External Sector

6

CHAPTER

The year 2008-09 was marked by adverse developments in the external sector of the economy, particularly during the second half of the year, reflecting the impact of global financial crisis on emerging market economies including India. Emerging economies were affected in varying degrees depending upon the extent of openness and the dependence on capital flows as the external environment deteriorated on account of slowdown in global demand, reversal of capital flows and reduced access to external sources of finance in the face of adverse global credit market conditions.

6.2 The external sector of the Indian economy exhibited resilience despite sharp deceleration in net capital flows during 2008-09 (April-December), which turned negative during October-December 2008. The impact of slowdown in export demand was partly offset by lower oil imports bill during October-December 2008 due to decline in the prices of crude in the international markets. The non-oil imports also moderated, following decline in commodity prices. The invisible receipts, particularly remittances and software services remained higher during April-December 2008 than the corresponding period last year. India remained an attractive investment destination as FDI flows on net basis (inward FDI-outward FDI) more than doubled to US$ 15.4 billion during April-December 2008 (US$ 6.9 billion during April-December 2007). The comfortable foreign exchange reserves position also alleviated the impact of global crisis on the external sector of the economy.

6.3 With gradual deepening of the global financial crisis, its impact was transmitted from the financial sector to real economic activity in advanced countries and then to emerging economies through the trade and financial channels. Growth in the volume of global trade in goods and services, which had shown signs of weakness in 2007, decelerated further in 2008 and is projected to record a decline of 11.0 per cent in 2009 (Table 6.1). Both import

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

Sl. No.	Items	2006	2007	2008	2009 Projection
1.	World Trade Volume (Goods & Services)	9.2	7.2	3.3	-11.0
2.	Imports				
	Advanced Economies	7.6	4.7	0.4	-12.1
	Emerging and Developing Economies	13.2	14.0	10.9	-8.8
3.	Exports				
	Advanced Economies	8.5	6.1	1.8	-13.5
	Emerging Markets and Developing Economies	10.9	9.5	6.0	-6.4
4.	World Trade Prices				
	Fuel (energy)	19.2	10.5	40.1	-94.4
	Non Fuel	23.2	14.1	7.5	-27.9
5.	Capital Flows				
	Emerging Market and Developing Countries - Private Capital Flows (Net) in US $ billion	202.8	617.5	109.3	-190.3

Source : World Economic Outlook - April 2009, IMF

and export volume growth rates decelerated in 2008, with the decline being sharper in advanced countries. The International Monetary Fund (IMF) projections indicate that fuel (energy) prices are expected to decline by 94.4 per cent in 2009, while non-fuel prices are estimated to show a decline of 27.9 per cent.

6.4 Capital flows to emerging and developing economies declined from a peak of US$ 617.5 billion in 2007 to US$ 109.3 billion in 2008. The situation is expected to deteriorate significantly in 2009, as it is estimated that there would be a capital outflow of US$ 190.3 billion from emerging and developing economies.

Balance of payments (BoP)

6.5 Emerging market economies like India were not significantly affected by the global financial crisis in the initial stages, which had set in around August 2007. In fact, the initial effect of the global financial crisis was positive, as India received huge Foreign Institutional Investment (FII) inflows of US$ 22.5 billion during September 2007 to January 2008, as against US$ 11.8 billion during April-July 2007. This contributed to the debate on "decoupling", where it was believed that the emerging economies might remain largely insulated from the crisis and provide an alternative engine of growth to the world economy. The argument was proved unfounded as the global financial crisis intensified and spread to emerging economies through capital and current account routes of the balance of payments (BoP).

6.6 The global crisis began to impact emerging market economies through slowing down and reversal of capital flows. The portfolio flows to India (net) turned negative due to sale of equity stakes by Foreign Institutional Investors (FIIs) to replenish overseas cash balances. This had knock-on effect on the stock market and the exchange rates through creating a supply-demand imbalance in the foreign exchange market.

6.7 The current account was also affected after September 2008 through slowdown in exports. The exports of US$ 36.7 billion in the third quarter (October-December, Q3) of the 2008-09 indicated 10.4 per cent decline over the third quarter of 2007-08, as against an increase of 33.0 per cent in Q3 of 2007-08 over Q3 of 2006-07. During 2008-09 (April-December 2008), the current account deficit was 4.1 per cent and capital account surplus 1.8 per

Table 6.2 : Balance of payments : Summary

(US$ million)

Sl. No.	Items	2003-04	2004-05	2005-06	2006-07	2007-08	Apr-Dec. 2007	Apr-Dec. 2008
						PR	PR	P
1.	Exports	66285	85206	105152	128888	166163	113614	133527
2.	Imports	80003	118908	157056	190670	257789	182894	238864
3.	Trade Balance	-13718	-33702	-51904	-61782	-91626	-69280	-105337
4.	Invisibles (net)	27801	31232	42002	52217	74592	53772	68868
	Non-Factor Services	10144	15426	23170	29469	37565	29998	37133
	Income	-4505	-4979	-5855	-7331	-4917	-4657	-3341
	Pvt. Transfers	21608	20525	24493	29825	41705	28323	34904
5.	Goods and Services Balance	-3574	-18276	-28734	-32313	-54061	-39282	-68204
6.	Current Account Balance	14083	-2470	-9902	-9565	-17034	-15508	-36469
7.	External Assistance (net)	-2858	1923	1702	1775	2114	1274	1861
8.	Commercial Borrowing (net)	-2925	5194	2508	16103	22633	17410	7114
9.	Non-resident Deposits (net)	3642	-964	2789	4321	179	-931	2115
10.	Foreign Investment (net) of which	13744	13000	15528	14753	44957	40197	4032
	(I) FDI (Net)	2388	3713	3034	7693	15401	6905	15373
	(II) Portfolio	11356	9287	12494	7060	29556	33292	-11341
11.	Other Flows (net)[a]	5735	9476	2427	9219	39315	34732	967
12.	Capital Account Total (net)	17338	28629	24954	46171	109198	82682	16089
13.	Reserves (increase (-) /decrease (+)	-31421	-26159	-15052	-36606	-92164	-67174	+ 20380

Source : RBI **PR: Partially Revised** **P: Preliminary**

a Includes, among others delayed export receipts and errors and omissions.

cent of GDP, leading to decline in foreign exchange reserves (excluding valuation) of US$ 20.4 billion, as against an accretion to reserves of US$ 67.2 billion in April-December 2007. However, despite setback, the BoP situation of the country continues to be resilient.

6.8 The current account, which had recorded an annual average surplus of 1.4 per cent of GDP during 2001-02 to 2003-04, returned to an annual average deficit of 1.1 per cent during 2004-05 to 2007-08. The current account deficit widened to 4.1 per cent of GDP during April-December 2008, following the slowdown in external demand and deceleration in capital flows.

6.9 Capital inflows, as a proportion of GDP, were on an uptrend during 2003-04 to 2007-08. They reached a high of 9.3 per cent of GDP in 2007-08 after a modest growth of 3.1 per cent in 2005-06 and 5.1 per cent in 2006-07. Capital inflows were lower at 1.8 per cent of GDP during 2008-09 (April-December) due to the global financial crisis.

6.10 With capital inflows exceeding current account deficits, foreign exchange reserves increase, on BoP basis (excluding valuation changes), was of the order of US$ 15.1 billion in 2005-06 (1.9 per cent of GDP), US$ 36.6 billion in 2006-07 (4.0 per cent of GDP) and US$ 92.2 billion (7.9 per cent of GDP) in 2007-08. During 2008-09 (April-December), foreign exchange reserves decline was US$ 20.4 billion (2.3 per cent of GDP) (Table 6.2).

Table 6.3 : International Comparison of Balance on Current Account

(as per cent of GDP)

Country/ Country Group	2001	2005	2006	2007	2008
Country					
Russia	11.1	11	9.5	5.9	6.1
China	1.3	7.2	9.5	11.0	10.0
India	0.3	-1.3	-1.1	-1.0	-2.8
Korea	1.6	1.8	0.6	0.6	-0.7
Brazil	-4.2	1.6	1.3	0.1	-1.8
Mexico	-2.6	-0.5	-0.5	-0.8	-1.4
South Africa	0.3	-4.0	-6.3	-7.3	-7.4
Country Group					
Advance Economies	-0.8	-1.1	-1.3	-1.0	-1.1
Central and Eastern Europe	-1.9	-4.8	-6.5	-7.7	-7.6
Developing Asia	1.5	4.0	6.0	6.9	5.8
Middle East	6.4	19.7	21.0	18.2	18.8

Source : World Economic Outlook Database, April 2009.

6.11 A comparison of current account position across country groups during 2001-08 reveals that advanced economies and central and eastern Europe recorded current account deficits, while developing Asia and Middle East showed current account surpluses. The current account surplus of China improved steadily from 1.3 per cent of GDP in 2001 to 11.0 per cent in 2007 and was 10.0 per cent in the year 2008, characterized by an adverse external environment (Table 6.3). India's current account deficit moved in a narrow range of 1.0-1.3 per cent and was 2.8 per cent in 2008.

6.12 The rising trend in capital inflows in India has been accompanied by a significant change in composition. The most welcome feature was the rise in inward foreign direct investment inflows (net) to US$ 22.7 billion in 2006-07, which further increased to US$ 34.2 billion in 2007-08. Notwithstanding a steady rise in outward FDI (net) from US$ 15.0 billion in 2006-07 to US$ 18.8 billion in 2007-08, the overall net FDI flows increased. In the fiscal 2008-09 (April-December), inward FDI flows (net) was US$ 27.4 billion while the outward FDI (net) was US$ 12.0 billion, resulting in net FDI of US$ 15.4 billion. Net portfolio investment also increased from US$ 7.1 billion in 2006-07 to US$ 29.6 billion in 2007-08. During 2008-09 (April-December), however, there was a net outflow of US$ 11.3 billion on account of global financial crisis.

6.13 On the debt side, net external assistance increased from US$ 1.8 billion in 2006-07 to US$ 2.1 billion in 2007-08. In 2008-09 (April-December) net credit from external assistance sources was US$ 1.9 billion. Net external commercial borrowings (ECBs) increased from US$ 16.1 billion during 2006-07 to US$ 22.6 billion in 2007-08, before falling to US$ 7.1 billion during April–December 2008. Net non-resident Indian (NRI) deposit flows which had declined from US$ 4.3 billion in 2006-07 to US$ 0.2 billion in 2007-08 increased to US$ 2.1 billion during 2008-09 (April-December), reflecting the impact of an upward adjustment in interest rates on NRI deposits. The net trade credit to India, which had increased from US$ 6.6 billion in 2006-07 to US$ 17.2 billion in 2007-08, was only US$ 0.5 billion during 2008-09 (April-December).

Current Account

6.14 Under current account of the BoP, transactions are classified into merchandise (exports and imports) and Invisibles. Invisible transactions are further classified into three categories, viz. (a) Group

Figure 6.1 (i) : Current account deficit, goods & services, trade and invisibles balance as a per cent of GDP

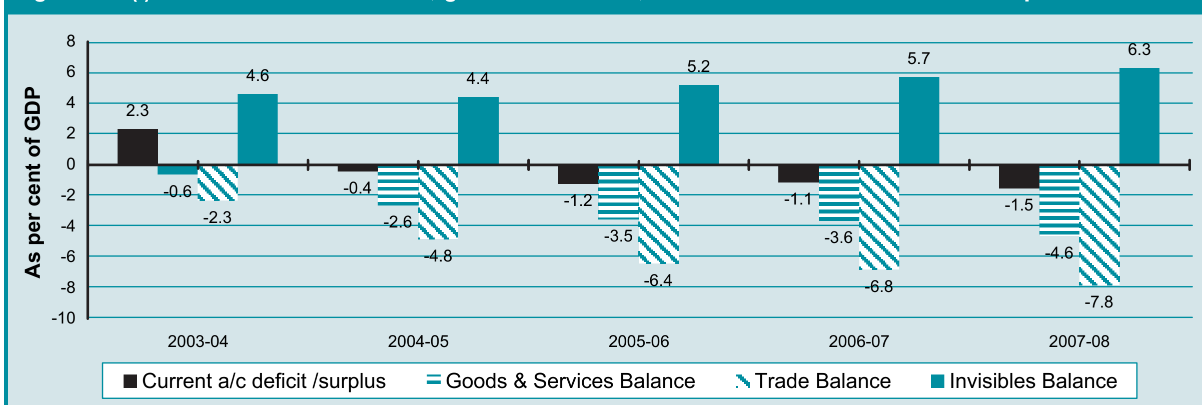
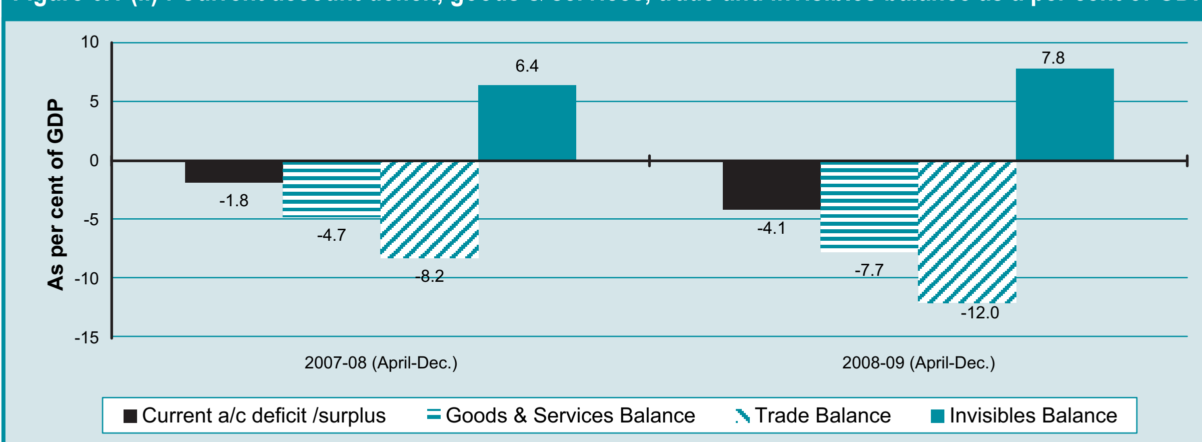


Figure 6.1 (ii) : Current account deficit, goods & services, trade and invisibles balance as a per cent of GDP



of Services–Travel, Transportation, Insurance, Government Not Included Elsewhere (GNIE) and Miscellaneous Services, which encompass communication services, construction services, financial services, software services, news agency services, royalties, management services and business services, (b) Income, and (c) Transfers (grants, gifts, remittances, etc) which do not have any *quid pro quo.*

6.15 The current account, after being in surplus during 2001-02 to 2003-04, reverted to a deficit from the year 2004-05. This was despite a robust growth in net invisibles account fuelled by software exports and private transfers. Thus, large merchandise trade deficit coexisted with a lower deficit on the goods and services account because of the surplus on non-factor services (Figure 6.1). The current account therefore has been characterised by persistence of high trade deficit and buoyant invisibles surplus, which have provided support to current account position.

Merchandise

6.16 A widening of merchandise trade was one way to absorb foreign savings and the increase in exports and imports was a key component of the growth process. Exports rose from 11.0 per cent of GDP in 2003-04 to 14.1 per cent in 2007-08 and 15.2 per cent during 2008-09 (April-December) (Table 6.4). The average annual growth rate of exports during 2005-06 to 2007-08 was 25.0 per cent. Imports, however, grew even faster at an annual average rate of 29.5 per cent during 2005-06 to 2007-08. As a proportion of GDP, imports were 22.0 per cent of GDP in 2007-08 while exports were at 14.2 per cent. Thus, trade deficit widened to 7.8 per cent of GDP in 2007-08. The higher trade deficit could be attributed to a rise in imports of petroleum, oil and lubricants (POL) as well as non-POL imports.

6.17 In the year 2008-09 (April-December), India's merchandise exports (on BoP basis) at US$ 133.5 billion posted a growth of 17.5 per cent as compared with 23.0 per cent in the corresponding period of 2007-08. As per the data available for April-November 2008 from the DGCI&S, the exports of engineering goods and petroleum products showed higher growth, while growth in exports of textile products, ores and minerals, and gems and jewellery registered sharp deceleration.

Table 6.4 : Selected indicators of the external sector

Sl. No.	Items	Years 2003-04	2004-05	2005-06	2006-07	2007-08	April-Dec. 2007-08	April-Dec. 2008-09
1.	Growth of exports - BOP (%)	23.3	28.5	23.4	22.6	28.9	21.9	17.5
2.	Growth of imports - BOP (%)	24.1	48.6	32.1	21.4	35.2	28.3	30.6
3.	Growth of Non-factor Service (credit)	29.4	61.0	33.3	28.0	22.1	25.9	16.3
4.	Growth of Non-factor Service (debit)	-2.3	66.4	24.0	28.5	18.5	10.7	9.7
5.	Exports/imports - BOP (%)	82.9	71.7	67.0	67.6	64.5	62.1	55.9
6.	Exports/imports of goods and services(%)	96.3	87.5	85.0	86.3	82.6	81.9	75.3
7.	Import cover of FER (No. of months)	16.9	14.3	11.6	12.5	14.4	14.3	9.8
8.	External assistance (net) /TC (%)	-17.1	6.9	6.7	3.9	2.0	1.6	12.2
9.	ECBs (net)/TC (%)	-17.5	18.5	9.8	35.6	21.0	21.2	46.5
10.	NR deposits(net)/TC (%)	21.8	-3.4	11.0	9.6	0.2	-1.1	13.8
		(As per cent of GDP mp)						
11.	Exports	11.1	12.2	13.0	14.1	14.1	13.5	15.2
12.	Imports	13.3	16.9	19.4	20.9	21.9	21.8	27.1
13.	Trade balance	-2.3	-4.8	-6.4	-6.8	-7.8	-8.2	-12.0
14.	Invisibles balance	4.6	4.5	5.2	5.7	6.3	6.4	7.8
15.	Goods and services balance	-0.6	-2.6	-3.6	-3.6	-4.6	-4.7	-7.7
16.	Current account balance	2.3	-0.4	-1.2	-1.1	-1.5	-1.8	-4.1
17.	ECBs	-0.5	0.7	0.3	1.8	1.9	2.1	0.8
18.	Foreign Direct Investment (net)	0.4	0.5	0.4	0.8	1.3	0.8	1.7
19.	Portfolio Investment	1.9	1.3	1.5	0.8	2.5	4.0	-1.3
20.	Total capital Account (net)	2.9	4.1	3.1	5.1	9.3	9.8	1.8
21.	External debt	17.8	18.5	17.2	17.9	18.9	24.5	26.2

Source : RBI

Note: (i) TC: Total Capital flows (net).
(ii) ECBs: External Commercial Borrowings.
(iii) FER: Foreign exchange reserves, including gold, SDRs and IMF reserve tranche.
(iv) GDPmp: Gross Domestic Product at current market prices.

6.18 Imports (on BoP basis) at US$ 238.9 billion recorded a growth of 30.6 per cent during April-December 2008 (28.2 per cent during April-December 2007). The higher growth rate was mainly due to a sharp rise of 43.3 per cent in oil imports during April-December 2008, as against 24 per cent growth in oil imports in April-December 2007.

6.19 Reflecting the impact of higher growth in imports coupled with the slowdown in export growth, merchandise trade deficit (exports minus imports) widened significantly to US$ 105.3 billion during April-December 2008 from US$ 69.3 billion in April-December 2007 (52.1 per cent increase). As per cent of GDP, exports were 15.2 per cent and imports 27.1 per cent in 2008-09 (April-December) vis-à-vis 13.5 per cent and 21.8 per cent respectively during the corresponding period of 2007-08. Trade deficit increased from 8.2 per cent of GDP in 2007-08 (up to Q3) to 12.0 per cent in 2008-09 (up to Q3).

6.20 The notable feature during 2008-09 was a decline of 10.4 per cent in merchandise exports on BoP basis in the third quarter of 2008-09 as against an increase of 33.0 per cent in Q3 of the year 2007-08. All commodities, particularly rice, raw cotton, sugar and molasses, iron ore, iron and steel, gems and jewellery showed decline with an exception of engineering goods. Import payments also registered lower growth of 8.9 per cent in Q3 of 2008-09 as compared to a high growth of 41.9 per cent in Q3 of 2007-08. The deceleration in import payments is attributed mainly to a sharp fall in oil prices to an average of US$ 53.55 per barrel during October-December 2008. Trade deficit was placed at a much higher level of US$ 36.3 billion during Q3 of 2008-09 (12.6 per cent of GDP) as compared to US$ 26.1 billion in Q3 of 2007-08 (8.4 per cent of GDP). Hence, the shrinkage in international demand because of global economic slowdown has a negative impact on Indian exports; while a sharp fall in international prices of oil has a positive impact on Indian imports during the third quarter of 2008-09.

6.21 As per the information available for 2008-09, exports at US$ 168.7 billion recorded a rise of 3.4 per cent over that of US$ 163.1 billion during 2007-08 (Ministry of Commerce and Industry estimates). Imports are placed at US$ 287.8 billion during 2008-09 indicating an increase of 14.3 per

cent over 2007-08. Trade deficit is estimated at US$ 119.0 billion during 2008-09 as against US$ 88.5 billion in 2007-08.

6.22 The share of POL in the total imports has increased over the years since 2003-04, with a corresponding decline in the share of non-POL items. In the year 2003-04, the share of POL in total imports was 26.3 per cent, which has gradually increased to 26.8 per cent in 2004-05, 29.5 per cent in 2005-06, 30.8 per cent during 2006-07, 31.7 per cent in 2007-09 and 32.4 per cent in the fiscal 2008-09.

Invisibles

6.23 The surplus on the invisible account has played a key role in balancing the high trade deficit and lowering the current account deficit. The net invisibles (services, transfers and investment income) surplus was US$ 74.6 billion in 2007-08 and US$ 68.9 billion during April-December 2008. Software services, comprising information technology (IT) and IT-enabled services (ITES) was the main driver of the surpluses generated from non-factor services. The remaining components of non-factor services in the invisibles account of BoP, viz., travel, transportation, insurance, financial services, communication services and business services contributed only 8 per cent of the surplus in services trade in 2007-08 and 11 per cent in April-December 2008. Travel receipts (net) grew at an average rate of growth of 24 per cent during 2005-06 to 2007-08 reflecting the attractiveness of India as a tourist destination. During April-December 2008, travel receipts (net) was US$ 1.4 billion as against US$ 1.3 billion in the corresponding period of 2007-08 reflecting 7.8 per cent growth.

6.24 Growth in software services receipts (both IT and ITES) was phenomenal at an annual average of 30.1 per cent during 2005-06 to 2007-08. The software services (net), recorded a rise of 28.3 per cent in 2007-08 on top of an increase of 31.7 per cent during 2005-06 and 30.4 per cent during 2006-07. This trend has continued in fiscal 2008-09 (April-December), following a growth of 28.2 per cent in receipts from software services (net). The non-software services (communication services, construction services, financial services, news agency services, royalties, management services and business services) also registered a growth of 26.7 per cent during fiscal 2008-09 (up to Q3) (Box 6.1).

6.25 Private transfers, mainly workers' remittances continued its traditional role of being a major source of the invisibles account surplus with an annual average growth of 27 per cent during 2005-06 to 2007-08 and were around 3 per cent of GDP during the same period. During April-December 2008, private transfers were placed higher at US$ 34.9 billion as against US$ 28.3 billion during April-December 2007, recording a rise of 23.2 per cent (Box 6.2).

