian companies through American Depository Receipts (ADRs) and Global Depository Receipts (GDRs). Such flows into India mirror the robustness of capital markets and overall macroeconomic conditions. Portfolio investment picked up steam initially in 1993-94 and later with the deepening of FII flows, shot up rapidly in 2003-04 and 2004-05. In 2005-06, with inflows at US\$68.1 billion and outflows at US\$55.6 billion, net portfolio inflow was a record high of US\$12.5 billion. GDRs/ADRs and others, which are a part of the portfolio flows rose from a level of US\$625

million in 2004-05, to reach US\$2.6 billion in 2005-06.

6.59 In sharp contrast to the increase in FDI in 2006-07 so far, portfolio investment (net) fell sharply from US\$5.4 billion in April-September 2005 to US\$1.6 billion in April-September 2006. While portfolio inflows increased by US\$21.2 billion (from US\$27.5 billion to US\$48.7 billion), outflows increased even more by US\$25.0 billion (from US\$22.1 billion to US\$47.1 billion), during the reference period. The sharp decline in portfolio net inflows was more than the increase in FDI (net) to result in a decline in foreign investment inflows between the first half of the previous year and current year.

6.60 FII inflows (net), which had shot up to US\$10.9 billion in 2003-04, after remaining strong in the two subsequent years, turned into a net outflow in the first six months of the current financial year. Data on FII (net) for April-November 2006, as released by RBI, report an inflow of US\$3.8 billion indicating a subsequent reversal, which may get reflected in the partially revised data of BoP at a later date.

External commercial borrowings (ECBs)

6.61 ECBs, which are medium and long-term loans, have seen net outflows only in four out of the last sixteen years ending in 2005-06. The most recent period of such net ECB outflows were the three year period 2001-04. ECBs turned back into net inflows in 2004-05, and such inflows were US\$2.7 billion in 2005-06. During the first half of the current year, such net inflows rose to US\$5.1 billion. On a gross basis, in the first half of the current year, inflow of ECBs rose to US\$7.1 billion from US\$6.4 billion in the first half of 2005-06, while repayments of such ECBs declined by 42.5 per cent. With acceleration in growth of manufacturing sector, improvement in India's credit rating, and the current interest and exchange rate outlook, ECBs continued to remain attractive for funding purposes.

6.62 Apart from ECBs, debt flows in the capital account comprise of two more components – external assistance and short-

Table 6.12 : Outstanding balances and net flows under various non-resident deposit Schemes

Panel A : Outstanding balances under different schemes*								
<i>(US\$ million)</i>								
As at the end of								
	March 2000	March 01	March 02	March 03	March 04	March 05	Mar-06 (P.E.)	Nov-06 (P.E.)
Foreign Currency Non-Resident (Banks)	8172	9076	9673	10199	10961	11452	13064	14270
Non-Resident External Rupee Accounts	6758	7147	8449	14923	20559	21291	22070	23481
Non-Resident (Non Repatriable) Rupee Deposits	6754	6849	7052	3407	1746	232		
Total	21684	23072	25174	28529	33266	32975	35134	37751
B. Net flows under non-resident deposits*								
<i>(US\$ million)</i>								
Schemes	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	Apr-Nov (P.E.)	
							2005-06	2006-07
FCNR(B)	904	594	526	762	492	1612	-32	1206
NR(E)RA @	860	1626	6195	4695	84	1177	508	1509
NR(NR)RD	553	508	-3745	-1816	-1538			
Total	2317	2728	2976	3641	-962	2789	476	2715
P.E.: Provisional Estimates.								
* All figures are inclusive of accrued interest.								
@ The inflows into NR(E)RA deposits from the year 2002-03 onwards may partly be due to crediting of maturity proceeds of the NR(NR)R deposits which were discontinued with effect from April 1, 2002.								
Note: Inflows/Outflows have been calculated by taking the monthly variation in rupee denominated deposits & converting those by monthly average exchange rate. All figures are inclusive of interest & valuation changes arising on account of fluctuation in non dollar currencies against US dollar.								
Source : RBI								

term loans. External assistance (net), which is loans from official sources at concessional rates, after being net outflows in the two years ending in 2003-04, remained positive in 2005-06. Short-term external loans to India in April-September 2006 exhibited a growth of 22.2 per cent, and with their repayments rising by 13.4 per cent, the net inflows from such short-term loans almost doubled.

