6

External Sector

The robust expansion in global economic activity observed in 2004, moderated somewhat in 2005, *inter alia*, on account of supply concerns arising from stiffening global energy prices. However, such concerns are yet to manifest in drastic revision of inflationary expectations and tightening of global financial markets. With the latter remaining reasonably benign, flow of funds to emerging markets has remained stable, though the latest World Economic Outlook (WEO, September 2005) of the International Monetary Fund (IMF) expects shorter term portfolio flows to emerging markets to reduce in the near term.

6.2 The momentum of the global economic expansion was provided mainly by the US and developing Asia (Table 6.1). This is in marked contrast to the leading roles played by the G-3 group of nations (i.e. the Euro Area, Japan and the US) in the earlier episodes of cyclical upswings in global output growth. Barring the US, where growth impulses were buoyed by steady

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

			Projections	
	2003	**2004**	**2005**	**2006**
World output	4.0	5.1	*4.3*	*4.3*
Advanced economies	1.9	3.3	*2.5*	*2.7*
United States	2.7	4.2	*3.5*	*3.3*
Euro area	0.7	2.0	*1.2*	*1.8*
Japan	1.4	2.7	*2.0*	*2.0*
Other advanced economies	2.5	4.4	*3.2*	*3.9*
Newly industrialised Asian economies	3.1	5.6	*4.0*	*4.7*
Other emerging market and developing countries	6.5	7.3	*6.4*	*6.1*
Developing Asia	8.1	8.2	*7.8*	*7.2*
China	9.5	9.5	*9.0*	*8.2*
India	7.4	7.3	*7.1*	*6.3*
ASEAN-4*	5.4	5.8	*4.9*	*5.4*
Commonwealth of Independent States (CIS)	7.9	8.4	*6.0*	*5.7*
Russia	7.3	7.2	*5.5*	*5.3*
World trade volume (goods & services)	5.4	10.3	*7.0*	*7.4*
World trade prices (in US $ terms)				
Manufactures	14.4	9.7	*6.0*	*0.5*
Oil	15.8	30.7	*43.6*	*13.9*
Non-fuel primary commodities	6.9	18.5	*8.6*	*-2.1*
Emerging market and developing countries :				
Private capital flows (net) (in US $ billion)	158.2	232.0	*132.9*	*53.8*

*** Includes Indonesia, Malaysia, Philippines and Thailand.**

Source : World Economic Outlook; September 2005; The International Monetary Fund.

improvements in financial and labour market conditions, the significance of the G-3 in charting global growth appears to be diluting. The Euro area, in particular, is showing increasing evidence of slipping into a contractionary mode. Despite encouraging signals of consolidation emanating from Japan, principally on account of robust growth in domestic consumption, the onus of carrying forward the process of global expansion seems to have fallen on developing Asia, and within the region, China and India in particular.

6.3 Notwithstanding concerns regarding 'overheating', the Chinese economy continues to maintain its remarkable progress mainly on account of heavy investment. However, the impact of its recent exchange rate reforms - in the form of a conscious and measured move towards a managed float regime – on domestic demand will only unfold gradually over time (Box 6.1). India, on the other hand, has emerged as the third fastest growing major emerging market economy, after China and Argentina, and is expected to retain a robust growth outlook in the near term.

6.4 Some concerns, particularly the high crude prices, continue to shroud the global economic outlook in the medium term. Not only was there a sharp increase in consumption of crude in 2004, but on the expectations of likely shortfalls in supply relative to continued high crude demand, forward markets for crude have become increasingly tight. If crude oil prices continue to remain high, then adverse effects on global activity are likely to follow from higher production costs and lower investor and consumer confidence. Energy price induced inflationary expectations can also raise global interest rates, and affect global capital flows, particularly to emerging markets.

6.5 Limiting the impact of such potential supply-side shocks calls for dedicated efforts towards expanding the global trade and commerce agenda. Though developing economies like India have been able to wrest some concessions from the recently concluded Hong Kong Ministerial of the World Trade Organisation (WTO), in the form of greater market access for industrial products and the facility to devise tariff lines for protecting livelihood securities of farmers, lack of sustained progress on the Doha Development Agenda (DDA) continues to impede rapid expansion of global trade.

Box 6.1 : Exchange rate reform in China

On July 21, 2005, China delinked the Renminbi (RMB) from the US Dollar, and announced that henceforth market forces would play a greater role in determining the value of the RMB against different global currencies. While the move put an end to the speculation over when China will introduce flexible exchange rate, the eventual flexibility granted was somewhat limited. The daily trading price of the RMB against the US Dollar has been allowed to float within a narrow band of +/- 0.3 per cent around the central parity decided by the People's Bank of China (PBOC). Similarly, trading prices of the RMB against other non-Dollar currencies have been allowed to float within a certain band fixed by the PBOC.

Since allowing the RMB to float, the Chinese currency has mildly strengthened against the US Dollar: from a monthly average of 8.23 against the US Dollar in July 2005 (and 8.11 Yuan per US Dollar on July 21, 2005) to a monthly average of 8.08 against the US Dollar in December 2005.

The international demand for allowing greater flexibility in determining the Chinese exchange rate has primarily been on account of the widening trade imbalances between the US and developing Asia. While the US current account deficit has been estimated to cross 6 per cent of its GDP in 2005 (WEO; September 2005; IMF), the growth of the deficit has been matched by similar growth in current account surpluses for leading Asian economies like China and Japan. A pegged Chinese currency acted as a benchmark for other export-oriented Asian economies in assessing competitiveness of their currencies vis-à-vis the US Dollar. A continued strengthening of the Yuan against the Dollar may set in motion a series of currency adjustments within developing Asia, leading to an overall appreciation of regional currencies vis-à-vis the Dollar, and a concomitant reduction in the current account imbalances between various economies of the region and the US.

Balance of Payments (BOP)

6.6 The year 2004-05 marked a significant departure in the structural composition of India's balance of payments (BOP), with the current account, after three consecutive years of surplus, turning into a deficit (Table 6.2). In a significant transformation, the current account deficit, observed for 24 years since 1977-78, had started shrinking from 1999-00. The contraction gave way to a surplus in 2001-02, which continued until 2003-04. However, from a surplus of US$14.1 billion in 2003-04, the current account turned into a deficit of US$5.4 billion in 2004-05. The deficit was caused by a burgeoning excess of merchandise imports over exports, which was left uncompensated by the net surplus in invisibles. While the magnitude of the deficit is one of the highest in recent times, it underscored the rising investment demand in the economy. As a proportion of GDP, the turnaround in the current account balance was from a surplus equivalent to 2.3 per cent in 2003-04 to a deficit of 0.8 per cent in 2004-05 (Table 6.3).

6.7 The turnaround in the current account during 2004-05 was accompanied by a significant strengthening of more than 80 per cent in the capital account resulting in continued reserve accretion (Table 6.2). Compared with 2003-04, when loan inflows had turned into net outflows, such inflows shot up rapidly during 2004-05 and bolstered the size of the capital account surplus with good support from robust foreign investment inflows. Reserve accumulation during 2004-05, at around four-fifths of such accumulation during 2003-04, maintained India's status as one of the largest reserve-holding economies in the world.

Table 6.2 : Balance of Payments : Summary#

(in US $ million)

	1990-91	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	(April-Sept.)	
									2004-05	2005-06
1. Exports	18477	34298	37542	45452	44703	53774	66285	82150	36715	44761
2. Imports	27915	47544	55383	57912	56277	64464	80003	118779	51483	76396
Of which : POL	6028	6399	12611	15650	14000	17640	20569	29844	14578	20834
3. Trade balance	**-9438**	**-13246**	**-17841**	**-12460**	**-11574**	**-10690**	**-13718**	**-36629**	**-14768**	**-31635**
4. Invisibles (net)	-242	9208	13143	9794	14974	17035	27801	31229	14283	18679
Non-factor services	980	2165	4064	1692	3324	3643	10144	14199	5980	9512
Income	-3752	-3544	-3559	-5004	-4206	-3446	-4505	-3814	-1917	-3078
Pvt. transfers	2069	10280	12256	12854	15398	16387	21608	20253	9968	12043
Official transfers	461	307	382	252	458	451	554	591	252	202
5. Current Account Balance	**-9680**	**-4038**	**-4698**	**-2666**	**3400**	**6345**	**14083**	**-5400**	**-485**	**-12956**
6. External assistance (net)	2204	799	891	410	1117	-3128	-2858	1923	346	436
7. Commercial borrowing (net)@	2254	4367	333	4303	-1585	-1692	-2925	5040	1526	2752
8. IMF (net)	1214	-393	-260	-26	0	0	0	0	0	0
9. NR deposits (net)	1536	961	1540	2316	2754	2978	3642	-964	-1334	174
10. Rupee debt service	-1192	-802	-711	-617	-519	-474	-376	-417	-279	-142
11. Foreign investment (net)	101	2312	5117	5862	6686	4161	13744	12147	2490	7411
of which :										
(i) FDI (net)	96	2380	2093	3272	4734	3217	2388	3240	1979	2304
(ii) FIIs	0	-390	2135	1847	1505	377	10918	8280	339	4227
(iii) Euro equities & others	5	322	889	743	447	567	438	627	172	880
12. Other flows (net)+	2284	623	3930	-3739	-96	8795	6111	13830	4672	8827
13. Capital account total (net)	**8401**	**7867**	**10840**	**8509**	**8357**	**10640**	**17338**	**31559**	**7421**	**19458**
14. Reserve use (- increase)	**1279**	**-3829**	**-6142**	**-5842**	**-11757**	**-16985**	**-31421**	**-26159**	**-6936**	**-6502**

 # Actuals.

@ Figures include receipts on account of India Development Bonds in 1991-92, Resurgent India Bonds in 1998-99 and India Millennium Deposits in 2000-01 and related repayments, if any, in the subsequent years.

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

Source : Reserve Bank of India.

6.8 The broad trends observed in the current and capital accounts in 2004-05 have been maintained during 2005-06. The current account continues to be in deficit with the size of the deficit during the first half of the current year (April-September 2005) almost twenty seven times that of the deficit in the corresponding previous period (Table 6.2). Indeed, the current account deficit of US$5.3 billion during the first quarter (April-June 2005) itself was almost equivalent to the deficit for the whole of 2004-05. During the second quarter (July-September 2005), the deficit became even larger (US$7.7 billion) after growing at almost 45 per cent over and above that of the previous quarter. The rapidly enlarging trade deficit, buoyed by remarkable import growth, has been pushing the current account deficit. During the period 2001-02 to 2003-04, the invisibles (net) always overcame the trade deficit to maintain the current account in surplus. However, the trend was reversed in 2004-05 and appears to be continuing in 2005-06 (Table 6.3). At present, India is one of the few leading economies in the South East Asian region to have a fairly large current account deficit (Box 6.2).

6.9 The widening of the current account deficit has been accompanied by a similar widening of the capital account surplus. The capital account surplus during the first half of the current year has been more than one and a half times the surplus in the corresponding period of the previous year (Table 6.2). Moreover, between the first and second quarters, while the current account deficit increased by 45 per cent, the capital account surplus almost doubled in size (US$12.9 billion in July-September 2005 vis-à-vis US$6.5 billion in April-June 2005). Since 2002-03, much of the strengthening of India's capital account has emanated from augmentation of non-debt creating foreign investment (net) inflows, particularly Foreign Institutional Investor (FII) inflows. During the current year,

Table 6.3 : Selected indicators of external sector

								(April-Sept.)	
	1990-91	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2004-05	2005-06
1. Growth of Exports - BOP (%)	9.0	9.5	21.1	-1.6	20.3	23.3	23.9	29.5	21.9
2. Growth of Imports - BOP (%)	14.4	16.5	4.6	-2.8	14.5	24.1	48.5	38.3	48.4
Of which, POL (%)	60.0	97.1	24.1	-10.5	26.0	16.6	45.1	58.2	42.9
3. Exports/Imports - BOP (%)	66.2	67.8	78.5	79.4	83.4	82.9	69.2	71.3	58.6
4. Import cover of FER (No. of months)	2.5	8.2	8.8	11.5	14.2	16.9	14.3	13.9	11.2
5. External assistance (net)/TC (%)	26.2	8.2	4.8	13.4	-29.4	-16.5	6.1	4.7	2.2
6. ECB (net)/TC (%)	26.8	3.1	50.6	-19.0	-15.9	-16.9	16.0	20.6	14.1
7. NR deposits/TC (%)	18.3	14.2	27.2	33.0	28.0	21.0	-3.1	-18.0	0.9
			As % of GDP at current market price						
8. Exports	5.8	8.3	9.9	9.4	10.6	11.0	11.8		
9. Imports	8.8	12.3	12.6	11.8	12.7	13.3	17.1		
10. Trade balance	-3.0	-3.9	-2.7	-2.4	-2.1	-2.3	-5.3		
11. Invisibles balance	-0.1	2.9	2.1	3.1	3.4	4.6	4.5		
12. Current account balance	-3.1	-1.0	-0.6	0.7	1.3	2.3	-0.8		
13. External debt	28.7	21.9	22.4	21.1	20.4	17.8	17.3		

Notes :

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

(ii) ECB : External Commercial Borrowing.

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

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

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

Box 6.2 : India's Current Account Deficit vis-à-vis leading South East Asian Economies

The emergence of a widening deficit in India's current account has drawn attention to whether such a deficit is consistent with the BOP trends observed elsewhere in developing Asia. The table below shows the current account deficits, as per cent of GDP, for some select Asian economies:

Current Account Balances as per cent of GDP for Select Asian Economies

Country	1990	1997	2005*
China	3.1	3.8	6.1
India	-2.5	-0.7	-1.8
Indonesia	-2.5	-1.6	-0.4
Japan	1.4	2.2	3.3
Korea	-0.8	-1.6	2.0
Malaysia	-2.1	-5.9	13.5
Philippines	-6.1	-5.2	2.1
Singapore	8.4	15.6	25.7
Thailand	-8.3	-2.1	-2.5
Vietnam	-4.0	-6.2	-4.7

Source : World Economic Outlook (WEO), Database, IMF.