6.26 Investment income outflows are in the form of interest, dividend, profit, etc. for servicing debt and non-debt liabilities in the capital account. The net investment income was placed at US$ (-) 2.9 billion in 2002-03. With the rapid build up of foreign

Box 6.1 : Performance of Indian IT software and services sectors

As per RBI data, software exports registered 28.2 per cent growth (US$ 32.3 billion) during 2008-09 (April-December) vis-à-vis US$ 25.2 billion during the corresponding period in 2007-08. During the third quarter (October-December) of 2008-09, when many sectors were reeling under the effect of global financial crisis, the software exports increased to US$ 10.2 billion as against US$ 8.8 billion during the same quarter of 2007-08, indicated 16.1 per cent growth over the year.

As per the National Association of Software and Services Company (NASSCOM), software and services export revenues are expected to reach US$ 47 billion by the end of fiscal 2008-09 at the growth rate of 16-17 per cent. Total IT–Business Process Outsourcing (BPO) industry is expected to reach US$ 71.7 billion, accounting for 5.8 per cent of India's GDP, software and services revenues (exports plus domestic) aggregated to about US$ 60 billion. Industry will continue to remain a net hirer and focus on value creation, direct employment at 2.23 million, indirect employment estimated at more than 8 million.

Industry is also diversifying geographically with Continental Europe registering the highest growth rate though United States remains the dominant market. Over a four-year period (2004-05 to 2007-08) Continental Europe is estimated to grow at 51.4 per cent as against an industry growth rate of 33.3 per cent, while the U.S. share is expected to come down from 68.2 per cent to 60 per cent of the industry share.

NASSCOM has taken a two-year view to factor in the volatile economic environment under which world growth is projected to fall 0.5 per cent in 2009, but recovers to 3 per cent in 2010 and estimates the Indian IT industry to grow at 15 per cent compound annual growth rate (CAGR) to achieve export revenues of US$ 60-62 billion by fiscal 2010-11.

Reference: NASSCOM Press Release on Performance of Indian IT Software and Services.

Box 6.2 : Global crisis and workers' remittances

Workers' remittances have been a major source of balance of payments support in many emerging economies. The flows also help in poverty alleviation, as a significant part of the remittances are in the nature of transfers for family maintenance. According to the World Bank estimates, remittances to developing countries were of the order of US$ 305 billion in 2008, which far exceed the flow of official assistance.

India has been a top recipient of private transfers in recent years. As per the Reserve Bank of India estimate, the magnitude of such transfers was US$ 30.8 billion 2006-07 and US$ 43.5 billion 2007-08. During 2008-09 (April-December), such transfers were US$ 36.9 billion. The third quarter of 2008-09 (October-December) however witnessed marginal deceleration in remittance flows to US$ 10.5 billion as against US$ 10.9 billion in the corresponding quarter last year due to global financial crisis.

According to a World Bank study, remittances are likely to decline by 5-8 per cent in 2009, which may cause hardship in many poor countries. However, the decline in nominal dollar terms would be smaller relative to the projected fall in private capital flows or official aid. The study identifies several reasons for the resilience of remittances in the face of economic downturns:

- Remittances are sent by the cumulated flows of migrants over the years and not by the recent migrants alone. This makes remittances flows to show robustness over time.
- Remittances are a small part of migrants' incomes, and migrants continue to send remittances even when hit by income shocks.
- Because of a rise in anti immigration sentiments and tighter border controls, especially in the U.S. and also in Europe, the duration of migration appears to have increased. Those staying back are likely to continue to send remittances.
- If migrants do indeed return, they are likely to take back accumulated savings. This may have been the case in India during the Gulf War of 1990 91, which forced a large number of Indian workers in the Gulf to return home. Also the "safe haven" factor or "home bias" can cause remittances for investment purposes to return home during an economic downturn in the host country.
- Several high income OECD countries are likely to undertake large fiscal stimulus packages in response to the financial crisis. This increase in public expenditure, if directed to public infrastructure projects, will increase demand for both native and migrant workers. Taylor (2000) found that public income transfer schemes in the United States resulted in increased remittances to Mexico.

Reference : World Bank

currency assets, investment income receipts grew rapidly. However, investment income payments grew even faster, with the result that net investment income remained negative at US$ (-) 6.7 billion in 2006-07, US$ (-) 4.3 billion in 2007-08 and US$ (-) 4.2 billion in 2008-09 (up to Q3).

6.27 The net invisible surplus grew by 42.9 per cent to reach US$ 74.6 billion in 2007-08 (6.4 per cent of GDP). Net invisibles (receipts minus payments) at US$ 68.9 billion during April-December 2008 were up by 28.1 per cent over US$ 53.8 billion during April-December 2007. The invisibles surplus financed about 65.4 per cent of trade deficit during April-December 2008 as against 77.6 per cent during April-December 2007.

6.28 Despite higher invisibles surplus, the trade deficit widened mainly on account of higher growth in imports coupled with slowdown in export growth in the third quarter of 2008-09. The current account deficit (CAD) therefore was higher at US$ 36.5 billion in April-December 2008 (135.1 per cent increase, over US$ 15.5 billion during April-December 2007). The ratio of CAD to GDP also increased from 1.8 per cent in 2007-08 (up to Q3) to 4.1 per cent in 2008-09 (up to Q3).

6.29 During the third quarter of the year 2008-09 (October-December), there was a nominal negative growth for both invisible receipts and payments reflecting the adverse impact of global economic slowdown. Invisible receipts declined on account of fall in travel, transportation and insurance receipts in the services category and private transfers and investment income receipts. Overall services exports, however, witnessed a marginal increase of 0.5 per cent during the third quarter (compared with a higher growth of 33.4 per cent in Q3 of 2007-08) due to increase in software exports. Private transfer receipts declined marginally during Q3 of 2008-09. Software services receipts, on the other hand, increased by 11.8 per cent during the quarter. Invisible payments also recorded a marginal negative growth of 2.1 per cent during Q3 of 2008-09, led mainly by sharp decline in payments under travel, software and business services account. There was also a marginal decline in payments under investment income in the form of interest payments and dividends. The net invisibles (receipts minus payments) rose marginally to US$ 21.7 billion in Q3 of 2008-09 (US$ 21.5 billion during Q3 of 2007-08). At this level, net invisibles surplus financed 59.7 per cent of trade deficit in Q3 of 2008-09 (82.6 per cent

in Q3 of 2007-08). Accordingly, the current account deficit rose sharply to US$ 14.6 billion (5.1 per cent of GDP) during Q3 of 2008-09, as compared to US$ 4.5 billion (1.5 per cent of GDP) in Q3 of 2007-08. This was mainly on account of large trade deficit and marginal increase in net invisibles during the third quarter of 2008-09

Capital account

6.30 Capital inflows can be classified by instrument (debt or equity) and maturity (short-term or long-term). The main components of capital account include foreign investment, loans and banking capital. Foreign investment comprising foreign direct investment and portfolio investment represents non-debt liabilities, while loans (external assistance, external commercial borrowings and trade credit) and banking capital including non-resident Indian deposits are debt liabilities.

6.31 Net capital flows rose from a level of US$ 45.2 billion in 2006-07 to US$ 108.0 billion in 2007-08, indicating a growth of 139 per cent, attributable to a significant rise in foreign investment in term of direct and portfolio investment, large inflow of banking capital and a quantum jump in loans, particularly short-term credit and external commercial borrowings (net). However, the net capital inflow during 2008-09 (April-December) was only US$ 15.3 billion.

Non-debt flows

Foreign investment

6.32 The foreign investment comprising foreign direct investment (FDI) and portfolio investment on net basis was US$ 14.8 billion in 2006-07 and US$ 45.0 billion in 2007-08 (204.7 per cent growth), before slowing down to US$ 4.0 billion during 2008-09 (up to Q3). As a proportion of total capital flows, net foreign investment stood at 41.6 per cent in 2007-08 (32.6 per cent in 2006-07). However, its share declined to 26.4 per cent during 2008-09 (April-December) on account of FII outflows as a result of the global financial crisis (Box 6.3).

Foreign direct investment

6.33 FDI is considered to be the most attractive type of capital flow for emerging economies as it is expected to bring latest technology and enhance production capabilities of the economy.

6.34 During 2005-06 to 2008-09, FDI flows assumed greater significance. High inflows indicate India as an attractive investment destination as a consequence of its liberalised investment climate (Box 6.3), stable and sound economic and political base, opportunities for economic growth, while capital investment abroad reflects the growing global competitiveness of the Indian corporate sector. The two-way flow of FDI, therefore, means that while the world is taking note of India's market potential, Indian companies are also constantly looking for synergistic acquisitions abroad.

6.35 With the reforms in policies, better infrastructure and vibrant financial sector, FDI inflows into India have accelerated since 2006-07. On a gross basis, FDI inflows into India increased from US$ 8.9 billion in 2005-06 to US$ 22.8 billion in 2006-07 and further to US$ 34.4 billion in 2007-08. In the fiscal 2008-09 (April-December) gross FDI into India was US$ 27.5 billion. FDI inflows are spread across a range of economic activities like financial services, manufacturing, banking services, information technology services and construction.

6.36 FDI has grown significantly on net basis. The year-to-year growth in FDI (net) was 153.6 per cent in 2006-07 and 100.2 per cent during 2007-08. Even as FDI flows into India grew substantially, a simultaneous pick up in outward investment moderated the overall net inflows. Outward investment by India increased from less than US$ 2.4 billion during 2003-04 and 2004-05 to US$ 15.8 billion in 2006-07 and US$ 21.3 billion in 2007-08.

6.37 During fiscal 2008-09 (April-December), FDI into India (net) remained buoyant at US$ 27.4 billion (US$ 20.0 billion in April-December 2007) reflecting relatively better investment climate in India and the continuing liberalization measures to attract FDI. Outward FDI (net) continued to remain high at US$ 12.0 billion during April-December 2008 even in the current economic situation, though it was marginally lower than its previous year's level of US$ 13.1 billion. Due to large inward flows, the net FDI (inward minus outward FDI) was higher at US$ 15.4 billion in April-December 2008, as compared with US$ 6.9 billion in April-December 2007.

Portfolio investment

6.38 Portfolio investment includes foreign institutional investors (FIIs) investment, issue of global depository receipts (GDRs)/American depository receipts (ADRs) and offshore funds. Net portfolio inflows into India was US$ 7.0 billion in 2006-07 and

Box 6.3 : Foreign Direct Investment

As per the United Nations Conference on Trade and Development (UNCTAD) report titled "Assessing the Impact of the Current Financial and Economic Crisis on Global FDI Flows" India achieved a growth of 85.1 per cent in FDI inflows which was the highest globally. The total flows increased from US$ 25.1 billion in 2007 to US$ 46.5 billion in 2008. This is despite 14.5 per cent decline in global FDI inflows from US$ 1,940.9 billion in 2007 to US$ 1,658.5 billion in 2008. India also ranked 9th in global FDI inflows in 2008. A comparative statement is given below:

Rank in 2008	Countries	2007	2008*	Growth rate (%)
1	USA	232.8	320.9	37.8
2	France	158.0	126.1	-20.2
3	UK	196.4	96.8	-50.7
4	Belgium	70.0	94.2	34.6
5	China	83.5	92.4	10.6
6	Russia	52.5	70.3	34.0
7	Spain	68.8	65.5	-4.8
8	Hong Kong China	59.9	63.0	5.2
9	India	25.1	46.5	85.1
10	Brazil	34.6	45.1	30.3
11	Sweden	22.1	40.4	83.1
	World	**1940.9**	**1658.5**	**-14.5**

*** preliminary estimates**

In terms of UNCTAD Survey 2008-10, China is the most preferred investment destination, followed by India, the United States, the Russian federation and Brazil. Similarly, AT Kearney's 2007 FDI Confidence Index shows China, India and USA as the most preferred locations in that order. For long-term prospects, JBIC survey of Japanese manufacturing Transnational Corporations (TNCs) showed India replacing China as the most promising country for business operations of Japanese TNCs.

Robust economic growth, an improved investment environment and opening up of critical sectors like telecommunications, civil aviation, refineries, construction, etc facilitated FDI inflows into India.

Reference: UNCTAD report titled "Assessing the Impact of the Current Financial and Economic Crisis on Global FDI Flows"; and World Investment Report 2008.

US$ 29.4 billion in 2007-08. Portfolio investment by FIIs however witnessed large net outflows of US$ 12.4 billion during April-December 2008 (as against net inflows of US$ 24.5 billion in April-December 2007) due to large scale sale of equities by FIIs in the Indian stock market. As per data available for the full year 2008-09, FII outflows amounted to US$ 15 billion vis-à-vis net inflow of US$ 20.3 billion during the year 2007-08.

6.39 The FII flows have exhibited significant volatility as measured by the ratio of net inflows to total inflows during 2003-04 to 2008-09. It remained in the range of 6.4 per cent to 40.2 per cent. During April-December 2008, net inflows turned negative while the total inflows were sizeable at US$ 109.9 billion (Table 6.5).

Other non-debt flows

6.40 The head "Other Capital" in "BoP" covers mainly the leads and lags in export receipts (the difference between the customs data and the banking channel data), funds held abroad, and other capital

Table 6.5 : Portfolio flows (net) as a proportion of inflow (US$ million)

Year	Inflow	Outflow	Net	Proportion (in per cent)
2003-04	28218	16862	11356	40.2
2004-05	40847	31560	9287	22.7
2005-06	68120	55626	12494	18.3
2006-07	109622	102560	7062	6.4
2007-08	235924	206368	29556	12.5
2008-09 (up to Q3)	109993	121334	(-) 11341	(-) 10.31

Source : RBI

transactions not included elsewhere such as flows arising from cross-border financial derivative and commodity hedging transactions, and sale of intangible assets such as patents, copyrights, trademarks, etc. In the year 2006-07, "Other Capital (net)" was placed at US$ 4.2 billion, which increased to US$ 9.5 billion in 2007-08 and was US$ 1.9 billion during April-December 2008.

Debt flows

External commercial borrowings (ECBs)

6.41 Management of debt flows, including private flows from ECB sources, have been guided by the overarching principles of prudent external debt management. This focuses on keeping the maturities long and servicing cost low. ECBs are approved within the overall annual ceiling that is revised upwards progressively, subject to a hierarchy of priorities for projects/sectors. With relative stability and strong capital inflows, liberalization of ECB norms has been in the nature of allowing corporates to borrow up to a certain limit under the "automatic route". ECB policy has been liberalized in terms of expanding the list of eligible borrowers, end-use of funds raised through ECBs and terms of raising ECBs to counter the effect of global crisis (Box 6.4).

Box 6.4 : Recent initiatives to liberalize ECBs

A number of policy initiatives have been taken to liberalize the external commercial borrowings to counter the negative fallout of declining investment flows. The chronology of liberalization measures is as under:

- Borrowers in infrastructure sector were allowed to avail ECBs up to US$ 100 million for Rupee expenditure for permissible end-uses under the approval route (May 29, 2008). The limit was enhanced to US$ 500 million per year for the borrowers in the infrastructure sector under the approval route (September 22, 2008). The requirement that borrowings in excess of US$ 100 million for Rupee capital expenditure in the infrastructure sector should have a minimum average maturity of 7 years was also dispensed with (October 22, 2008).
- The existing limit of US$ 20 million for Rupee expenditure for permissible end-uses for borrowers (other than those in the infrastructure sector) under the approval route was enhanced to US$ 50 million (May 29, 2008).
- Banks were permitted to allow payment of lease rentals, opening of letters of credit towards security deposit etc. in respect of import of aircraft/aircraft engine/helicopter on operating lease basis (July 2008). Banks have also been allowed to convey "no objection" from the Foreign Exchange Management Act (FEMA), 1999 angle for issue of corporate guarantee in favour of the overseas lessor, for operating lease in respect of import of aircraft/aircraft engine/helicopter (April 20, 2009).
- ECBs up to US$ 500 million per borrower per financial year were permitted for rupee and/or foreign currency expenditure for permissible end-uses under the automatic route (October 22, 2008).
- Payment for obtaining licence/permit for 3G Spectrum will be considered as an eligible end-use for the purpose of ECB (October 22, 2008).
- Systemically important non-deposit taking NBFCs have been temporarily permitted to raise short-term foreign currency borrowings under the approval route, subject to their complying with the prudential requirements of capital adequacy and exposure norms (October 31, 2008).
- Housing finance companies, registered with National Housing Bank, have been permitted to raise short-term foreign currency borrowings under the approval route (November 15, 2008).
- Non-banking financial companies (NBFCs), which are exclusively involved in financing of the infrastructure sector, have been allowed to avail of ECBs from multilateral/regional financial institutions and Government-owned development financial institutions for on-lending to the borrowers in the infrastructure sector under the approval route (January 2, 2009).
- Corporate in the services sector viz., hotels, hospitals and hoftware companies which were hitherto allowed to avail of ECB up to USD 100 million per financial year for import of capital goods under the approval route have been permitted to avail ECB up to USD 100 million per year for both foreign currency and/or Rupee capital expenditure for permissible end-use, other than for land acquisition, under the automatic route (January 2, 2009).
- Corporates engaged in the development of integrated township have been permitted to avail of ECB under the approval route (January 2, 2009).
- With effect from January 2, 2009, the requirement of all-in-cost ceilings on ECB has been dispensed with until June 30, 2009. Eligible borrowers proposing to avail of ECB beyond the permissible all-in-cost ceilings of six month Libor+300 bps and six-month Libor+500 bps for ECBs for average maturity period of three-five years and more than five years respectively are required to approach the Reserve Bank of India under the approval route.
- The limit for FII investment in Government securities was enhanced from US$ 3.2 billion to US$ 5 billion and that for corporate debt from US$ 1.5 billion to US$ 3.0 billion from June 6, 2008; the latter was enhanced further to US$ 6 billion and US$ 15 billion with effect from October 16, 2008 and January 2, 2009 respectively.

6.42 In the last three years, ECB receipts have grown at high rates of 57.9 per cent in 2005-06, 45.6 per cent in 2006-07 and 45.5 per cent in 2007-08. In the same period, repayments have exhibited high volatility with high growth of 204.2 per cent owing to a one-off effect of redemption of India Millennium Deposits (IMD) in 2005-06, followed by a decline of 59.6 per cent in 2006-07 and an increase of 62 per cent in 2007-08. The net inflows under ECBs have therefore been uneven during 2005-06 to 2007-08. Net flows increased to US$ 16.1 billion in 2006-07 from US$ 2.5 billion in 2005-06 and further to US$ 22.6 billion in 2007-08. Net external commercial borrowings (ECBs) slowed down to US$ 7.1 billion in April-December 2008 (US$ 17.4 billion in April-December 2007) mainly due to tight liquidity conditions in the overseas markets.

6.43 In 2006-07, net ECBs accounted for 34.8 per cent of total capital account net flows, which declined to 21 per cent in 2007-08. ECB inflows in the recent past have been enabled by favourable global liquidity conditions, rising credit needs, interest differential and currency expectations.

Short-term credits, non-resident deposits and external assistance

6.44 While ECBs were the dominant source and constituted 65.8 per cent of the debt flows in 2006-07 and 54.0 per cent in 2007-08, the other debt flows comprising the non-resident deposits, short-term loans and external assistance were also important as they had specific functional roles in the financing trade and development.

6.45 The short-term trade credit (net) was US$ 17.2 billion in 2007-08. Net short-term trade credit stood at US$ 0.5 billion (inclusive of suppliers' credit up to 180 days) during April-December 2008 as compared with US$ 10.7 billion during the corresponding period of 2007-08.

6.46 Non-resident deposits constitute an important source of capital flows. Net NRI deposits increased from US$ 3.7 billion in 2005-06 to US$ 4.3 billion in 2006-07 but fell to US$ 0.2 billion in 2007-08. NRI deposits witnessed a net inflow of US$ 2.1 billion in April-December 2008, a turnaround from

Table 6.6 : Non-resident deposits under different schemes

(US$ million)

Part A: Outstanding balances under different schemes

Scheme	As the end of March							
	2003	2004	2005	2006	2007	2008	Dec 2007	Dec 2008
Foreign currency non-resident (banks) FCNR (B)	10199	10961	11452	13064	15129	14168	14758	12936
Non–resident (external) rupee account (NR(E)RA)	14923	20559	21291	22070	24495	26716	26078	23226
Non-resident (non-repatriable) rupee deposits (NR(NR)RD)	3407	1746	232	-	-	-	-	-
Non-resident ordinary rupee account (NRO)	-	-	-	1148	1616	2788	2198	4134
Total	**28529**	**33266**	**32975**	**36282**	**41240**	**43672**	**43034**	**40296**

(US$ million)

Part B : Net flows under non-resident deposits

Scheme	2003-04	2004-05	2005-06	2006-07	2007-08	2007-08	2008-09
						April-December	
Foreign currency non-resident (banks) FCNR (B)	762	492	1612	2065	-960	-371	-1232
Non-resident (external) rupee account (NR(E)RA	4695	84	1177	1830	109	-960	1383
Non-resident (non-repatriable) rupee deposits (NR(NR)RD)	-1816	-1538	-	-	-	-	-
non-resident ordinary rupee account (NRO)	-	-	930	426	1030	400	1963
Total	**3641**	**-962**	**3719**	**4321**	**179**	**-931**	**2114**

Source : RBI

Box 6.5 : G-20

The leaders of G-20 met in London on April 2, 2009 at the backdrop of the worst economic and financial crisis, a crisis which has deepened further since the Washington Summit held on November 15, 2008.

To ensure early, amongst other things, India has strongly emphasized the need to continue with coordinated contra-cyclical policies within an overall framework of fiscal sustainability and restoration of the banking system in the industrialized countries to full functionality; to avoid protectionist sentiments in the trade of both goods and services emerging in the industrialized economies in the backdrop of global financial crisis; and to take concrete steps to ensure adequate credit flows, including trade finance, to developing countries for which it is imperative to raise resources of the international financial institutions (IMF, World Bank, ADB), and to bring forward the quota review in the IMF.

Further, India has stressed upon the need for longer term reform of the global financial architecture including increasing the representation of developing and emerging market economies; reform of the global financial system through stronger regulation and improved supervision, especially of systemically important financial institutions, through, among other things, developing an effective early warning system which can spot a build up of risks threatening global financial stability. India has also endorsed sharing information and bringing tax havens and non-cooperating jurisdictions under closer scrutiny.

The leaders of G-20 on April 2, 2009 resolved to restore confidence, growth and jobs; repair the financial system to restore lending; strengthen financial regulation to rebuild trust; fund and reform the international financial institutions; promote global trade and investment and reject protectionism; and build an inclusive and sustainable recovery.

As per the London communiqué the leaders have agreed to treble resources available to the IMF to US$ 750 billion, to support a new SDR allocation of US$ 250 billion, to support at least US$ 100 billion of additional lending by the multilateral development banks (MDBs), to ensure US$ 250 billion of support for trade finance, and to use the additional resources from agreed IMF gold sales for concessional finance for the poorest countries, constitute an additional US$ 1.1 trillion programme of support to restore credit, growth and jobs in the world economy.

