Chapter VI Exports And Exchange Rate Policy

6.1 Introduction and Background

There is a tendency to view the balance of payments only as a relation between the country's credits and debits on the international account. But, in essence, balance of payments is also a reflection of the relation between the aggregate real income and the aggregate real expenditure of the economy. Interpreted in this way, balance of payments deficits is an excess of aggregate expenditure over aggregate income in the economy. This approach helps to focus attention on the basic and fundamental issues of a persistent disequilibrium on the external account and the changing pattern of trade policy.

This chapter analyses the recent adverse changes in the international economic climate and the pressures on the Indian economy to adjust to these developments with a view to arriving at a judgement on the feasibility of an autonomous, non-dependent path of development in India. We find it useful to analyse the variables considered to be crucial in determining its international economic standing. Analysis of variables like exports, exchange rate, financing of balance of payments (BOP), external debt and debt servicing etc. helps us to arrive at a conclusion regarding the role of international economy in regard to domestic development policy. Here, it should be noted, in retrospect, that devaluation of the Indian rupee in 1966 could be regarded as a major event in the evolution of Indian foreign trade policy because it set

into motion the process of import substitution and growth in the exports of non-traditional items - more prominently, of engineering goods, iron and steel products and chemicals and allied products.[1] In view of this, we first review India's balance of payments in the period prior to devaluation. Later on, we take up more specific issues and analyse them for the period 1960-61 to 1987-88.

6.2 Pre-Devaluation Balance of Payments :

During the period of First Five Year Plan the import policy was one of progressive but controlled liberalisation in keeping with the needs of economic development. Thus import quotas of a number of commodities were stepped to meet the increasing demand of the industry. At the same time there was considerable relaxation of the discrimination against dollar imports. Despite the fairly liberal import policy, the import bill did not rise appreciably; and in the last year of 1st Plan there was a small accretion to the reserves of Rs.10 crores. The cumulative effects of the successive liberalisations of the import policywere felt during the period of the 2nd Plan. The high tempo of industrial activity in the private sector, coinciding with the large scale import demands of the public sector pushed up import payments in 1956-57 to the high level

1. For a detailed analysis, see Deepak Nayyar (1982), "India's balance of payments", Economic and Political Weekly, Annual number

Of Rs.1102 crores, involving in turn a draft on the reserves to the extent of Rs.221 crores. From that year onwards the shortage of foreign exchange became the key problem of the Indian economy with the result that drastic cuts were effected in respect of imports of non-essential consumer goods. Since 1957 the import policy, while making adequate provision for development and maintenance imports to sustain industrial activity at a high level, had basically remained a very restrictive one with successive tightening at every stage and with only marginal adjustments and modifications aimed at relieving the shortage of raw materials and components by different industries at different times. The pressure on foreign exchange reserves which persisted throughout 2nd plan period was further accentuated during the period of the 3rd plan. Imports including plan and maintenance imports were expected to be at an annual average of Rs.1270 crores, which exceeded the annual average of Rs.1080 crores during 2nd plan by about Rs.190 crores. The balance of trade position is given in Table.1.

It will be seen that the balance of trade deficit increased from Rs.117.54 crores during 1st plan to Rs.482.92 crores during 3rd plan. What is, however, distressing is insignificant increase in exports. Exports increased from Rs.605 crores to Rs.761.70 crores during the same period.

TABLE : 1 : INDIA'S FOREIGN TRADE

(Rs. Crores)

	Imports	Exports	Exports as % of Imports	Balance of Trade
Average of Pre-Plan period	599.49	493.46	82	-106.03
Average of First Plan (1951-56)	723.40	605.86	85	-117.54
Average of Second Plan (1956-61)	976.45	609.25	63	-367.20
Average of Third Plan (1961-66)	1244.61	761.70	61	-482.92
1966-67	2078.36	1156.56	55	-921.80
1967-68	2007.61	1198.69	59	-808.92
1968-69	1908.63	1357.87	71	-550.76
Average of Fourth Plan (1969-74)	1951.87	1791.97	93	-159.90

Source : Monthly Statistics of Foreign Trade of India (DGCI&S) Calcutta.