*** : Estimates for 2005 are projections**

In their current accounts, China, Japan, and Singapore have had, not only consistent surpluses but also surpluses that were increasing over time. As far as the other economies are concerned, since the 1997 East Asian crisis, barring India and Thailand, current account balances have either turned positive (e.g. Korea, Malaysia and the Philippines) or in deficit, gone down as a proportion of GDP (e.g. Indonesia and Vietnam). Current account deficits have widened only in India and Thailand.

There is a major difference between the East Asian crisis affected countries pre-1997 and India in recent years. Pre-1997, the crisis-affected countries financed their large current account deficits by short-term debt capital. Under liberal capital account regimes, banks and financial institutions in these economies had mobilized large resources through short term portfolio flows and invested them in high-risk assets. These investments became non-performing after sharp drops in exchange rates and withdrawal of capital flows, triggering financial system collapses. The potential disruptive consequences of the sharp expansion in the capital account appear limited in the case of India because of the calibrated policy followed in liberalizing the capital account and the non-debt nature of the capital flows. Nevertheless, given the marked difference in the current account performance between India and most other economies in the region, there may be a continuing need to maintain a close watch on the quality of the capital flows financing the current account deficit.

robust FII inflows were more than eleven times higher than such inflows during April-September 2004 (Table 6.2). The bulk of this increase occurred during July-September 2005, in response to the rising buoyancy in the stock markets. The period also witnessed an increase in inflows of commercial borrowings and short term credits on account of lower interest rate spreads on external borrowings and higher import financing requirements. The cumulative impact of higher debt and non-debt creating flows was a notable expansion in the size of the capital account surplus. The expansion succeeded in retaining an overall surplus in the balance of payments and resulted in a net reserve accretion of US$6.5 billion during April-September 2005 (Table 6.2), which was only marginally lower than the accretion of US$6.9 billion during April-September 2004.

Invisibles

6.10 In the three successive years of current account surpluses ending in 2003-04, buoyant net earnings from invisibles more than compensated for the trade deficits. In

2004-05, with growth of more than 12 per cent, earnings from invisibles crossed US$30 billion; but with the trade deficit growing by a much larger 167 per cent to over US$36 billion, the current account balance turned into a deficit (Table 6.2). In the first half of 2005-06 as well, while invisibles grew by 31 per cent, the trade deficit grew much faster by 114 per cent, and resulted in a sharp widening of the current account deficit.

6.11 Within invisibles, the contribution of different categories to overall invisible earnings has changed significantly since the early 1990s (Figure 6.1). Traditionally, private transfers, comprising mainly remittances from Indians working abroad, had been the main source of invisible earnings. Over time, however, non-factor services have emerged as another key component of invisibles. Indeed, beginning from 1991-92 till 2001-02 (except 1999-2000), private transfers always exceeded invisibles (net). However, since 2002-03, overall invisibles have been higher than private transfers, mainly due to rising contribution of non-factor services (Table 6.2). As a proportion of total invisibles (net), the share of private transfers has declined from 121 per cent in 1996-97 to around 65 per cent in 2004-05, while that of non-factor services has improved from 7 per cent to 45.5 per cent during this period.

6.12 The increasing share of non-factor services in invisibles can be traced to the buoyancy in export of software services. Net earnings from software services increased by 34.1 per cent from US$12.3 billion in 2003-04 to US$16.5 billion in 2004-05. The rate of growth was more or less maintained during the first half of 2005-06 with such receipts growing by 30 per cent from US$7.6 billion in April-September 2004 to US$9.8 billion. Indeed, the robust growth in export of software services has been responsible for an overall growth of 59 per cent in net non-factor services receipts in April-September 2005 vis-a-vis April-September 2004 (Table 6.2), since the other leading components of non-factor services, travel and transportation, became net outflows during April-September 2005. While higher outbound tourist traffic has resulted in net travel outflows, such developments in transportation also reflect higher outgo related to rising volume of imports and mounting freight rates.

6.13 India continues to remain the highest remittance receiving country in the world (Box 6.3). Buoyant private transfers have imparted strength and stability to net invisibles receipts. Between 1990-91 and 2003-04, private transfers increased every year except in 1997-98 and 1998-99. In 2004-05, however, private transfers declined by 6.3 per cent (Table 6.2). Developments in the first half of the current year, with growth of 20.8 per cent in private transfers, probably indicate a return to the earlier secular trend (Table 6.2).

Box 6.3 : Remittances from overseas workers into India

Over the years, remittances from overseas Indians have emerged as a stable source of foreign exchange inflows for the country. In 2004, inward remittances into India were US$21.7 billion. This made India the highest remittance receiving country in the world, followed by China (US$21.3 billion), Mexico (US$18.1 billion), France (US$12.7 billion) and Philippines (US$11.6 billion). India's share in total global remittances of US$225.8 billion in 2004, was almost 10 per cent (Global Economic Prospects, 2006; World Bank).

High level of migration is one of the necessary conditions for higher remittance flow into an economy. Migration of workers from India has been steadily increasing during the 1990s, particularly since the onset of the information technology revolution. While earlier the bulk of migration from India used to be towards the Persian Gulf, in more recent years, Indian workers have been increasingly moving to the US and Canada. Indeed, currently, remittances from Indians living in the US account for about a half of the total remittances into India. There is also a marked difference in the skill-endowments between the earlier and more recent migrants. Compared to the relatively low-skilled Indian workers who used to migrate in the past, mostly to the Gulf, Indians migrating to the US and other advanced nations in recent times possess well-developed technical skills, particularly in IT operations. The difference in skills has also led to an increase in average earnings of the more recent migrants, and in turn, to larger volume of inward remittances.

Apart from high migration, strong incentives for remitting funds, and easy procedures for doing so, are significant determinants of remittances. The robustness of India's macroeconomic fundamentals and rapid economic growth has made the 'home' country an attractive destination for repatriating money. At the same time, such flows have also been facilitated by increasing availability of speedier and cost-effective money transfer arrangements through banks and post offices. Apart from the availability of regular banking channels, two schemes, viz. Money Transfer Service Scheme (MTSS) and Rupee Drawing Arrangements (RDA), providing benefits of easier and speedier operations, have helped in expanding the outreach of remittances to remote parts of the country.

External Trade

6.14 India's total external trade, including goods and services, grew by 44.2 per cent to US$268 billion in 2004-05. Growth was 41.5 per cent in the first half of 2005-06, with value of such trade at US$163 billion. Trade in services has been growing faster than merchandise trade – for example, in 2004-05, growth in services trade was 78.6 per cent, compared to 33.6 per cent in merchandise trade. The share of services in total trade increased from 23.5 per cent in 2003-04 to 29.1 per cent in 2004-05 and further to 34.4 per cent in the first half of 2005-06.

Merchandise Trade

6.15 India's merchandise exports (in dollar terms and customs basis), by continuing to grow at over 20 per cent per year in the last 3 years since 2002-03, have surpassed targets. In 2004-05, export growth was a record of 26.2 per cent, the highest since 1975-76 and the second highest since 1950-51(Appendix table 7.1(B)). Supported by a buoyant world economy (5.1 per cent) and import volume (10 per cent) growth in 2004, there was an upswing in India's exports of primary commodities and manufactures, and Indian exports crossed US$80 billion in 2004-05. The good performance of exports (growth of 18.9 per cent) continued in April-January 2005-06, despite the slightly subdued growth of global demand, and floods and transport disruptions in the export nerve centres of Mumbai and Chennai.

6.16 While volume growth dominated export performance till 2002-03, there is an increasing contribution of higher unit values in recent years (Table 6.4 and Appendix Table 7.6). This change, evident in the last two years, coincided with a rising share of high value gems and jewellery items, gradual shift to garments from fibres and fabrics, and the sharp rise in prices of non-fuel primary items like ores and minerals, iron and steel and non ferrous metals. The net terms of trade which have been witnessing a continuous decline since 1999-00, showed a sharp rise in 2003-

04 mainly due to the rising export unit values. Growth of exports in dollar terms was faster than the same in rupee terms with the continued appreciation of the rupee between 2003-04 and early 2005. Export volume growth, which was subdued in 2003-04, picked up in 2004-05. With a rise in both export volume and unit value, export's purchasing power to import measured by the income terms of trade, which has been improving consistently during the 1990s (except 1996-97) improved further in 2003-04. However, in 2004-05, there was a sharp deterioration in both net and income terms of trade mainly due to the sharp rise in import unit value of crude petroleum, gold and other primary commodities.

6.17 India moved one notch up the rankings in both exports and imports in 2004 to become the 30th leading merchandise exporter and 23rd leading merchandise importer of the world. The momentum in export growth continued, though at a decelerated pace, in 2005-06. After a fall in November 2005, export growth rebounded in December 2005. Overall exports in April-January 2005-06 was US$ 74.9 billion, vis-à-vis the target of US$ 92 billion for 2005-06 as a whole.

6.18 Both external and domestic factors have contributed to the satisfactory performance of exports since 2002-03. While improved global growth and recovery in world trade aided the strengthening of Indian exports, firming up of domestic economic activity, especially in the manufacturing sector, also provided a supporting base for strong sector-specific exports. Various policy initiatives for export promotion and market diversification seem to have contributed as well. The opening up of the economy and corporate restructuring have enhanced the competitiveness of Indian industry. India's impressive export growth has exceeded world export growth in most of the years since 1995; but, since 2003, it has lagged behind the export growth of developing countries taken together, mainly because of China's explosive export growth. India's share in world merchandise exports, after rising from 0.5 per cent in 1990 to 0.8 per cent in 2003, has been stagnating at that level since then with marginal variation at the second decimal place (Table 6.5 and Appendix table 7.5). This is a cause for concern. Foreign Trade Policy (FTP) 2004-09 envisages a doubling of India's share in world exports from 0.75 per cent to 1.5 per cent by 2009. To achieve this target, Indian exports may need to exceed US$150 billion by 2009 as world exports are also growing fast.

6.19 The world economy in 2004 had recorded its strongest growth in more than a decade, providing the foundations for a volume expansion of world exports and imports by 9 per cent and 10 per cent, respectively, powered by the growth in trade of manufactures at 10 per cent. The strong

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

Year	Export Growth			Import Growth			Terms of Trade	
	Value (in US dollar terms)	Volume	Unit Value	Value (in US dollar terms)	Volume	Unit Value	Net	Income
1990-00	7.7	10.6	8.4	8.3	12.4	7.2	1.5	11.7
1990-95	8.1	10.9	12.6	4.6	12.9	7.6	5.0	16.5
1995-00	7.3	10.2	4.3	12.0	11.9	6.9	-2.0	7.0
2000-01	21.0	23.9	3.3	1.7	-1.0	8.2	-4.5	18.3
2001-02	-1.6	3.7	-1.0	1.7	5.0	1.1	-2.1	1.5
2002-03	20.3	21.7	0.3	19.4	9.5	10.7	-9.4	10.3
2003-04	21.1	6.0	8.5	27.3	20.9	-0.1	8.6	15.1
2004-05	26.2	13.2	8.9	39.7	8.8	25.7	-13.0	-2.0
2005-06*	18.9			26.7				

***April-January**
Source : DGCI&S

Table 6.5 : Export growth and share in world exports of selected countries									
	Percentage growth rate				Share in world exports				Value (US $ billion)
Country	1995-01	2003	2004	2005*	2001	2003	2004	2005*	2004
1. China	12.4	34.5	35.4	32.1	4.3	5.9	6.6	7.2	593.0
2. Hong Kong	3.6	11.9	15.6	11.4	3.1	3.0	2.9	2.8	259.0
3. Malaysia	6.6	6.5	26.5	12.1	1.4	1.3	1.4	1.4	125.7
4. Indonesia	5.7	5.1	11.2	44.6	0.9	0.9	0.8	0.8	71.3
5. Singapore	4.1	15.2	24.5	14.8	2.0	1.9	2.0	2.0	179.6
6. Thailand	5.9	17.1	20.0	12.9	1.1	1.1	1.1	1.1	96.0
6. India	8.5	15.8	25.7	21.0	0.7	0.8	0.8	0.8	71.8
8. Korea	7.4	19.3	30.9	18.1	2.5	2.6	2.8	2.8	254.0
9. Developing countries	7.9	18.4	27.1	21.2	36.8	38.8	40.7	42.4	3685.1
10. World	5.5	15.9	21.2	14.9	100.0	100.0	100.0	100.0	9049.8

Source: IFS statistics, IMF. * January-August, 2005

growth in world trade in 2004 was more in nominal terms, with value of world merchandise growth registering a rise of 21 per cent. This was mainly due to the price increase in primary commodities following a sharp rise in demand particularly for fuels and other mining products, and a rise in Europe's dollar prices and nominal trade values from the depreciation of the US dollar by 9 per cent vis-à-vis a basket of European currencies. After the estimated markedly lower expansion of 6.5 per cent for 2005, according to the WTO, with a moderate recovery of the world economy in 2006, volume of world merchandise trade is likely to accelerate to 7 per cent in 2006.

6.20 While high growth in global output and demand, especially in the major trading partners of India, helped, it was the pick up in domestic economic activity, especially the consistent near double-digit growth in manufacturing, that constituted the main driver of the recent export surge. In 2004-05, India's manufacturing exports grew by 21 per cent and had a share of around 74 per cent in total exports. Vis-à-vis the US dollar, the Indian rupee, which had started strengthening from June 2002 onwards, appreciated by around 2.2 per cent on an annual average basis in 2004-05. As per the revised Real Effective Exchange Rate (REER) of the RBI, which is a six-currency-trade-based-weights index providing a better reflection of India's trade competitiveness, rupee appreciated by 2.5 per cent in 2004-05, on an annual basis. While the appreciation of the rupee remained around the benchmark over the long horizon and orderly and smooth, the adjustment cost to industry appears to have been limited with productivity gains. Furthermore, in more recent times, though the REER (six currency index) for November 2005 reflects an appreciation of above 7 per cent, the rupee started to depreciate in nominal terms from August 2005.