The other major initiatives agreed upon are:

- For *Strengthening the Financial System* a new Financial Stability Board (FSB) with a strengthened mandate, as successor to the Financial Stability Forum (FSF), including all G-20 countries, FSF members, Spain, and the European Commission, which should collaborate with the IMF to provide early warning of macroeconomic and financial risks and actions needed to address them. Extend regulation and oversight to all systemically important financial institutions, instruments and markets, including systemically important hedge funds, for the first time.
- For *strengthening global financial institutions,* leaders committed to implement the package of IMF quota and voice reforms agreed in April 2008 and to complete the next review of quotas by January 2011. For World Bank also, similar reform should be completed on an accelerated time scale, to be agreed by the 2010 Spring Meetings.
- For *resisting protectionism and promoting global trade and investment,* members have committed to refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organization (WTO) inconsistent measures to stimulate exports and will not retreat into financial protectionism, particularly measures that constrain worldwide capital flows, especially to developing countries.
- For *ensuring a fair and sustainable recovery* all leaders reaffirm their commitment to meet the Millennium Development Goals and achieving respective ODA pledges, including commitments on Aid for Trade, debt relief and the Gleneagles commitments, especially to sub-Saharan Africa.

net outflow of US$ 0.9 billion in April-December 2007. The outstanding amount under various NRI deposit schemes also increased from US$ 41.2 billion at end-March 2007 to US$ 43.7 billion at end-March 2008 (Table 6.6).

6.47 External assistance (net), which had increased from US$ 1.9 billion in 2006-07 to US$ 2.1 billion in 2007-08, was US$ 1.9 billion during April-December 2008.

Capital account balance

6.48 The capital account surplus has increased over the years from US$ 24.9 billion (3.1 per cent of GDP) in 2005-06 to US$ 46.1 billion (5.1 per cent of GDP) in 2006-07 and further to US$ 109.1 billion (9.3 per cent of GDP) in 2007-08. Capital account balance of US$ 16.1 billion (1.8 per cent of GDP) during 2008-09 (up to Q3) represented a decline of 80.5 per cent from US$ 82.7 billion during the corresponding period in 2007-08.

6.49 During Q3 of 2008-09, the capital account balance turned negative indicating a net outflow of US$ 3.7 billion, as against an inflow of US$ 31.0 billion in Q3 of 2007-08 attributable to net outflow under portfolio investment, banking capital and short-term trade credit. Net ECBs remained lower at US$ 3.9 billion in Q3 of 2008-09 (US$ 6.2 billion in Q3 of 2007-08), as the liquidity conditions tightened in the international financial markets and external commercial borrowings became more expensive. Short-term trade credit witnessed a net outflow of US$ 3.1 billion as against an inflow of US$ 4.1 billion

in Q3 of 2007-08. Net FDI flows (inward FDI minus outward FDI) was US$ 0.8 billion in Q3 of 2008-09 (US$ 2.0 billion in Q3 of 2007-08). There was, however, a turnaround in the inflows under the NRI deposits to US$ 1.0 billion during Q3 of 2008-09 (an outflow of US$ 0.9 billion during Q3 of 2007-08), which responded to the hike in ceiling interest rates on NRI deposits.

World merchandise trade

6.50 The economic slowdown in U.S. in 2007 following the subprime crisis in August 2007 which resulted in a fall in GDP growth from 2.8 per cent in 2006 to 2.0 per cent in 2007 and consequent fall in U.S. import growth had started affecting India's exports to the U.S. in 2007. However, this simmering crisis accelerated and turned into a full blown global recession with the dramatic escalation of the global financial crisis in September 2008 which resulted in an unprecedented contraction of world growth to 3.2 per cent and trade to 3.3 per cent with the growth and imports of advanced economies at 0.9 per cent and 0.4 per cent respectively. This situation worsened in 2009 with world output projected at -1.3 per cent and world trade volume at -11.0 per cent. The fall in growth and imports of advanced economies was worse with projections at -3.8 per cent and -12.1 per cent respectively. This has severely affected the growth and trade of all the countries. India was no exception though it has weathered the crisis more confidently than many other countries including the developed countries (Box 6.5).

6.51 While the IMF in April 2009 has projected a 11 per cent fall in world trade volume of goods and services, WTO has forecast in March 2009 a 9 per cent decline in global trade for 2009, the largest such decline in over 60 years. The World Bank has also projected in March 2009 a fall in both global GDP by 1.7 per cent and world trade in goods and services by 6.1 per cent in 2009. The collapse in world trade has been attributed to the unprecedented fall in global demand and shortages of trade finance causing supply side constraints to export growth (Box 6.6).

Box 6.6 : Trade Finance : International developments and impact on India

Trade financing has been used in more than 90 per cent of trade transactions (mostly short-term credit) in the world. The global financial crisis, which has resulted in slowdown in economic growth, has also impaired the access to trade finance. Developing and emerging economies are most vulnerable to the shortages in trade finance.

During the period of economic boom, trade (particularly when it takes place between associated companies in developed countries) was not financed by banks through letters of credit, but by general credit extended by the companies, usually secured on other types of collateral. This type of credit has been badly affected by the financial crisis, due to the general pessimism about the prospects of the companies, and the prices of their assets. International banks, which used to extend credit to local banks (by way of letters of credit confirmations, bill of exchange endorsements or interbank loans, swaps, hedges and other treasury activities, which enable the local banks to offer trade finance denominated in foreign currencies), started adopting a cautious approach, in the wake of financial market turmoil, and reduced the "bank limits" or "country limits." As a result, the cost of trade finance in developing countries went up by 3 to 4 per cent.

Exporters in general started seeking confirmed letters of credit, where they had exported on the basis of open account or cash against delivery (CAD). The banks' perception of risk was leading to tightening of liquidity, and therefore greater difficulty in getting confirmed letters of credit. According to Bankers' Association for Finance and Trade (BAFT), USA, in addition to cost escalation due to financial turmoil and low level of risk appetite, increased capital costs under Basel-II, is also expected to increase the cost of trade finance for developing country exporters. There are also reports that even developed country buyers/banks, in the guise of intense scrutiny, were rejecting/delaying the processing of trade documents on the basis of minor discrepancies. In such a situation, the acceptability of letters of credit from least developed markets, as also from some of the developing markets, was scrutinized by the banks critically, restricting the wheels of trade finance.

Scarcity in trade finance was a result of pressures from both demand-side and supply-side. In the initial months of crisis, Indian credit market faced credit squeeze, which was led by net capital outflows, as international investors withdrew capital from India to compensate their losses incurred in exotic derivatives trading. This eventually affected the Indian firms as there was lending restraint shown by the banks. Further, there was contraction in trade credit extended by supplier firms, as also increase in demand for trade credit by the end-user firms, affecting the working capital liquidity of exporters. To combat the working capital liquidity, Indian companies turned to trade financing.

The shortage of availability of trade credit, following the financial crisis, could be viewed from the decline in short-term trade credit inflows into India, as reflected in India's overall balance of payment statistics. During the period April-December 2008, net capital inflows under the head "short-term trade credit" have shrunk to US$ 0.5 billion, as compared to US$ 10.7 billion received during the corresponding period of the previous year. Short-term trade credit to India witnessed a net outflow of US$ 3.1 billion in the third quarter of 2008-09 (as against inflows of US$ 4.1 billion during the same period of 2007-08), mainly due to lower disbursements reflecting tightness in the overseas market and increased repayments as roll over was difficult. Exporters were also reporting challenges of liquidity in foreign currency, and high cost of foreign currency, especially for pre-shipment credit, where they need to source raw materials to service an export order.

6.52 Fall in global output and demand led to fall in commodity prices and this along with the appreciation of the US dollar against a number of currencies accelerated the fall in world trade as the financial crisis intensified. As pointed out by the WTO, the drying up of global liquidity combined with a general reassessment of risks by commercial banks led in the second half of 2008 to a rise in the cost of trade finance instruments such as letters of credit, and in some cases, to serious gaps between demand and supply with spreads above LIBOR increasing by some 25 to 300 basis points per annum and in some cases as much as 600 basis points. Trade finance experts who met in WTO in March 2009 have pointed out to a market gap in developing countries that is imminent demand for trade financing of between US$ 100 billion and US$ 300 billion on an annual and roll-over basis (Box 6.7). All the above causes reinforced on each other in this highly globalized world which had seen a rising presence of global supply chains in total trade in recent years leading to a sharp decline in world trade towards the end of 2008 and into 2009.

6.53 According to the World Trade Organisation (WTO) statistics, world merchandise trade growth at 2.0 per cent in real (i.e. constant price) terms in 2008 was lower than the 6.0 per cent growth in 2007. The growth of merchandise trade in 2006 was the second highest since 2000 and well above the average annual growth of the last decade (1996-2006). Growth of world demand for exports decelerated from 8.5 per cent in 2006 to 6.0 per cent in 2007, and further to 2.0 per cent in 2008.

Box 6.7 : Measures initiated to enhance trade finance

Various measures have been taken by the multilateral institutions to enhance trade financing. World Bank/International Finance Corporation (IFC) has announced tripling of the ceiling of the trade finance guarantees available under the IFC's Global Trade Finance Programme (GTFP), a trade facilitation measure introduced to support trade from developing countries, from US$ 1 billion to US$ 3 billion.

IFC is also developing a programme to provide funded support to major financial institutions with wide trade finance networks in emerging markets, and to increase engagement with export credit agencies. IFC has also proposed to create a Global Trade Liquidity Pool (GTLP), in association with multilateral/regional institutions that are active in trade finance, to fund trade transactions for up to 270 days, which is expected to be self-liquidating once the conditions of trade finance improve. The Asian Development Bank (ADB) has announced expansion of its Trade Finance Facilitation Programme (TFFP) from the existing US$ 150 million to US$ 1 billion. The African Development Bank (AfDB) intends to support trade finance through a US$ 1 billion trade finance initiative (TFI). The European Bank for Reconstruction and Development, which expects the demand for trade finance from the member countries, proposes to hike the budget for its trade facilitation programme, from the present • 800 million to • 1.5 billion for the year 2009, to boost trade with and within eastern Europe, Central Asia, Russia and Ukraine. The Inter-American Bank for Development (IADB) has also announced increased limit for its Trade Finance Facilitation Programme (TFFP) from US$ 400 million to US$ 1 billion. G-20 has announced a US$ 250 billion trade finance package to be available over a period of two years.

The core of this package is a pool of money in which international institutions and national governments contribute 40 per cent, and commercial banks, the remaining 60 per cent. Berne Union proposes to strengthen its network and various means of coordination among members, to share the experiences in tackling the previous financial crisis in Asia and Russia, and real-time knowledge exchange, to enhance export credit, credit insurance and reinsurance.

The national governments have been supporting trade finance activities, some of them through the respective export credit agencies or developmental institutions. For example, the United States through U.S.-Exim Bank is making additional resources available to increase access to affordable trade finance. U.S.-Exim Bank, has already announced a programme to provide US$ 4 billion in new short-term trade finance facilities and US$ 8 billion in medium- and long-term trade finance facilities to support export of U.S. goods to emerging markets. Other countries like China, Japan, South Korea have also been providing similar facilities

The national governments have also been extending guarantees stimulating the financing system in a crisis period. For example, U.S.-Exim Bank has announced US$ 2.9 billion insurance cover to help meet the growing demand to insure U.S. lenders' confirmation of letters of credit issued by 11 Korean financial institutions. The U.K. Government has announced plans to guarantee as much as £ 20 billion of bank loans to small and medium companies ensuring flow of credit. Other countries like Germany, France, Hong Kong, Japan have been providing similar guarantees.

Various measures have been taken by the RBI/Government of India to address the liquidity challenges faced by the exporters, as also to enhance the availability of trade finance which include interest subvention of 2 per cent as a temporary measure for the period December 1, 2008 to September 30, 2009 to many labour-oriented sectors, increase in the period of pre-shipment and post-shipment credit, extension of period of realization of export proceeds from six months to 12 months, raising the ceiling on export credit in foreign currency, enhancing the eligible limit of export credit refinance (ECR) facility, expanding the lendable resources available to EXIM Bank of India and extension of back-up guarantee to Export Credit Guarantee Corporation (ECGC).

Table 6.7 : Growth rate of major trading partners of India, 2008-09 (US$ terms)

	Exports			Imports		
	Apr-Aug 08	Sept-Dec 08	Jan-March 09	Apr-Aug 08	Sept-Dec 08	Jan-March 09
World	16.5	-3.7	..	18.1	-2.2	..
USA	19.8	-0.9	-22.3	14.9	-4.4	-29.9
Hong Kong	7.9	-0.1	-18.3	9.5	-1.5	-21.2
Singapore	16.9	-6.2	-40.2	23.5	0.5	-35.8
Japan	16.4	-5.1	-40.6	28.7	13.5	-29.0
China	23.0	8.6	-19.7	30.6	-1.6	-30.8
India	29.5	-3.6	-24.1	40.9	16.2	-25.3

Source : For U.S., China HK and Japan from World Trade Atlas, for India from DGCI&S and for world and Singapore from IFS, IMF.

6.54 Country/region-wise in 2008, while export growth in real terms decelerated in the United States in European Union (27) it became zero. The fall in imports in major markets of India was more marked than in exports with the United States, European Union and Japan registering negative import growth in 2008. Import growth continued to be high in natural resource rich countries like CIS, Africa, Middle East, besides India though it decelerated slightly.

6.55 Examination of the performance of exports and imports for world and some major trading partners of India in the three time periods of 2008-09, namely April-August 2008, September-December 2008 and January-March 2009 shows that the good growth in the first period started becoming negative in the second period and worsened to be highly negative for the third period (Table 6.7). Growth of world exports and imports in September-December 2008 was negative. In most of the important trading partners of India, export growth was negative in the fourth quarter of 2008. In China it turned negative only in the first quarter of 2009. Import growth also shows a lag effect with high negative growth in the first quarter of 2009 for the major trading partners of India. Month-wise export growth figures (Figure 6.2) show that negative growth set in for the world and some countries in October 2008 and in almost all cases was negative from November 2008 to March 2009. Imports growth in most cases started becoming negative in November 2008 and continued till March 2009.

6.56 The impact of global recession on India's trade sector in 2008-09 can be seen clearly by comparing the performance in April-August 2008-09 (pre-recession) and September-March 2008-09 (post-recession). Both exports and imports growth were very robust in the pre-recession period, but turned negative in the post-recession period (Table 6.8). In the post-recession period import growth of POL was negative and non-POL and non-POL + non-bullion import growths were very low. Growth of trade deficit also fell drastically.

India's merchandise trade

6.57 India's Foreign Trade Policy, 2004-09 announced on August 31, 2004 sought to achieve two major objectives, namely (a) to double the percentage of India's merchandise trade within five years; and (b) to use trade expansion as an effective instrument for economic growth and employment generation.

Figure 6.2 : Month-wise growth of exports of India and some major trading partners of India

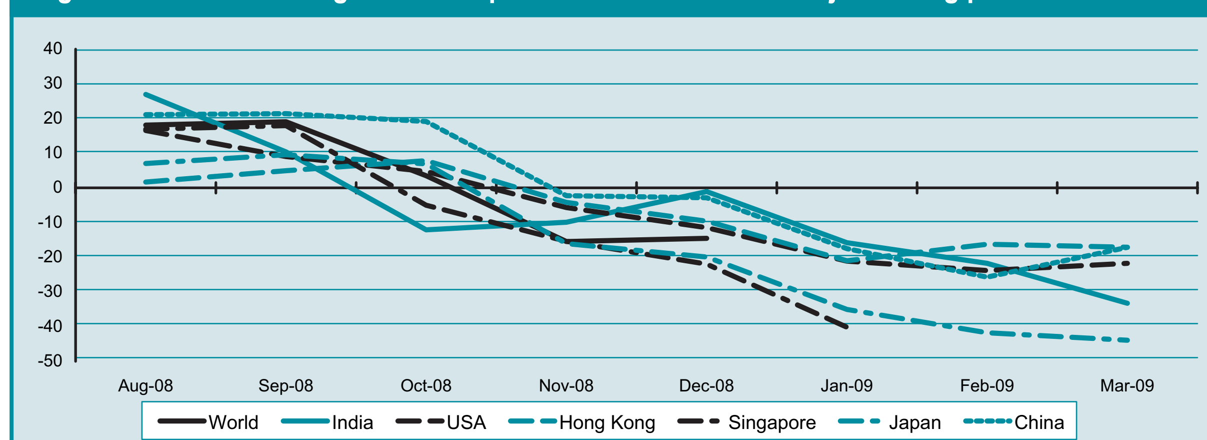
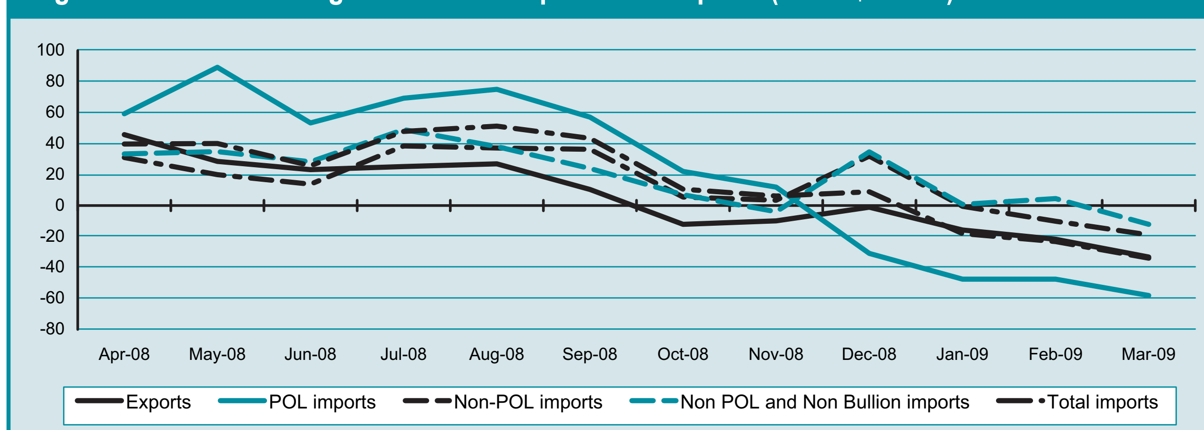


Table 6.8 : Growth rate of exports and imports (US$ terms)

	Exports	Imports POL	Imports Non-POL	Imports Gold & Silver	Non-POL + Gold & Silver	Imports Total	Trade Balance
2007-08							
April-Aug	20.8	18.4	43.6	131.7	33.0	34.4	68.4
Sept-Mar	35.3	56.1	38.5	-30.3	49.2	44.0	63.7
2008-09							
April-Aug	29.5	69.2	27.9	-13.7	36.7	40.9	61.2
Sept-Mar	-12.1	-12.8	4.0	3.2	2.9	-1.7	17.8

Source : Calculated on the basis of data from DGCI&S.

Figure 6.3 : Monthwise growth rate of exports and imports (in US $ terms)



6.58 The export target of US$ 75 billion set for the year 2004-05 was progressively increased under the policy to US$ 160 billion for 2007-08. As compared to the targets, the actual export performance exceeded, year after year. For the year 2008-09, an export target of US$ 200 billion was set earlier and later it was revised to US$ 175 billion. In 2008-09, the value of merchandise exports reached US$ 168.7 billion with a growth of 3.6 per cent despite global recession, thus achieving 96.4 per cent of the revised export target. While export growth was robust till August 2008, it became low in September and became negative from October 2008 to March 2009 due to the global recession (Figure 6.3). The negative trend continued in April 2009 with export growth at (-)33.2 per cent.

6.59 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 in exports both in terms of

Table 6.9 : Performance of the foreign trade sector

(Annual per cent change)

	Exports			Imports			Terms of Trade	
	Value (in US$)	Volume	Unit Value	Value (in US$)	Volume	Unit Value	Net	Income
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	-10.9	5.0
2005-06	23.4	11.8	9.0	33.8	48.2	-10.7	22.7	36.9
2006-07	22.6	15.8	8.1	24.5	24.1	2.7	5.2	21.8
2007-08	28.9	5.4	8.8	35.4	27.2	-5.4	14.8	21.0
2008-09	3.6			14.4				

Source : Calculated on the basis of data from DGCI&S.

volume and unit value with a relatively higher growth of volume (Table 6.9). However, during 2007-08, export performance was dominated by growth in unit values at 8.8 per cent mainly due to the rise in commodity prices particularly iron ore, and other base metals and fuel prices particularly of petroleum products. Export volume growth on the other hand, at 5.4 per cent was very low compared to earlier years and was even lower than the growth in unit value mainly due to fall in export volumes of commodities like iron ore and other base metals and chemicals and related products.

6.60 The growth rate of the unit value index of imports has fluctuated widely since 2000-01 partly due to fluctuations in the global prices of oil and other commodities and partly due to unit value changes in machinery and transport equipment and chemicals and related products. During 2007-08, unit value index of imports registered a negative growth of (-) 5.4 per cent over 2006-07 mainly due to fall in unit values of machinery and transport equipment, miscellaneous manufactured articles and vegetable oils. Though the volume of imports has shown a rising trend since 2000-01, the 27.2 per cent growth in 2007-08 was the second highest in this decade mainly due to high volume growth of machinery and transport equipment, miscellaneous manufactured articles, chemicals and related products and vegetable oils. In the case of most of the major commodities determining the upward and downward movements of export and import growth in 2007-08, there is in fact an opposite movement of the unit value and volume indices.

6.61 The net terms of trade, which measures the unit value index of exports as a proportion of unit value index of imports, fell sharply in 2004-05 and increased in subsequent years mainly due to the sharp rise/fall in unit value index of imports. It moderated in 2006-07 registering a growth of 5.2 per cent and increased to 14.8 per cent in 2007-08. Income terms of trade, reflecting the capacity to import, continued to maintain the growth rate of around 21 per cent in 2007-08 as in the previous year.

6.62 India's share in world merchandise exports after remaining unchanged at 1.0 per cent between 2005 and 2006 reached 1.1 per cent in 2007 and continued to remain at that level in 2008. The increase in China's share of world exports between 2000 and 2008 at 5.1 percentage points is slightly less than one-half of the total increase in the share of developing countries over this period. However, China's export growth rate which was above 25 per cent in this decade till 2007 moderated to 17.3 per cent in 2008, while India continued to grow at around 21 per cent during 2006 to 2008. Brazil and Russia, with higher value of exports than India in absolute terms registered higher growth rate than India in 2008 (Table 6.10).

