Balance of Payments

45. The balance of payments situation in 1997-98 remained sound. The current account deficit fell to about 1.0 per cent of GDP in 1996-97, reflecting mainly the slow-down in industrial growth and investment and growth of net invisibles. In 1997-98, the current account deficit is expected to be about 1.5 per cent of GDP, which is significantly less than the average deficit of about 2.3 per cent of GDP during the Seventh Plan period (1985-86 to 1989-90). Net long-term capital inflows (excluding IMF), averaged 1.8 per cent of GDP in the Seventh Plan. In contrast, during the Eighth Plan period (1992-93 to 1996-97), the current account deficit declined to an annual average of 1.2 per cent of GDP, while net capital inflows rose to 2.2 per cent of GDP. A major factor has been the buoyancy of inflows of foreign investments, particularly direct investment.46. Total imports in 1996-97, on payments basis, recorded a growth of only 10.1 per cent in US dollar terms, compared with 21.6 per cent in 1995-96. The demand for imports has been subdued over the last two years, reflecting moderation in industrial activity. Non-oil imports based on DGCI&S data (in US dollar terms), declined by 0.2 per cent in 1996-97, after an increase of about 29 per cent per year in the previous two years. During 1997-98, such imports recovered to grow by about 14.5 per cent (provisional).

47. In spite of the sharp deceleration in import growth, the trade deficit in 1996-97 widened by about US $2.9 billion (BOP basis), because the growth of exports also decelerated sharply. The continued sluggishness in export growth for the second year in succession in 1997-98 was a cause for concern. Based on DGCI&S data, export growth, in US dollar terms, decelerated to 5.3 per cent in 1996-97 and to 2.6 per cent (provisional) in 1997-98, after three successive years of increase ranging from 18 to 21 per cent per annum.

48. The slowdown in export performance reflects a range of factors of foreign and domestic origins. The two most important factors were probably the sharp decline in the growth of the value (US$) of world trade in 1996 and 1997, and the appreciation of the rupee *vis-à-vis* the currencies of India's major trading partners and competitors. The real effective exchange rate of the rupee has shown a gradually appreciating trend over the last few years, because of the appreciation of the US dollar against other major currencies and the low international inflation rates relative to ours. The dramatic depreciation of some East Asian currencies during 1997 has also been a contributory factor to our export sluggishness.

49. Other external factors included the decline in export prices of some major items of manufactured goods, and tighter requirements of quality, standards, testing and labelling in the major trading partner countries for some major items of India's exports. Other domestic factors are the slow down in growth of power, tighter supply conditions in the domestic market for agricultural items especially rice and wheat, tightening of domestic environmental regulations, and infrastructure bottlenecks.

50. As a measure of import decontrol, four hundred and eighty eight items were moved from the restricted list to the OGL between April 1, 1996 and April 1,1997. An additional 128 items, mainly textiles, were freed during 1997-98, and another 340 items were shifted from the Restricted List to the OGL in April 1998. The import policy for gold and silver was further liberalised. From October 21, 1997, eight banks and three canalising agencies were authorised by the RBI to import gold and silver for sale in the domestic market. No license is required for this purpose, and the import duty of Rs. 220 per 10 gm. of gold and Rs. 500 per Kg. of silver, is payable in rupees.

51. "Invisible" receipts accelerated after 1992-93 and the buoyancy was sustained in 1996-97. The upsurge in invisible receipts has been led by the inflow of private transfer receipts. Tourism receipts, in US dollar terms, have also risen at a rate of about 8.2 per cent per annum during the four years ended 1996-97. The inflow of invisible receipts in recent years has been augmented by a noteworthy improvement in software and technology related exports. Despite a significant increase in travel payments and some increases in interest and dividend payments, the net surplus under invisibles has recorded a five-fold increase during the Eighth Plan. As a result, the net inflow under invisibles financed about 74 per cent of the trade deficit in BOP in 1996-97, up from about 35 per cent in 1992-93.