6.21 Further productivity gains in the export sector require a deepening of domestic reforms, and an accelerated removal of infrastructure bottlenecks, including export infrastructure. Infrastructure remains the single most important constraint to export growth. Achievement of the ambitious export target set in Foreign Trade Policy (2004-09) requires a projected augmentation of the installed capacity of ports by 140 per cent. Indian ports, which handle over 70 per cent of India's foreign trade even in value terms, have a turn-around time of 3-5 days as against only 4-6 hours at international ports like Singapore and Hong Kong. As for internal transport, while there has been a perceptible improvement in the national highways, secondary roads need to be improved and the issue of delays caused at inter-state check points need to be addressed. As trade grows and the number of consignments increases, there is a need not only for improved trade infrastructure, but also for streamlining trade data infrastructure to remove any data anomalies and provide the basis for appropriate policy formulation. Exporters need to place more emphasis on non-price factors like product quality, brand image, packaging, delivery and after-sales service. A more aggressive push to FDI in export industries will not only increase the rate of investment in the economy but also infuse new technologies and management practices in these industries.

6.22 Availability of adequate export credit at competitive rates continued to remain an important policy consideration of Government. Export credit as a proportion of the net bank credit declined from 9.8 per cent in March 24, 2000 to 6.8 per cent in March 18, 2005, as against the stipulated level of 12 per cent (Table 6.6). While this may partly reflect the strength of the Indian export sector, which may be availing less export credit, it may also be a reflection of the relatively higher cost of export credit in India compared to other countries.

6.23 Growth in India's merchandise imports in 2004-05 at 40 per cent in dollar terms was the highest since 1980-81 (Appendix table 7.1B). This surge in growth in 2004-05 was mainly due to the steep rise in price of crude petroleum and other commodities with value of POL imports increasing by 45.1 per cent. While volume growth in import of POL was subdued at 6.4 per cent, largely in response to the price increase, larger imports filled the gap between growing demand and stagnant domestic crude oil production. In 2004-05, lower tariffs, a cheaper US dollar, a buoyant manufacturing sector and high export growth boosted non-oil imports by 39 per cent, particularly capital goods, intermediates, raw materials and imports needed for exports. Buoyant growth of imports of capital goods at 21 per cent, on top of the 40 per cent growth in 2003-04, reflected the higher domestic investment and firming up of manufacturing growth. A significant contributor to the rise in non-POL imports was the 59.6 per cent growth of gold and silver on the back of a 59.9 per cent growth in 2003-04, due to the high international gold prices. The duty reduction on imported gold from Rs.250 to Rs.100 per 10 gram and liberalization of such imports as per trade facilitation measures announced in January, 2004 could also have provided a fillip. Non oil, non bullion imports increased by 31 per cent in 2004-05, compared to a rise of 28.5 per cent in 2003-04.

6.24 In the current year, imports continued to grow, though at a decelerated pace. The 26.67 per cent growth in imports in April-January 2005-06 was contributed by the growth in POL imports of 46.91 per cent. This was mainly due to the rise in prices, as quantity growth was only 1.6 per cent in April-November 2005. While non-oil imports increased by 18.81 per cent in April-January 2005-06, non-oil non-bullion imports increased by 30.8 per cent in April-October 2005-06 (on top of a 29.9 per cent increase in the corresponding period of the previous year), indicating the economy's growing absorptive capacity for imports. Gold and silver import growth accelerated during the same period, owing to the firming up of international gold prices which reached a high of US$510 per troy ounce in December 2005. Gold prices rose further to US$570.9 per troy ounce on February 2, 2006.

6.25 Unlike in 2003-04, the surge in POL imports in 2004-05 and 2005-06 (April-November) was dominated by the price impact (Figure 6.2). International crude oil (Brent variety, per barrel) prices, trending upwards since 2002, on average, rose from US$27.6 in 2002-03 to US$28.9 in 2003-04, US$42.1 in 2004-05, and further to US$56.64 per barrel in April-November 2005 with a peak of US$67.33 on August 12, 2005. The stiffening of global crude oil prices was contributed by a combination of heightened demand, limited spare capacity and geopolitical threats to the existing capacity. Crude oil prices have since moderated and was ruling at US$60.76 per barrel as on Febuary 9, 2006. The surge in crude oil prices has sharpened the focus on the adverse impact of such volatility on domestic prices and the need to minimize such impact. Given India's relatively high oil intensity and increasing dependence on imported crude oil, efforts are being made to diversify sourcing of such imports away from the geopolitically sensitive regions. Another development has been the decision to build up strategic oil reserves, equivalent of about 15 days requirement, to minimize the impact of crude price volatility in the short term. In a related initiative, India is coordinating with large oil importing countries in Asia, in exploring possibilities for evolving an Asian products marker, in place of an Asian premium, which would reduce the premium paid by Asian countries and thus, to some extent help in controlling the country's oil import bill.

Table 6.6 : Export credit

Outstanding as on	Export credit (Rs crores)	Variations (Per cent)	Export credit as per cent of NBC
March 24, 2000	39118	9.0	9.8
March 23, 2001	43321	10.7	9.3
March 22, 2002	42978	-0.8	8.0
March 21, 2003	49202	14.9	7.4
March 19, 2004	57687	17.2	7.6
March 18, 2005	65914	14.3	6.8
March 18, 2005*	67467	NA	NA
October 28, 2005*	71826	6.5	NA

Note : Data relate to select banks accounting for 90 per cent of bank credit

*** Pertains to 52 banks**

Source : Reserve Bank of India

6.26 With a widening trend in recent years, the trade deficit reached a high of US$28.6 billion (as per customs data) in 2004-05, and this high was surpassed by a record US$33.8 billion in April-January 2005-06 itself. While this is a cause for concern, it may reflect a lag between export growth and growth in import of capital, intermediate and basic goods. With a slowdown in imports in November, December, 2005 and January 2006, growth in trade deficit has decelerated from 71 per cent in April-September 2005 to 69 per cent in April-November 2005 and further to 54 per cent in April-December 2005 and 48 per cent in April-January 2005-06. One notable feature in the recent past is the deficit in non-oil balance; in surplus in 2003-04, it turned negative with a deficit of US$5.6 billion in 2004-05 and US$5.8 billion in April-October, 2005, considerably higher than the deficit of US$1.1 billion in April-October, 2004. This may again reflect the growing industrial and export demand, which will materialize only with a lag.

Composition of merchandise trade

6.27 Export growth in 2004-05 continued to be broad-based with good performance in most of the sectors. Manufactured exports, with a share of 73.7 per cent in total merchandise exports, continued to grow at 21 per cent. The most notable feature was the

91 per cent growth in exports of petroleum products, with a perceptible increase in its share in total exports. It reflected not only the rise in POL prices, but also India's enhanced refining capacity developed with a supportive tariff structure [Table 6.7 and Appendix Tables 7.3(A) and 7.3(B)]. Exports of primary products grew by 29.4 per cent with rapid growth in exports of ores & minerals, induced by strong international demand and higher prices. Within manufacturing, high performers were: engineering goods (mainly manufactures of metals, machinery and instruments, transport equipment and primary, semi-finished iron & steel and non-ferrous metals); gems and jewellery; and chemicals and related products (including basic chemicals, pharmaceuticals and cosmetics, plastics and linoleum, rubber, glass and other products and residual chemicals and allied products). Despite the new opportunities that opened up with the phasing out of textiles quotas, textiles exports showed a disappointing negative growth. In agriculture exports, besides traditional items like cereals, cashew nuts, spices and rice and pulses, non-traditional items like poultry and dairy products and fruits and vegetable seeds registered high growth.

6.28 Export performance in April-October 2005 continued to be broad-based, with manufactures in the lead, and engineering goods, gems and jewellery, and chemicals and related products registering good performance. The growth of petroleum products, though impressive, was slightly subdued possibly due to the fire at Mumbai High and transport disruptions due to floods. Primary products growth moderated somewhat due to slowdown in demand from China for ores and minerals, though its growth was still impressive. One notable feature was the growth in project goods by more than 200 per cent (see Box 6.4).

6.29 In textiles, with the quota regime giving way to free market at the global level at the beginning of 2005, there is a lot of expectation from the Indian textile industry (Box 6.5). So far, while China's performance exceeded expectations, India's performance has not been satisfactory. Following the supportive measures announced in Budget 2005-06, textiles exports showed a revival with a growth of 10.5 per cent in April-October, 2005. But, China's growth of textiles exports was double at 21 per cent in the comparable period of April-November, 2005. While export growth was somewhat better in readymade garments (16 per cent) and to the US (25 per cent in April-November, 2005), it was far below the corresponding growth of Chinese exports to the US of 51 per cent. The low scale intensity of textiles manufacturing has

Table 6.7 : Commodity composition of exports, April-October 2004-05

Commodity Group	Percentage share				Growth rate*			
			April-October				April-October	
	2003-04	2004-05	2004	2005	2004	2005	2004	2005
I. Primary products	16.4	16.8	14.8	16.1	17.3	29.4	39.7	17.0
Agriculture & allied	12.4	10.5	11.2	9.9	11.9	7.4	27.0	8.8
Ores & minerals	4.0	6.3	4.9	5.4	18.2	97.1	81.1	35.9
II. Manufactured goods	76.9	73.7	74.1	72.4	20.0	20.8	20.2	20.5
Textiles including ready made garments	15.6	12.1	13.2	11.8	21.5	-2.2	9.3	10.5
Gems & jewellery	16.6	17.1	17.4	17.9	16.8	29.9	20.8	26.9
Engineering goods	19.3	20.6	20.2	20.1	30.2	31.8	36.6	23.1
Chemical & related products	11.9	12.1	11.8	11.1	22.7	25.1	30.1	15.9
Leather & manufactures	2.3	1.9	2.1	1.7	15.7	6.1	16.9	6.3
Handicrafts	0.8	0.5	0.5	0.5	-4.8	-26.4	-19.6	11.6
III. Petroleum, crude & products	5.6	8.4	8.7	11.1	38.1	90.5	89.4	57.7
TOTAL EXPORTS (I+II+III)	**100.0**	**100.0**	**100.0**	**100.0**	**21.1**	**26.2**	**28.3**	**23.5**

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

Box 6.4 : Project Exports from India : Performance and Potential

From a modest beginning in the late 1970s, project exports have evolved over the years to reflect the country's technological maturity and industrial capabilities; give visibility to Indian technical expertise and project execution capability; and create entry points for other Indian firms for supplies, consultancy and manpower exports. Exports of projects and services including construction and industrial turnkey projects and consultancy services increased from US$629 million in 1998-99 to US$911 million in 2004-05, and crossed US$956 million in April-October, 2005 itself.

Destination of project exports has undergone a change between 1999-00 and 2004-05, with the share of West Asia (mainly Oman, UAE and Iraq) increasing from 28.4 per cent to 63.9 per cent, North Africa (mainly Sudan) increasing from 9.1 per cent to 28.5 per cent, South Asia falling from 41.5 per cent to 5.7 per cent, and South East Asia falling from 15.8 per cent to 0.9 per cent. In 2004-05, turnkey contracts had the major share (57.2 per cent), followed by construction contracts (36.4 per cent), and consultancy contracts (6.4 per cent).

There is a growing realisation across Asia and Africa that the experience of Indian companies is more appropriate to their project needs, especially in hydro-power, irrigation, transportation and water supply systems. Indian exporters need to make inroads into the lucrative markets in West Asia, including Iraq and Libya, which are showing signs of revival. There is need to obtain a major share of all funded projects in SAARC region through intensive marketing; to forge strategic alliances with leading European companies to target multilaterally funded projects in CIS countries, and with companies in Latin America to participate in projects funded by Inter-American Development Bank (IADB); to use the Comprehensive Economic Cooperation Agreements (CECAs) to promote such exports; and to secure sub-contracts from major European/American/Japanese companies.

The challenges for Indian project exports include: relatively lower ability to compete with many other countries, including developed ones and China, in the absence of competitive credit; lack of experience in handling barter deals and counter-trade practices; and low levels of effective and strategic tie-ups with reputed international consultancy firms and quality accreditation. Some important initiatives have been taken to promote project exports. Government of India (GoI) Lines of Credit, since 2003 routed through Exim Bank, and with GoI guarantee for repayment of principal and payment of interest, facilitate offer of competitive credit. Bid Intervention Service by Exim Bank, on behalf of Indian companies, seeks redressal in case of discriminiation against Indian companies in multilateral tenders. Exim Bank has so far intervened in 32 bid intervention cases, of which 19 were successful with contracts ultimately going in favour of Indian companies.

Box 6.5 : Textile Sector in the Post-Quota Era

Textiles and clothing (T&C) sector is India's largest industry, accounting for nearly 20 per cent of the economy's industrial output, direct employment of 35 million workers, and for around 12 to 16 per cent of the total export earnings. India has a share of 5 per cent and 4 per cent in global exports of textiles and clothing, respectively, compared with China's 18 per cent and 35 per cent, respectively.

The Uruguay Round of trade negotiations resulting in the Agreement on Textiles and Clothing, provided for the sector's integration into the framework of GATT over a period of 10 years ending on 31st December 2004. Studies undertaken during the integration period had concluded that the major beneficiaries of quota elimination would be India and China. In the event, China, with a share of about one sixth of the total world exports of T&C, has performed well and far better than India. US trade data shows that India's exports to the US during the period January-September 2005 grew by 25.17 per cent, which was higher than that of Pakistan (10.86 per cent) and Bangladesh (19.81 per cent), but much lower than that of China (58.60 per cent). In January-May 2005, China's T&C to the EU of products liberalised in January, 2005 surged by 80 per cent, compared to India's modest 10.5 per cent. Similarly, US data for the first six months of 2005 show that exports of T&C of liberarlised product lines from China surged by 242 per cent.

The revaluation of the Chinese Yuan by around 2.05 per cent has helped India in becoming price competitive vis-à-vis China in some items like girls skirts, women/girls shorts and blouses, and men's shirts, but the impact of the revaluation has been limited. China enjoys substantial advantage on account of huge capacities across the entire textile value chain with economies of scale, flexible labour laws, cheap power, low interest rates, efficient and sound infrastructure, and cluster-oriented integrated industrial structures. Other competing developing countries, including Pakistan and Bangladesh have taken fiscal and other policy initiatives such as duty free import of capital goods, and flexible labour laws. Bangladesh is also benefiting from its status as a Least Developed Country (LDC).