India's export policy was geared to stimulate exports with a view to increasing the foreign exchange earnings so vitally needed for economic development. Export councils were set up for a number of commodities. The drastic fall in foreign exchange reserves during 2nd plan, on the one hand, resulted in the introduction of a stringent import policy and, on the other, focussed attention on the need to promote the exports, since the cushion erstwhile provided by the accumulated sterling balances had more or less disappeared. As 2nd Plan progressed, it became apparent that a broad based export programme was called for to step up export earnings and infact the accent an export promotion gathered momentum each year. Promotional measures were directed along the following lines: liberalisation of export quotas wherever practicable. Fiscal reliefs and concessions in the form of abolition of export duties, grant of drawback and rebates on customs and excise duties in respect of materials and component parts used in the manufacture of export products, freight and railway concessions for specified exports, and the remission of sales tax on a wide range of commodities.

A central feature of the export promotion policy was the introduction of a number of export incentive schemes in the form of import entitlements. The import linked schemes are of two varieties. There is first a group of schemes whose

objective is a modest one, namely, that of ensuring normal supplies of imported raw materials, and thereby insulating export production from the rigours of import control. Schemes for cashew kernels, shellac, unmanufactured tobacco are illustrations of this variety. The second type of import linked schemes consists of those which not only ensure supplies of imported materials for export production but provide a level of incentives which leave a margin over the actual requirements of export production. The intention behind these schemes is to offer a monetary attraction for exports by allowing the industry to earn entitlements which could be either used to expand domestic production or sold in the domestic market at a price higher than the international price, the rationale being that the loss arising from the sale of a product abroad at the international price would be covered through higher prices on internal sales. Most of the schemes relating to textiles and new manufactures like chemicals and plastics etc. contain such arrangement. In general most of these schemes are intended to aid new manufactures. However, there are a few export aided schemes which cover traditional exports like cotton textiles, woollen rugs, etc. Obviously these schemes are capable of helping a limited extent.

Devaluation and its Effects

The mounting pressures on India's balance of payments from the investment outlays of the successive Plans got

accentuated by the requirements of defence build-up and the lags in and failure of agricultural production. The position became acute in 1965 and early 1966. Inspite of the high utilisation of foreign assistance and drawing rights from the IMF, the foreign exchange reserves, excluding gold, declined from Rs.785 crores in the beginning of 2nd Plan to Rs.18 2 crores towards the end of March 1966. The value of rupee in foreign markets fell, and the dollar-rupee rate which stood at Rs.7.69 per $ in December 1965 dived to Rs.9.10 per $ in June 1966.

A number of measures were taken to improve the position. A scheme of bonus import licences upto the extent of 60 percent of the remittances on account of gifts, family maintenance, transfer of capital, sale proceeds of foreign securities by. Indian nationals abroad, was introduced in October 1965. Drastic import cuts were imposed, and at a later stage the new licencing of imports was suspended for two months from May 1966. The import entitlement schemes which aimed at serving the twin purpose of providing the essential imports of raw materials for export production and compensating for any losses suffered on exports remained in force. These schemes no doubt constituted a short term measure but they served a purpose. They had their drawbacks in as much as they tended to develop dependence on instable props and diverted attention from the urgent need of cost reduction and increase of productivity.

The increase in exports, in the face of continuously mounting import bill, did not to any significant extent help the balance of payments position. The artificially proped value of the rupee, the wide disparity between Indian and foreign prices, and the existence of rising demand for imported materials even at higher prices, murtured a black market in foreign exchange and caused the development of practices of under-invoicing of exports and over-invoicing of imports unauthorised sale of foreign currency, remittance through unauthorised channels, smuggling of gold, etc. The high premiums available on imported materials did not feature in the account-books. Leakages in foreign exchange constituted a cause for serious anxiety. Consequently the rupee was devalued by 36.5 per cut in June 1966.

Devaluation in effect is a generalised tariff on imports and a generalised subsidy on exports. It aims at improving the balance of payments by activating the twin engines of exports and imports, and for this purpose the tool employed is the price mechanism. Devaluation helps to boost export partly by reducing the foreign prices of exports and partly by raising the relative profitability of exports over domestic sales. The greater profitability of exports is expected to lead to greater flow of investment and resources to the export industries. Imports are expected to be discouraged by the rise in the domestic prices of imported goods and, additionally, by the

increase in production of impert substitutes in the domestic economy. It is at the same time expected that there would be a tendency towards more investment in the import substitution industries. Devaluation encourages the flow of remittances to the country concerned and correspondingly discourages the flow of remittances out ot it, and that the foreign exchange burden arising from the repatriation of capital, profits add royalty payments decreases.