Non-resident deposits

6.63 In the last sixteen years ending 2005-06, non-resident deposits remained an important and relatively stable source of capital flows. As a proportion of total capital flows, it had strengthened in the four-year period 2000-04 to above 20 per cent. But, such deposits became a source of negative flows in 2004-05. There was a resumption of the earlier trend in 2005-06, with the proportion rising to 11.5 per cent.

6.64 With the discontinuance of Non-Resident (Non-Repatriable) Rupee deposits with effect from April 1, 2002, the outstanding on the other two forms of NRI deposits, namely, NR(E)RA and FCNR(B) at US\$35.1 billion at end-March 2006 are mainly on account of the former. At end-November 2006, such outstandings at US\$37.8 billion, however, indicate growth in both forms. FCNR(B) inflows have been strong in every single month in 2006-07 up to November 2006. NR(E)RA flows have also been strong in the same period, but were marginal in the months of April and October. Together, these resulted in the total inflows of US\$2.7 billion in both the non-resident accounts as against US\$ 476 million in the corresponding period of the previous year (Table 6.12).

Exchange rate developments

6.65 With a flexible exchange rate regime, and interventions limited to maintaining orderly market conditions, the Rupee exhibited considerable two-way movement in 2005-06 and 2006-07 so far. The average annual exchange rate of the Rupee steadily depreciated from Rs.33.45 per US dollar in 1995-96 to Rs.48.40 per US dollar in 2002-03. It has since appreciated steadily to reach Rs.44.27 per US dollar in 2005-06.

6.66 Movements in monthly average exchange rates and daily exchange rates provide further evidence of the flexibility of the Rupee exchange rate. The monthly exchange rate of the Rupee vis-à-vis the US dollar has moved in the range of Rs.43.49 to Rs.46.34 in the last two years. Against other major world currencies, particularly Euro and Pound, the Rupee has exhibited similar two-way movements.

6.67 In 2006-07 so far, in terms of the monthly average of the exchange rate of the Rupee vis-à-vis the US dollar, the rupee depreciated steadily until August 2006, before starting to appreciate thereafter. This broad pattern was mirrored even in the Rupee rates vis-à-vis the other major currencies such as Euro and Pound. Against Yen, however, the Rupee started appreciating from June 2006 rather than August 2006.

6.68 The NEER-5 (base 2000=100) composed of a basket of five currencies, namely, US dollar, Euro, Pound Sterling and Yen, had been depreciating on a yearly basis till 2004-05 to reach a level of 90.76. With a bout of appreciation initially in April-July 2005 and subsequently in January-February 2006, it rose, on an annual basis, to 94.06. It depreciated steadily in 2006-07 till August 2006, reaching a low of 88.05, whereafter it has picked up and was at 91.31 in November 2006.

6.69 The real effective exchange rate (REER), which is the NEER adjusted for price differentials, displayed some signs of appreciation. REER-5 (Base 2000=100) with the same currency basket as NEER-5, rose steadily to reach 106.79 in 2005-06. During 2006-07, it declined to reach a level of 100.65 in August 2006 and thereafter has risen to 109.04 in November 2006.

Foreign exchange reserves

6.70 The continuance of the robust net capital inflows not only helped finance the rising current account deficits seamlessly, but also resulted in further accretion to foreign exchange reserves. During 2005-06, accretion of such reserves through the BoP was US\$15.1 billion. With the US dollar appreciating vis-à-vis other major currencies, there was a valuation loss of US\$5.0 billion

Table 6.13 : Sources of accretion to foreign exchange reserves

(US\$ billion)

Items	2004-05	2005-06	April-September	
			2005-06	2006-07
I. Current account balance	-5.4	-10.6	-7.2	-11.7
II. Capital account (net) a to f	31.6	25.7	13.7	20.3
a. External assistance	1.9	1.4	0.4	0.4
b. External commercial borrowings	5.0	1.6	2.9	5.1
c. Foreign investment	12.2	18.2	7.5	5.8
d. Short-term credit	3.8	1.7	1.0	1.9
e. Banking capital	3.9	1.4	2.8	3.2
Of which : NRI deposits	-1.0	2.8	0.2	2.0
f. Other items in capital account	4.8	1.4	-0.9	3.9
III. Valuation change	2.4	-5.0	-5.0	5.1
TOTAL (I+II+III)	28.6	10.1	1.5	13.7

Source : Reserve Bank of India, Mumbai.

on the existing stock of foreign exchange reserves (Table 6.13). Thus, during 2005-06, foreign exchange reserves rose by US\$10.1 billion from US\$141.5 billion at end-March 2005 to US\$151.6 billion at end-March 2006. In the first half of 2006-07, accretion of reserves through the BoP was US\$8.6 billion. With other major currencies appreciating vis-à-vis the US dollar, there was a valuation gain of US\$5.1 billion on the existing stock of foreign exchange reserves. Thus, during April-September 2006, foreign exchange reserves rose by US\$13.7 billion from US\$151.6 billion at end-March 2006 to US\$165.3 billion at end-September 2006.