A number of steps were taken to prepare the T&C sector in India for the post-quota period, but the opportunities unleashed have not materialized in full because of reservation of certain items for small-scale sector until recently, absence of labour market flexibility and an effective exit policy, which has prevented development of scale economies, longer lead time, and infrastructural and administrative bottlenecks, including delays at customs. Greater FDI in the T&C sector from major textile importers like the EU and the US can catalyse the sector. There is also need to increase productivity, to apply the prowess gained in the new economy sectors like IT to this old economy sector, and to redress the problem of lackluster growth in the synthetic segment, where world demand is high, but India's output of fibres and fabrics have fallen in the current year.

deprived India the opportunity to make the best of her comparative advantage in labour. Some of the major problems plaguing the sector, like reservation for the small scale sector, have been addressed. Nevertheless, substantial investment, both domestic and foreign, is needed to achieve a quantum jump in textiles exports.

6.30 Growth of exports of gems and jewellery, a major contributor to India's exports, accelerated in April-October 2005, with USA the largest market accounting for 25 per cent of such exports from India. While exports of engineering goods, comprising transport equipment, machinery and parts and manufactures of metals, remained key drivers, there was a significant loss of growth momentum compared to the previous year. Among engineering exports, there was a sharp deceleration in primary and semi-finished iron and steel, with strong domestic demand and a slowdown in demand from countries like Germany and UAE, though demand from China continued to be strong. With buoyant Japanese demand, there was a turnaround in marine product exports with growth of 16 per cent compared to the decline a year ago. Among agricultural items, export growth was impressive in items like rice and pulses and in non-traditional items like poultry and dairy products, meat and preparations, and fruits and vegetable seeds. Exports of

Table 6.8 : Share of Major Exports of India in World Exports

(Items with one per cent share and above)

HS rev.1	Product	2000	2004
03	Fish, crustaceans, molluscs, aquatic invertebrates, nes	3.4	2.4
05	Products of animal origin, nes	1.2	1.4
07	Edible vegetables and certain roots and tubers	1.3	1.1
08	Edible fruit, nuts, peel of citrus fruit, melons	2.1	1.4
09	Coffee, tea, mate and spices	5.8	4.7
10	Cereals	2.3	3.1
12	Oil seed, oleagic fruits, grain, seed, fruit, etc, nes	1.7	1.5
13	Lac, gums, resins, vegetable saps and extracts nes	11.9	8.0
14	Vegetable plaiting materials, vegetable products nes	4.4	6.1
15	Animal,vegetable fats and oils, cleavage products, etc	1.2	1.2
23	Residues, wastes of food industry, animal fodder	2.4	3.1
25	Salt, sulphur, earth, stone, plaster, lime and cement	2.7	3.3
26	Ores, slag and ash	1.9	10.7
28	Inorganic chemicals, precious metal compound, isotopes	0.6	1.0
29	Organic chemicals	1.2	1.7
32	Tanning, dyeing extracts, tannins, derivatives, pigments etc	1.5	1.6
41	Raw hides and skins (other than furskins) and leather	1.8	2.4
42	Articles of leather, animal gut, harness, travel goods	4.1	3.5
46	Manufactures of plaiting material, basketwork, etc.	0.1	2.0
50	Silk	11.3	11.1
52	Cotton	6.6	4.9
53	Vegetable textile fibres nes, paper yarn, woven fabric	4.5	3.5
55	Manmade staple fibres	2.0	2.4
57	Carpets and other textile floor coverings	7.5	10.7
58	Special woven or tufted fabric, lace, tapestry etc	2.4	1.4
61	Articles of apparel, accessories, knit or crochet	2.1	2.3
62	Articles of apparel, accessories, not knit or crochet	3.6	2.9
63	Other made textile articles, sets, worn clothing etc	6.3	7.0
64	Footwear, gaiters and the like, parts thereof	1.4	1.7
67	Bird skin, feathers, artificial flowers, human hair	1.7	3.0
68	Stone, plaster, cement, asbestos, mica, etc articles	1.9	2.7
71	Pearls, precious stones, metals, coins, etc	6.5	7.4
72	Iron and steel	0.9	1.3
73	Articles of iron or steel	1.2	1.0
83	Miscellaneous articles of base metal	0.5	1.0

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

coffee grew satisfactorily, while that of raw cotton grew at over 187 per cent.

6.31 Efforts at export diversification continued. However, India has a share of one per cent and above in world exports in only 35 out of a total of 99 commodity categories at the two digit (Harmonised System (HS) Revision 1) level, with a reasonable share in only a few items (Table 6.8). Recently, world exports of items like scientific instruments have increased tremendously to equal the value of textiles exports, but in these new areas, India's export contribution continues to be low. Among the top 150 items of world exports at the four digit level, in 2004, India had significant shares only in four items, and a share of more than one per cent in only 28 items. The items with large potential, in which India has not yet made a mark while China has already established itself, include many electronic and electrical items, processed food items, scientific instruments and apparatus, toilet papers and handkerchiefs, electro-medical appliances, furniture and toys.

6.32 Manufacturing constitutes around 74 per cent of India's merchandise exports, and there is enormous scope for accelerating such exports. Export of manufactures played a crucial role in the export performance of most of the emerging market economies. Between 1965 and 1985, exports of manufactures from the Republic of Korea grew at an average annual rate of around 35 per cent, which was more than double the pace of growth in world exports of manufactures. Bringing manufacturing to the central stage can help in increasing merchandise exports at rates substantially above the world average, to reach a higher share in world exports. The setting up of the National Manufacturing Competitiveness Council (NMCC) to prepare a strategy for the revival of the manufacturing sector should help in accelerating the export of manufactured items.

6.33 With high 'value added,' the quality of India's exports was somewhat different from that of China, which continued to include a large portion of imported inputs, the so called exports from China to China as per the UNCTAD Trade & Development Report, 2005. India's share in world agricultural exports continued to be low at 1.1 per cent in 2004. India, which has been spearheading the WTO negotiations on agriculture on behalf of the developing countries, needs to quickly take steps to increase supply of agricultural items for world market to make use of the possible opportunities, as a result of WTO negotiations. A three-pronged approach covering more and concerted initiatives to review and implement the relevant standards domestically; recourse to bilateral and multilateral avenues to remove barriers to agricultural exports; and expanding the supply base of exportable agricultural items can help. The Integrated Food Law which is in the offing may be a good step forward.

6.34 The consistent rise in imports, in both 2004-05 and April-October, 2005, is attributable to not only the over 40 per cent growth of POL imports with a share of around 30 per cent in India's import basket, but also to other items like gold and silver, capital goods and export related items (Table 6.9). While the increase in the price of the Indian basket, for example, by over 44 per cent in April-November 2005, contributed to the growth in POL imports, and the rising international bullion prices contributed to the growth in gold and silver imports, the rise in imports of capital goods and export related imports was due to the rising industrial demand and exports, which was also reflected in the high growth of capital goods production.

6.35 Non-electrical machinery, transport equipment, manufactures of metals and machine tools were the main contributors of the rise in capital goods imports. After five successive years of decline, project goods imports, which reflect the technological maturity and industrial capabilities of a country, made a rebound in 2004-05, with the growth accelerating in the current year. This augurs well for the industrial sector and infrastructure sectors of the economy. Among bulk goods, imports of fertilizer, metalliferrous ores and scraps, and iron and steel registered steep rise during April-October

Table 6.9 : Imports of principal commodities								
Commodity	Percentage Share				Growth Rate*			
			April-October				April-October	
	2003-04	2004-05	2004	2005	2003	2004	2004	2005
POL	26.3	27.3	30.2	31.8	16.6	45.1	56.8	41.4
Pearl, precious & semi-precious stones	9.1	8.6	7.9	8.1	17.6	32.1	12.6	36.4
Capital goods	12.7	11.5	9.6	10.3	40.3	20.9	23.3	44.2
Electronic goods	9.6	8.9	9.3	8.2	34.0	30.0	33.3	17.9
Gold & silver	8.8	10.0	9.4	9.0	59.9	59.6	31.5	34.1
Chemicals	7.4	6.0	6.2	5.6	39.9	31.7	31.9	19.7
Edible oils	3.2	2.1	2.6	1.6	40.1	-8.1	-11.9	-15.3
Coke, coal and briquettes	1.8	2.6	2.8	2.0	13.7	97.5	99.5	-3.2
Metaliferrous ores & metal scrap	1.7	2.2	2.2	2.6	24.9	84.8	72.1	57.0
Professional instruments and optical goods	1.6	1.4	1.4	1.3	8.6	21.0	15.2	26.8
Total imports	**100.0**	**100.0**	**100.0**	**100.0**	**27.3**	**39.7**	**36.9**	**34.3**

***In US Dollar terms**

2005. Fertiliser import growth, which witnessed a turnaround in 2003-04 after three years of decline, accelerated further in 2004-05 and April-October, 2005. While the turnaround in 2003-04 in fertilizer imports was due to price increases, the increase in 2004-05 and April-October, 2005 was caused by higher volumes induced by falling prices, and reflected robust demand by the agriculture sector. Import of food and allied products declined with a fall in imports of edible oils, in both value and volume terms, in 2004-05 and April-October, 2005, with higher domestic output. The very high growth in iron and steel imports — due to both volume and price increase in 2004-05, and mainly due to volume increase in the current year with a fall in international steel prices in the last few

Table 6.10 : India's major trading partners, 2000-2005

(Percentage share in total trade (exports+imports))

Country	2000-01	2002-03	2003-04	2003-04	2004	2005
					April-October	
USA	13.0	13.4	11.6	10.3	11.1	10.0
UK	5.7	4.6	4.4	3.7	3.6	3.7
Belgium	4.6	4.7	4.1	3.7	3.7	3.4
Germany	3.9	4.0	3.8	3.5	3.5	3.6
Japan	3.8	3.2	3.1	2.7	2.6	2.4
Switzerland	3.8	2.4	2.6	3.3	3.2	3.3
Hong Kong	3.7	3.1	3.3	2.8	2.8	3.0
UAE	3.4	3.8	5.1	6.2	5.6	5.4
China	2.5	4.2	4.9	6.4	5.6	6.4
Singapore	2.5	2.5	3.0	3.4	3.3	3.7
Malaysia	1.9	1.9	2.1	1.7	1.9	1.4
Total (1 to 11)	**48.6**	**47.9**	**48.1**	**48.0**	**46.8**	**46.4**

Source : DGCI&S, Kolkata

Box 6.6 : India and Regional Cooperation in Asia

Asia has emerged as an engine of growth in the world accounting for around one fifth of world GDP. In 2004, total Asian trade amounted to US$2388 billion, or above a quarter of world trade (26.8 per cent). Intra-Asian export has increased from 12.6 per cent of world trade in 2003 to around 13.5 per cent in 2004. While intra-ASEAN exports constituted around 22 per cent of the region's total exports in 2004, the shares of NAFTA at 55 per cent and EU-25 at 67 per cent were much higher. India unveiled the "Look East" policy in 1991. East Asia-including Japan, China, South Korea and ASEAN - is today India's largest trading partner, ahead of EU and the US.

Proliferation of Free Trade Agreements (FTAs) is the clearest evidence of Asian countries' desire to forge closer economic relationships. The growing importance of CECA's indicates that such agreements are becoming deeper, extending to areas beyond just tariff reduction. Intra-regional trade and investment require building up of shared infrastructure. Many Asian countries have joined together to develop cross-border infrastructure to lay the foundations for closer trading relationships and increased connectivity among countries. The Greater Mekong Subregion is quite advanced in this endeavor. Similar initiatives are underway in South Asia and in Central Asia, with exciting prospects for future development. The spirit of enhanced monetary cooperation in Asia is evident from initiatives like the Chiang Mai Initiative and the Asian Bond Fund having major potential for financing regional investments.

Asia remains one of the least integrated regions lacking a continent-wide regional organization. Forging closer links among Asian nations through appropriate institutional mechanisms can lead to substantial enhancement of national, regional and global productivity and output. In the past, India had adopted a very cautious approach to regionalism, and was engaged in only a few bilateral/regional initiatives, mainly through Preferential Trade Agreements (PTAs). Recognising that RTAs would continue to feature in world trade for a long time, and with the intention of expanding its export market, India began concluding in principle agreements as a possible step towards CECAs, which cover FTA in goods (zero customs duty regime within a fixed time frame on items covering substantial trade, and a relatively small negative list of sensitive items with no or limited duty concessions), services, investment and identified areas of economic cooperation. The recently concluded CECA with Singapore was implemented from 1st August, 2005. The Agreement on South Asia Free Trade Area (SAFTA) was signed by member countries of South Asian Association for Regional Cooperation (SAARC) in January, 2004. Negotiation on all aspects of SAFTA was concluded recently and the tariff liberalization programme is scheduled to be implemented from July 1, 2006. Framework Agreement on Comprehensive Economic Cooperation between ASEAN and India, Framework Agreement for Bangladesh, India, Myanmar, Srilanka and Thailand Economic Cooperation (BIMSTEC) FTA, and India-Thailand Framework Agreement have also been signed, and FTA on Goods, Services and Investment with BIMSTEC are under negotiation. India-China, India-Japan, and India-South Korea joint study groups have also been set up.

months — reflected rising demand in a buoyant economy.

Direction of Trade

6.36 The share of the 11 major trading partners of India, accounting for a share of around 48 per cent in India's trade, has not changed much since 2000-01(Table 6.10). While USA continues to be the single largest trading partner of India, its share has fallen in 2004-05 and April-October, 2005. China emerged as the second major trading partner in 2005-06 and the share of combined China-Hong Kong at 9.4 per cent was close to that of USA. The impressive growth in trade with China was contributed by ores, slag, ash, iron and steel and organic chemicals on the export side, and by electrical machinery, other machinery and organic chemicals on the import side. While UAE is the next major trading partner, and is important both in terms of imports and exports, another important country, whose share has been increasing steadily, is Singapore, with which India has recently signed a Comprehensive Economic Cooperation Agreement (CECA). In the case of India-Singapore trade, precious stones, metals, mineral fuel, oil, ships and boats and other machinery were the major contributors in exports, and other machinery, electrical machinery, organic chemicals, books, newspapers and manuscript, and aircraft & spacecraft in imports.