To what extent the advantages of devaluation are realisable depends primarily upon the dimension to which this measure stimulates greater exports and generates greater investment in export production and import substitution industries. The improvement in the balance of payments eventually depends on the elasticity of foreign demand for the country's exports, elasticity of domestic demand for imports and elasticities of supply of exports in the domestic economy and imports in the foreign countries. Thus it is clear that if the elasticities of foreign demand for India's exports and the domestic demand for imports are high and her economy is able to throw up adequate surpluses for export, the measure of devaluation has bright chances of success.

We find that devaluation helped India to reduce the negative balance of payments gap. Since it is not a permanent solution of the problem, the effects wore off in course of time and the problem became serious as ever. This was due to a few

other effects of devaluation. Firstly, devaluation augmented the inflationary pressures in the economy. The prices of imported goods rose in the country as a result of devaluation, and there were sympathetic rises in prices of other commodities. Moreover imported capital goods and materials became more expensive and costs of production in industries using these were pushed up. The inflationary rise of prices soon nullified the advantage our exports had acquired in the world markets. Secondly, devaluation reduced prices of Indian exports in foreign markets, their money value and the country's foreign exchange earnings did not increase enough inspite of increase in the physical quantities of commodities exported.

The gain was only marginal. Devaluation was not an unmixed blessing. The cost of debt servicing increased as a result of the fall in the value of the rupee. The Indian government is therefore bearing a heavier burden on this account due to devaluation of the rupee.

Preceding review of balance of payments situation reveal major problem areas of concern for the policy-makers and it is also suggestive of poor external economic viability of Indian economy. We find it useful to study and analyse following issues for the period 1960-61 to 1987-88.

i) Analysis of Balance of payments in terms of sources of finance.

ii) India's external debt and debt servicing obligations

TABLE : 2 : PRINCIPAL RATIOS RELATING TO INDIA'S EXPORTS AND IMPORTS.

	Increase in exports (percent)	increase in imports (percent)	Exports/GNP (Percent)	Imports/GNP (Percent)	India's share in World exports	Trade deficit/GNP (Percent)
1950-51	-	-	6.3	6.8	1.88	0.5
1951-52	22.0	45.1	7.3	9.4	1.97	2.1
1955-56	2.5	18.0	5.9	7.6	1.35	1.6
1960-61	0.3	16.8	4.3	7.5	1.03	3.2
1965-66	-1.2	4.4	3.4	5.9	0.81	2.5
1970-71	8.6	3.3	3.8	4.1	0.63	0.2
1975-76	21.2	16.5	5.5	7.1	0.49	1.6
1980-81	4.6	37.3	5.3	9.8	0.43	4.6
1981-82	16.3	8.4	5.3	9.2	0.42	3.9
1982-83	12.8	5.0	5.4	8.7	0.50	3.3
1983-84	11.0	10.8	5.1	8.2	0.50	3.1
1984-85	20.2	8.2	5.5	8.0	0.49	2.5
1985-86	-7.2	14.7	4.5	8.1	0.41	3.6
1986-87	15.4	2.8	4.6	7.5	0.50	2.8
1987-88	25.2	10.9	5.2	7.4	0.50	2.2

Source : India Data Base - The Economy, volume II, pp.944 - 945, H.L.Chandhok and the policy group, 1990.

iii) An assessment of export trends and identifying the major constraining factors retarding export growth.

iv) Relationship between India's exports and exchange rate.