6.71 Balance of payments data is available only up to September 2006. With active purchase of foreign exchange by RBI of US\$9.8 billion in the first nine months of 2006-07, the stock of foreign exchange reserves reached US\$180.0 billion on February 2, 2007. The sustained appreciation of other major currencies vis-à-vis the US dollar in the current year

suggests that cumulative accretion to reserves of US\$28.4 billion up to February 2, 2007 includes a large element of valuation gain. Foreign exchange reserves on February 2, 2007 provided an import cover of about 11 months.

External debt

6.72 India's external debt stock stood at US\$126.4 billion at end-March 2006, reflecting an increase of US\$3.2 billion over the year. After increasing by US\$5.8 billion in the first quarter of 2006-07, it increased by a further US\$4.3 billion in the second. The total external debt of the country stood at US\$136.5 billion (Rs. 638,181 crore) at the end of September 2006 (Table 6.14). The rise in external debt stock during this period was brought about essentially by a rise in ECBs, NRI deposits and short-term debt. As compared to end-March 2006, long-term debt at US\$125.9 billion and short-term debt at US\$10.6 billion at the end of September 2006 were higher by 7.0 per cent (or US\$8.2 billion) and 21.7 per cent (or US\$1.9 billion), respectively.

Table 6.14 : India's external debt

	End-March				End June	End Sept.
	2003R	2004R	2005R	2006R	2006R	2006QE
	(US \$ million)					
Long-term debt	100,245	107,214	115,680	117,695	123,098	125,937
Short-term debt	4,669	4,431	7,524	8,696	9,105	10,579
Total external debt	104,914	111,645	123,204	126,391	132,203	136,516
	(Rupees crore)					
Long-term debt	476,624	471,827	506,467	525,392	568,969	589,565
Short-term debt	22,180	19,251	32,922	39,199	41,960	48,616
Total external debt	498,804	491,078	539,389	564,591	610,929	638,181
	(Ratio as per cent)					
External debt to GDP	20.4	17.8	17.3	15.8	*	*
Short-term debt to total external debt	4.5	4.0	6.1	6.9	6.9	7.7
Short term debt to foreign currency assets	6.5	4.1	5.6	6.0	5.8	6.7
Debt service ratio	16.0(12.4)	15.9(8.1)	6.1(5.7)	10.2(6.1)	*	*
Concessional debt to total debt	36.8	36.1	33.0	31.2	30.1	29.3
R : Revised QE : Quick Estimates * : Not computed for the broken year.						
Note : Figures in brackets indicate debt service ratios excluding exceptional transactions such as prepayments for 2002-03 and 2004-05, and prepayments as well as redemptions of Resurgent India Bonds (RIBs) for 2003-04 and pre-payments as well as redemption of India Millennium Deposits in 2005-06.						

Table 6.15 : International comparison of external debt– 2004

Sl. No.	Country	Total external debt (US \$ billion)	Debt sustainability indicators			
			Debt to GNI	Debt service	Short term debt to total external debt	Concessional debt to total debt
(ratio as per cent)						
1	China	248.9	12.9	3.5	47.2	15.5
2	Brazil	222.0	38.0	46.8	11.4	1.5
3	Russian Federation	197.3	34.7	9.8	17.8	0.0
4	Argentina	169.2	117.4	28.5	16.2	0.8
5	Turkey	161.6	53.6	35.9	19.7	2.9
6	Indonesia	140.6	56.5	22.1	17.4	27.7
7	Mexico	138.7	20.8	22.9	6.6	1.0
8	India*	122.7	17.9	6.1**	6.1	35.0
9	Poland	99.2	41.7	34.6	17.0	6.4
10	Hungary	63.2	66.8	25.2	19.5	0.3

* According to World Bank data.
 ** As World Bank did not provide debt service ratio for India for 2004, information has been taken from India's External Debt: A Status Report

Source : Global Development Finance 2005, The World Bank.