6.37 Region-wise, in 2004-05, India's exports to Asia and Oceania, (with a share of 47.4 per cent) registered a robust growth of 27 per cent. This was powered by the high growth of exports to China, Singapore, UAE and the Republic of Korea. The other two major regions — EU-25 and America (with shares of 21.7 per cent and 20.4 per cent respectively) registered growth of around 20 per cent. Exports to Africa and Latin American countries were also impressive (Appendix Table 7.4 B). In April-October, 2005, while performance was similar to that in 2004-05, growth of exports to EU 25 accelerated, and exports to China-Hong Kong, Singapore and Korea continued to be impressive. Significant growth was also seen in trade with Sri Lanka and Thailand, with which India has a Free Trade Agreement (FTA). The growing importance of Asia in India's exports indicates that the regional trading arrangements (RTAs) strategy is bearing fruit (Box 6.6). Framework Agreements on economic cooperation have also been entered into with MERCOSUR and Chile. India is also engaged with Gulf Cooperation Council and Mauritius for FTA/ Comprehensive Economic Cooperation Partnership Agreement. India-Israel and India, Brazil, South Africa (IBSA) joint Study Groups have also been set up.

6.38 In 2004-05, India's imports from Asia and Oceania, accounting for 35.4 per cent of total imports, was buoyant with growth of 40 per cent. Import growth from EU 25 (with a share of 16.9 per cent) at 20 per cent and that from America (with a share of 8.4 per cent) at 29 per cent were also impressive. In America, US was the major source of import, and Belgium, Germany and the UK were the major import sources in EU 25. In Asia, import growth from major sources like China and Singapore and, within SAARC, growth in imports from Sri Lanka and Pakistan, were impressive (Appendix Table 7.4 A). In April-October, 2005, there was an acceleration of growth in imports from EU 25, and growth in imports from Asia and Oceania, and from America continued to be impressive, despite

Box 6.7 : India's IT Sector : Performance and Prospects

Total spending on products and services of the IT sector in India increased from US$5 billion in 1997-98 to nearly $20 billion in 2003-04 as per a NASSCOM study and software exports reached US$ 17.2 billion in 2004-05. Employment in the sector grew by 30.1 per cent per year between 1999-00 to 2003-04. By 2008, the industry is projected to grow from 4.1 per cent of GDP in 2004-05 to 7.0 per cent of GDP and account for 35 per cent of total exports. Government's "hands off" approach has been the most cited reason for this success story.

India accounts for 65 per cent of the global market in offshore IT services and 46 per cent of the global BPO market in 2004-05. With only 10 per cent of the potential market tapped so far by all the countries put together, the potential for further growth is very large. With annual growth of over 25 per cent, these two can generate export revenues of US$60 billion by 2010. Studies suggest that growth will be driven by more traditional outsourcing service lines – such as hardware and software maintenance, network administration and help desk services – and not lines such as application development and management (ADM) and R&D services, with penetration already at 30-35 per cent.

Achieving high growth in software exports will require deep and enduring innovation across multiple dimensions, like business model innovation; focusing on new service lines, like infrastructure off-shoring and knowledge innovation; developing Internet Protocol based solutions, systematic talent enhancement, better technology and research capabilities. Some of the key challenges which need to be overcome include documenting procedures and establishing performance benchmarks, addressing concerns around data security, improving the workforce quality and skills and continuously innovating and developing new service lines along with improved operational excellence.

Slow IT uptake in the domestic market has led to an underinvestment in IT capital. Among the 30 economies worldwide studied by NASSCOM, 10 per cent is the critical share of IT capital in total capital that separates invested from underinvested economies. The share in India of only 3.5 per cent is among the lowest. Personal computer penetration rate of around seven per 1000 people is less than an eighth of the average in other IT-underinvested economies and a fourth of that in China. Studies show that a 10 per cent increase in IT capital in economies underinvested in IT increases GDP by 1.6 per cent, and the impact is seven times greater than the impact of investing in non-IT capital.

Within IT, relative to software and services sector, IT hardware has lagged far behind. One of the reasons for the underinvestment in IT sector is the slow development of the hardware sector. With the implementation of the ITA 1 agreement in April, 2005, there are zero duties for the ITA 1 items and greater international competition for the hardware sector. IT production development has to focus on the combined hardware-software sector and production for domestic sector along with exports.

a moderation. While the country-wise performance was almost similar to that in 2004-05, within SAARC, besides Sri Lanka and Pakistan, imports from Bangladesh witnessed an impressive rebound in growth in the first seven months of 2005-06, after a decline in 2004-05.

Services Exports

6.39 Services exports grew by 71 per cent in 2004-05 to US$46 billion, and 75 per cent to US$32.8 billion in April-September, 2005. In 2004-05, software service exports grew by 34.4 per cent to US$17.2 billion and by 32 per cent to US$10.3 billion in the first half of 2005-06. India's share in the world market for IT software and services (including BPO) increased from around 1.7 per cent in 2003-04 to 2.3 per cent in 2004-05 and an estimated 2.8 per cent in 2005-06. (Box 6.7)

6.40 A new development in services exports is the explosive growth of business services, including professional services. This is reflected in the growth of miscellaneous services excluding software, which grew by 216 per cent to US$16.3 billion in 2004-05, and 181 per cent in the first half of the current year to reach a level of US$15.4 billion and surpass even the value of software services exports. The enormous opportunities for further growth of these services make WTO negotiations in services all the more important for India (Box 6.8).

6.41 While India is negotiating for greater market access in developed country markets, domestic regulations create barriers for Indian service providers even when trading partners have taken firm commitments. Quick domestic policy reforms are needed, especially in qualification and licensing requirements and procedures, to impart effective market access for our service providers. Some of the ways of promoting services could include facilitation to become known suppliers of quality services, providing relevant export market information, providing appropriate export financing with reduced transaction costs by reviewing the common practice of collateral backing, good marketing of services by energizing Indian embassies and industry associations, anchoring brand ambassadors for promoting services, and leveraging the country's potential services purchasing power in multilateral and bilateral negotiations and in the CECA's.

Box 6.8 : Services, GATS and Strategies for India

Services account for more than 60 per cent of world GDP, and trade in services has grown more rapidly than merchandise trade since 1985. In 2004, while India's share in world merchandise exports was 0.8 per cent, the corresponding share in world commercial services was 1.9 per cent. Services, accounting for 54.1 per cent of GDP in 2005-06, is a sector of critical interest in India.

In the ongoing negotiations at WTO under the General Agreement on Trade in Services (GATS), the offers of most countries do not provide any significant new openings for trade, especially in areas of interest for developing countries. Given its strong competitive edge in IT and ITES, and competence of its professionals, India's efforts have been to get binding commitments in cross-border supply of services (Mode 1) and movement of natural persons (Mode 4). In Mode 4, India has been pushing for clear prescription of the duration of stay and removal of the Economic Needs Test (ENT). Though the Services negotiations have been salvaged at the Hong Kong Ministerial, quick and detailed work is needed in the form of examining the detailed requests and offers and arriving at concrete proposals in each of the 12 main categories and 156 sub-categories of services.

Besides software in which India has already made an impact, there is good potential for export of many other professional services, like super-speciality hospital; satellite mapping; printing and publishing; accounting, auditing and book-keeping services. Besides greater efforts at marketing, there is a need to negotiate both multilaterally and bilaterally, issues like the National Health Service Systems in European countries like UK which virtually deny market access; lack of coverage of medical expenditure incurred abroad by US medical insurance companies; need based quantitative limits; need to be natural persons; and accreditation rules. Similarly, in the case of accounting, auditing and bookkeeping services, market access limitations, which are mainly in the form of licensing, accreditation, in-state residency and state level restrictions in countries like US, have to be negotiated. Some liberal sectoral commitments by developed countries get automatically negated by the restrictive horizontal limitations of entry for speciality occupations which needs to be addressed in WTO negotiations.

Trade Policy

6.42 In Union Budget 2005-06, peak rate of customs duty for non-agricultural products was reduced from 20 per cent to 15 per cent. An additional 108 items, including 30 items in the category of textile products, including hosiery, were identified for de-reservation from the ambit of small-scale industries to help textiles and clothing exports in the post-quota regime. The emphasis on infrastructure development continued with the decision to set up a special purpose vehicle (SPV) for large infrastructure projects. Stress on diversification of agriculture towards fruits, vegetables, flowers, dairy, poultry and fisheries was a move supportive of exports of agriculture and allied products.

6.43 The FTP 2004-05 announced in August 2004 had the twin objectives of doubling India's share in global merchandise trade and of acting as an effective instrument of economic growth, especially through generation of employment opportunities. The policy also aimed at unshackling controls and creating an atmosphere of trust and transparency by bringing down transactions costs and identifying and nurturing focus areas to develop India as a global hub for manufacturing, trading and services. The Annual Supplement to the Foreign Trade Policy 2004-09, announced in April, 2005 incorporated additional policy initiatives and further simplified the procedures. State governments would be actively involved in providing an enabling environment for boosting international trade, by setting up an Inter-State Trade Council. Different categories of advance licences were merged into a single category for procedural facilitation and easy monitoring. The Supplement provides renewed thrust to agricultural exports by the extension of Vishesh Krish Upaj Yojna to poultry and dairy products, and removal of cess on exports of all agricultural and plantation commodities. As per the Supplement, the incremental direct and total (direct plus indirect) employment generated by exports in 2004-05 was ten lakh and one crore, respectively. Achievement of the US$150 billion target would generate another one crore jobs. Government also decided to set up a National Export Insurance Account to provide export credit risk cover to large value export transactions and project exports.

6.44 The Special Economic Zone (SEZ) Bill was passed by Parliament in June 2005. To implement the provisions of the SEZ Act, 2005, SEZ Rules have been framed and notified. The Act provides for very attractive fiscal incentives and tax concessions for the developers as well as manufacturers. Other salient features of the Act relate to establishment of free trade and warehousing zones to create world class trade-related infrastructure; establishment of an Authority for each SEZ to impart greater administrative autonomy; and designation of special courts and single enforcement agency to ensure speedy trial and investigation of notified offences committed in SEZs. The Act will provide confidence and stability to domestic and foreign investors and signal the government's commitment to SEZ policy framework. At present there are 15 functional SEZs, and in principle approval has been given to 62 others.

6.45 Contingency trade policy and non-tariff measures (NTMs) have become significant barriers to exports from developing countries. Such barriers are considerably stiffer for products with lower value addition and technological content (e.g. agriculture, textiles, and leather products), which are of major interest to developing countries like India. Keeping this in view, India has been actively pursuing for negotiations on NTMs in WTO. Use of contingent protection measures like anti-dumping duties and countervailing duties has increased over time. With its diversified manufacturing base, India has been one of the major users as well as one of the major targets of anti-dumping measures in the world (Table 6.11).

6.46 Between January 1, 1995 and June 30, 2005, India initiated 412 anti-dumping investigations against 51 countries, including China, EU, Taiwan, Korea, USA, Japan and Singapore. Chemicals and petro-chemicals, pharmaceuticals, fibers/yarns, steel and other

Table 6.11 : Top ten users of anti-dumping measures, 1995–2005										
Country	**1995**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005 Jan-June**	**1995 June 2005**
India	6	27	65	41	79	81	46	21	13	412
United States	14	36	47	47	75	35	37	26	4	358
European Community	33	22	65	32	28	20	7	30	15	318
Argentina	27	8	23	45	26	14	1	12	1	193
South Africa	16	41	16	21	6	4	8	6	17	191
Australia	5	13	24	15	23	16	8	9	2	174
Canada	11	8	18	21	25	5	15	11	0	133
Brazil	5	18	16	11	17	8	4	8	3	119
Mexico	4	12	11	6	5	10	14	6	4	82
China, P.R.	0	NA	Na	6	14	30	22	27	11	110
All countries	**157**	**256**	**355**	**292**	**364**	**312**	**232**	**212**	**96**	**2743**

Source : WTO

metal and consumer goods are the major sectors on which anti-dumping duties have been levied. Cases initiated by India, after peaking in 2001 (79) and 2002 (81), came down steeply in 2003 (46) and further in 2004 (21). Internationally, during the first half of 2005, South Africa reported the highest anti-dumping initiations (17) followed by the EU (15) and India (13). As regards the final measures (definitive duty), the US reported the highest number of measures (13) followed by China (10) and India (7). India is also one of the major targets of anti-dumping investigations. During 1995-2005 (till June 2005), 115 investigations were initiated against India, which included 27 by EC, 20 by South Africa and 18 by the United States.

6.47 Contingency trade measures allowed under the WTO Agreements on Anti-dumping Subsidies and Countervailing Measures are aimed at allowing Members to liberalize trade without being threatened by the fear of being subjected to unfair trade practices like dumping and the entry of subsidized imports. While more awareness building about the specific provisions of these Agreements among the domestic industry is called for, trade and industry also needs to maintain proper records of cost related to production and marketing in a systematic manner so that they can effectively face any anti-dumping investigations that may be initiated against them. Under the provisions in the WTO Agreement on Safeguards, 18 cases have been investigated by India since 1998. While six of these cases were investigated in 1998, no case has been initiated in January-June, 2005.

World Trade Organization (WTO) related issues

6.48 The Doha Round of negotiations launched in 2001 received a fillip with a positive outcome at the Sixth WTO Ministerial Conference at Hong Kong, December 13-18, 2005. The Ministerial Declaration adopted at the end of the conference called for conclusion of negotiations launched at Doha in 2006, and established time-frames and targets in specific areas (Box 6.9).