Before we take up all these issues, it is important to study the role of short term liquidity indicators in India for policy making. They are also reckoned as broad and rough measures of the economic vulnerability of an economy. Table:2 summarises this information. It can be seen that Exports as percentage of GNP has not increased at all over the period of almost four decades. This has been maintained around 5.5 percent; On the other hand, the trade deficit/GNP ratio has increased from 0.5 in 1950-51 to 2.2 percent in 1987-88. Furthermore, compared to the period of 50's, 60's and 70's, percentage growth rate of exports in the recent period(1981-82 and onwards) on average exceed those of imports and this seems to be a healthy sign. But, however, the absolute value of imports has always been exceeding that of the value of exports. For example, the value of imports in 1980-81, 1984-85 and 1987-88 were Rs.12549,17134 and 22399 crores respectively and the corresponding values for exports for the same years were Rs.6711, 11744 and 15741 crores. Quite obviously, this has led to deterioration of the current account balance; For the year 1980-81, '84-85 and '87-88, current account deficits were of the order of Rs.5838, 5390 and 6658 crores respectively. In fact, barring a short period

In the late 1960s - early 1970s, India's trade balance has shown a continuous tendency of deficit since 1960. The early sixties were marked by fairly large external deficits, which at that time were balanced primarily by inflows of foreign aid. In the latter part of the seventies, trade deficits were largely compensated by increase in invisibles representing the inflow of remittances from Indian workers abroad. However, since the late seventies, the trade account has experienced very large and growing deficits which have in turn been reflected in large current account account deficits as well. This has further given rise to a far more serious problem of growing external debt and debt service obligations. In table :3 information is provided on debt service ratio which indicates the burden in the form of interest obligations on the money borrowed. A higher ratio indicates that interest payments or debt servicing remains higher than the export receipts. Total debt service burden on such external debt increased from Rs.801.9 crore in 1980-81 to Rs.2084.7 crore in 1987-88, registering a rise of 160 percent during a short six-year period. The Economic Survey also reported that "the country's debt service in 1986-87 on external debts on government account, non-government account, IMF drawals and commercial borrowings. (including supplier's credits) amounted to about 22 percent of current receipts. This is likely to increase to 23 to 24 percent in 1987-88 because of higher IMF repayments and debt service on commercial borrowings contracted in earlier years".

TABLE : 3 : EXTERNAL DEBT SERVICING

	Total External debt servicing (Rs. CRORES)	External debt servicing as a percentage of exports.
1970-71	450.0	29.31
1971-72	479.2	28.80
1972-73	507.3	25.74
1973-74	595.6	23.61
1974-75	625.8	18.80
1975-76	600.7	14.88
1976-77	654.0	12.71
1977-78	729.3	13.48
1978-79	796.0	13.90
1979-80	800.7	12.47
1980-81	803.9	11.98
1981-82	849.1	10.87
1982-83	947.5	10.76
1983-84	1032.5	10.56
1984-85	1176.2	10.01(21.48)
1985-86	1366.6	12.54(30.23)
1986-87	2029.1	16.29(38.00)
1987-88	2084.7	16.66(38.68)
1988-89	2946.0	17.80(39.64)

Source : Economic Survey, 1988-89

Note : Data upto 1974-75 include debt servicing payments on accoun of government loans, non-government loans and suppliers' credit. From 1975-76 onwards, the same is exclusive of suppliers' credit. It should be noted that the data on external debt servicing reported here in column(5) are incomplete as they do not include amortization and interest payments on account of : a) drawing from IMF b) external commercial borrowing. If they are included then the figure is higher as is reported in brackets for 84-85 to 88-89.

Table: 3 indicates debt service ratio to be 38 percent in 1987-88 if interest payments on IMF and other commercial borrowing is included.

The World debt tables(1987-88) shows that the total debt service burden(repayment of principal and interest payments) on long term public and publicly guaranteed credit and long term non-guaranteed private credit rose from $1,200.3 million in 1980 to $3,713.3 million in 1986, an increase of 210 percent. It is important to note that these amounts do not include interest on short term debt and also the debt service on IMF credit.