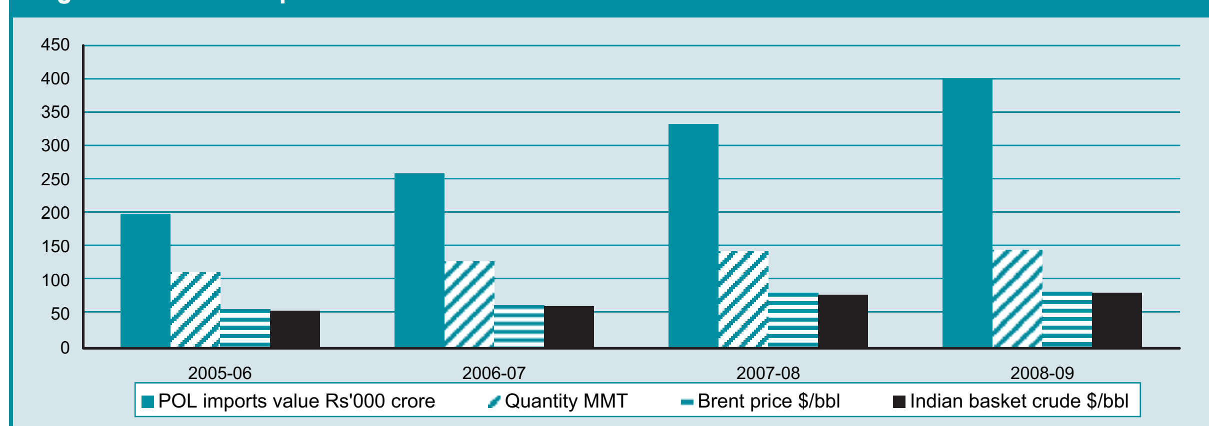
6.63 Merchandise imports grew by 35.4 per cent to US$ 251 billion in 2007-08 due to the high growth of 39.4 per cent of POL and 33.6 per cent of non-POL. POL import growth was due to both volume

Table 6.10 : Export growth and share in world exports

	Value (US$ billion)	Growth rate %				Share in world exports (%)				change in shares
		CAGR	Annual							
	2008	2000-05	2006	2007	2008	2000	2006	2007	2008	2008/ 2000
China	1429	25.0	27.2	25.6	17.3	3.9	8.0	8.8	9.1	5.1
Hong Kong	363	7.5	9.5	8.7	5.3	3.2	2.6	2.5	2.3	-0.9
Malaysia	210	7.5	14.0	9.6	19.1	1.5	1.3	1.3	1.3	-0.2
Indonesia	148	5.9	19.0	14.7	24.4	1.0	0.9	0.9	0.9	-0.1
Thailand	173	9.8	18.7	17.0	12.9	1.1	1.1	1.1	1.1	0.0
Singapore	338	10.8	18.4	10.1	13.0	2.2	2.2	2.2	2.1	0.0
India	176	18.6	21.3	20.3	20.7	0.7	1.0	1.1	1.1	0.4
Brazil	198	16.5	16.3	16.6	23.2	0.9	1.1	1.2	1.3	0.4
Mexico	292	5.2	17.1	8.6	7.3	2.6	2.1	2.0	1.8	-0.8
Russia	512	18.2	24.7	16.9	44.3	1.7	2.5	2.6	3.2	1.6
Korea	422	10.5	14.4	14.1	13.6	2.7	2.7	2.7	2.7	0.0
Emer.& Develop. Eco.	6052	16.5	22.7	14.7	21.1	26.0	36.0	36.2	38.4	12.4
World	15776	10.4	16.0	13.9	14.3	100.0	100.0	100.0	100.0	0.0

Source : IFS April, 2009 IMF CAGR : Compound Annual Growth Rate

Figure 6.4 : POL imports



growth by 11.6 per cent and increase in import price of the Indian crude oil import basket by 27.3 per cent. While the price of Indian crude basket continued to be lower than the Brent price, the rise in Brent price at 28.3 per cent was higher than the rise in price of the Indian crude import basket (Figure 6.4).

6.64 Non-POL import growth was 33.6 per cent in 2007-08 compared to 22.2 per cent in the previous year. Non-POL non-bullion imports grew by 35.1 per cent reflecting the growing needs of imports for industrial activity and as inputs for exports.

6.65 During 2008-09 import growth was subdued at 14.4 per cent with growth in both POL and non-POL imports moderating to 16.9 per cent and 13.2 per cent respectively. Gold and silver imports registered negative growth of (-)7 per cent and non-POL non-bullion imports grew by 15 per cent. This was due to the global recession resulting in lower fuel prices with the Brent price rising by only 1.9 per cent, and the price of the Indian crude import basket rising by 4 per cent; slowdown in industrial activity and lower demand for exports resulting in lower demand for imports needed for exports and industrial activity. In fact, import growth started declining from October 2008, with a one month lag from export growth and even turned negative from January to March 2009. The negative trend continued in April 2009 with import growth at (-)36.6 per cent. While oil import growth was lower at 58.5 per cent, non-oil import growth was lower at 24.6 per cent over April 2008.

6.66 Trade deficit increased to US$ 88.5 billion (as per customs data) in 2007-08 and US$ 119.1 billion in 2008-09 but fell in April 2009 by 42.8 per cent. Net POL imports grew at 32.4 per cent in 2007-08. During 2008-09 (April-February), the high growth of net POL imports continued with the huge oil price hike in the first half of 2008-09 (Table 6.11). Imports

Table 6.11 : Growth in POL trade and non-POL imports[a] (US$ terms)

	Total imports	POL imports	POL exports	Net POL imports	Non- POL imports	Gold & silver imports	Non-POL, non-gold & silver imports
2001-02	1.7	-10.5	12.0	-13.6	9.0	-1.2	10.6
2002-03	19.4	26.0	21.6	26.8	17.0	-6.4	20.3
2003-04	27.3	16.6	38.5	12.9	31.5	59.9	28.5
2004-05	42.7	45.1	95.9	34.4	41.8	62.6	39.0
2005-06	33.8	47.3	69.8	40.4	28.8	1.5	33.1
2006-07	24.5	30.0	59.3	19.1	22.2	29.4	21.4
2007-08	35.4	39.4	53.6	32.4	33.6	22.0	35.1
2008-09 (Apr-Feb)	21.8	22.4	3.5	32.7	21.5	10.1	22.9

Source : DGCI&S and own calculations

[a] **Growth rate in US dollar terms**

of gold and silver are highly variable and have increased moderately in April-February 2008 after a high growth during 2006-07 and 2007-08.

Trade composition

6.67 High export growth in 2007-08 was due to the high growth of all the three major category of exports, namely, petroleum products with 53.6 per cent growth, manufactured goods with 21 per cent growth and primary products with 41.9 per cent growth. In the primary products sector, exports of agricultural and allied products grew by nearly 45 per cent. Export growth in manufactures was powered by the high growth of important items like gems and jewellery at 23.2 per cent and chemicals and related products at 22 per cent and moderate growth of engineering goods at 14.5 per cent and textiles including RMG at 11.8 per cent.

6.68 However, in 2008-09 (April-February) as a result of global recession, the overall growth of exports in US$ terms was only 6.6 per cent compared to 29 per cent in the corresponding period of the previous year. Manufactured goods with 10.4 per cent registered double digit growth. Among the manufactured goods, engineering goods registered higher growth. Petroleum exports including coal witnessed a growth rate of only 3.5 percent. While gems and jewellery, handicrafts, agriculture and allied items and ores and minerals exports registered negative growth, textiles including RMG and leather and leather manufactures showed low growth (Table 6.12).

6.69 There was relatively less change in the composition of imports than that of exports (Table 6.13). POL continues to be the single major item of import with its share stabilized at the 30-31 per cent level prior to 2007-08. This share increased to 32.8 per cent in 2008-09 (April-February) due to high rise in oil prices. The share of capital goods imports with high rise in 2007-08 fell sharply in 2008-09 (April-February) to 13.4 per cent partly due to relatively lower growth in imports of machinery and transport equipment as a result of global recession and partly due to rise in shares of POL and fertilizers in the import basket.

6.70 During 2008-09 (April-February) high import growth was registered by fertilizers (164.2 per cent) and edible oils (32.8 per cent) to meet domestic demand; pearls precious and semi-precious stones (76.5 per cent) due to revival of gems and jewellery exports and chemicals (24.3 per cent). Cereals import growth was highly negative and pulses import growth was slightly negative. POL import growth which was robust at 46.3 per cent during April-December 2009 due to unusually high crude oil prices in the first half of 2008-09, moderated to 22.4 per cent in April-February 2008-09 due to fall in crude oil prices. However as the world recession worsened and import growth became negative from January to March 2009, negative growth was registered in both POL and non-POL imports. Even non-POL non-bullion import growth declined and became negative reflecting the fall in exports and fall in demand for imports by industrial sector.

Services trade

6.71 Services, particularly finance including insurance and transportation of goods, are traditional complements to goods trade. With the spread of telecommunications and computer technologies, virtually all commercial services have become tradable across borders. The trend of globalization, reinforced by liberalization policies and the removal of regulatory obstacles, has fuelled steady growth of international investment and trade in services.

World trade in services

6.72 In the US$ 3.7 trillion world export of commercial services in the year 2008, the major exporters of services are the developed countries. India and China were among the top 10 exporters of commercial services in the world in 2008, the rest being the developed countries. As in the case of merchandise trade, India has also improved its rank in commercial services trade. As per the latest "International Trade Statistics, 2008" brought out by WTO. World export and import growth of services decelerated from 19 & 18 per cent respectively to 11 per cent in both cases. The deceleration was more or less similar in most of the major regions like North America, Europe and Asia. Import growth of services in the United States was particularly low at 7 per cent, while the deceleration in EU by 9 percentage points was particularly sharp. While India improved its rank in world merchandise exports from 28th position in 2006 to 26th position in 2007 and maintained the same in 2008 also, in commercial services exports it has improved its rank from 10th position in 2006 to 9th position in 2007 and maintained it in 2008. China ranked 7th in commercial services exports in 2008.

Table 6.12 : Composition of exports by major markets

		Percentage share			CAGR	Growth rate[a]		
		2000-01 (Apr-Mar)	2007-08 (Apr-Mar)	2008-09 (Apr-Feb)	2000-01 to 2005-06	2006-07	2007-08	2008-09 (Apr-Feb)
I	**Primary products**							
	World	16.0	16.6	14.6	17.3	19.8	41.9	-2.3
	USA	9.4	5.9	6.6	6.1	-3.1	7.4	10.5
	EU	13.1	8.9	7.8	8.9	17.0	21.5	-1.2
	others	19.8	21.1	18.4	20.9	22.5	47.7	-3.2
(a)	**Agri & allied products**							
	World	14.0	11.6	10.6	11.0	23.5	44.9	-0.5
	USA	9.0	5.6	6.3	5.8	-1.7	6.8	11.5
	EU	11.9	7.8	7.1	7.4	17.8	25.1	3.0
	others	16.8	13.9	12.5	13.0	28.6	53.4	-2.1
(b)	**Ores and minerals**							
	World	2.0	5.0	4.0	42.7	12.6	35.3	-6.6
	USA	0.4	0.3	0.3	12.2	-25.3	19.5	-8.3
	EU	1.3	1.1	0.7	19.9	12.5	0.6	-29.8
	others	3.0	7.2	5.8	46.5	13.1	37.8	-5.3
II	**Manufactured goods**							
	World	78.8	64.4	68.3	16.1	16.9	21.0	10.4
	USA	90.6	89.9	92.1	12.9	12.0	7.6	0.7
	EU	86.8	78.5	80.5	14.8	18.7	22.8	12.5
	others	70.9	55.0	59.8	18.2	18.0	25.0	12.6
(a)	**Textiles incl. RMG**							
	World	23.6	10.9	10.7	7.3	5.7	11.8	2.9
	USA	27.2	19.2	18.5	9.4	1.5	-1.2	-4.6
	EU	33.5	31.1	31.8	12.3	3.5	12.2	0.9
	others	45.7	21.2	20.8	2.3	10.9	20.1	8.7
(b)	**Gems & jewellery**							
	World	16.6	12.1	11.2	16.0	2.9	23.2	-3.7
	USA	29.3	24.0	20.2	9.9	8.8	4.6	-18.5
	EU	11.5	7.6	6.7	10.1	1.7	28.5	-4.3
	others	13.9	11.2	11.1	21.8	0.3	31.6	2.7
(c)	**Engineering goods**							
	World	15.7	20.7	23.9	25.0	38.1	14.5	23.0
	USA	13.4	21.0	25.2	21.9	12.9	14.7	20.2
	EU	14.0	22.9	26.8	25.3	30.6	31.1	30.4
	others	17.2	19.9	22.6	25.8	47.0	9.4	20.8
(d)	**Chemical & related products**							
	World	10.4	10.7	11.0	20.9	19.1	22.1	11.3
	USA	5.7	11.3	13.2	22.7	24.1	28.1	19.2
	EU	9.7	11.0	11.1	17.9	25.7	27.1	14.7
	others	12.5	10.4	10.5	21.5	16.2	19.4	8.5
(e)	**Leather & leather mnfrs.**							
	World	4.4	2.1	2.1	6.6	12.1	12.6	3.2
	USA	3.7	1.4	1.7	-2.0	-4.2	-0.8	14.3
	EU	11.4	6.4	6.2	6.5	11.0	19.5	3.8
	others	1.6	0.8	0.8	12.8	21.7	2.5	-1.8
(f)	**Handicrafts including carpet handmade**							
	World	2.8	0.9	0.6	0.9	4.1	7.2	-26.4
	USA	6.0	2.4	1.8	-0.8	-3.1	-4.7	-31.3
	EU	4.4	1.6	1.2	2.7	7.1	-6.8	-17.0
	others	0.8	0.4	0.3	1.2	15.2	65.6	-32.4
III	**Petroleum, crude & products**							
	World	4.3	17.8	16.8	43.8	59.3	53.6	3.5
	USA	0.0	3.3	0.9	273.5	-60.8	138.8	-76.3
	EU	0.0	11.8	11.5	377.4	-19.4	103.4	16.0
	others	7.9	22.5	21.5	35.0	91.9	46.1	4.1
	Total exports							
	World	100.0	100.0	100.0	18.3	22.6	28.9	6.6
	USA	100.0	100.0	100.0	13.3	8.7	9.8	-1.6
	EU	100.0	100.0	100.0	16.7	15.6	28.5	11.5
	others	100.0	100.0	100.0	20.6	29.0	33.5	6.6

Source : Calculated on the basis of data from DGCI&S, Kolkata
[a] Growth rate in US dollar terms

Table 6.13 : Commodity composition of imports

Commodity Group	Share				CAGR	Growth rate (per cent)[a]		
	2001-02	2006-07	2007-08	2008-09 (Apr-Feb)	2001-02 to 2005-06	2006-07	2007-08	2008-09 (Apr-Feb)
I. Food and allied products, of which	**4.7**	**2.9**	**2.3**	**2.2**	**11.5**	**42.4**	**8.3**	**7.2**
1. Cereals	0.0	0.7	0.3	0.0	18.8	3589.7	-46.8	-93.9
2. Pulses	1.3	0.5	0.5	0.4	-4.2	53.8	55.2	-4.6
3. Edible oils	2.6	1.1	1.0	1.2	10.5	4.2	21.4	32.8
II. Fuel, of which	**29.5**	**33.2**	**34.2**	**36.4**	**33.3**	**29.0**	**39.4**	**25.3**
4. POL	27.2	30.8	31.7	32.8	33.1	30.0	39.4	22.4
III. Fertilizers	**1.2**	**1.6**	**2.0**	**4.8**	**33.8**	**52.4**	**66.2**	**164.2**
IV. Capital goods, of which	**11.4**	**15.4**	**18.7**	**13.4**	**41.4**	**21.8**	**63.8**	**11.8**
5. Machinery except electrical & machine tool	6.2	7.5	7.9	7.3	36.8	24.9	43.3	7.1
6. Electrical machinery	1.2	1.1	1.2	1.1	26.1	30.3	53.3	12.7
7. Transport equipment	2.2	5.1	8.0	2.8	66.5	6.8	113.1	-1.8
V. Others, of which	**48.5**	**43.8**	**38.9**	**39.0**	**27.2**	**24.6**	**20.2**	**15.2**
8. Chemicals	6.8	5.2	4.9	5.3	25.1	14.1	25.9	24.3
9. Pearls, precious & semi-precious stones	9.0	4.0	3.2	4.9	18.6	-18.0	6.5	76.5
10. Gold & silver	8.9	7.9	7.1	6.8	25.4	29.4	22.0	10.1
11. Electronic goods	7.4	8.6	8.2	7.4	36.8	20.6	29.3	6.4
TOTAL IMPORTS	**100.0**	**100.0**	**100.0**	**100.0**	**30.5**	**24.5**	**35.4**	**21.8**

Source : Calculated from DGCI&S data
[a] Growth rate in US dollar terms

6.73 Based on OECD data, WTO has stated that in Q3 of 2008, the value of exports and imports of services in OECD countries, measured in current US dollars, fell by a seasonally-adjusted -1.5 per cent and -2.2 per cent respectively compared with the previous quarter. These were the first declines since the third quarter of 2006. Year-on-year, growth in the value of services exports in OECD countries slowed sharply to 11.8 per cent, while import growth fell to 10.6 per cent. Apart from the contraction in financial services industry, other global industries like air transport, maritime transport, and tourism were also affected. The contraction in air freight traffic in December 2008 over December 2007 (-22.6 per cent) worsened in January 2009 for the eighth consecutive month as per the International Air Transport Association (IATA) with International passenger demand falling year-on-year basis by (-) 5.6 per cent in January 2009, marking the fifth consecutive month of contraction. There was a significant slowdown in tourism demand in the second half of 2008, a trend which is expected to continue in 2009.

6.74 The three broad categories of commercial services namely transport, travel and other commercial services witnessed a decline in growth rate in 2008 compared to a high growth in 2007. (Table 6.14).

Table 6.14 : World exports of commercial services trade by major category, 2008

	Value (US$ billion)	Annual percentage change			
	2008	2000-08	2006	2007	2008
Commercial services	3730	12	13	19	11
Transport	875	12	10	20	15
Travel	945	9	10	15	10
Other commercial services	1910	14	16	22	10

Source : WTO

6.75 In commercial services imports, India moved from 15th position in 2004 to 13th position in 2005 and further to 12th position in 2008, with 2.6 per cent share. The United States, European Union-15 and Japan are the major importers of services in the world.

India's services exports

6.76 Services exports reached US$ 90.1 billion in 2007-08 with a sustained high growth of export of services, which however moderated to 22.1 per cent in 2007-08. Growth has been rapid in the miscellaneous services category particularly software services and business services. The annual average growth of miscellaneous services was 33.8 per cent during 2000-01 to 2005-06 and 31.2 per cent and 20.8 per cent respectively in 2006-07 and 2007-08 (Table 6.15).

6.77 The impact of global recession was relatively less on India's services exports till December 2008 although the services export growth rate during April-December (2008-09), moderated to 16.3 per cent. A negative growth rate of (-) 8.2 per cent in insurance and sharp fall in growth rate to 6.2 per cent in travel services was registered during this period. Even transport services and miscellaneous services registered lower growth. Software services grew at 26 per cent, while financial services registered a robust growth of 45.7 per cent despite the global financial crisis and fall in growth rate in

Table 6.15 : Export of services

Commodity Groups	Percentage share				CAGR	Growth rate[a]			
			April-December		2000-01 to			April-December	
	2000-01	2007-08	2007-08	2008-09	2005-06	2006-07	2007-08	2007-08	2008-09
Travel	21.5	12.6	12.1	11.0	17.6	16.2	24.4	26.2	6.2
Transportation	12.6	11.1	10.7	10.7	25.3	26.1	25.6	18.4	16.3
Insurance	1.7	1.8	1.8	1.4	31.5	12.5	37.2	37.0	-8.2
GNIE	4.0	0.4	0.4	0.4	-13.6	-19.4	30.4	34.0	22.2
Miscellaneous of which	60.3	74.1	75.1	76.5	33.8	31.2	20.8	26.7	18.4
Software services	39.0	44.7	42.9	46.4	30.1	32.6	28.8	26.3	25.9
Non-software services of which	21.3	29.4	32.2	30.0	39.8	29.3	10.5	27.2	8.5
Business services	2.1	18.6	19.1	17.1	94.5	56.3	15.3	16.4	3.9
Financial services	2.1	3.6	3.6	4.5	28.4	156.9	3.6	13.3	45.7
Communication services	7.0	2.7	2.7	2.4	6.7	43.6	6.5	5.2	4.1
Total services exports	**100.0**	**100.0**	**100.0**	**100.0**	**28.8**	**28.0**	**22.1**	**25.9**	**16.3**

Source : Calculations based on RBI data [a] Growth rate in US dollar terms

Table 6.16 : Imports of services

Commodity Group	Share (per cent)				CAGR	Growth rate (per cent)			
			April-December		2000-01 to			April-December	
	2000-01	2007-08	2007-08	2008-09	2005-06	2006-07	2007-08	2007-08	2008-09
Travel	19.2	17.6	19.0	18.3	18.8	0.7	38.5	31.1	5.9
Transportation	24.4	21.9	23.8	27.5	18.6	-3.2	42.7	33.8	26.5
Insurance	1.5	2.0	2.1	2.1	38.0	-42.5	62.6	50.8	10.0
GNIE	2.2	0.7	0.9	1.2	10.6	-23.8	-6.7	5.0	39.9
Miscellaneous of which	52.6	57.7	54.1	50.9	18.4	59.6	6.3	-3.0	3.1
Software services	4.1	5.8	6.8	6.3	17.8	69.4	34.9	55.1	1.2
Non-software services of which	48.6	51.9	47.3	44.5	18.5	58.8	3.9	-7.9	3.3
Business services	7.0	31.8	32.1	26.5	50.0	104.8	5.4	7.2	-9.3
Financial services	13.5	6.0	5.6	6.2	-13.3	209.9	4.9	14.7	21.6
Communication services	0.9	1.6	1.7	2.0	17.9	175.4	7.9	12.7	24.4
Total Services imports	**100.0**	**100.0**	**100.0**	**100.0**	**18.8**	**28.5**	**18.5**	**10.7**	**9.7**

Source : Calculations based on RBI data. GNIE : Government not included elsewhere [a] Growth rate in US dollar terms

world financial services exports. But business services growth was at a lower rate of 3.9 per cent.

India's services imports

6.78 Imports of commercial services have become important in recent years reaching US$ 52.5 billion in 2007-08 though its growth moderated to 18.5 per cent in 2007-08 (Table 6.16). Business service is the most important category of service in imports, followed by transportation and travel. However, with a high base rate of growth, business services grew by only 5.4 per cent in 2007-08. Transportation, travel and insurance registered robust growth partly due to lower base effect. In 2008-09 (April-December), there was a sharp fall in the growth rate of business services imports (as in the case of business services exports) mainly due to the fall in imports of business and management services and relatively low growth in imports of architectural, engineering and other technical services. Import growth of travel services fell sharply to 5.9 per cent, while transportation import growth registered good growth though it moderated to 26.5 per cent. Interestingly, good growth of imports was registered in financial services and communication services despite the global financial crisis.

Foreign exchange reserves

6.79 Foreign exchange reserves are an important component of the balance of payments and an essential element in the analysis of an economy's external position. The level of India's foreign exchange reserves comprising foreign currency assets (FCA), gold, SDRs and reserve tranche position (RTP) in the IMF, which had touched a low of US$ 5.8 billion at end-March 1991, peaked at US$ 314.6 billion at end-May 2008. The reserves declined thereafter to US$ 247.7 billion at the end of November 2008 and were at US$ 252.0 billion at the end of March 2009. Fallout of the global crisis and strengthening of the US dollar vis-à-vis other international currencies has been responsible for the decline. The component-wise details of foreign exchange reserves from 1950-51 to 2008-09 (March 2009) in rupees and US dollar are at the Appendix 6.1(A) and 6.1(B).