6.49 *Agriculture* continued to occupy centre-stage in the negotiations under the Doha Work Programme. The protracted work on technical aspects of post-July (2004) Framework, particularly on the issue of the methodology for converting non-*ad valorem* duties (NAVs) to their *ad valorem* equivalents (AVEs) in order to establish a transparent and agreed basis for application of the tariff reduction formula, reflected the deep divergences in the positions of WTO Members. A broad understanding on this conversion methodology reached in May 2005 served to shift the negotiations from technical matters

Box 6.9 : Key outcomes and timelines of Hong Kong Ministerial Declaration

- Resolve to complete the Doha Work Programme fully, and to conclude negotiations in 2006.
- To establish modalities in agriculture and non-agricultural market access (NAMA) by April 30, 2006 and prepare draft Schedules by July 31, 2006.
- To eliminate export subsidies in agriculture by 2013, with a substantial part in the first half of the implementation period. Developing countries without Aggregate Measurement of Support (AMS), such as India, will be exempt from reductions in *de minimis* and the overall cut in trade-distorting domestic support, consisting of AMS, the Blue Box and *de minimis*, that is entitlement to provide Amber Box subsidies up to 10 per cent of value.
- To submit a second round of revised services' offers by July 31, 2006 and submit final draft schedules by October 31, 2006.
- Amendment to TRIPS Agreement reaffirmed to address public health concerns of developing countries.
- Duty-free, quota-free market access for all LDCs' products to all developed countries. Developing country declaring itself to be in a position to do so, to also provide such access, though flexibility in coverage and in the phase in of their commitments is provided.
- In cotton, export subsidies to be eliminated by developed countries in 2006 and trade-distorting domestic subsidies to be reduced more ambitiously and over a shorter period of time.

to substantive negotiations. The G-20 has gained recognition as a credible negotiating entity in the negotiations. The Ministerial Declaration adopted at Hong Kong addresses some of the concerns of developing countries related to agriculture. It has been agreed that development programmes of developing countries that have minimal distorting effects will be incorporated into the green box. It has further been agreed that the three heaviest subsidisers, namely, the EC, the US and Japan, will attract the highest levels of cuts in their trade-distorting domestic support entitlements, and that these cuts must be effective.

6.50 In market access, to address their food security, livelihood security and rural development needs, developing countries will be able to self-designate as 'Special Products' an appropriate number of tariff lines for more flexible tariff reduction treatment. In order to address situations of a surge in imports and fall in international prices, both import quantity and price triggers have been agreed under the Special Safeguard Mechanism, the details of which will be further defined in the subsequent negotiations. There will be four bands for structuring the tariff cuts across all agricultural products. Actual commitments and other issues, including the thresholds for developing countries will be taken up in the next phase of negotiations. In export competition, it was agreed that the exact date of elimination of export subsidies by 2013, with a substantial part realised half way through the implementation period, will be confirmed only upon the completion of modalities, which will include disciplines on export credits, export credit guarantees or insurance programmes, exporting state trading enterprises and food aid, to ensure the parallel elimination of all forms of export subsidies. Developing countries like India will continue to have the right to provide marketing and transport subsides on exports for 5 years beyond the end date for elimination of all forms of export subsidies.

6.51 In *Non-agriculture Market Access (NAMA),* the Hong Kong Ministerial Declaration seeks to achieve the objective of reduction or elimination of tariffs, including tariff peaks, high tariffs and tariff escalation, in particular on the products of export interest for the developing countries through the use of a Swiss formula with coefficients at levels aimed at achieving the aforesaid objective as well as address the issue of special & differential treatment (S&DT) including the issue of less than full reciprocity in reduction commitments for developing countries. Flexibilities granted to developing countries under the S&DT include both a longer implementation period as well as applying less than formula cuts or no cuts for a specified list of tariff lines or retention of some of these tariff lines as unbound. These have been declared as an integral part of the modalities for negotiations under NAMA. On the sectoral initiatives, India, as most other developing countries has emphasized that formula approach should be the main modality for negotiation and sectoral initiative can only be a voluntary initiative. The base rate for the unbound tariff lines has been agreed to in the Ministerial text as being computed on the basis of a non-linear mark up on the applied rates.

6.52 In Services, India submitted its Revised Offer in August 2005, which is a substantial improvement over the Initial Offer. Eleven sectors and 94 sub-sectors are covered in the Revised Offer as opposed to seven sectors and 47 sub-sectors in the Initial Offer. In Mode-3 (commercial presence), India's Revised Offer covers commitments in new services. Commitments on FDI levels have also been enhanced in existing sectors such as computer related services, engineering, R & D, technical testing, telecom, financial services, construction and related engineering services, and tourism services. The major sectors in which restriction on foreign investment remains are: retailing, legal, auditing and accounting, and postal services. Under Mode-4, at the Initial Offer stage itself, India had made substantial improvements in its commitments by including all the categories of natural persons like intra-corporate transferees, business visitors, contractual service suppliers and independent professionals, specifically mentioning sectors where access is available. In the Revised Offer, further improvements have been made in the sectoral coverage of both contractual service suppliers and independent professionals.

6.53 So far, 30 countries including India have submitted their Revised Offers. A number of Initial and Revised Offers are still pending. However, the Revised Offers have provided few commercial opportunities and even two rounds of offers have not proved satisfactory in meeting Members' expectations. An analysis of the Revised Offers tabled by developed Members shows that there is no substantial improvement in terms of quality of offers, especially in areas of interest to India and other developing countries viz., movement of natural persons (mode-4) and cross border supply (mode-1). India's efforts have been to get binding commitments in cross border supply of services (mode 1) and movement of natural persons (mode 4). A number of negotiating proposals were tabled at the WTO in furthering India's objectives. As for Mode 4, India has been pushing for issues such as removal of the Economic Needs Test (ENT), clear prescription of the duration of stay, provisions of extension, etc. It has often been noticed that domestic regulations create barriers for India's service providers even when the trading partners have taken firm commitments. Disciplining such domestic regulations is necessary to impart effective market access for Indian service providers, especially in mode-4. In the Hong Kong Ministerial Declaration, some of these concerns have been addressed. India managed to secure guidance for getting the current levels of market access bound in Mode-1 and also a direction to discuss modalities of doing away with ENT.

6.54 Among *other decisions* taken in the Hong Kong Ministerial, it was agreed that all developed country Members, and those developing countries declaring themselves in a position to do so, shall provide duty-free and quota-free market access on a lasting basis to all products originating from all LDCs. Agreement was also reached on some other outstanding S&DT proposals by LDCs. On the issue of relationship between Trade Related Intellectual Property Rights (TRIPS) and Convention on Bio Diversity (CBD) and protection of traditional knowledge, the Declaration calls for intensification of the consultation process. On implementation issues, Ministers agreed to redouble their efforts to find appropriate solutions to them and it was agreed that the Council shall review progress and take appropriate action no later than July 31, 2006. The fresh time line for reaching results on S&D cluster is December 2006. The Ministerial Declaration also addresses issues such as aid-for-trade; coherence; technical assistance; concerns of small, vulnerable economies; commodity issues and integrated framework for LDCs.

6.55 The WTO Negotiating Group on Rules has been considering proposals from various

Members to clarify and improve existing disciplines of the Anti-Dumping (AD) Agreement and Agreement on Subsidies and Countervailing Measures (SCM), including fisheries subsidies. A number of proposals seeking to strengthen disciplines in these two agreements have been tabled. India has made four submissions thus far, including a textual proposal submitted in early 2005 on mandatory application of 'Lesser Duty Rule'. India is also participating actively in the negotiations on fisheries subsidies and working closely with other Members, including seeking effective S&DT in any new disciplines. Ministerial Conference directed the Group to intensify and accelerate the negotiating process in all areas of its mandate, on the basis of detailed textual proposals before the Group or the ones yet to be submitted, and complete the process of analyzing proposals by the Members on AD and SCM Agreements as soon as possible and mandated the Chairman to prepare, early enough to assure a timely outcome within the context of the 2006 end date for the Doha Development Agenda, consolidated texts of the AD and SCM Agreements that shall be the basis for the final stage of the negotiations.

6.56 The amendment to the TRIPS Agreement on December 6, 2005 by the General Council to address public health concerns was welcomed by the Hong Kong Ministerial Conference. This amendment enables manufacture and export of pharmaceutical products under compulsory license to countries with limited or no manufacturing capacities in the pharmaceutical sectors. On TRIPS, CBD relationship and protection of traditional knowledge, India along with a number of other developing countries, rich in bio-diversity, proposed that the TRIPS Agreement of WTO should be amended to provide for : (i) disclosure of source and country of origin of biological resource and of the traditional knowledge used in the invention; (ii) disclosure of evidence of prior informed consent under the relevant national regime; and (iii) disclosure of evidence of benefit sharing under the relevant national regime.

6.57 The Ministerial Conference has mandated intensification of the consultative process and taking appropriate action no later than July 31, 2006. Similar mandate is available on the issue of the extension of additional protection to geographical indications (GIs) other than wines and spirits, where India has been supporting the proposal for extension of additional protection. On the establishment of multilateral register for wines and spirits, India maintains that the register should be open for all GIs, including products other than wines and spirits. But it also considers that a multilateral register could mean an obligation to protect thousands of GIs of other Member countries in lieu of just a few Indian GIs registered so far. This obligation, though part of the TRIPS Agreement obligations, should not involve financial burden, or obligations, so as to create additional infrastructure, inspection agencies, developing technical expertise and other associated expenditure. The Hong Kong Ministerial Conference has mandated to intensify the negotiations in order to complete the work within the overall timeframe for the conclusion of other negotiations. At Hong Kong, the Ministers also reaffirmed the mandate of para 31 of the Doha Ministerial Declaration, in particular para 31 (iii) regarding reduction or as appropriate elimination of tariff and non-tariff barriers to environmental goods and services, and instructed the Member countries to complete the work expeditiously to fulfill the mandate.

6.58 Trade Facilitation is the only subject from the bundle of four Singapore Issues on which negotiation had commenced pursuant to the July Framework Agreement of 2004. The aspect of technical and financial assistance for capacity building in developing countries is also being looked at. India has laid emphasis on compliance issues through an effective cooperation mechanism between customs administrations. It has made a joint proposal with the US to have a multilateral mechanism for information exchange.

6.59 The negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to RTAs are presently focusing on reaching some agreement to improve the transparency of such agreements. While supportive of the proposals to increase transparency of RTAs, India has been expressing reservations on the proposal by several countries that in order to enhance transparency, all RTAs, including those formed under the Enabling Clause which provides flexibility to developing country Members, should be notified to the Committee on Regional Trade Agreements (CRTA) and be subjected to a factual enquiry process. One important area of discussion under the ongoing negotiations on improving substantive disciplines of General Agreement on Tariffs and Trade (GATT) Article XXIV is to define the term 'substantially all trade' for the purpose of elimination of tariffs.

Capital Account

6.62 According to the projections of the latest WEO (September 2005) of the IMF, after robust growth in 2003 and 2004, private capital inflows were expected to moderate during 2005 and 2006 for emerging market and developing economies. While longer term direct investment inflows were expected to remain stable, portfolio flows of the shorter variety were expected to decline. Emerging Asia (comprising economies of developing Asia and the Newly Industrialised Asian economies, i.e. Indonesia, Malaysia, Philippines and Thailand) was also not an exception to the trend. According to the WEO, net private capital flows were expected to decline from US$132.9 billion in 2004 to US$84.6 billion in 2005 for emerging Asia, primarily on account of net portfolio outflows, while direct investment inflows (net) were expected to increase marginally to US$84.2 billion in 2005 from U$81.6 billion in 2004. The projected moderation in capital flows was mainly due to an expected tightening of global financial markets with enhanced inflationary expectations induced by higher energy prices.

6.63 So far, in India, however, there have not been any signs of dampening of portfolio flows. Between 2002-03 and 2004-05, the capital account surplus grew steadily from US$10.6 billion to US$31.6 billion (Table 6.2). The growth was driven mainly by foreign investment inflows, out of which portfolio flows, comprising chiefly foreign institutional investment (FII) inflows, were the leading contributors.

6.64. Since 1990-91, India's capital account has experienced several interesting changes in terms of the relative roles played by different varieties of capital flows in augmenting the overall balance. Between 1998-99 and 2001-02, the share of foreign investment in the overall capital account balance increased steadily from 29 per cent to 80 per cent. Thereafter, however, the proportion has followed an oscillating pattern within a band of 39 to 79 per cent. It appears that the importance of debt-creating flows in the overall balance of payments increased with the emergence of a current account deficit in 2004-05. Debt-creating flows comprising external assistance, commercial borrowings and non-resident deposits, after being negative for two successive years, were 19 per cent of the capital account surplus in 2004-05. This trend in debt-flows appears to have continued in 2005-06.

Foreign Investment

6.65 Foreign investment flows in the BOP comprise FDI flows and portfolio flows consisting of FII flows and resources mobilized by Indian companies through ADRs and GDRs. Since 1995-96, overall foreign investment flows were the lowest in 1998-99 and 2002-03 (Figure 6.2). However, FII flows reflected the confidence of the international financial community in Indian capital markets, and foreign investment flows rose rapidly in 2003-04 (Figure 6.3 and Table 6.2). The traditional dominance of FDI over portfolio flows observed since 1996-97 (except in 1999-2000) ended — at least for the time being — in 2003-04.

Foreign Direct Investment (FDI)

6.66 After exhibiting a downward trend for two years since 2001-02, FDI (net) flows grew by 36 per cent in 2004-05 (Table 6.2 and Figure 6.3). The increased flows were mainly to the electrical equipment (including computer software and electronics) and services sectors. The overall FDI numbers reflected in the BOP are inward FDI, netted for outward FDI. During the year 2004-05, inward FDI flows into India, at US$5.6 billion, were more than US$1 billion higher than such inflows worth US$4.3 billion in 2003-04. Higher inflows of equity investment valued at US$3.7 billion in 2004-05, as compared with US$2.2 billion in 2003-04, were responsible for enhancing overall inward FDI flows. Outward FDI from India during 2004-05 was also somewhat higher at US$2.4 billion, as against US$1.9 billion in 2003-04, reflecting the growing reach of Indian corporates in foreign markets. However, overall FDI was around US$850 million higher in 2004-05 compared with the previous year, on account of the rate of growth of inward FDI flows being much higher than that of outward FDI.