The repayment of IMF credit, the growing proportion of commercial credits in the total credit and also the growing proportion of non-concessional and non-grant elements in the official credit, have raised the debt service payments substantially in 1987 and 1988 from the level obtaining in 1986. Rough estimates indicate that the debt service budden of India would exceed $ 4,500 million at the end of 1988(Rs.6,500 crores at the average exchange rate prevailing in September 1988). According to the World Bank projections, the debt service on long term debt alone amounts to $ 3,929.9 million in 1988, $ 4,009.8 million in 1989 and $ 4,172.5 million in 1990. For the recent years, it is revealing to note that in more recent years, debt charges are fast approaching net inflow of external finance, reducing by half the availability of gross inflow

TABLE : 4 : INFLOW OF EXTERNAL ASSISTANCE

Year	Gross External Assistance (disbursed) (Rs. Crores)	Net External Assistance (disbursed)
1979-80	1353	552.3
1980-81	2162	1358.1
1981-82	1870	1020.9
1982-83	2250	1302.5
1983-84	2268	1235.5
1984-85	2354	1177.8
1985-86	3165	1798.4
1986-87	3596	1566.9
1987-88	5032	2409.0
1988-89	5291	2345.0

Source : Compiled from Economic Survey, 1989-90-

TABLE : 5 : TRADE DEFICIT

Year	Trade deficit exports (Percent)
1950-51	8.15
1951-52	28.64
1955-56	27.09
1960-61	74.76
1965-66	74.81
1970-71	6.44
1975-76	30.45
1980-81	87.00
1981-82	74.32
1982-83	62.36
1983-84	62.02
1984-85	45.89
1985-86	82.80
1986-87	60.72
1987-88	42.30

Source : Economic Survey, 1980-81 and 1989-90.

for balance of payments financing. Data available on debt flows for the years 1979-80 to 1987-88 are given in Table:4. The first column indicates gross external assistance and second column indicates net external assistance disbursed. Over a period of nine years, since the total debt servicing has shown a phenomenal increase of 268 percent, throughout the period of eighties, forty to fifty percent of gross external assistance was utilised for debt servicing purposes and this has been putting considerable strain on the resources for financing our balance of payments. However, a more realistic picture of the debt servicing capacity can be had from the trade deficit/export ratio given in table:5. Changes in this ratio over time will directly indicate the changes in the gap (trade deficit) the country has already bridged (or otherwise) and the gap it still has to bridge before generating a capacity for servicing its debt service obligations. Ultimately the ability of a country to service its external debt depends. On the surplus of its export earnings over import payments. In most developing countries, so also India, net invisible earnings are negligible. The workers' remittances, which provided considerable support in recent years are highly unstable. A fall in the TD/XG ratio will reflect a narrowing of the gap to take the country nearer to the stage of generating a debt servicing capacity. A rise in the ratio will reflect directly that the distance the country has to traverse has increased, and therefore it has become more difficult for it

to generate a debt servicing capacity. The inadequacy of the conventional debt service ratio will become obvious when we recognise that an increase in exports can be accompanied by a proportionate or more than proportionate increase in imports, thereby worsening the country's debt servicing capacity despite an increase in exports. A worsening of the TD/XG ratio will in addition also directly point to the movement of the country towards greater dependence on external resources, and thereby larger debt servicing obligations in the future.

The TD/XG ratio for India during 1978-86 shows that the debt service ratio had sharply deteriorated to 86 percent in 1981 and thereafter progressively improved till 1984 to reach 59.5 percent. During 1980-81wwhile exports increased by 4.6 percent over the preceding year, imports from a higher absolute level rose even faster by 34.2 percent due to higher oil imports. The significant decline in the ratio during 1982-84 is explained by the deceleration in the growth of imports at a time when exports were registering modest growth rates. 1985-86 saw a precipitous rise in the ratio to 82.8 percent, indicating a sharp deterioration in our capacity to generate export surplus to finance the debt service obligations. This change in the trend was due mainly to the surge in import of capital goods while exports actually declined by about 6 percent.

The variations in the ratio also indicate directly the changes in our external resource requirements for financing the

trade deficits and, thereby, the potential increase in the magnitude of the external debt. The external resource requirements on account of trade deficit remained very high throughout the period following 1981. In this context, it is instructive to inquire as to how the current account deficit in India has been financed in the recent years.