6.80 A major fallout of the global financial crisis has been the reversal of portfolio flows (net outflow of US$ 11.3 billion during April-December 2008). Together with the widening trade deficit, such outflows have upset the supply-demand balance in the domestic foreign exchange market, leading to decline in the rupee exchange rate vis-à-vis US dollar. The value of rupee declined from Rs 40.0 in April 2008 to Rs 48.66 in October 2008. The currency came under sharp pressure after the collapse of the Lehman Brothers in September 2008. The Reserve Bank, therefore, intervened to augment supply in the domestic foreign exchange market aimed at reducing undue volatility. The rupee thereafter attained a measure of stability. The exchange rate was Rs. 51.2 per US dollar in March 2009, reflecting 21.9 per cent depreciation during the fiscal 2008-09. The Foreign Currency Assets (FCAs) are held in diverse currencies like US dollar, Euro, pound sterling, Australian dollar, etc. An appreciation in the value of US dollar against major international currencies translates into lower US dollar equivalent for assets held in other currencies. Thus, during fiscal 2008-09, out of the decline of US$ 57.8 billion in FCA (from US$ 299.2 billion on 31.3.2008 to US$ 241.4 billion on 31.3.2009), the fall of US$ 39.7 billion (69 per cent) was due to valuation change and only US$ 17.9 billion (31 per cent) was on account of net sale of dollars by the RBI. The US dollar has appreciated

Table 6.17 : Sources of accretion to foreign exchange reserves (US$ billion)

Sl.No.	Items	2006-07	2007-08	April-December 2007-08	April-December 2008-09
I	Current account balance	-9.6	-17.0	-15.5	-36.5
II	Capital account (net) (A to F)	46.2	109.2	82.7	16.1
A	External assistance	1.8	2.1	1.3	1.9
B	External commercial borrowing	16.1	22.6	17.4	7.1
C	Foreign investment	14.8	44.9	40.2	4.0
D	Short-term credit	6.6	17.2	10.7	0.5
E	Banking capital	1.9	11.8	5.9	-0.1
	Of which: NRI deposits	*4.3*	*0.2*	*-0.9*	*2.1*
F	Other items in capital account	4.2	9.5	7.1	2.7
III	Valuation change	10.9	18.4	8.9	-33.4
	Total (I+II+III)	**47.5**	**110.6**	**76.1**	**-53.8**

Source : RBI

Table 6.18 : International comparison of foreign exchange reserves (US $ billions) and ratio of reserves to imports of goods & services

Country/ Country Group	2001	2005	2006	2007	2008
Russia	33.1 (44.6)	176.5 (107.4)	296.2 (141.7)	466.7 (165.1)	421.3 (114.4)
China	216.3 (79.7)	822.5 (115.5)	1069.5 (125.4)	1531.3 (148.0)	2134.5 (163.6)
India	46.4 (65.0)	132.5 (72.8)	171.3 (75.5)	267.6 (95.1)	271.7 (79.3)
Brazil	35.6 (49.0)	53.3 (54.4)	85.2 (70.7)	179.5 (113.8)	192.9 (87.6)
Mexico	44.8 (24.2)	74.1 (30.5)	76.3 (27.4)	87.1 (28.5)	94.6 (28.3)
Country Group					
Developing Asia Excluding China & India	116.9 (37.9)	200.5 (38.6)	248.4 (42.4)	329.2 (49.9)	339.4 (42.9)
Middle East	157.9 (78.7)	351.6 (91.7)	477.2 (101.6)	670.4 (114.7)	823.1 (106.7)

Source : World Economic Outlook Database, April 2009

Note : Reserves are based on offical holding of gold valued at SDR 35 an ounce. This convention results in a marked underestimation of reserves for countries that has substantial gold holdings

India's FOREX reserves was US$ 256.0 billion (end of December 2008) and US$ 252.0 billion at the end of March 2009

Figures in parentheses indicate ratio of reserves to imports of goods and services

by 38.8 per cent against pound sterling, 19.3 per cent against Euro and 32.6 per cent against Australian dollar between March 2008 and March 2009. The constituent-wise sources of accretion to foreign exchange reserves during 2006-07, 2007-08 and 2008-09 (April-December) are indicated in Table 6.17.

6.81 In line with the principles of preserving the long-term value of reserves in terms of purchasing power and minimizing risk and volatility in returns, the foreign currency assets are invested by RBI in multi-currency, multi-asset portfolio as per the existing norms broadly in line with the best international practices. Total foreign exchange reserves stood at US$ 252.0 billion at end-March 2009. The ratio of foreign exchange reserves to total external debt at end-December 2008 was 110.9 per cent, while the ratio of short-term external debt to total foreign exchange reserves was 18.5 per cent.

6.82 The rate of return, net of depreciation, on foreign currency assets and gold deployed by the Reserve Bank increased marginally to 4.8 per cent in 2007-08 from 4.6 per cent in 2006-07.

6.83 A comparative picture of foreign exchange reserves and the import cover as measured by the ratio of foreign exchange reserves to import of goods and services for select country groups and countries' including India is presented in Table 6.18. Among the country groups, "Developing Asia" and "Middle East" accumulated reserves during the period 2001-08, leading to a steady improvement in the ratio of reserves to import of goods and services for these country groups till 2007, before falling marginally in 2008.

Foreign exchange rate policy

6.84 The foreign exchange rate policy in recent years has been guided by the broad principles of careful monitoring and management of exchange rates with flexibility, without a fixed or a pre-announced target or a band, while allowing the underlying demand and supply conditions to determine the exchange rate movements over a period in an orderly manner. Subject to this predominant objective, the Reserve Bank of India's intervention in the foreign exchange market has been driven by the objectives of reducing excess volatility, maintaining adequate level of reserves, and developing an orderly foreign exchange market.

6.85 In the year 2006-07, the average annual exchange rate of rupee was 45.25 per US dollar, Rs 85.64 per pound sterling, Rs 58.05 per euro and Rs 38.73 per 100 yen. During the fiscal 2007-08, due to high capital inflows, the rupee appreciated against major international currencies. The appreciation was 12.4 per cent against the US dollar (Rs 40.26 per dollar), 6.0 per cent against pound sterling (Rs 80.83 per pound sterling), 1.8 per cent against euro (Rs 57.06 per euro) and 9.6 per cent against Japanese yen (Rs 35.35 per 100 yen).

6.86 In the fiscal 2008-09, however, the rupee depreciated against major international currencies, except pound sterling, due to deceleration in capital flows and widening trade deficit. The annual average exchange rate was Rs 45.99 per US dollar, Rs 64.98 per euro and Rs 46.22 per 100 yen, indicating depreciation by 12.5 per cent, 12.2 per cent and 23.5 per cent respectively in 2008-09. The rupee appreciated by 3.2 per cent against pound sterling (Rs 78.29 per pound sterling).

Table 6.19 : Exchange rates and RBI's sale/purchase of foreign currency in exchange market, 2008-09

Month	Monthly average exchange rates (Rupee per foreign currency)*,				
	US$	Pound	Euro	Yen**	RBI Net sale (-) / purchase (+) US$ million
April 2008	40.02 (0.8)	79.20 (2.0)	63.03 (-0.6)	38.93 (3.0)	(+) 4325
May 2008	42.13 (-5.0)	82.74 (- 4.3)	65.55 (- 3.9)	40.41 (- 3.7)	(+) 148
June 2008	42.82 (-1.6)	84.11 (-1.6)	66.57 (-1.5)	40.07 (0.9)	(-) 5229
July 2008	42.84 (-0.04)	85.17 (- 1.3)	67.56 (- 1.5)	40.15 (-0.2)	(-) 6320
August 2008	42.91 (-0.2)	81.34 (4.7)	64.45 (4.8)	39.34 (2.1)	(+) 1210
September 2008	45.56 (-5.8)	82.06 (-0.9)	65.55 (-1.7)	42.74 (-8.0)	(-) 3784
October 2008	48.66 (-6.3)	82.65 (-0.7)	64.84 (1.1)	48.57 (-12.0)	(-) 18666
November 2008	49.01 (-0.7)	75.18 (9.9)	61.67 (5.1)	51.15 (-5.0)	(-) 3101
December 2008	48.63 (0.8)	72.56 (3.6)	65.67 (-6.1)	53.30 (-4.0)	(-)318
January 2009	48.79 (-0.3)	70.77 (2.5)	65.10 (0.9)	54.04 (-1.4)	(-) 29
February 2009	49.26 (-1.0)	70.83 (-0.1)	62.89 (3.5)	53.47 (1.1)	(+) 230
March 2009	51.23 (-3.8)	72.90 (-2.9)	66.92 (-6.0)	53.51 (1.8)	(-) 3388
Average 2008-09	**45.99** **(-12.5)**	**78.29** **(3.2)**	**64.98** **(-12.2)**	**46.22** **(-23.5)**	

Source : RBI
*** FEDAI indicative rate;**
**** Per 100 Yen Figures in parentheses indicate appreciation (+) and depreciation (-) over the previous month/year.**

6.87 The month-to-month movement of exchange rate in the year 2008-09 indicated that the rupee depreciated against the US dollar in May-June 2008 but remained almost stable during July-August 2008. It depreciated sharply against the US dollar during September-October 2008 (Rs 45.6 in September 2008 and Rs 48.7 in October 2008) and moved in a narrow range of Rs 48.6 to Rs 49.3 during November 2008-February 2009. The rupee however recorded a depreciation of 3.8 per cent to Rs. 51.2 in March 2009.

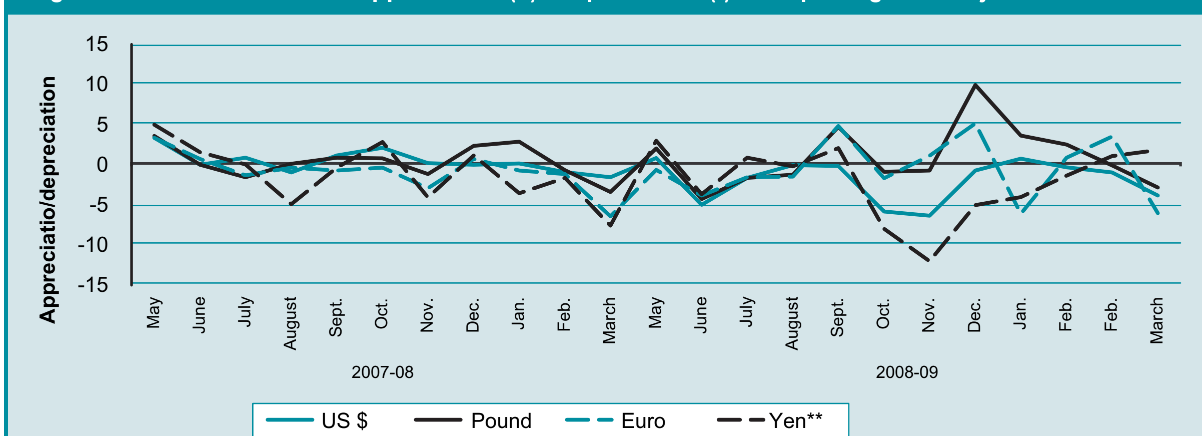
6.88 The daily movement of exchange rate during 2008-09 revealed that the rupee/US dollar exchange rate, which was Rs 40.4 per dollar at end March 2008, crossed Rs 50.1 per US dollar mark on October 27, 2008 and depreciated further to Rs 52.1 per dollar on March 5, 2009, before recovering to Rs 50.2 per dollar on March 20, 2009. The rupee depreciation during 2008-09 reflected mainly the supply-demand imbalance in the foreign exchange market, which widened significantly during September-October 2008, as a fallout of the global crisis. This led RBI to augment supply of dollars to stabilize the rupee in the foreign exchange market (Table 6.19).

6.89 Movement in exchange rate of rupee vis-à-vis major international currencies during 2007-08 to 2008-09, month-wise is presented in Figure 6.5.

6.90 The exchange rate of rupee vis-à-vis select international currencies since 1980-81, year-wise, and during 2008-09, month-wise, is indicated at Appendix 6.5.

6.91 The indices of nominal effective exchange rate (NEER) and real effective exchange rate (REER) is used as indicators of external competitiveness of the country over a period of time. NEER is the weighted average of bilateral nominal exchange rates of the home currency in terms of foreign currencies. REER is defined as a weighted average of nominal exchange rates adjusted for relative price differential between the domestic and foreign countries. REER captures movements in cross-currency exchange rates as well as inflation differential between India and its major trading partners. RBI has been

Figure 6.5 : Month on month appreciation (+) / depreciation (-) of Rupee against major currencies



constructing six currency (US dollar, euro for eurozone, pound sterling, Japanese yen, Chinese renminbi and Hong Kong dollar) and 36 currency indices of NEER and REER.

6.92 While the rupee has depreciated against the US dollar by 12.5 per cent, the rupee depreciation against the six-currency trade-weighted NEER was modest during 2008-09. The average six-currency trade-weighted REER (base:1993-94=100) at 114.09 in 2007-08 indicated an overvaluation of rupee by 14.1 per cent in real terms. REER declined from 112.16 in April 2008 to 95.65 in March 2009 mainly on account of significant depreciation of the rupee against US dollar, euro and Japanese yen. The sharp decline in inflation rate in recent months has also contributed towards the correction in overvaluation of the rupee (Table 6.20 and Appendix 6.6)

6.93 In the international market, the US dollar appreciated against most of the other major international currencies as the U.S. investors were liquidating their investment in overseas equity and bonds and repatriating the money back to the United States as direct fallout of the global economic slowdown. Notwithstanding the deepening of financial crisis and weakening in economic activity after the collapse of the Lehman Brothers in mid-September 2008, the flight to safety considerations facilitated strengthening of

Table 6.20 : Movement of rupee and indices of NEER and REER during 2008-09

Month/Year	Rs per US dollar	Appreciation (+)/ depreciation (-) in Rs per dollar over previous month	NEER *	REER *	Appreciation (+)/ depreciation (-) in NEER over previous month	Appreciation (+)/ depreciation (-) in REER over previous month
2007-08 (April March)	40.26		74.17	114.09		
2008-09						
April 2008	40.02		70.63	112.16		
May 2008	42.13	-5.0	67.48	108.23	-4.5	-3.5
June 2008	42.82	-1.6	66.38	108.20	-1.6	-0.03
July 2008	42.84	-0.04	65.83	107.94	-0.8	-0.2
August 2008	42.91	- 0.2	67.22	111.30	+ 2.1	+ 3.1
September 2008 (P)	45.56	- 5.8	64.46	107.11	- 4.1	-3.8
October 2008 (P)	48.66	- 6.4	62.08	102.36	- 3.7	-4.4
November 2008 (P)	49.01	- 0.7	63.06	102.80	+ 1.6	+0.4
December 2008 (P)	48.63	0.8	62.12	100.18	- 1.5	-2.6
January 2009 (P)	48.79	- 0.3	62.28	99.64	+ 0.3	-0.5
February 2009 (P)	49.26	- 1.0	62.80	99.87	+ 0.8	+0.2
March 2009 (P)	51.23	-3.8	60.18	95.65	-4.2	-4.2

Source : RBI

*** 6-Currency Trade Based Weights- Base: 1993-94 (April-March) =100**

Table 6.21 : Exchange rate of US dollar against international currencies

Month/Year	GBP/US$	Euro/US$	US$/JPY
March 2008	1.9885	1.5812	100.10
April 2008	1.9668	1.5540	104.08
May 2008	1.9735	1.5508	105.66
June 2008	1.9917	1.5764	106.40
July 2008	1.9805	1.5611	107.99
Aug 2008	1.8128	1.4716	108.31
Sept 2008	1.8161	1.4395	105.87
Oct 2008	1.6076	1.2726	98.46
Nov 2008	1.5380	1.2705	95.57
Dec 2008	1.4626	1.3978	90.60
Jan 2009	1.4435	1.3409	90.87
Feb 2009	1.4322	1.2668	97.63
March 2009	1.4327	1.3249	98.84
US$ Appreciation (+) / Depreciation (-) (End March 2008– End March 2009)	38.8	19.3	- 1.3

Source : RBI

the US dollar. During 2008-09, the US dollar appreciated against the euro and the pound sterling; however, it depreciated against the Japanese yen. The exchange rate of US dollar vis-à-vis other major international currencies, viz., pound sterling, euro, and Japanese yen is presented in Table 6.21.

External debt

6.94 India's external debt stock at US$ 224.77 billion (Rs. 8,98,750 crore) at end-March 2008 recorded an increase of US$ 53.44 billion over end-March 2007. Of the total increase, long-term debt accounted for US$ 34.6 billion and short-term debt was higher by US$ 18.9 billion.

6.95 During 2008-09 up to December 2008, total external debt increased further by US$ 6.1 billion (2.7 per cent) to US$ 230.8 billion (Rs. 11,18,565 crore). Long-term debt at US$ 183.4 billion at end-December 2008 posted an increase of US$ 5.6 billion and accounted for 79.4 per cent of the total external debt (79.1 per cent at end-March 2008). Short-term debt increased marginally to US$ 47.5 billion at the end of December 2008 and constituted 20.6 per cent of the total external debt (20.9 per cent at end-March 2008) (Table 6.22).

Table 6.22 : India's external debt

Components	(US$ billion)						
	End March				End-June 2008 PR	End-Sept. 2008 PR	End-December 2008 QE
	2005	2006	2007R	2008 PR			
Long-term debt	115.25	118.59	143.20	177.77	175.16	173.97	183.37
Short-term debt	17.72	19.54	28.13	47.00	48.62	50.68	47.48
Total external debt	132.97	138.13	171.33	224.77	223.78	224.65	230.85
	(Rs crore)						
Long-term debt	5,04,274	5,28,989	6,24,287	7,10,826	7,52,298	8,12,587	8,88,514
Short-term debt	77,528	87,155	1,22,631	1,87,924	2,08,820	2,37,846	2,30,051
Total external debt	5,81,802	6,16,144	7,46,918	8,98,750	9,61,118	10,50,433	11,18,565
Debt sustainability indicators	(Ratio as per cent)						
External debt to GDP	18.5	17.2	18.1	19.0	-	-	-
Short-term debt to total external debt	13.3	14.1	16.6	20.9	21.7	22.6	20.6
Short-term debt to foreign exchange reserves	12.5	12.9	14.1	15.2	15.6	17.7	18.5
Concessional debt to total external debt	30.9	28.6	23.1	19.7	19.1	18.5	18.7
Debt-service ratio	5.9^	10.1#	4.8	5.4	-	-	-

Notes :

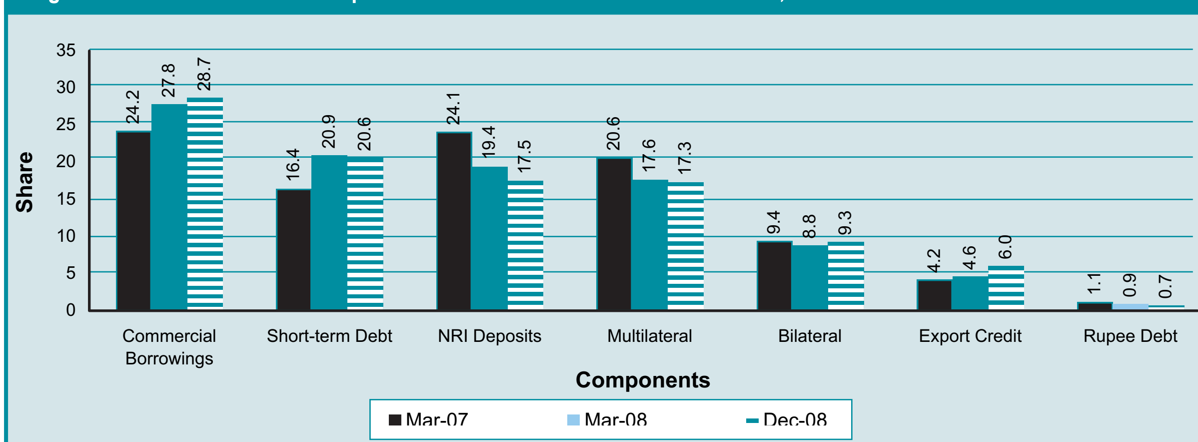
^ Works out to 5.7 per cent, with the exclusion of prepayment of US$ 381 million.

 # Works out to 6.3 per cent, with the exclusion of India Millennium Deposits (IMDs) repayments of US$ 7.1 billion and prepayment of US$ 23.5 million.

NRO deposits are included under total external debt since 2005-06.

R: Revised; PR: Partially Revised; QE: Quick Estimates; - : Not computed for the broken year.

Figure 6.6: Share of various components of external debt at end-March 2007, end-March 2008 and end-December 2008



6.96 Commercial borrowings emerged as the largest component of external debt, with its share increasing from 27.8 per cent at end-March 2008 to 28.7 per cent at end-December 2008. Non-resident Indian deposits accounted for 17.5 per cent of the total external debt, followed by multilateral debt (17.3 per cent), bilateral debt (9.3 per cent), export credit (6.0 per cent) and rupee debt (0.7 per cent). Under the short-term debt, trade related credits at US$ 43.8 billion constituted 92.1 per cent of total short-term debt and 18.9 per cent of total external debt at the end of December 2008 (Figure 6.6).

6.97 Government (sovereign) external debt at US$ 56.9 billion at end-March 2008 registered an increase of 17.8 per cent over end-March 2007 and increased marginally to US$ 57.4 billion at the end of December 2008. However, sovereign debt as per cent of GDP declined from 5.1 per cent in 2006-07 to 4.8 per cent in 2007-08 and its share in total external debt fell from 28.2 per cent at end-March 2007 to 25.3 per cent at end-March 2008 and further to 24.8 per cent at end-December 2008.

6.98 India's external debt statistics are being compiled and published on the basis of both original and residual maturity on a quarterly basis beginning the quarter ended December 2007. Total short-term residual maturity obligations, which comprise outstanding short-term external debt (original maturity) and payments falling due in one year or less under outstanding long-term external debt, was US$ 89.9 billion, accounting for 38.9 per cent of the total external debt at end-December 2008 (Box 6.8).

Figure 6.7 : Currency composition of India's external debt at end-December 2008 (per cent)

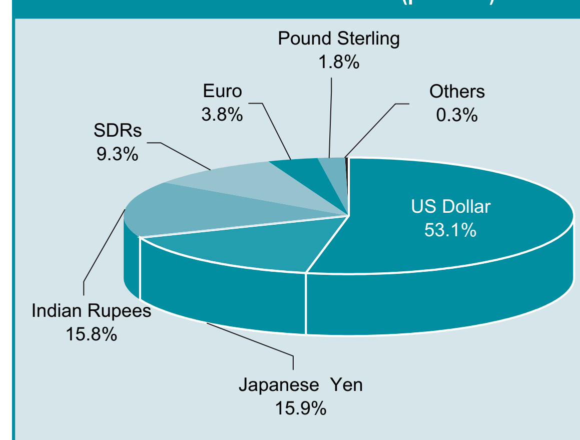


Table 6.23 : Currency composition of India's external debt (as per cent of total external debt)

Sl. No.	Currency	As at end-March						As at end of		
		2003	2004	2005	2006	2007	2008 R	June 2008 PR	Sept. 2008 PR	Dec. 2008 QE
1.	US dollar	46.6	40.5	48.0	49.2	51.4	54.4	56.5	54.0	53.1
2.	SDR	15.2	15.5	14.2	13.7	11.9	10.0	10.0	9.6	9.3
3.	Indian rupee	17.3	22.7	19.6	18.9	18.6	17.5	16.4	16.0	15.8
4.	Japanese yen	10.7	11.6	10.5	10.9	11.5	12.0	11.3	14.3	15.9
5.	Euro	6.2	5.8	4.6	4.4	3.9	3.6	3.5	4.0	3.8
6.	Pound sterling	3.0	3.4	2.6	2.6	2.4	2.2	2.0	1.9	1.8
7.	Others	1.0	0.5	0.5	0.3	0.3	0.3	0.3	0.2	0.3
Total		**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

R: Revised PR: Partially Revised. QE Quick Estimates

Box 6.8 : Short-term external debt by residual maturity

External debt by residual maturity indicates the principal components of both short- and long-term debt, maturing during a reference period. Particularly important is short-term debt by residual maturity, which comprises outstanding short-term external debt (original maturity) and principal payments falling due in one year or less under outstanding long-term external debt.