6.67. The scenario during April-September 2005 regarding FDI flows is not much different from what it was in April-September 2004. While FDI flows into India have been marginally higher at US$3.2 billion in April-September 2005, compared with US$3.0 billion in April-September 2004, outward flows at around US$0.9 billion, have been somewhat lower than similar flows worth US$1.1 billion in the corresponding previous period. As a result, overall FDI flows have been around US$325 million higher during April-September 2005 vis-à-vis April-September 2004. While it is encouraging to note that by the middle of the current year, FDI (net) flows have amounted to 71 per cent of such flows during the whole of 2004-05, and are likely to be finally higher than their previous year level, it is essential to maintain such growth for not only strengthening the capital account, but also for imparting it a more stable dimension in terms of larger proportion of longer duration non-debt flows.

Foreign Institutional Investment (FII)

6.68. Compared to FDI, FII inflows into the Indian economy were not one of the leading varieties of capital flows until 2003-04. In the aftermath of the 1997 East Asian crisis, such flows had actually become net outflows in 1998-99 (Figure 6.3 and Table 6.2). While there was a modest recovery in 1999-2000, languishing FII flows steadily declined to US$377 million in 2002-03. However, the years 2003-04 and 2004-05, have been remarkably robust years for such flows. Beginning from 1993-94, till 2002-03, the highest share of FII (net) flows in total foreign investment inflows was recorded at 43.5 per cent in 1995-96. During 2003-04 and 2004-05, their share shot up to 79.4 per cent and 68.2 per cent, respectively, indicating the significant contribution being made by FII investment to the capital account in recent years.

6.69. During the current year so far, FII investment has maintained the healthy trends of the previous two years. After recording a modest inflow of US$435 million in April-June 2005, FII inflows shot up nine times to reach US$3.8 billion during July-September 2005. At the end of the first half of the current year, FII inflows at US$4.2 billion are just over 50 per cent of their last year level. During 2004-05, the surge in FII flows had actually occurred in the second half of the year, when such flows were US$7.9 billion compared to only US$339 million in April-September 2004-05. If FII flows record the kind of growth in the second half of the current year as they did in the corresponding period of the previous year, then the overall foreign investment inflows during the current year will increase sharply.

6.70 The acceleration in volume of FII inflows in recent years has drawn attention to whether India's capital account is becoming increasingly dominated by 'hot money' – a phrase commonly, but incorrectly, used for describing FII flows – given the tendency of such flows to suddenly reverse direction in response to adverse market sentiments and precipitating large capital outflows. While theoretically 'herd' behaviour by FIIs and concomitant withdrawal cannot be ruled out, such possibilities are limited if the fundamentals are strong, the market is well-regulated and the participants are mainly pension funds, life insurance companies and mutual funds, which are more involved with longer term investments. Right now, the Indian capital market is not only buoyant, but is also endowed with a strong regulatory framework, which is conducive to greater longer term FII participation. Furthermore, stable flows (i.e. all forms of capital flows excluding portfolio flows and short term credits) still accounted for around 60 per cent of total capital flows in 2004-05. Thus, notwithstanding a quantum jump in volume of FII flows in recent years, low levels of short- term debt as a proportion of total external debt and adequate reserve coverage mitigate the risk of potential reversals.

External Commercial Borrowings (ECBs)

6.71 The transformation of the current account of the BOP from a surplus to a deficit since 2004-05 has been accompanied by a turnaround of debt-creating capital categories from net outflows to inflows. After reaching a net inflow of more than US$4.3 billion in 2000-01, commercial borrowings had become larger and larger outflows until 2003-04. Such borrowings recovered to a record US$5.0 billion worth of net inflows in 2004-05 (Table 6.2). During the current year so far, ECBs have not only continued to remain net inflows, but have showed clear signs of consolidating further by exhibiting a growth of 80 per cent in April-September 2005 over the corresponding period of the previous year.

6.72 During 2004-05, disbursements of commercial borrowings increased sharply to US$8.5 billion compared with US$5.2 billion worth of disbursements in 2003-04. The corresponding repayments in 2003-04 and 2004-05, were US$8.2 billion and US$3.5 billion, respectively. Indeed, higher repayments on account of redemption of the Resurgent India Bond (RIB) proceeds were one of the main reasons behind ECBs becoming net outflows during 2003-04, while no such developments occurred during 2004-05. However, much higher ECB disbursements during 2004-05 also underscore a sharp increase in demand for ECBs. The enhanced demand is attributable to two factors. First, a step-up in domestic industrial activity since 2004-05 has increased the corporate sector's appetite for funds. Second, low interest rate spreads overseas have motivated Indian corporates to raise larger resources through foreign currency convertible bonds (FCCBs).The growing volume of ECB inflows during the current year indicates that the fundamentals driving demand for such inflows continue to remain strong.

6.73 Like in 2003-04, the current year witnessed the redemption of India Millennium Deposits (IMDs) issued in 2000 with a five year maturity. Given the outgo of around US$7.1 billion on IMD repayments, the growth in disbursement during the next two quarters will have to be significantly large so as to maintain

ECBs as net inflows for the year. However, if ECBs do become net outflows, the rate of increase in the size of the capital account surplus, might actually get stunted.

Non-Resident Deposits

6.74 Expatriate deposits, traditionally, have been a key source of stable inflows for the capital account. After reaching a peak of US$3.3 billion in 1996-97, such deposits slackened somewhat during the later years of the decade of 1990s, but recovered to reach a record level of US$3.6 billion in 2003-04. Thereafter, however, for the first time since 1990-91, non-resident (NR) deposits became net outflows in the year 2004-05. During the current year, till November 2005, such deposits have been net inflows worth US$248 million. On a quarterly basis, the BOP estimates indicate that from net outflows worth US$108 million in April-June 2005, NR deposits turned into net inflows worth US$282 million in July-September 2005, indicating a likely turnaround in the pattern of flows of such deposits.

6.75 At present, fresh NR deposits accrue in two accounts: the Foreign Currency Non Resident (Banks) FCNR(B) and Non-Resident (External) Rupee Accounts NR(E)RA respectively. Fresh inflows in both the accounts declined during 2004-05, with the drop in the NR(E)RA account being particularly sharp (Table 6.13). Reduction in volume of fresh inflows combined with continuing outflows from the erstwhile NR(NR)RD account (the account has been discontinued since April 1, 2002; the proceeds on maturity are being credited to NR(E)RA accounts) led to overall net outflows for NR deposits during the year. During the current year (in April-November 2005), there was a recovery in NR(E)RA flows, while FCNR(B) flows, became net outflows (Table 6.12). These trends are in complete contrast to those in the corresponding period of the previous year, when FCNR(B) accounts were net inflows, but NR(E)RA accounts were net outflows. NR(E)RA deposits have recovered significantly to become net inflows worth

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

(US$ million)

Panel A : Outstanding Balances under different schemes*

	As at the end of								
	March 98	March 99	March 2000	March 01	March 02	March 03	March 04	March 05 (P.E.)	Nov-05 (P.E.)
FCNR(A)	1	**	**	**	**	**	**	**	**
FCNR(B)	8467	7835	8172	9076	9673	10199	10961	11452	**11430**
NR(E)RA @	5637	6045	6758	7147	8449	14923	20559	21291	**20615**
NR(NR)R	6262	6618	6754	6849	7052	3407	1746	232	
Total	20367	20498	21684	23072	25174	28529	33266	32975	**32045**

B. Net flows under Non-Resident Deposits* (US$ million)

	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05 (P.E.)	Apr-Nov (P.E.) 2004-05	Apr-Nov (P.E.) 2005-06
FCNR(A)	-2270	0	0	0	0	0	0	0		
FCNR(B)	971	-632	337	904	594	526	762	492	235	-23
NR(E)RA @	1197	799	885	860	1626	6195	4695	84	-693	271
NR(NR)RD	1256	793	318	553	508	-3745	-1816	-1538	-850	0
Total	1154	960	1540	2317	2728	2976	3641	-962	-1308	248

P.E. : Provisional Estimates.

*** All figures are inclusive of accrued interest.**

**** Withdrawn effective August 1994.**

@ The inflows into NR(E)RA deposits from the year 2002-03 onwards may partly be due to crediting of maturity proceeds of the NR(NR)R deposits which were discontinued with effect from April 1, 2002.

Note : Inflows/Outflows have been calculated by taking the monthly variation in rupee denominated deposits & converting those by monthly average exchange rate. All figures are inclusive of interest & valuation changes arising on account of fluctuation in non dollar currencies against US dollar.

Source : RBI

US$271 million during April-November 2005 as against outflows of US$693 million during the corresponding period of the previous year.

Exchange Rate Developments

6.76 India has been following a broadly market-determined exchange rate policy for quite some time, allowing the Indian rupee to move in response to the changes taking place in global foreign exchange markets. The Rupee has indeed demonstrated adequate flexibility, which is evident from the pattern of its movement against major global currencies (i.e. the Euro, Pound, US Dollar and Japanese Yen). During 2003-04, the average value of the Rupee against the US Dollar, Japanese Yen, Pound and the Euro, respectively, were Rs 45.92, Rs 40.71 (per 100 Yen), Rs 77.74 and Rs 54.01, respectively. The Rupee appreciated by around 2.2 per cent against the US Dollar in 2004-05 and recorded an annual average value of Rs 44.95. However, against the other currencies, the Rupee showed a depreciating trend in nominal terms. The highest depreciation of 6.3 per cent was recorded against the Pound, at an annual average value of Rs 82.94 during 2004-05. Similarly, Rupee depreciated by 4.5 per cent and 2.6 per cent against the Euro and Japanese Yen, respectively, and recorded annual average values of Rs 56.55 and Rs. 41.81, respectively, during 2004-05.

6.77 The trends of appreciation/depreciation displayed by the Rupee in nominal terms against the four major global currencies in 2004-05 changed somewhat during 2005-06. At the end of the first ten months of 2005-06, i.e. April-January 2005-06, the Rupee appreciated by around 2.1 per cent against the US Dollar compared to the corresponding period of the previous year. While such appreciation maintained the progressively strengthening trend displayed by the Rupee against the US Dollar in recent years, month-wise analysis reveals that, after July 2005, the Rupee has depreciated against the Dollar in all months up to November 2005. Within this period, the sharpest monthly depreciations (around 2.1 per cent) were noted during October and November 2005. Since December 2005, the Rupee has started strengthening again. On the other hand, while the Rupee weakened against the Euro, Pound and Yen during 2004-05, it has strengthened against all the three currencies during the current year. During April-January 2005-06, the Rupee has appreciated by 6.4 per cent against the Yen, 4.3 per cent against the Euro and 4.5 per cent against the Pound respectively, vis-à-vis the corresponding previous period. Month-wise analyses for these currencies indicate that during 2005-06, after gaining consistently against the Euro during April-July 2005, the Rupee has been steadily weakening thereafter. Such a trend has also become noticeable vis-à-vis the Pound from November 2005. While the Rupee has continued to gain against the Yen, the extent of gains has started reducing during the later months of the calendar year 2005.

6.78 During the current financial year, the Rupee exhibited two-way movement reflecting the movement of dollar in the international market, the developments in global interest rates (particularly the US Fed rates) movement of capital flows and oil prices. While the bilateral exchange rate developments indicated above underline nominal trends, the changes in the exchange rate are best reflected in indices of Nominal Effective Exchange Rates (NEER). The month-wise NEER-5 (Base : 2000 = 100), which shows the appreciation/depreciation of the Rupee vis-à-vis a composite basket of currencies (i.e. US Dollar, Euro, Pound Sterling and Yen), shows a consistently appreciating trend during April-July 2005 and a depreciating trend from August-November 2005 (Figure 6.4). The depreciation, however, has been almost negligible during December 2005. This is broadly consistent with the bilateral currency trends mentioned earlier. The Real Effective Exchange Rate (REER) indices, which are the NEER indices adjusted for price differentials, also reflect a strengthening of the Rupee till July 2005 and a steady weakening thereafter till October 2005. The REER appeciated marginally in November 2005 but depreciated again in December 2005. It is however, interesting to note that the depreciation in the two indices during August-October 2005, was more in real terms than in NEER (Figure 6.4). The observation probably indicates that a weakening of the Indian Rupee vis-à-vis major global currencies during the period was not matched by a similar weakening of domestic prices vis-à-vis other country prices in the currency basket.

Foreign Exchange Reserves

6.79 In spite of a deficit in the current account, the total stock of foreign currency assets went up by US$26.1 billion (on BOP basis) during 2004-05. At end-March 2005, India's total foreign exchange reserves (including foreign currency assets (FCA), gold, special drawing rights (SDR) and reserve tranche position (RTP) in the IMF) stood at US$141.5 billion, reflecting an increase of US$28.5 billion, as compared with US$113.0 billion at end-March 2004.

6.80 Unlike the recent years, the current financial year, till end-January 2005, has not experienced any addition to the stock of reserves. From a level of US$135.6 billion at the end of March 2005, FCA has dropped to US$133.8 billion at the end of January 2006, indicating an erosion of US$1.8 billion. Similarly, total foreign exchange reserves have declined by US$2.0 billion during the year to reach US$139.2 billion as on January 27, 2006. Month-wise movements in FCA indicate that except for the months of April, July, August, and October, FCA has declined in every other month during the period April-January 2005-06. The biggest declines were during the months of May and December 2005, of the order of US$3.0 billion and US$5.6 billion respectively. However, the sharp decline in reserves during December 2005 can be largely explained by the foreign exchange outgo on account of redemption of India Millennium Deposits (IMDs) (Box 6.11).

6.81 One of the obvious reasons behind the lack of accretion to reserves during the current year has been the widening of the current account deficit. However, even with such a deficit, on BOP basis (excluding valuation changes), there was a net addition of reserves worth US$6.5 billion during April-September 2005. However, this accretion was offset to a very large extent by valuation losses (Table 6.13). Continuation of such losses, along with further expansion of the current account deficit during the remaining part of the year, may result in relatively lower accretion of foreign exchange reserves during the current year, compared with much higher volumes of such accretion during the last few years.