6.73 Debt servicing as a proportion of gross external current receipts rose from 6.1 per cent in 2004-05 to 10.2 per cent in 2005-06, mainly due to the one-off redemption payments of India Millennium Deposits. With rapidly rising imports and import-related trade credit, short-term debt rose both as a proportion of total debt as well as a proportion of foreign currency assets. While external debt has increased in absolute terms, as a proportion of GDP, it has dropped from 17.3 per cent at end-March 2005 to 15.8 per cent at end-March 2006. Furthermore, according to the Global Development Finance 2006, (World Bank), India was eighth in position among the top ten debtor countries in 2004 after China, Brazil, Russian Federation, Argentina, Turkey, Indonesia and Mexico (Table 6.15). This contrasts with India being the third largest debtor country in the world in 1991.

6.74 The cautious external debt management policy pursued by the Government focuses on raising funds on concessional terms and from less expensive sources with longer maturities, monitoring of short-term debt, prepaying high-cost loans, restricting end-use and enforcing limits on ECBs and encouraging non-debt creating

capital flows. This has helped in containing the accumulation of external debt and maintaining external debt within manageable limits.

6.75 In the Report of the Committee on Fuller Capital Account Convertibility (Tarapore Committee II), there are several recommendations on external debt management (Box 6.9).

6.76 As part of the Special Data Dissemination Standards of IMF, the member countries disseminate data on external debt on a quarterly basis in different formats. To facilitate cross-country comparisons, World Bank and IMF developed jointly a centralized database system called 'Quarterly External Debt Statistics (QEDS)' prescribing certain standard formats of debt data reporting. India formally joined QEDS during the year (in November 2006) by supplying external debt data for the quarter ending June 2006 to World Bank in the prescribed format. As per their request, similar details were also furnished subsequently for the period of end-March 2006. The external debt data for India in the QEDS main table provides quarter wise data on calendar year basis (Box 6.10).

Box 6.9 : Committee on Fuller Capital Account Convertibility (Tarapore Committee II) - Recommendations concerning external debt

- Overall ECB ceiling as also the ceiling for automatic approval should be gradually raised. Rupee denominated ECB (payable in foreign currency) should be outside the ECB ceiling. ECBs of over 10-year maturity in Phase I* and over 7-year maturity in Phase II* should be outside the ceiling. End-use restriction should be removed in Phase I.
- Volume of trade credit should be a matter of concern, as there could be sudden changes in the availability of such credit. Furthermore, adequate coverage of trade credit figures, even while noting that suppliers' credit of less than 180 days are excluded from these data, should also be a matter of concern. Import-linked short-term loans should be monitored in a comprehensive manner. The per transaction limit of US\$20 million should be reviewed and the scheme revamped to avoid unlimited borrowing.
- The banks' borrowing facilities are at present restrictive, though there are various special facilities which are outside the ceiling. The limits for borrowing overseas should be linked to paid-up capital and free reserves, and not to unimpaired Tier-I capital, as at present, and raised substantially to 50 per cent in Phase I, 75 per cent in Phase II and 100 per cent in Phase III*. Ultimately, all types of external liabilities of banks should be within an overall limit.
- At present only NRIs are allowed to maintain FCNR(B) and NR(E)RA deposits. Non-residents (other than NRIs) also should be allowed access to these deposit schemes. Since NRIs enjoy tax concessions on FCNR(B) and NR(E)RA deposits, it would be necessary to provide FCNR(B)/NR(E)RA deposit facilities as separate and distinct schemes for non-residents (other than NRIs) without tax benefits. In Phase I, the NRs (other than NRIs) could be first provided the FCNR(B) deposit facility, without tax benefits, subject to Know Your Customer/Financial Action Task Force (KYC/FATF) norms. In Phase II, the NR(E)RA deposit scheme, with cheque writing facility, could be provided to NRs (other than NRIs) without tax benefits after the system has in place KYC/FATF norms. The present tax regulations on FCNR(B) and NR(E)RA deposits for NRIs should be reviewed by Government.
- The present FII limit for investment of US\$2 billion in G-secs (Centre and States) as a percentage of total gross issuances of Centre and States for 2005-06 amounts to only 4.8 per cent. Rather than an *ad hoc* fixation of ceiling, the ceiling should be calibrated as a percentage of annual gross issuance and this ceiling should be gradually raised.
- The limit for FII investment in G-secs could be fixed at 6 per cent of total gross issuances by the Centre and States during 2006-07 and gradually raised to 8 per cent of gross issuance between 2007-08 and 2008-09, and to 10 per cent between 2009-10 and 2010-11. The limits could be linked to the gross issuance in the previous year to which the limit relates. The allocation by Securities and Exchange Board of India (SEBI) of the limits between 100 per cent debt funds and other FIIs should be discontinued.
- The FII ceiling for investments in corporate bonds of US\$1.50 billion should in future be linked to fresh issuances and the present absolute limit should be retained for the year 2006-07 and be fixed at 15 per cent of fresh issuances between 2007-08 and 2008-09 and at 25 per cent between 2009-10 and 2010-11. The allocation by SEBI of the limits between 100 per cent debt funds and other FIIs should be discontinued.