The short-term external debt by residual maturity is being increasingly used as liquidity and vulnerability indicator. It indicates the refinancing risk in the international capital markets, especially during times of crisis. The crises in the emerging market economies in the second half of the 1990s underlined the importance of using short-term debt by residual maturity as a vulnerability indicator against the backdrop that the excessive accumulation of short-term external debt vis-à-vis level of international reserves was a common characteristic of these crises (Calafell and Bosque 2000). This view was supported by economists such as Furman and Stiglitz (1998), Radelet and Sachs (1998), Greenspan (1999). The empirical research also lent support to the viewpoint that the adequacy of foreign exchange reserves of a country should be seen in the context of the ability to meet repayment obligations falling due in the near term, as measured by short-term debt by residual maturity. The IMF incorporated the ratio of international reserves to short-term external debt as one of the vulnerability indicators in its early warning system. Considering the need for comprehensive, comparable and reliable information on external debt and the importance of additional data for an assessment of potential vulnerability to solvency and liquidity problems arising from the gross external debt position, the IMF encouraged countries to compile and present data on gross external debt position on the basis of remaining maturity for analytical purposes (IMF, 2003).

The deleveraging process and its impact on capital flows to emerging markets in the recent global financial crisis have again raised concerns about the external debt refinancing needs in volatile market conditions. The IMF estimates of external debt financing needs in 2009 i.e., short-term debt at initial maturity at end-2008 plus amortizations on medium- and long-term debt link the same to reserves position of select regions and emerging market countries (Global Financial Stability Report, 2009). The ratio of extenal debt refinancing needs to reserves is estimated at 33 per cent for India, 14 per cent for China, 40 for Brazil and 34 per cent for Russia.

India's short-term external debt by residual maturity stood at US$ 89.9 billion, accounting for 38.9 per cent of total external debt at end-December 2008. Total foreign exchange reserves of the country were 2.8 times of short-term external debt by residual maturity at end-December 2008. The outstanding stock of short-term debt by residual maturity included suppliers' credit of less than 6 months estimated at US$ 18.4 billion at end-December 2008, which is not captured in external debt statistics of several countries.

Short-term external debt by residual maturity

(US$ million)

Sl. No.	Components	At the end of December 2008	At the end of September 2008
I.	Total External Debt	230,846	222,612
	i) Sovereign Debt	2,867	2,898
	ii) External Commercial Borrowings	7,789	6,961
	iii) NRI Deposits	31,839	31,956
	iv) Short-term Debt (by Original Maturity)	47,477	50,104
	Of which:		
	a) Trade Credits	43,766	46,335
II.	Total Short-term debt by Residual Maturity (i to iv)	89,972	91,919
	a) Short-term debt (Residual Maturity) as per cent of Total Debt	38.9	41.3
	b) Short-term (Residual Maturity) as per cent of Foreign Exchange Reserves	35.1	29.7

Note: Data relating to short-term debt by residual maturity are as published in the quarterly report on "India's External Debt" released on December 31, 2008 and March 31, 2009.

Amongst the medium- and long-term debt obligations falling due in a year, NRI deposits represent the largest component with repayment obligation of US$ 31.8 billion. However, the NRI deposits are largely renewed and are also locally withdrawn from the NRI rupee deposits accounts (NR(E)RA and NRO deposit schemes). The local withdrawals/redemptions from NRI deposits cease to exist as liability in the capital account and assume the form of private transfers in the current account of the balance of payments. During 2007-08, the share of local withdrawals in total outflows from NRI deposits was around 65.0 per cent and it is estimated at US$ 16.2 billion, i.e., 63.3 per cent of total outflows from NRI deposits during April-December 2008 (India's Balance of Payments Developments during the Third Quarter of 2008-09 and April-December 2008, RBI Bulletin, April 2009). Sovereign debt repayment obligations at US$ 2.9 billion represent payments to multilateral and bilateral creditors. As of now, the Government does not raise resources through the issue of sovereign bonds in the international capital markets.

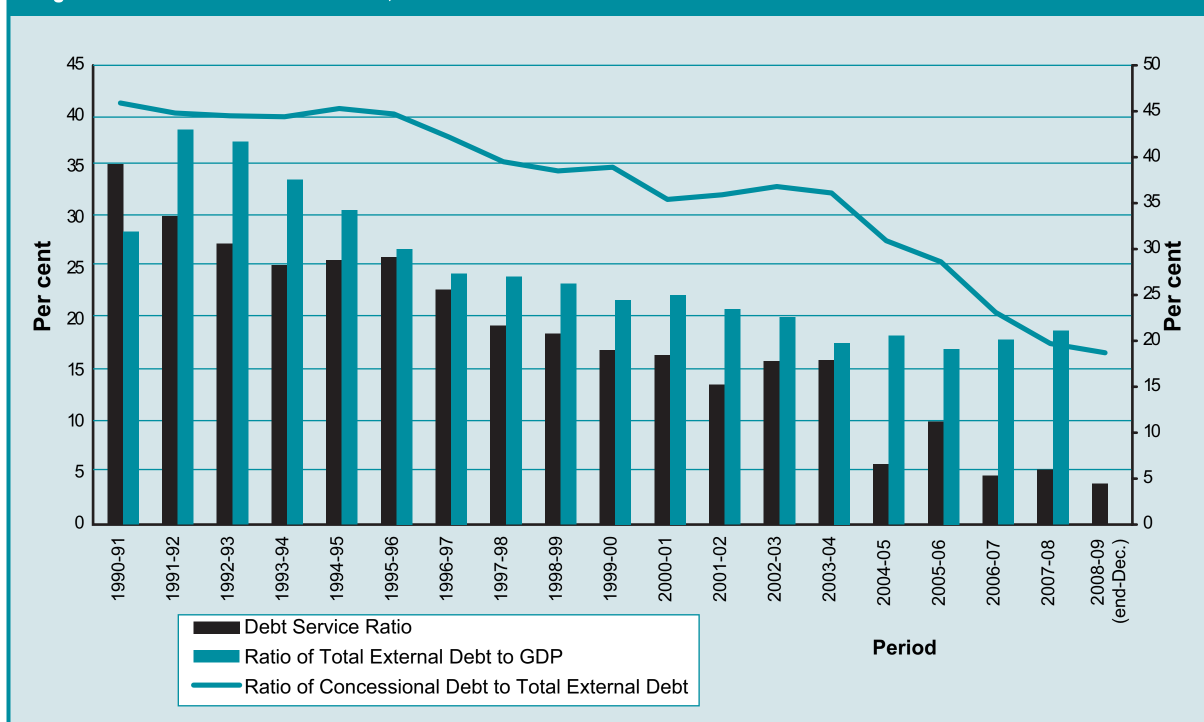
The maturing ECB obligations is the main component exposed to refinancing risk in the international financial markets. However, in terms of magnitude, it was relatively small at US$ 7.8 billion. The terms of commercial borrowings have undoubtedly been affected due to tight liquidity conditions in the global markets and all-in-cost ceilings applicable to ECBs have therefore been gradually liberalised during 2008-09. Net external commercial borrowings have remained positive, though lower in magnitude, during April-December 2008. The conventional refinancing risk i.e., the risk related to raising of fresh bank loans/bonds to refinance maturing obligations in the international capital market is applicable essentially to ECBs.

References : Berg & Catherine Pattillo, 'The Challenge of Predicting Economic Crises' IMF, July 2000.

IMF, External Debt Statistics, Guide for Compilers and Users, 2003

Calafell & Rodolfo Padilla del Bosque, The Ratio of International Reserves to Short-term External Debt as an indicator of External Vulnerability: Some Lessons from the Experience of Mexico and other Emerging Economies.

Figure 6.8: India's debt service ratio, ratio of external debt to GDP and ratio of concessional to total external debt



6.99 In terms of currency composition of external debt, US dollar denominated debt accounted for 53.1 per cent of total external debt at end-December 2008, followed by Japanese yen (15.9 per cent), Indian rupee (15.8 per cent), SDR (9.3 per cent) and euro (3.8 per cent) (Table 6.23 and Figure 6.7).

6.100 In terms of the major debt sustainability indicators, the ratio of foreign exchange reserves to total external debt improved from 116.2 per cent in 2006-07 to 137.8 per cent in 2007-08. The ratio of concessional to total external debt has continued to decline from 23.1 per cent in 2006-07 to 19.7 per cent in 2007-08 and further to 18.7 per cent at end-December 2008. The ratio of short-term debt to foreign exchange reserves, which had increased from 14.1 per cent at end-March 2007 to 15.2 per cent at end-March 2008, rose further to 18.5 per cent at the end of December 2008 (Figure 6.8 and Table 6.24).

International comparison

6.101 A cross-country comparison of external debt position based on the "Quarterly External Debt

Table 6.24 : India's key external debt indicators (per cent)

Year	External debt (US$ billion)	Ratio of total external debt to GDP	Debt-service ratio	Ratio of foreign exchange reserves to total external debt	Ratio of concessional debt to total external debt	Ratio of short-term debt to foreign exchnage reserves	Ratio of short-term debt to total debt
1990-91	83.8	28.7	35.3	7.0	45.9	146.5	10.2
1995-96	93.7	27.0	26.2	23.1	44.7	23.2	5.4
2001-02	98.8	21.1	13.7	54.7	35.9	5.1	2.8
2005-06	138.1	17.2	10.1#	109.8	28.6	12.9	14.1
2006-07 PR	171.3	18.1	4.8	116.2	23.1	13.2	16.4
2007-08 PR	224.8	19.0	5.4	137.8	19.7	15.2	20.9
End-June 08 PR	223.8	-	-	139.5	19.1	15.6	21.7
End-Sept. 08 PR	224.6	-	-	127.5	18.5	17.7	22.6
End-Dec. 08 QE	230.8	-	-	110.9	18.7	18.5	20.6

PR: Partially Revised; QE: Quick Estimates. - Not worked out for the broken period

Works out to 6.3 per cent, with the exclusion of India Millennium Deposits (IMDs) repayments of US$ 7.1 billion and prepayment of US$ 23.5 million.

Note: Debt-service ratio is the proportion of gross debt service payments to external current receipts (net of official transfers).

Table 6.25 : Gross external debt position of select countries (US$ million)

Sl. No.	Countries	End-December 2008				Ratios as per cent			
		Short-term debt	Long-term debt	Total external debt	Foreign exchange reserves@	Short-term debt to total external debt (per cent)	Foreign exchange reserves to total debt	Short-term debt to foreign exchange reserves	External debt to GNI^
1	Russian Federation	79,779	4,04,948	4,84,726	4,27,080	16.5	88.1	18.7	29.4
2	China#	2,10,785	1,63,876	3,74,661	19,46,030	56.3	519.4	10.8	11.6
3	Turkey	50,714	2,26,120	2,76,834	74,254	18.3	26.8	68.3	38.8
4	Brazil	36,466	2,26,466	2,62,931	1,93,783	13.9	73.7	18.8	18.7
5	Poland	50,809	1,91,248	2,42,057	62,180	21.0	25.7	81.7	47.7
6	**India**	**47,477**	**1,83,369**	**230,846**	**255,968**	**20.6**	**110.9**	**18.5**	**18.9**
7	Hungary*	26,111	1,83,523	2,09,634	33,457	12.5	16.0	78.0	..
8	Mexico	24,218	1,76,175	2,00,393	95,298	12.1	47.6	25.4	17.7
9	Indonesia	20,488	1,34,578	1,55,067	51,639	13.2	33.3	39.7	33.9
10	Argentina	56,253	71,859	1,28,112	46,386	43.9	36.2	121.3	49.7
11	Kazakhstan	10,174	97,639	1,07,813	19,401	9.4	18.0	52.4	103.7
12	Ukraine	21,983	81,253	1,03,236	31,543	21.3	30.6	69.7	52.9
13	Malaysia	30,892	44,399	75,292	91,536	41.0	121.6	33.7	29.4
14	Thailand	20,317	44,529	64,846	111,008	31.3	171.2	18.3	26.5
15	Chile	14,251	50,517	64,768	23,162	22.0	35.8	61.5	40.3
16	Croatia	6,620	47,830	54,450	12,958	12.2	23.8	51.1	97.7
17	Philippines	7,001	46,855	53,856	37,551	13.0	69.7	18.6	41.9
18	Romania	15,900	36,066	51,966	39,343	30.6	75.7	40.4	51.5
19	Colombia	5,684	40,708	46,392	23,670	12.3	51.0	24.0	22.5
20	Venezuela RB# #	11,925	33,075	45,000	37,035	26.5	82.3	32.2	24.7

Source : Table 1 of the Quarterly External Debt Database, World Bank & IMF.

\# Based on information disseminated by State Administration of Foreign Exchange, Government of China

* For Hungary, External debt to GNI ratio is not available.

@ Based on Special Data Dissemination System database of IMF.

\## For Venezuela RB, Information is as per Global Development Finance, 2008

^ Relates to the year 2007 and is based on World Bank data

(QEDS) Database" and World Development Indicators is presented in Table 6.25. India ranked sixth in terms of total external debt stock (at end-December 2008) among select developing countries. The ratio of short-term debt to total external debt stood at 20.6 per cent and it accounted for 18.5 per cent of total foreign exchange reserves at the end of December 2008. The ratio of external debt stock to Gross National Income as of 2007, as per World Development Indicators Database was 18.9 per cent and was the fourth lowest after that of China, Mexico and Brazil.

Direction and composition of trade

6.102 The directional pattern of India's trade has changed during the decade. Trade with the top 16 trading partners increased by over 3.6 percentage points since 2003-04 to 58.9 percentage share of total in 2007-08. The share of the United States, the largest trading partner, declined by 1.5 percentage points to 10.1 per cent in 2007-08, while that of the United Kingdom and Belgium declined by 1.6 and 2 percentage points, respectively (Table 6.26). The share of China, the second largest partner in 2007-08 increased to 9.2 per cent in 2007-08 from 4.9 per cent in 2003-04. China became the largest trading partner of India in April-February 2008 with trade share of the United States falling drastically by 2 percentage points compared to 2007-08

6.103 With rising POL prices resulting in higher import values and India's rising exports of refined POL products, the United Arab Emirates (UAE) and Saudi Arabia have emerged as the third and fourth largest trading partners of India. In 2008-09 (April-February), the share of UAE, Hong Kong, Korea Republic, Belgium, Indonesia, South Africa and Brazil has increased.

6.104 Though India had a large overall trade deficit, it had a trade surplus with the United States, UAE, United Kingdom, Hong Kong, Belgium, Italy and

Table 6.26 : India's trade and export/import ratio with major trading partners

Sl. No.	Countries	Share in total trade (percent)						Export/import ratio[a]		
		2003-04	2004-05	2005-06	2006-07	2007-08	2008-09 (Apr-Feb)	2006-07	2007-08	2008-09 (Apr-Feb)
1.	China PRP	4.9	6.5	7.0	8.3	9.2	8.6	0.5	0.4	0.3
2.	USA	11.6	10.6	10.6	9.8	10.1	8.2	1.6	1.0	1.2
3.	UAE	5.1	6.1	5.1	6.6	7.0	8.1	1.4	1.2	1.0
4.	Saudi Arabia	1.3	1.4	1.4	5.1	5.6	5.6	0.2	0.2	0.2
5.	Germany	3.8	3.5	3.8	3.7	3.6	3.6	0.5	0.5	0.6
6.	Singapore	3.0	3.4	3.5	3.7	3.7	3.3	1.1	0.9	1.1
7.	UK	4.4	3.7	3.6	3.1	2.8	2.6	1.3	1.4	1.0
8.	Hong Kong	3.3	2.8	2.6	2.3	2.2	2.6	1.9	2.3	1.1
9.	Korea RP	2.5	2.3	2.5	2.3	2.1	2.5	0.5	0.5	0.4
10.	Japan	3.1	2.7	2.6	2.4	2.5	2.3	0.6	0.6	0.4
11..	Belgium	4.1	3.6	3.0	2.4	2.1	2.2	0.8	1.0	0.8
12.	Indonesia	2.3	2.0	1.7	2.0	1.7	2.0	0.5	0.4	0.4
13.	Italy	2.0	1.9	1.7	2.0	1.9	1.8	1.3	1.0	0.9
14.	South Africa	1.7	1.6	1.6	1.5	1.5	1.6	0.9	0.7	0.3
15.	France	1.7	1.8	2.5	2.0	2.1	1.3	0.5	0.4	0.9
16.	Brazil	0.4	0.8	0.8	0.8	0.8	0.9	1.5	2.7	2.2
	Total (1 to 16)	55.3	55.0	54.1	58.1	58.9	57.1	0.8	0.7	0.6

Source : Computed from DGCI&S data.
[a] **The coefficient of exports and import ratio between 0 and 1 implies that India's imports are greater than exports and if the coefficient is greater than one, India exports more than what it imports.**

Brazil in 2007-08. During 2008-09 (April-February), India had a trade surplus with US, UK, Singapore, Brazil and Hong Kong with a sharp decline in the case of Hong Kong. The largest trade deficits were with Saudi Arabia and China as indicated by the export-import ratio (Table 6.26). One notable feature is the stabilization of India's export-import ratio at above 2 per cent with Brazil.

6.105 In terms of export destination, the United States continued to be the principal destination accounting for 12.0 per cent of India's total exports in 2008-09 (April-February), followed by UAE (10.8 per cent), China (5.1 per cent), Singapore (4.8 per cent), Hong Kong (3.7 per cent) and U.K. (3.6 per cent). Region-wise, over half of India's exports were to Asia (including ASEAN), up from around 40 per cent in 2001-02. During 2008-09 (April-February), exports to Asia (including ASEAN) grew by 6.9 per cent, to Europe by 10.2 per cent and to the United States by (-) 1.6 per cent. India's merchandise exports to South Asian countries declined by 5.2 per cent.

6.106 In 2008-09 (April-February), Asia and ASEAN continued to be the major source of India's imports accounting for 61.7 per cent of total imports. Country-wise, imports from UAE and China recorded high growth of 39.1 per cent and 13.3 per cent respectively. Growth of imports from EU-27 (with a share of 13.5 per cent) was at 12.3 per cent and from North America (with a share of 6.7 per cent) at 27.0 per cent.

6.107 A comparison of the commodity-wise growth of major exports to the United States, the European Union and other countries in the last year's Economic Survey had clearly shown the possible effect of a U.S. slowdown on India's exports in 2006-07 and the first half of 2007-08. Though the manufactured sector is the dominant sector in India's exports to all destinations, India's export basket to the United States is more dominated by manufactures compared to European Union and more so with respect to Others. Primary products have a share of 6.6 per cent, 7.8 per cent and 18.4 per cent in India's export basket to the United States, European Union

and Others respectively in 2008-09 (April-February). The share of petroleum, crude & products was low at 0.9 per cent in India's export basket to U.S. while it had a share of 11.5 per cent and 21.5 per cent in India's export basket to EU and Others.

6.108 Table 6.12 clearly shows that the U.S. slowdown which had affected India's exports in 2006-07 and 2007-08 worsened in 2008-09 (April-February) due to the global recession originating in the United States resulting in negative growth of India's exports to the United States at (-)1.6 per cent. In the case of EU and Other countries, India's export growth was robust in 2007-08, but in 2008-09 (April-February), the slowdown is visible on India's export growth, with export growth to EU and Other countries at 11.5 per cent and 6.6 per cent respectively. Unlike in 2007-08, the impact of global recession on India's exports to the United States was mainly in manufactured goods, while primary products including agricultural products performed well though ores and minerals showed negative growth. In the case of EU and Others, the impact was more marked in the case of primary products than manufactures. India's export growth of textiles to the United States which had started decelerating in 2006-07 and turned slightly negative in 2007-08 continued this trend even during 2008-09 (April-February). In the case of India's exports to EU, textile exports growth which had decelerated in 2006-07 had actually picked up in 2007-08, but again decelerated to 0.9 per cent in 2008-09 (April-February). In the case of Others, textile export growth accelerated in 2006-07 and 2007-08 but decelerated slightly in 2008-09. Gems and jewellery sector was worst hit by the recent global recession. Gems and jewellery exports of India to the United States in 2008-09 (April-February) were

Box 6.9 : Export of gems and jewellery

Gems & jewellery (G&J) sector which has been identified as one of the thrust sectors under special focus initiatives under the Foreign Trade Policy 2004-09, continued to be one of the leading sectors in terms of its contribution to foreign exchange earnings and employment generation and accounted for about 12 per cent of India's total merchandise exports in 2007-08. This sector consists of three subsectors, namely cut and polished diamonds; gold jewellery; and colour gemstones & other items with share in exports at around 70, 22 and 8 per cent respectively in 2007-08. USA, Hong Kong, UAE, Belgium & Israel are the major markets for G&J exports, with Hong Kong being the largest market of G&J exports from India accounting for about 26 per cent of India's G&J exports in 2007-08.

The G&J industry is extremely global in nature - given the geographic dispersion of the value chain - from mining of gold, diamonds, and platinum in Africa, Canada, Australia, and Russia to polishing and jewellery manufacturing in India, China, and Turkey and marketing in the United States, European Union, Japan, Middle East countries and the emerging markets of China and India. The current global financial crisis, along with other developments like volatile prices of precious metals, etc. has impacted the export performance of the industry.

The sector has seen ups and downs in the recent past. While G&J export growth fell in 2006-07 due to U.S. slowdown, it recovered in 2007-08. It was however affected again by the global financial crisis resulting in a decline of 3.7 per cent during the period 2008-09 (April-February). The major impact was from the U.S. market where G&J exports of India registered a high negative growth of 18.5 percent in 2008-09 (April-February) over and above a low export growth in 2007-08. As per latest data of the Gems and Jewellery Export Promotion Council (GJEPC), overall exports of G&J increased by 1.45 per cent in US dollar terms (13.52 per cent in rupees term) in 2008-09. The marginal positive growth was mainly due to trading activity with reduction of import duty on cut and polished diamonds and other inputs. Export of cut and polished diamonds gold jewellery from DTA and coloured gemstones fell by 8.24 per cent, 27.77 percent, and 3.68 percent respectively. Main reasons for the poor performance of gems and jewellery exports are fall in consumer demand across the world, build up of inventories due to lack of sufficient demand and liquidity problems. The Government is constantly monitoring the situation and has taken a number of steps to address the impact of the crisis which, among others, include removal of import restrictions on worked corals, allowing personal carriage of gold in primary form up to 10 kilograms in a financial year subject to RBI and customs guidelines for authorized person of G&J units in EOU, expanding the list of nominated agencies for the purpose of import of precious metals, etc.

While the current global economic crisis is likely to continue for the next year as well, better export performance once the existing economic downturn passes by would depend on among others, the following; forward integration of diamond processing sector to jewellery manufacturing, where the value addition achieved is the highest; moving up the value chain by the jewellery manufacturing sector to more high-end jewellery with bigger size diamonds and precious stones in addition to daily wear jewellery with smaller diamonds; developing new and emerging markets like China, CIS countries, Middle East, Far East and Latin American countries, besides retaining the share in existing markets; developing and establishing "Indian Brands" overseas; making India a gem and jewellery trading hub; adopting latest quality standards; promoting traditional handmade jewellery in the international market, and investment in exploration and mining of diamonds and precious metals in overseas countries.

highly negative at (-)18.5 per cent, while it was slightly negative in the case of India's exports to EU and decelerated to single digit in the case of India's exports to others (Box 6.9).