Box 6.10 : India Millennium Deposits (IMDs)

Hardening of international crude oil prices in early-2000 escalated India's import bill and resulted in a decline in foreign currency assets of the RBI by around US$3 billion during April-October 2000. To cope with volatility in international oil price and to ensure a measure of comfort of foreign exchange reserves imparting stability to India's overall balance of payments position, India Millennium Deposits (IMDs) scheme was launched by the State Bank of India (SBI) for non-resident Indians (NRIs) during the last quarter of 2000 with the approval of Government of India and the RBI. Added objective of the scheme was to provide an investment opportunity for NRIs in long-term fixed income instruments. The tenor of IMDs was 5 years, and denominations were in US dollar, Pound Sterling and Euro, with the option of cumulating and non-cumulating interest. Government's guarantee, *inter alia*, covered Government's commitment to bear foreign exchange risk beyond 1 per cent per annum on a cumulative basis on the total pool of foreign currency deposits raised through the scheme and also tax benefits to the deposit holders. Amounts raised and interest rates offered were as follows:

Table: India Millennium Deposits

Currency	Amount collected (US$ million)			Interest rate
	Cumulative Deposits	**Non-cumulative Deposits**	**Total**	(% per annum)
A. US dollar	2861	2318	5179	8.50
B. Pound Sterling	186	59	245	7.85
	(131)	(42)		
C. Euro	60	13	73	6.85
	(70)	(16)		
D. Total (A+B+C)	**3107**	**2390**	**5497**	

Note: Figures in brackets indicate respective foreign currencies in million

The rupee proceeds of the deposits were utilised by the SBI for investment in Government Securities, on-lending to collecting banks as per the arrangement, and financing infrastructure projects and other lending. The IMDs matured on December 29, 2005. The redemption entailed total foreign exchange outgo of US$ 7,080 million which was entirely met by RBI by way of direct sale out of its foreign exchange reserves to SBI for equivalent rupee consideration. As Indian Rupee appreciated between calendar 2000 and 2005, there was an exchange gain of around 5 per cent and therefore no exchange loss was to be borne by the Government. The arrangements put in place jointly by RBI and SBI ensured that the redemption process was broadly seamless without impairing much the money, securities and foreign exchange markets.

External Debt

6.82 India's external debt at US$ 123.3 billion at end-March 2005 reflected a rise of US$11.6 billion over the year, of which US$8.5 billion was accounted for by long-term debt and US$3.1 billion by short-term debt. All the

Table 6.13 : Sources of accretion to foreign exchange reserves

(US$ billion)

Items	2003-04	2004-05	April-September 2004	April-September 2005
I. Current Account Balance	14.1	-5.4	-0.5	-13.0
II. Capital Account (net) (a to f)	17.4	31.6	7.4	19.5
a. External Assistance	-2.9	1.9	0.3	0.4
b. External Commercial Borrowings	-2.9	5.0	1.5	2.7
c. Foreign Investment	13.7	12.1	2.5	7.4
d. Short-term Credit	1.4	3.8	1.9	0.9
e. Banking capital	6.0	3.9	0.6	3.0
Of which : NRI Deposits	*3.6*	*-1.0*	*-1.3*	*0.2*
f. Other items in Capital Account	2.1	4.9	0.6	5.1
III. Valuation Change	5.4	2.4	-0.3	-5.0
TOTAL (I+II+III)	**36.9**	**28.6**	**6.6**	**1.5**

Source : Reserve Bank of India

Table 6.14 : India's external debt						
	End-March					End-Sept.
	2000	2002	2003R	2004R	2005R	2005QE
	(US $ million)					
Long-term Debt	94,327	96,098	100,289	107,284	115,754	116,023
Short-term Debt	3,936	2,745	4,669	4,431	7,524	8,303
Total External Debt	98,263	98,843	104,958	111,715	123,278	124,326
	(Rupees crore)					
Long-term Debt	411,388	468,932	476,831	472,128	506,793	511,575
Short-term Debt	17,162	13,396	22,180	19,251	32,922	36,525
Total External Debt	428,550	482,328	499,011	491,379	539,715	548,100
	(Ratio as per cent)					
External Debt to GDP	21.9	21.1	20.4	17.8	17.3	*
Short-term debt to Total External Debt	4.0	2.8	4.5	4.0	6.1	6.7
Short-term debt to Foreign Currency Assets	11.2	5.4	6.5	4.0	5.6	6.1
Debt Service to current receipts	17.1	13.6	16.0	16.3	6.2	*
			(12.4)	(8.5)	(6.14)	*
Concessional debt to total debt	38.9	35.9	36.8	36.1	33.3	31.6

Note : Figures in brackets indicate debt service ratios excluding exceptional transactions such as prepayments for 2002-03 and 2004-05, and prepayments as well as redemptions of Resurgent India Bonds (RIBs) for 2003-04.

R : Revised QE : Quick Estimates * : Not computed for the broken year.

components of long-term debt, except bilateral and rupee debt, showed increases during 2004-05, with commercial borrowings registering a larger increase of around US$5 billion as benign conditions in international capital markets provided increased access to Indian corporates. Short-term debt expanded due to larger imports. Owing to the same factors, India's external debt increased further to US$124.3 billion at end-September 2005 (Table 6.14). However, the redemption of IMDs of US$5.5 billion put through on December 29, 2005 is expected to result in a moderation of India's external debt during 2005-06.

Table 6.15 : International Comparison of Top Ten Debtor Countries—2003							
Sl. No.	Country	Total External Debt (US $ Billion)	International Classification	Debt Sustainability Indicators			
				Debt to GNP	Debt Service	Short term debt to total external debt	Concessional debt to total debt
				(ratio as per cent)			
1	Brazil	235.4	Severe	50	63.8	8.3	1.4
2	China	193.6	less	15	7.3	37.7	16.8
3	Russian Federation	175.3	Moderate	50	11.8	17.6	0.8
4	Mexico	140	less	23	20.9	6.6	0.9
5	Argentina	166.2	Severe	104	37.9	13.8	0.8
6	Indonesia	134.4	Severe	80	26	17	27.4
7	Turkey	145.7	Severe	77	38.5	15.8	3.5
8	**India***	**113.5**	**less**	**22**	**18.1**	**4.2**	**37.8**
9	Poland	95.2	Moderate	49	25.1	20.5	7.1
10	Philippines	62.7	Moderate	77	22.1	9.9	22.6

*** According to World Bank data.**

Source : Global Development Finance 2005, The World Bank.

6.83 Notwithstanding an increase in the absolute amount of external debt, important debt indicators, such as debt-to-GDP and debt service ratios, suggested a moderation in India's external debt situation during 2004-05 (Table 6.14). The total external debt to GDP ratio improved further to 17.3 per cent at end-March 2005. Similarly, the debt service ratio dropped to 6.2 per cent during 2004-05. The share of short-term debt in total external debt and ratio of short-term debt to foreign currency assets, however, rose to 6.1 per cent and 5.6 per cent, respectively, at end-March 2005. With comparatively comfortable external debt indicators, India continued to rank eighth among the top ten debtor countries of the world according to the *Global Development Finance 2005, World Bank* (Table 6.15).

6.84 The external debt management policy of the Government continued to focus on raising loans from least expensive sources with longer maturities, monitoring of short-term debt, keeping commercial debt under manageable limits with end-use stipulations and option to convert external commercial borrowings into equity, restriction on trade credits, encouraging non-debt creating capital flows and accelerating the growth of exports.

Outlook

6.85 India's balance of payments (BOP) has been undergoing a major structural transformation since 2003-04. The nascent current account deficit that emerged in 2004-05 after three consecutive years of surpluses has assumed much larger proportion in the current year. The deficit primarily reflects an excess of investment over savings, which is being financed by external capital flows. If domestic industry continues to remain upbeat, then sustained industrial demand for imports might increase the size of the deficit, as a proportion of GDP, further in the remaining months of 2005-06. On the other hand, the rate of growth of the trade deficit might start slowing, if the export-related imports absorbed by the economy thus far, start to yield rapid growth of exports in the coming months

6.86 The size of merchandise, as well as services trade, has been increasing steadily in recent years, reflecting greater integration of the economy with the rest of the world. Such integration can expand manifold through regional trading arrangements. India has been actively pursuing such arrangements with neighboring Asian countries, which have emerged as its leading trading partners. Recently concluded agreements with Singapore and Thailand, are expected to enlarge opportunities for Indian exports in the near term. Such prospects, indeed, appear to be robust as more manufacturing exports from a resurgent Indian industry adds greater value to India's overall export basket, which already has a leading edge in services.

Fig. 6.1 Net Inflows of Non-Factor Services, Private Transfers and Invisibles : 1991-92 to 2004-05

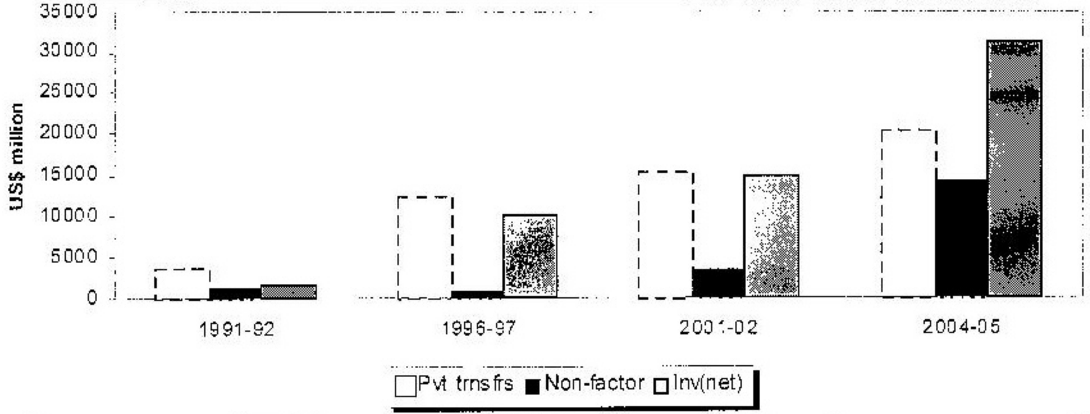
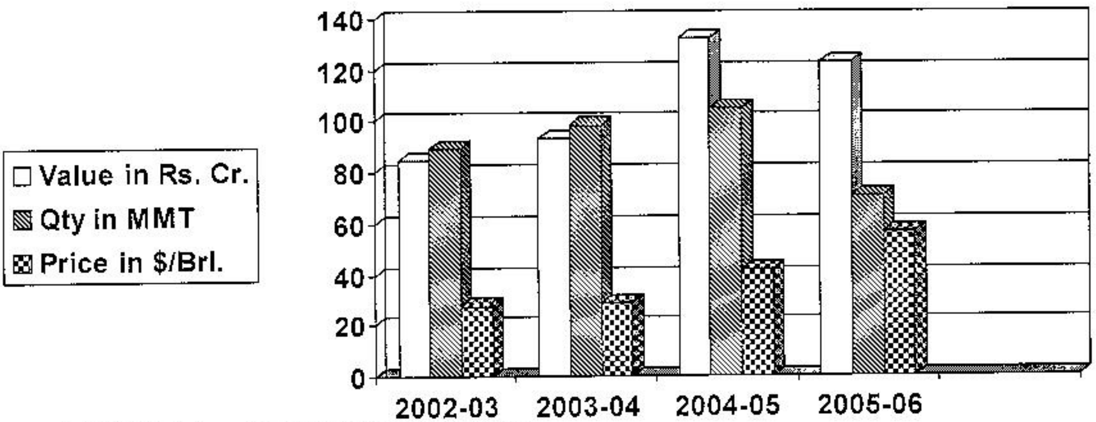


Fig. 6.2

Growth in POL imports



Note : 1. 2005-06 data pertains to April-November 2005
2. Average price in US$ for Brent Crude per barrel

Fig. 6.3

Total Foreign Investment, FDI and FII flows (net): 1995-96 to 2004-05

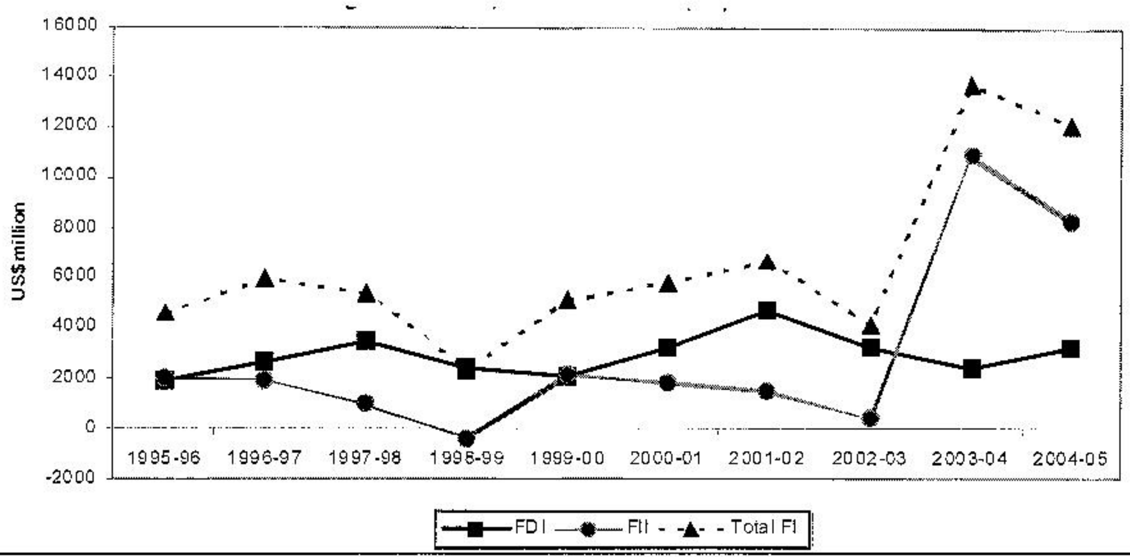


Fig. 6.4 **Monthwise Indices of NEER-5 and REER-5 during 2005-06 (Base 2000 = 100)**