* Phase I: 2006-07, Phase II: 2007-08 & 2008-09 and Phase III: 2009-10 & 2010-11

Box 6.10 : World Bank/IMF's QEDS - Gross external debt position by sector

(in US \$ million)

	2006Q1	2006Q2	2006Q3
General Government	45236.0	45877.0	46396.0
Short-term	0.0	0.0	0.0
Money market instruments			
Loans			
Trade credits			
Other debt liabilities			
Arrears			
Other			
Long-term	45236.0	45877.0	46396.0
Bonds and notes	270.0	375.0	538.0
Loans	43906.0	44435.0	44797.0
Trade credits	1060.0	1067.0	1061.0
Other debt liabilities			
Monetary Authorities	0.0	0.0	0.0
Short-term	0.0	0.0	0.0
Money market instruments			
Loans			
Currency and deposits			
Other debt liabilities			
Arrears			
Other			
Long-term	0.0	0.0	0.0
Bonds and notes			
Loans			
Currency and deposits			
Other debt liabilities			
Banks	35809.0	36254.0	37161.0
Short-term	0.0	0.0	0.0
Money market instruments			
Loans			
Currency and deposits			
Other debt liabilities			
Arrears			
Other			
Long-term	35809.0	36254.0	37161.0
Bonds and notes	40.0	41.0	41.0
Loans	635.0	562.0	557.0
Currency and deposits	39134.0	35651.0	36563.0
Other debt liabilities			
Other Sectors	45346.0	50072.0	52959.0
Short-term	8696.0	9105.0	10579.0
Money market instruments			
Loans			
Currency and deposits			
Trade credits	8696.0	9105.0	10579.0
Other debt liabilities			
Arrears			
Other			
Long-term	36650.0	40967.0	42380.0
Bonds and notes	9397.0	11605.0	11919.0
Loans	26507.0	28627.0	29743.0
Currency and deposits			
Trade credits	746.0	735.0	718.0
Other debt liabilities			
Direct investment: Intercompany lending			
Debt liabilities to affiliated enterprises			
Arrears			
Other			
Debt liabilities to direct investors			
Arrears			
Other			
Gross external debt position	126391.0	132203.0	136516.0
The data on external debt of India as well as of other countries, on a comparable basis is available at the website www.worldbank.org of the World Bank.			

Outlook

6.77 In the coming year, the external economic environment is likely to remain supportive of India's growth momentum. Global output growth in 2007 has been projected at 4.9 per cent by WEO (September 2006).

6.78 With the ongoing upswing in investment, exports are expected to continue with its observed buoyancy in recent years. Simultaneously, rising investment and higher growth will also result in higher imports. But, a continuation of the relatively benign crude prices of recent months will have a softening impact on import growth. The current account of the balance of payments, which had turned into a deficit in 2004-05 and 2005-06, is likely to remain in deficit in 2006-07. However, going forward, this deficit may come down with rapid growth in invisibles (particularly software and business services) receipts, higher exports, and a slowing down of import growth. From the investment-saving perspective to the current account, the observed increase in the domestic savings rate, with accelerating growth and declining dependency ratio, also supports such a prognosis.

6.79 While downside risks from volatile crude prices and large global imbalances

remain, with strong capital flows – particularly of the non-debt variety — financing the current account deficit through surpluses on the capital account should not pose difficulties. In fact, it is quite likely that the 'problems of plenty' with large increases in foreign exchange reserves will continue with its associated implications for monetary management.

6.80 The Economic Advisory Council to the Prime Minister has raised certain valid issues in the context of projections of BoP for 2006-07 like the need to reconcile divergence of trade data between DGCI&S and RBI, the need to cut delays and ensure its timely availability, and minimizing the extent of revisions. Though beyond the final revisions of data (or even after about a year) there has been lesser divergence, the estimation of the various parameters of external sector, so critical for its management, has become arduous. The movement towards fuller capital account convertibility may also require a sound system of monitoring of the external sector variables and hence a modern real time system of data management is an imperative, lest the ability of the country to diagnose the symptoms of a crisis in time and take corrective action stands compromised.