6.109 In 2008-09 (April-February), engineering goods export growth was robust in all the three markets. chemicals and related product export growth was reasonably good to U.S. and EU markets despite the deceleration, while it was low in the case of others. Leather and leather manufactures exports of India showed varied performance, with acceleration to 14.3 per cent to U.S. after a negative growth for the past few years. It decelerated sharply to EU market to 3.8 per cent and showed negative growth in Others. Handicrafts including carpet handmade which has been showing negative export performance in the U.S. market in the last few years, turned highly negative in the first nine months of 2008-09. In the EU market it was negative only in 2007-08 and in 2008-09 (April-December). In the Others also it turned highly negative in 2008-09 (April-February) after a buoyant performance in 2007-08. Thus the impact of the global recession was more marked in the case of India's exports to U.S. than EU and Others particularly in sectors like textiles, gems and jewellery, handicrafts including carpets and ores and minerals. Engineering goods and chemicals and related products exports which were not affected till 2008-09 (April-February) registered negative growth in January-March 2009 as per the latest data on imports from India of some countries like China and the United States. For example, China's imports from India for the above period of inorganic and organic chemicals registered (-)8.3 per cent and (-)29 per cent growth respectively, while machinery and electrical machinery registered (-)13 per cent and (-)0.4 per cent growth respectively. In the United States, imports from India's major items under chemicals like pharmaceuticals registered negative growth of (-)49 per cent though organic chemicals showed a small positive growth of 5 per cent. Major engineering items imported from India by U.S. like machinery other than electrical and electrical machinery registered growths of (-)7 per cent and 1 per cent respectively. While iron and steel products grew by only 9 per cent, iron and steel registered negative growth of (-)68 per cent.

Export diversification

6.110 In 2007, India had a global export share of 1 per cent or more in 44 out of a total of 99 commodities at two digit HS level, but a significant share of 5 per cent or more only in eight items (as in 2006). Only one of these items, namely cotton had an increase in global share by 1.11 per cent point or more in 2007 over 2006. Four items lost global shares which include silk; carpets and other textiles floor coverings; other made textile articles, sets, worn clothing, etc; and coffee, tea, mate and spices. In the remaining 36 items 15 items lost their share in 2007 over 2006 (Table 6.27).

6.111 Though India has been diversifying its exports, there is plenty of scope to diversify into sectors where global demand is high and increasing (Box 6.10). Countries closely integrated with the global trading system have joined the process of exporting dynamic products by continuously restructuring their production bases with efficiency, improved productivity and constantly improving their global share in exports.

Table 6.27 : Share of India's major exports in world exports

(in per cent)

HS rev 1		2006	2007	Change
50	Silk	11.48	10.66	-0.82
13	Lac, gums, resins, vegetable saps and extracts nes	10.20	10.25	0.05
57	Carpets and other textile floor coverings	9.46	8.78	-0.68
52	Cotton	7.58	8.69	1.11
71	Pearls, precious stones, metals, coins, etc.	6.67	6.82	0.15
63	Other made textile articles, sets, worm clothing etc.	6.24	5.76	-0.48
9	Coffee, tea, mate and spices	5.34	5.28	-0.05
67	Bird skin, feathers, artificial flowers, human hair	4.69	5.07	0.37
53	Vegetable textile fibres nes, paper yarn, woven fabric	4.03	4.79	0.75
55	Manmade staple fibres	3.53	4.15	0.62
17	Sugar and sugar confectionery	2.56	3.72	1.16

Source : Calculated from NCTI data based on UN-ITC Trade Map Data, 2007.

Box 6.10 : Global demand and India's exports of dynamic products

Dynamic products are drivers of global exports growing rapidly with greater share in world trade. They are mainly technology-intensive manufactured exports and are more insulated against external shocks. Dynamic products are identified here based on the twin criteria of size of the market share and growth rate of items at four digit HS level.

The export products of the world (out of top 100 items) with a CAGR of 12 per cent for the period 1999-2001 (average exports) to 2004-06 (average exports) and share of 0.2 per cent are 42 in number. These are termed as world's dynamic export products here. For these items if matching exports of India with similar criteria of 12 per cent CAGR and 0.2 per cent share are taken then there are 21 such items.

These matching dynamic exports of India in the top dynamic export of the world include besides petroleum products, medicaments, medical and surgical instruments, iron and steel products, air or vacuum pumps, items of polymers, jewellery items, refined copper and alloys packaging articles, cyclic hydrocarbons, T-shirts, etc, prefabricated building structures, etc. The CAGR of India in most of these items are high than world CAGR, but shares can be improved in the case of items like medical and surgical instruments, air or vacuum pumps, packaging articles etc. In the remaining 21 items of world's dynamic export products, there is potential to increase India's shares. These include items like transmission apparatus for radio telephony, reception apparatus for television, diodes, transistors and similar semiconductor devices, compression- ignition internal combustion pistons, printed circuits, some electrical machines, orthopedic appliances etc.

Dynamic export products in the top 100 export products of the world

Rank	HS4	Description	World		India	
			CAGR	Share	CAGR	Share
3	2710	Oil (not crude) from petrol & bituminous mineral etc,	22.1	3.3	62.0	11.8
8	3004	Medicaments nesoi, mixed or not, in dosage etc	20.3	2.0	22.6	2.0
23	9018	Medical, surgical, instruments for dental or veterinary sciences	12.6	0.6	23.1	0.2
32	7208	Flat-roll iron & non-alloy steel not under 600mm wide, no	18.8	0.4	58.8	0.7
34	8414	Air or vacuum pumps, compressor & fans	12.1	0.4	26.8	0.2
40	3901	Polymers of ethylene, in primary forms	15.7	0.4	59.8	0.4
45	3907	Polyether, expoxides & polyesters, in primary forms	14.5	0.3	77.5	0.4
48	3920	Plates, sheets, film and not cellular, laminated, etc	12.0	0.3	22.6	0.3
50	7113	Articles of jewellary & parts, of precious metal	12.2	0.3	27.1	3.6
51	7403	Refined copper & copper alloys unwrought	19.4	0.3	90.8	1.0
52	7210	Flat-roll iron & non-alloy steel under 600mm wide	13.2	0.3	38.4	1.4
59	3923	Containers (boxes, bags etc), closurers etc, plastics	12.4	0.3	56.8	0.2
60	2902	Cyclic hydrocarbons	22.3	0.3	62.6	0.6
67	7219	Flat-roll stainless steel products, not under 600mm wide	19.2	0.3	63.6	0.3
68	7326	Articles of iron or steel, springs and leaves for springs	12.8	0.3	17.7	0.2
70	2601	Iron ores & concentrates, including roast pyrites	20.6	0.3	49.4	3.5
73	6109	T-shirts, singlets, tank tops etc, knit or crochet	12.5	0.2	18.6	1.1
80	7207	Semi-finished products of iron or non-alloy steel	22.6	0.2	61.2	0.2
82	3902	Polymers of propylene or other olefins, primary forms	17.3	0.2	37.7	0.4
83	7308	Structures & parts thereof, of iron or steel bridges roof	13.9	0.2	20.3	0.2
87	7304	Tubes, pipes etc, seamless, iron & steel	18.7	0.2	45.1	0.2

Note: CAGR for the period 1999-2001 (average exports) to 2004-06 (average exports)

Share : 2004-06 (average exports)

Source: Calculated from PC-TAS data ITC, Geneva for world exports and CMIE: India trades using DGCI&S data for India's exports

Trade policy

Recent trade policy measures

6.112 Trade policy measures announced by the Government and the RBI in this year were mainly to mitigate the effects of global recession. Three stimulus packages were given in the second half of the 2008-09 to help export sector in general and some sectors affected or likely to be affected by the global recession in particular (Box 6.11)

Trade infrastructure development and facilitation measures

6.113 Providing good transport/logistic support to India's foreign trade and the resolution of problems experienced by the trading community in the carriage of goods by courier, sea, air, rail and road are also necessary ingredients of a good trade policy. The Government has been taking steps for greater containerization, computerization of cargo clearance and electronic data interchange, warehousing, setting up of air cargo complexes, inland container depots,

Box 6.11 : Trade policy measures in 2008-09

Measures taken by the Government

- Interest subvention of 2 per cent from 1.12.2008 to 30.9.2009 to the labour-intensive sectors of exports such as textiles (including handloom), handicrafts, carpets, leather, gems and jewellery, marine products and small and medium enterprises.
- An additional allocation for export incentive schemes of Rs. 350 crore.
- Inclusion of handicrafts items in Vishesh Krishi and Gram Udyog Yojana (VKGUY);
- Support under VKGUY scheme for some additional commodities.
- Extension of market-linked focus product scheme for bicycle parts, motor cars and motor cycles, apparels and clothing accessories, auto components, etc.
- Provision of additional Rs. 1,100 crore to ensure full refund of claims of CST/terminal excise duty/duty drawback on deemed exports.
- Continuation of duty entitlement passbook (DEPB) scheme up to December 31, 2009.
- Restoration of DEPB rates for all items where they were reduced in November 2008 and increase in duty drawback rates on certain items effective from September 1, 2008.
- Backup guarantee made available to ECGC to the extent of Rs. 350 crore to enable it to provide guarantees for exports to difficult markets/products. Funding for ECGC also provided from the National Export Insurance Account for providing higher risk cover to MSME exporters and select export sectors.
- Provision of additional funds of Rs. 1,400 crore for textile sector to clear the backlog claims of Technology Upgradation Fund (TUF).
- Export duty on iron ore fines eliminated, and for lumps, reduced to 5 per cent.
- Some pending issues relating to service tax refund on exports resolved.
- For fast track resolution of a number of procedural issues to reduce delays for the exporters, a committee constituted under the chairmanship of the Finance Secretary including Secretaries of the Department of Revenue and the Commerce.
- Excise duty reduced across the board by 4 per cent for all products except petroleum products and those products where current rate was less than 4 per cent.
- The guarantee cover under credit guarantee scheme for micro and small enterprises on loans doubled to Rs. 1 crore with a guarantee cover of 50 per cent. The guarantee cover extended by credit guarantee fund trust increased to 85 per cent for credit facility up to Rs. 5 lakh. The lock-in period for such collateral free loans reduced.
- CVD on TMT bars and structurals and on cement removed.
- Exemption from basic customs duty on zinc and ferro alloys withdrawn.
- Duty credit scrips under DEPB scheme and Freely Transferable Scrips under chapter 3 of FTP shall now be issued without waiting for realization of export proceeds.
- Rs. 325 crore outlay earmarked under the promotional schemes for leather, textile etc. for exports made with effect from 1.4.09.
- Benefit of 5 per cent under FPS has been notified for export of handmade carpets, in lieu of 3.5 per cent benefit allowed earlier under VKGUY scheme.
- Technical textiles and stapling machine have been added under the focus product scheme. An additional benefit of 2.5 per cent is notified for export of dried vegetables under VKGUY
- STCL Limited, Diamond India Limited, MSTC Limited, Gem & Jewellery Export Promotion Council and Star Trading Houses (for gem and jewellery sector) have been added under the list of nominated agencies for the purpose of import of precious metals.The procedure and monitoring provisions for implementation of these additional agencies have been announced.
- Authorized person of gem & jewellery units in EOU allowed personal carriage of gold in primary form up to 10 kilograms in a financial year subject to RBI and customs guidelines.
- Export obligation period against advance authorizations extended up to 36 months without payment of composition fee in view of the present global economic slowdown.
- Supply of an Intermediate product by the domestic supplier directly from their factory to the port against advance intermediate authorization for export by ultimate exporter has been allowed.
- Elimination of import duties for naphtha for use in power sector.
- Simplification of export licensing requirements for blood samples
- Elimination of import duty on rough cubic zirconia and reduction in import duty on polished cubic zirconia and rough corals.

Measures taken by the RBI

- Increase in liquidity to the banks for improving credit flow, by:
  - Reducing CRR, SLR, repo rate and reverse repo rates
  - Putting in place a special refinance facility for banks for the purpose of extending finance to exports, micro and small enterprises, mutual funds and NBFCs. Provisioning requirements have been lowered. Export credit refinance facility for commercial banks increased from 15 per cent to 50 per cent of the outstanding rupee export credit.
  - Refinance facility to the EXIM Bank for an amount of Rs. 5,000 crore for providing pre-shipment and post-shipment credit in rupees or dollars.
- **Increase in Forex liquidity:**
  - RBI's assurance for continued selling of foreign exchange (US$) through banks, to augment supply in the domestic foreign exchange market.
  - Ceiling rates on export credit in foreign currency raised from LIBOR+100 basis points to LIBOR+350 basis points subject to the condition that the banks will not levy any other charges, i.e., service charge, management charge, etc. except for recovery towards out of pocket expenses incurred.
  - The ceiling on interest rates for non-residents deposits raised.
  - Banks' overseas borrowing limits increased and ECB borrowing norms eased; "all in cost" ceiling of such borrowings to be removed under the approval route of RBI.
  - RBI to provide forex liquidity to Indian public and private sector banks up to June 30, 2009, through forex swaps of tenure up to 3 months.
- **Easing of credit terms:**
  - Enhancing the period of pre-shipment and post-shipment Rupee Export Credit by 90 days each;
  - Increasing the time period of export realization for non-status holder exporters to 12 months;
  - Authorized dealers category-I banks permitted to consider applications for premature buy-back of FCCBs from their customers.
  - Other announcements made by the PSU banks consequent to measures announced by RBI:
    i) Reduced interest rate for micro enterprises and SMEs;
    ii) PSU banks will grant need-based ad hoc working capital loan of up to 20 per cent of their overall credit facility if it is less than Rs. 10 crore.
    iii) For export units, margin money on guarantees will be reduced

container freight stations, etc. Some of the steps taken by the Government in the recent past for trade infrastructure development and trade facilitation include the following.

- Two high level committees, viz. the Standing Committee on Promotion of Exports by Sea (SCOPE-Shipping) and the Standing Committee on Promotion of Exports by Air (SCOPE-Air) are functioning.
- Single- window clearance for the proposals for setting up of inland container depots (ICDs), container freight stations (CFSs) and air cargo complexes (ACCs) are being given through an Inter-Ministerial Committee (IMC). In 2008-09 (up to January 6, 2008), a total of 19 letters of intent (LOI) were issued for setting up of ICDs/ CFSs/ACCs.
- A core group of secretaries under the Chairmanship of Cabinet Secretary has been constituted to deal with the issues relating to infrastructure required for exports and imports. The core group recommends measures for removal of critical bottlenecks in infrastructure hampering the growth of exports and imports, reviews the functioning of service providers at ports, airports, LCSs, etc. with a view to identifying procedures / systems that inhibit trade and take measures to remove them.
- Besides the above, issues raised by the associations / organizations of exporters / importers viz (i) difficulties faced by shippers while importing/ exporting consignments resulting in enhanced transaction cost on account of arbitrary, (ii) exorbitant charges by shipping lines, consolidators, freight forwarders and other service providers, (iii) collusive price fixing by the service providers at ports / airports and cartelization of the shipping liners resulting in sharp cost escalation, (iv) congestion at various ports etc. are taken up care of by the concerned departments.

- To promote exports from the North-eastern region, a North-east Cell has been set up in the Department of Commerce. Consequent to the announcement made by the Prime Minister for the development of exports from the region, an Export Development Fund (EDF) was set up with the objective of promoting exports from the region. So far 51 projects amounting to Rs. 47.48 crore have been sanctioned under this scheme.

Policy for promoting state-wise exports

6.114 State-wise exports are reflected in data on state of origin of export goods which at present are the only available comparable data for State-wise exports (Table 6.28). This does not include export of services

6.115 In 2007-08, the major exporters were Maharashtra, followed by Gujarat, Tamil Nadu and Karnataka. In terms of export growth rate, the top states were Orissa followed by Madhya Pradesh, Gujarat, West Bengal and Andhra Pradesh. In April-December 2008, export growth was the highest in Punjab, followed by Andhra Pradesh and Orissa.

6.116 To encourage exports by the States, outlay under Assistance to States for Developing Export Infrastructure and Allied Activities (ASIDE) scheme, in the Eleventh Five Year Plan, the outlay has been more than doubled to Rs. 3,664.63 crore (tentative) compared to the Tenth Five year Plan. Allocation for the year 2008-09, under this scheme, is Rs. 570 crore of which Rs. 434.5 crore has been released till December end 2008. Under ASIDE, projects aimed at balancing of critical infrastructure for exports are approved viz. creation of new Special Economic Zones and augmenting facilities in existing ones, equity participation in infrastructure projects, development of complementary infrastructure such as roads connecting production centres to ports, setting up inland container depots (ICDs) and container freight stations, stabilizing power supply, etc. As per findings of IL&FS report, States have shown keen interest in funding projects under ASIDE scheme and the funding pattern of the projects shows a healthy mix of ASIDE funds, State Government funds and private sector participation, in a ratio of 4:4:2 indicating successful leverage of funds.

Table 6.28 : Major Exporting States

(US$ million)

Sl. No.	State	2006-07	2007-08	(April-December) 2007-08	(April-December) 2008-09	Share 2007-08	Growth rate 2007-08	Growth rate 2008-09 (Apr-Dec)
1.	Maharashtra	35873	44841	31978	35720	27.5	25.0	11.7
2.	Gujarat	24209	34736	25714	30041	21.3	43.5	16.8
3.	Tamil Nadu	13097	14816	10650	12906	9.1	13.1	21.2
4.	Karnataka	12676	14641	10253	10045	9.0	15.5	-2.0
5.	Andhra Pradesh	5479	7427	5183	6907	4.6	35.6	33.2
6.	West Bengal	4011	5679	3888	4581	3.5	41.6	17.8
7.	Delhi	4880	5183	3614	3928	3.2	6.2	8.7
8.	Haryana	3792	4414	3042	3437	2.7	16.4	13.0
9.	Uttar Pradesh	3632	4295	3098	3193	2.6	18.3	3.1
10.	Orissa	1971	3024	1983	2631	1.9	53.5	32.7
11.	Rajasthan	3356	3276	2347	2510	2.0	-2.4	6.9
12.	Punjab	2148	2598	1744	2372	1.6	21.0	36.0
13.	Madhya Pradesh	1993	2915	1848	2277	1.8	46.3	23.2
14.	Kerala	2293	2364	1721	1918	1.5	3.1	11.4
15.	Goa	1424	1387	881	1103	0.9	-2.6	25.2
	Total Exports	**126361**	**162904**	**113475**	**130716**	**100.0**	**28.9**	**15.2**

Source : DGCI&S

Note: The above data has been generated by "state of origin of export goods" as reported in the DTRs by the customs.

6.117 State-wise allocation of funds under ASIDE scheme for the last three years shows that the position of the top states has not changed which indicates that there is no change in the relative performance of States in merchandise exports. The States having the highest allocation are Maharashtra followed by Gujarat, Tamil Nadu, Karnataka, Uttar Pradesh and West Bengal. The top 14 states had a share of 85.3 per cent in 2007-08 in total allocation.

6.118 Though export share and growth was higher for Andhra Pradesh, Uttar Pradesh received higher allocation than Andhra Pradesh under ASIDE. There are some other examples of this nature. This is due to the decision to allocate less for coastal states than landlocked states as the State-wise export data based on state of origin of exports under represents landlocked States and over represents coastal states.

Special economic zones

6.119 Another major policy issue in the trade sector which was debated was that of SEZs. 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 units in SEZs for attracting investments into SEZs (including foreign investment) as well as for SEZ developers. These incentives and facilities are expected to trigger a large flow of foreign and domestic investment in SEZs, particularly in infrastructure and productive capacity, leading to generation of additional economic activity and creation of employment opportunities. The SEZ Rules provide for different minimum land requirements for different classes of SEZs. Every SEZ is divided into a processing area where alone the SEZ units are set up and a non-processing area where the supporting infrastructure is to be created. The SEZ Rules also provide for simplified procedures for development, operation and maintenance of the SEZ and 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.

6.120 As on May 13, 2009 as many as 568 SEZs have been accorded formal approval and 318 SEZs have been notified. The benefits derived from SEZs are evident from the export, employment and investment generated (Table 6.29).

Customs duty issues

6.121 One issue in the context of the global economic crisis is the protectionist measures, particularly related to customs duties resorted to by several countries to deal with the situation. Recent increase in import tariffs on some items by India has also found mention in some international reports. Though import tariffs have been increased on certain items in November and December 2008 in India, these were only to restore the import duty rates to the levels prevailing before the duty cuts affected earlier as part of inflation management measures. In April-May 2008, to combat the severe inflationary pressure on the economy, import duties on edible oils, crude petroleum/petrol/diesel and many iron and steel items were reduced/exempted. In the later part of the year, however, the economic environment changed, with inflation down to single-digit, and domestic industries were faced with the spectre of slow down due to fall in demand and loss of export markets. To provide relief to manufacturers, exporters and the financial sector, the Government announced fiscal stimulus packages. As part of this, the full exemption from customs duty/ countervailing duty provided earlier on certain items were withdrawn. However, the increase in rates was only in respect of few items (not all on which import duty rates were reduced) and only up to the earlier levels and in no case higher (Box 6.12).

Table 6.29 : Performance of SEZs

Export from SEZs in 2008-09	Rs. 99,688 crore
Export Growth in 2008-09	36%
Projection of export for 2009-10	Rs. 1,10,000 crore
Total employment generated as on 31.03.2009	3,87,439 persons
Total incremental employment generated since February 2006	2,52,735 persons
Total private investment as on 31.03.2009	Rs. 98,498 crore
Incremental private investment after coming into force of SEZ Act 2005	Rs. 98,498 crore

Box 6.12 : Some cases of increase in customs or countervailing duty in India

- Customs duty was reduced from 5 per cent to nil on pig iron, spiegleisen, and specified iron and non-alloy steel items on April 29, 2008. From November 18,.2008 customs duty rate on all these items has been restored to 5 per cent (the rate since 2004).
- Customs duty was reduced from 5 per cent to nil on zinc and ferro alloys on April 29, 2008. From January 2, 2009 customs duty rate on these items has been restored to 5 per cent.
- Customs duty was reduced from 40 per cent to nil on crude soyabean oil on April 1, 2008. From November 18, 2008 customs duty rate on crude soyabean oil has been increased to 20 per cent (less than the earlier prevailing rate of 40 per cent).
- Countervailing duty was reduced from 14 per cent to nil on TMT bars and structural on April 29,.2008. From January 2, 2009, the exemption has been withdrawn and CVD (now at 10 per cent i.e, on par with excise duty) is applicable.
- Countervailing duty and special CVD of 4 per cent were exempted on cement on April 3, .2007. From January 2, .2009, the exemption has been withdrawn and CVD (now at 10 per cent) as well as special CVD of 4 per cent are now applicable.

Box 6.13 : Customs duty exemptions and revenue loss

A comparison of actual duty collections in 2008-09 with notional duty collections (with 2007-08 actual import data) for the entire range of 11,000 or so ITC (HS) lines at eight digit level helps in estimating the revenue loss due to exemptions.