52. Payments on the current account were also simplified. This included: (a) greater flexibility in the Exchange Earner Foreign Currency (EEFC) accounts held by exporters, in terms of the

proportion of earnings which can be retained in these accounts and the scope of utilisation of funds in the accounts; (b) more liberal indicative ceilings for release of foreign exchange by authorised dealers, for basic travel quota, studies abroad, medical expenses, casual (gift) remittances, donations, release of exchange for persons proceeding on employment abroad; (c) modification in the exchange control regulations governing remittances by exporters and importers in respect of advance payments against exports, refund of export proceeds, merchant trade and advance payments for other transactions such as service related transactions, feasibility studies, medical treatment abroad; and (d) greater flexibility for remittances for purchases of foreign services by residents.

53. The capital account of balance of payments exhibited a handsome surplus in 1996-97, following sustained buoyancy in foreign investment flows and a surge in net inflow of non-resident deposits. Net capital inflows in 1997-98, are estimated to be at about the 1996-97 level. Total foreign investment rose to US $6.0 billion in 1996-97 from US $4.9 billion in 1995-96. During 1997-98, total foreign investment amounted to US $4.8 billion. Of particular interest is Foreign Direct Investment (FDI). Inflow of FDI in 1996-97 increased by about 26 per cent to US $2.7 billion. During 1997-98, FDI amounted to US $3.2 billion, an increase of 18.6 per cent over the corresponding period in 1996-97.

54. Foreign investment and access to foreign capital by domestic companies has been progressively liberalised. Aggregate investment ceilings for FIIs and non-resident Indians (including OCBs) have been increased up to 30 per cent subject to approval by the companies' shareholders. FIIs have also been permitted to purchase/sell Treasury Bills within the overall approved debt ceilings. Guidelines for foreign investment in preference shares issued by the Indian companies were also issued. These provide greater flexibility to Indian corporations in using preference shares as a form of financing. Indian companies having foreign investment approval from SIA/FIPB, will no longer require any further prior approval from RBI for receiving the inward remittance on issuing shares to foreign investors. External Commercial Borrowing (ECB) funds can now be used to meet certain categories of rupee expenditure, which were hitherto not generally allowed. RBI has been delegated power to sanction small loans up to US $3 million. Companies having foreign exchange earnings are now permitted to raise ECB up to twice the average amount of annual exports during the previous three years, subject to ceiling. Holding companies/promoters have been permitted to raise ECB up to a maximum of US $50 million (or equivalent) to finance equity investment in a subsidiary/joint venture company engaged in an infrastructure project. ECB of ten years average maturity is now outside the ECB ceiling, though prior approval is still necessary.

55. The surpluses in the capital account of balance of payment in 1996-97 and 1997-98 exceeded the deficits in the current account by a large margin, resulting in sizeable accretions to foreign currency assets of the Reserve Bank. The foreign currency assets increased by US $5.3 billion in 1996-97 and by US $3.6 billion in 1997-98 to attain US $26.0 billion at the end of March 1998. Total foreign exchange reserves (including gold and SDRs) at the end of March 1998 amounted to US $29.4 billion.

56. The exchange rate of the rupee displayed reasonable stability during the year 1996-97. The rate vis-à-vis the US dollar moved in a narrow range of Rs.34.24 in April 1996 and Rs.35.87 in March 1997. The stability in the exchange rate of the rupee was disturbed in the last week of August 1997, when the currency experienced a mild contagion effect of currency turmoil in Southeast Asia. Beginning in the second week of November 1997, the exchange rate of the rupee against the US dollar came under renewed downward pressure. The rupee depreciated to a low of Rs.40.36 per US dollar by January 16, 1998, but recovered to Rs.39.50 by the end of March 1998, marking a depreciation of 9.1 per cent against the US dollar compared with the rate at the end of March 1997. The recent market movement in the rupee-dollar rate, however, corrects a part of the appreciation in real effective exchange rate, which has occurred over the last two years.

57. India's external debt increased marginally by US $0.7 billion from US $92.2 billion at the end of 1996-97 to US $92.9 billion at the end of September, 1997. As a per cent of GDP, external debt declined to about 24 per cent at end September 1997 from about 26 per cent in 1996-97. Debt service payments declined from 24.3 per cent of current receipts in 1995-96 to 21.4 per cent in 1996-97,despite the bunching of repayments of India Development Bonds. In

1997-98, the ratio is expected to decline to about 18 per cent.