The notional total duty collection on non-oil imports is Rs. 1,41,826 crore based on 2007-08 imports (The oil account consists of crude oil and diesel. The estimated duty collection in this head is only Rs. 689 crore on account of diesel. There is no duty on crude.). The notional duty collection of Rs. 1,41,826 crore may fall substantially in the range of Rs. 1,29,000 crore since non-oil imports in 2008-09 are down by 9.3 per cent in rupee terms.

The revised estimate of actual duty collection in 2008-09 is Rs. 1,01,710 crore. The difference of Rs. 27,260 crore between the notional and actual collections is the revenue loss on account of 558 cases of exemptions consisting of 443 in industry groups and 115 thematic exemptions mainly under the subjects of exports, country preferences and defence (Table). Specific exemption on a case to case basic is also given under section 25(2) of Customs Act, 1962. These too erode the notional duty base considerably.

Customs duty rates and notional collections in 2008-09[1]
(based on 2007-08 Import Levels#)

(Rs. crore)

	Total duty (%) (As on April 1, 2009)	No. of tariff lines 2	Non-oil imports (07-08)	Notional duty on 2007-08 imports		
				Total duty	Basic duty	Countervailing duties
0	Nil	50	4,808	-	-	-
1	5.01 - 10.00 @	215	52,866	3,593	2,030	1,563
2	10.01 - 15.00	1,219	2,11,312	24,584	17,313	7,270
3	15.01 - 20.00	1,993	1,46,588	25,509	6,561	18,948
4	20.01 - 25.00	4,823	2,32,648	52,053	19,264	32,789
5	25.01 - 30.00	16	19,235	4,987	1,590	3,397
6	30.01 - 35.00	191	12,810	3,993	2,656	1,338
7	35.01 - 40.00	434	1,641	593	459	134
8	40.01 - 50.00	146	23,543	11,195	2,622	8,573
9	50.01 - 100.00	58	6,071	3,248	2,960	288
10	100.01 - 150.00	130	11,156	11,725	11,300	425
11	More than 150	33	208	347	281	67
	Total	**9,308**	**7,22,887**	**1,41,826**	**67,035**	**74,791**

[1] The Tariff ranges do not cover exemption notifications. As on May 15, 2009, these ran into 558 cases consisting of exemption in 443 industry groups and 115 thematic exemptions mainly under the subjects of exports, defence and country preferences. Besides this, specific discretionary exemptions are also sanctioned from time to time.

Excluding petroleum oils & High Speed Diesel (HSD): HS codes 27090000 & 27101930 crude oil is at zero duty while diesel basic duty is 2.5 per cent with Rs. 1.60 per litre as CVD of excise.

2 Only those cases where imports could be matched with the DGCI&S data at the eight-digit HS level.

@ Includes one case where total duty was 4 per cent.

In 2009-10, the duty collection will fall further as excise cuts in late 2008-09 impacting the countervailing duty of excise have to be accounted for. Further, the impact of exemptions on revenue due to additional debits in customs revenue on account of promotional measures like DEPB, enlargement and launch of new initiatives like VKGUY, Focus Market Scheme (FMS), Focus Product Scheme (FPS), and High-Tech Products Export Promotion Scheme (HTPEPS) by way of duty credit redemption will result in further erosion of customs revenue.

6.122 In no case has the customs duty/CVD rate been increased beyond the rate(s) prevailing earlier. The increase in import duties, if any, has only been to the extent of restoring status quo for items where reductions were made to combat inflationary pressures. Despite these changes India's tariff levels remain well within the WTO bindings as well as the self-imposed roadmap for autonomous reductions as part of opening up the economy.

6.123 Customs duties are powerful tools in trade policy. The previous Economic Survey had highlighted the issue of customs duty exemptions in India. Exemptions result in distortions and discriminations in the economic structure resulting in tax arbitrage, rent seeking and rise in transaction and administrative costs. It also leads to economic loss (Box 6.13).

6.124 Exemptions lead to lower tariff collection rates. However, this cannot be leveraged to our advantage in WTO negotiations as only the actual tariff rates and not tariff collections are considered for WTO negotiations. The need is to have a low tax regime with few exemptions with each exemption notification having a sunset clause triggering automatic review of exemptions. Besides customs duty exemptions, there are some other issues related to customs duty which need reforms. One such issue is the specific customs duties (Box 6.14)

Contingency trade policy and non-tariff measures

6.125 Contingency trade policy and non-tariff measures (NTMs) which continued to act as significant barriers to exports from developing countries, but with somewhat reduced intensity in recent years have started a comeback resulting in protectionist tendencies of different countries as a reaction to the global economic crisis. The WTO has reported that a pattern is beginning to emerge

Box 6.14 : Specific customs duties

Specific duties hide the real impact of tariffs. Many developed countries have specific duties for items of interest to them. The tariff equivalents of the same are very high in most of the countries. For example, as per WTO, Trade Policy Review of US, in the United States where non-ad valorem tariff form 10.6 per cent of all tariff lines in 2004, the average ad valorem equivalents (AVEs) of non-ad valorem tariff rate was 10.7 per cent. For some sectors and items, the AVEs are very high. Specific duties in the United States are mainly in agricultural products, footwear and headgear, textiles, watches and precision tools. According to the European Commission's Report on U.S. Barriers to Trade and Investment Report for 2007, the U.S. textile sector has high tariff peaks of 32 per cent for some clothing, 25 per cent for fabrics and 13.2 per cent for yarns in addition to specific duties for a wide range of textile products. In the case of several footwear products, tariffs are 48 per cent or 37.5 per cent plus a specific rate of 90 cents per pair. As per the WTO report, tariff peaks are often concealed by specific (and other non-ad valorem) rates, which are an important feature of the Quad and some other WTO members' tariff schedules, particularly for agricultural products and especially in the EU and the United States. The peaks will remain even after the Uruguay Round is fully implemented, partly as a consequence of the "tariffication" of agricultural non-tariff barriers, which were largely converted into specific or mixed duties, rather than into pure ad valorem tariffs, and often combined with quotas. Specific duties are intrinsically more opaque than ad valorem tariffs, tending to conceal high ad valorem equivalents (AVEs). For example, between 94 and 98 of the top 100 tariffs (in AVE terms) in Canada, the EU and Japan involve specific duties; they range from 61per cent to nearly 210 per cent in EU, from 47 per cent to roughly 1,739 per cent in Japan, and from 56 per cent to 314 per cent in Canada. In the United States, 84 of the top 100 tariffs included specific duties whose AVEs ranged from 34 to nearly 253 per cent.

While in developed countries the specific duties are mainly in agriculture, textiles and leather sectors, in India, the specific duties are mainly in the textiles sector (Chapters 51-63) which is levied along with ad valorem customs duty of 10 per cent. There are only three items other than textiles where there are specific duties, namely, almonds (080211 & 080212), electrical energy (2716) and some codes in platinum (711011 & 711019). For these items there are only specific duties and no ad valorem duties.

In India, in the textiles sector, though there are 47 items at 4 digit level and 523 items at 8 digit level with specific duties, they form only 0.32 per cent of the value of total imports. Items where ad valorem equivalents of specific duties in textiles sector are above the 10 per cent ad valorem duty are 450 in number at 8 digit level forming only 0.31 per cent of the value of total imports. The textile items with specific duties at 8 digit levels having import value above Rs. 100 crore in 2007-08 and having relatively high ad valorem equivalents include mainly woven fabrics. Carpets, tulles and other net fabrics, T-shirts, etc. and men or boys shirts of cotton are some other items. Though specific duties in India form a very small percentage of total imports, there is a need to examine this issue along with specific duties in other countries while rationalizing the tax structure.

of increases in import licensing, import tariffs and surcharges and trade remedies to support industries that have faced difficulties early in this crisis like automobiles, footwear and steel sector (Box 6.15).

Box 6.15 : Select list of some trade restrictions and distortionary measures introduced after the global financial crisis

Footwear	
Argentina:	Initiation of anti-dumping investigations on imports from China
Brazil:	Initiation of anti-dumping investigation on imports from China
Canada:	Initiation of anti-dumping investigation on waterproof footwear from China.
	Initiation of anti-dumping investigation on plastic footwear from Vietnam.
EC:	Imposition of anti-dumping duties on imports of leather footwear from China and Vietnam.
Turkey:	Imposition of safeguard measures; in place until November 2009.
Ukraine:	Increase of tariff duties for all footwear products. Implemented in March 2009, for a period of six months.
Automobile Sector	
Argentina:	Introduction of reference price covering around 1,000 imported products considered sensitive (among them auto parts).
Canada:	Offer to loan up to C$ 4 billion (US$ 3 billion) to GM and Chrysler (as on March 19, 2009 no disbursement of loans has been made).
China:	Reduction of sales tax for cars.
Russian Federation:	Temporary increase of import tariffs (for nine months) on cars, trucks and buses.
	Reduction of import tariffs on: motors and major components of motor vehicles Direct help (rubles 83 billion) or (US$ 2.4 billion) to domestic car makers, including assemblers of foreign branded cars.
United States:	Loans to General Motors and Chrysler. Under this programme, U.S. Treasury agreed to loan General Motors (GM) US$ 13.4 billion (delivered in three instalments) and to loan Chrysler US$ 4 billion. On December 29, 2008, U.S. Treasury announced that it would purchase US$5 billion in senior preferred equity with an 8 per cent dividend from GMAC LLC as part of broader programme to assist the domestic automotive industry in becoming financially viable.
	Additionally, the U.S. Treasury agreed to lend up to US$ 1 billion to General Motors so that GM could participate in a rights offering at GMAC in support of GMAC's reorganization as a bank holding company. On January 16, 2008, U.S. Treasury announced a US$ 1.5 billion five-year loan to a special purpose entity created by Chrysler Financial to finance retail automotive purchases.
Steel Sector	
Argentina:	Introduction of non-automatic import licensing requirements, covering steel and metallurgical products, among others.
EC:	Anti-dumping duties on imports of certain iron or steel fasteners from China. Provisional anti-dumping duties on imports of bars and rods, hot rolled, in irregularly wound coils, of iron , non-alloy steel or alloy steel other than of stainless steel, originating in China and Maldova.
Egypt:	Anti-dumping or safeguard duties on imports of cold rolled flat tin sheets.
India:	Introduction of licensing requirements for imports of certain steel products. Some of these requirements were removed between December 2008 and January 2009. New mandatory product quality certification from the Bureau of Indian Standards for 17 steel imported products. The Government deferred implementation of this regulation by one year on February 10, 2009.
	(The deferment of a regulation cannot be classified as a trade restrictive regime as the WTO report seems to have done).
Indonesia:	Introduction of mandatory standards for steel products (hot-rolled steel sheets and coils and zinc-aluminium alloy coated steel sheets and coils), to protect consumer safety, increase product quality, and establish a fair trade competition. Increase of import tariffs on some steel products.
Malaysia:	New technical regulations for 57 steel products, requiring certificates of approval for conformity with Malaysian standards
Philippines:	New "Mineral Ore Export Permit" for the transport/shipment of mineral ores Provisional safeguard on steel angle bars.
United States:	The American Recovery and Reinvestment Act of 2009 (ARRA) requires the use of U.S.-produced steel, iron and manufactured goods in public works funded by the ARRA, subject to certain exceptions (public interest, non-availability or unreasonable cost). The ARRA requires that this provision be applied in a manner consistent with U.S. obligations under international agreements. Further, Congress has indicated that the "buy American" provision for iron, steel and manufactured goods is not intended to apply to LDCs. Imposition of anti-dumping and countervailing duties on welded stainless steel pressure pipes from China.

Source : WTO, Report to the TPRB from the Director-General on the Financial and Economic Crisis and Trade-Related Developments, March 26, 2009.

6.126 Anti-dumping investigations of all countries, after reaching a peak in 2001 had started falling reaching a number of 164 in 2007. However, in 2008, they have again started rising with 205 anti-dumping initiations in 2008. In line with world trend, India's anti-dumping initiations increased in 2008 to 53 from 47 in 2007 (Table 6.30).

6.127 During the financial year 2008-09, the Director General of Anti-Dumping (DGAD) in India has initiated 21 fresh anti-dumping investigations. The products involved are all fully drawn or fully oriented yarn/spin drawn yarn/flat yarn of polyester (FDY), plain medium density fibre board, power steering gear system, thyionyl chloride, plastic processing machinery, cathode ray television picture tube - III, nylon tyre cord fabrics, flax fabrics, ceramic tiles, tyres curing presses, radial tyres, pencillin - G, phosphoric acid, diethyl thio phosphoryl chloride (DETC/DETPC), cold rolled products of stainless steel, hot rolled steel products, front axle beam and steering knuckles; and carbon black. The countries involved in these investigations are China, Australia, Thailand, Vietnam, Malaysia, New Zealand, Sri Lanka, EU, Indonesia, Belarus, Hong Kong, Korea RP, Japan, South Africa, Taiwan, USA, Iran, Kazakhstan, Saudi Arabia, Russia, Romania,Turkey Oman, Singapore and Ukraine. During 2008-09, the DGAD has also initiated one fresh countervailing duty (anti-subsidy) investigations pertaining to imports of sodium nitrite from China.

6.128 The bailout packages of some countries have also introduced new protectionist measures. WTO has reported various kinds of non-tariff measures affecting trade, such as standards and technical regulations (including SPS measures). For example, the 2009 Omnibus Appropriations Act of the U.S. prohibiting use of funds made available in the Act for importing poultry products from China. There is an increase in State Aids and Trade distorting subsidies in some countries to support industries like steel and automobiles including direct funding, special loans and guarantees and thus prolonging the operations of uncompetitive or insolvent firms and denying market access to more efficient firms, for example, loans by the U.S. Government to General Motors, Chrysler and government credit for car makers in Brazil. If these NTMs coming with greater vigour in new forms are not nipped in the bud, it could lead to retaliatory NTMs.

WTO negotiations and India

6.129 The year 2008-09 saw an intensive process of negotiation following the resumption of the Doha Round of talks in February 2007. To facilitate the process, the Chair of the WTO's Committee on Agriculture and the Chair of the Negotiating Group on Market Access, brought out four draft proposals so far beginning with a first version on July 17, 2007. The fourth revision of the draft was issued on December 6, 2008. A mini-Ministerial meeting was held from July 21-29, 2008 in the WTO to discuss the modalities in agriculture and non-agricultural market access (NAMA). In agriculture, the issues discussed included reductions in overall trade-distorting domestic support by developed countries, tariff cuts, designation of sensitive products, special products, the special safeguard mechanism (SSM) for developing countries, etc. While in the end, discussion focused almost exclusively on the SSM which could not be resolved, this was not the only contentious issue. Several issues in agriculture and NAMA were not discussed at all and remained unresolved. Multilateral discussions on agriculture resumed at the WTO in October 2008. The Chair of the WTO Agriculture Negotiating Group has specifically identified certain elements in the Fourth Revised Draft Modalities Text of December 6, 2008, as areas where large negotiating gaps remain to be bridged. These are Sensitive Products (SEPs), tariff quota creation, non-SEPs with tariffs higher than 100 per cent, tropical and diversification products, preference erosion and the SSM, proposals for reduction in subsidies for cotton and tariff simplification.

Table 6.30 : Investigations initiated by top 10 users of anti-dumping measures (1995-2008)

Country	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008	1995-2008
India	6	41	78	81	46	21	28	34	47	53	562
United States	14	47	75	35	37	26	12	8	28	15	417
European Community	33	32	28	20	7	30	25	35	9	19	391
Argentina	27	43	26	14	1	12	12	11	8	19	241
South Africa	16	21	6	4	8	6	23	3	5	1	206
Australia	5	15	23	16	8	9	7	10	2	4	195
Brazil	5	11	17	8	4	8	6	12	13	23	170
Canada	11	21	25	5	15	11	1	7	1	1	143
China PR	0	6	14	30	22	27	24	11	5	13	152
Turkey	0	7	15	18	11	25	12	8	6	23	138
All countries	**157**	**290**	**364**	**312**	**232**	**213**	**200**	**202**	**164**	**205**	**3425**

Source : WTO

6.130 The Doha Round of WTO negotiation is a Development Round and development concerns are at the core of the Round. The major issues for negotiations are related to agricultural negotiations, NAMA, services negotiations and rules negotiations. In the context of recent developments, self-designation of an appropriate number of special products (SPs) to take care of India's food security, livelihood security, and rural development needs were considered in the revised draft text of December 6, 2008. It proposes an average tariff cut of 11 per cent for a 12 per cent of total tariff lines to be designated as SPs with 5 per cent of tariff lines taking zero or no tariff cuts. Although the issue was discussed during the mini-Ministerial meeting, there are a number of elements yet to be resolved to the full satisfaction of India and its coalition partners in the G-33. The revised text of December 6, 2008, on NAMA incorporates some of the numbers proposed on formula coefficients, flexibilities and anti-concentration by the Director General of the WTO on July 25, 2008 during the Mini Ministerial meeting.

6.131 India has been working closely with her coalition partners in developing country groupings such as the G-20 and the G-33 in order to achieve an outcome in the agricultural negotiations that would reflect the level of ambition of the Doha mandate and the interests of developing countries.

Bilateral and regional cooperation

6.132 India gives primacy to engagements in multilateral negotiations at the World Trade Organization. However, recognizing the fact that the regional cooperation would continue to feature for a long time in the world trade, India has engaged itself with its trading partners with the intention of expanding its export market. Regional Trading Arrangements, from India's point of view, should be "building blocks" towards the overall objective of trade liberalization and should complement the multilateral trading system.

6.133 Some of the recent developments related to bilateral and regional trade and cooperation are the following:

- *India-ASEAN CECA :* A Framework Agreement on Comprehensive Economic Cooperation between the Association of South East Asian Nations (ASEAN) and India was signed by the Prime Minster of India and the Heads of Nations/ Governments of ASEAN members during the Second ASEAN-India Summit on October 8, 2003 in Bali, Indonesia. In August 2008, an understanding has been reached on an Agreement on Trade in Goods including Dispute Settlement Mechanism. Negotiations towards Trade in Services and Investment are expected to conclude by 2009. AIFTA (Asian-India Free Trade Agreement) is likely to come into effect in 2009.
- *India-South Korea CEPA :* Negotiations for FTA in Goods, Services and Investment completed. CEPA may be signed soon.
- *India-Japan EPA :* FTA in goods, Services and Investment are under negotiations. The eleventh round of negotiations took place in New Delhi in December 2008.
- *India-EU Trade and Investment Agreement* : India and EU had set up a High Level Trade Group (HLTG) to study and explore ways and means to deepen and widen their bilateral trade and investment relationships. Negotiations commenced after India-EU Summit held in Helsinki on October 13, 2006, endorsed the views of the HLTG that both sides moved towards negotiations for a broad-based bilateral trade and investment agreement. So far six rounds of negotiations have been held. Last round of negotiations was held in New Delhi in March 2009.
- *India-Gulf Cooperation Council (GCC) Framework* : Agreement Framework Agreement signed on August 25, 2004. FTA covering goods, services and investment is being negotiated. Third round of talks is scheduled to take place in New Delhi in 2009.
- *India-SACU PTA* : A PTA is being negotiated. Third round of negotiations took place in New Delhi in November 2008.
- *India-EFTA* : First round of negotiations took place in New Delhi in October 2008. Third round of negotiations took place in New Delhi in February 2009.
- *Asia-Pacific Trade Agreement* : APTA's Fourth Round of negotiations was launched on October 26, 2007, where commitment to further widen product coverage and deepen the tariff cuts was reaffirmed. The negotiations of the Fourth Round are scheduled and expected to be completed by the Third Session of the Ministerial Council to be held in 2009.
- *Indo-UK Economic and Financial Dialogue* : The Second Round Ministerial level Economic and Financial Dialogue (EFD) was held on August 11, 2008 in London. Topics discussed were (i) Global Economy and Trade, (ii) Financial Services, (iii) Public Private Partnership, (iv) Climate change, (v) Low carbon low cost car technology and (vi) Development and Poverty Reduction. India and UK signed an MoU on the PPP and issued a joint statement with the HM Treasury at the conclusion of the EFD.

- *India-Australia Economic Policy Dialogue* : An India-Australia Economic Policy Dialogue was held in April 2008, New Delhi. The dialogue covered the following topics: Global and Regional Economic Outlook, Financial Sector reform, Goods and Services Tax and FDI.

6.134 In India's regional and bilateral trading arrangements, the neighbouring countries of India like Bangladesh, Sri Lanka, Bhutan and Nepal figure again and again. In the case of most of RTAs/FTAs which have been implemented, exports are generally higher than imports. Import and export growth rates have increased immediately after the RTAs/FTAs were implemented due to unshackling of restrictions though import growth was generally higher.

Challenges and Outlook

6.135 The outlook for the trade sector 2009 in India is not very encouraging with IMF projecting a negative growth in world output at -1.3 per cent and World Trade Volume projected to grow at a negative (-) 11.0 per cent. With import demand falling from our major trading partners, India’s exports of goods and services is expected to be impacted. The steep fall in petroleum prices and cooling down in the prices of commodities could have a positive effect on the import side and for the industrial sector though moderation in petroleum prices has taken place recently. In 2010, recovery is expected with IMF projections at 1.9 per cent for world output and 0.6 per cent for world trade volume of goods and services. These projections could be revised with improvement in the world economic scenario. The Baltic Dry Index has also shown some signs of recovery in May 2009 after falling below the 1,160 mark in the fourth quarter of 2008. (a level reached last in the last quarter of 2001 the latest year (i.e. 2001) when world trade volume growth was (-)0.4 per cent). While the bailout packages given in different countries and India may have started working, it is too early to predict that the turnaround has taken place.

6.136 The subdued global economic outlook, calls for efforts at both national and international levels to revive growth. While efforts to promote exports are needed, there is a need to guard against protectionist measures originating from our trading partners. We also need to desist from any protectionist tendencies and proceed on the reform path. The G-20 has also stated that "falling demand is exacerbated by growing protectionist pressures and a withdrawal of trade credit. Reinvigorating world trade and investment is essential for restoring global growth. We will not repeat the historic mistakes of protectionism of previous eras". These words should also be reflected in the actions and policies of the major trading countries.

6.137 In the Indian case, besides the short term relief measures and stimulus packages, some fundamental policy changes are needed. For the merchandise trade sector, these include continuation of the reduction in customs and excise duty to make our exports and industry competitive, streamlining of existing export promotion schemes, giving special attention to export infrastructure along with rationalization of port service charges based on services rendered by ports in tune with our competing countries, weeding out unnecessary customs duty exemptions, rationalizing the tax structure including specific duties in a calibrated manner taking into account the specific duty levels in our trading partner countries, checking the proliferation of SEZs, evolving clear-cut policy for beneficial CECAs even with some developed countries instead of just FTAs/PTAs which should be well integrated with our economic and trade policy reforms and the blueprint for possible changes due to WTO negotiations.

6.138 In the services sector a road map of specific policies needs to be drawn not only to overcome the impact of the current global crisis, but also to accelerate the growth of the economy and total exports, as this sector has been showing a steady and promising performance with relatively lesser support compared to merchandise sector. A more systematic approach could increase our dividends from this sector manifold. In particular, one major area where reforms can help in sustaining export growth is domestic regulations. Domestic regulations perform the role of tariffs in regulating services trade. Streamlining many of our domestic regulations like licensing requirements and procedures, qualification requirements and procedures, technical standards and regulatory transparency can help in the growth and export of services. Similarly, negotiating for streamlining domestic regulations in our major trading partners could help in increasing our market access. These along with policies like marketing of services, including "services" in negotiations in different regional and bilateral trading arrangements and successful services negotiations in WTO, could help.