6.3 External Economic Viability :

It should be noted that the analysis of external economic viability of a nation is never complete in the absence of an analysis of the sources of finance for real transfers, if any, from abroad.[2] Details on these can only be obtained from a break down of BOP returns into real transfers (defined as current account balance less interest charges on foreign loans) and the sources of Finance. It is possible to attempt an analysis of the recent trends in India's balance of payments data for some selected years from 1960-61 to 1987-88. The Table:6 summarizes information on this. Row(3) of table:6 reports the annual value of real transfers to India between 1960-61 to 1987-88, broken into sub-heads on commodity trade deficit and invisible surpluses net of interest payments on foreign loans. Row(4) of the table enumerates the sources of finance which consists of three components: (a) net inflow of capital from sources othert than international Monetary Fund. (b) net transactions with the fund and (c) changes in official reserves. For the year 1960-61, Net inflow, provided around 90 percent of finance and this had increased to 119 percent

2. J.Bhagwati and Desai P.(1970) - India: Planning for Industrialization, Oxford University Press, New York.

by 1970-71 and then it has decreased to 66 percent in 1974-75 when the country had to resort to borrowing from IMF which provided 89 percent of requisite sum of finance. It is revealing that not more than a third of the value of net real transfers from abroad have been financed, over the three years, 1980-81 to 1982-83, by item(a); The latter is arrived at by adjusting the gross inflows against outflows. At least for these three years, the country had to fall back on other sources, the loans from IMF and depletion of official reserves, the latter providing as much as two thirds of the requisite sum of finance in 1981-82. Decumulation of official reserves, providing substantial sums during 1980-81 and 1981-82, could not be tapped continuously and in 1982-83, the fund sources proved the major channel of finance, contributing as much as 90 percent of the value of real transfers during the year. Reserves were thus replenished over the year preceded by depletions during the previous years. Interestingly after 1982-83, the situation seems to have been improving to the extent that the net inflow of capital has been the major source of requisite finance providing on average about 98 percent of finance for current account deficit for the years 83-84, 84-85, 85-86 and 86-87. This is partly because from 1983-84, Government receipts have started exceeding that of its payments and hence net government position has been in surplus contributing to a greater inflow of capital. On the face of it, this has the desirable consequence that the reliance on drawals from IMF and resorting to depletion of reserves have been reduced; this is true

Table - 6 : Financing of Current Account Deficit in India - 1960-61 to 1987-88

(Rs. Crores)

	1960-61	1970-71	1974-75	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88
1. Gross inflow of Capital (excl official financing through Fund borrowing and or changes in Reserves)	482	803.2	1174.4	1543.6	1867.9	2005.3	2614.3	3147.1	4750.8	6571.6	9523.6	10739.73
of which :												
(a) Loans and Grants	416.5	778.6	1163.5	1493.7	1692.6	1812.3	2160.2	1870.3	1953	2481.2	3056.2	4453.9
(b) Pvt. receipts	51.5	15.7	10.9	49.9	162.6	193.6	385.7	888.8	1406.7	2566.9	3141.4	3880.5
(c) Banking capital(Net)	9.7	1.2	_	_	12.7	-	68.4	181.6	-	186.1	-	74.8
(d) Govt. (Net)	4.3	7.7	_					206.4	1325.7	1337.4	3326	3661.2
2. Gross Outflow of capital and current payments as interests	-106.4	-463.8	-811.9	-1195.1	-1220	-1374.4	-1974.2	1629.8	2607.6	3049.4	5157.5	6526.1
of which :												
(a) Amortisation on foreign loans	-37.6	-231	-269.8	-534.9	-686.1	-653.8	-691.4	-810.1	-907.8	-1465.3	-3039.9	-3611
(b) Private Payments	-35	-29.8	-23.7	-71.7	-65.6	-111.7	-152.2	-150.2	-193.9	-212.6	-514.2	-966.3
(c) Banking Capital (net)	-	-	-47.3	-81.7	-	-12.6	-	-	-193.4	-	-70.1	-
(d) Government (Net)	-	-	-254.4	-226.5	-187.4	-235	-494.1	-	-	-	-	-
(e) Interest payments on foreign loans	-33.8	-203	-216.7	-280.3	-280.9	-361.3	-634.5	-809.5	-1312.6	-1371.5	-1533.3	-1948.8

Contd. Table-6

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(Rs. Crores)

	1960-61	1970-71	1974-75	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88
3. Deficit in trade:goods and invisibles other than interest on loans	-417.9	-283.9	-543.9	-490.8	-1937.7	-2456.6	-2111.6	-1392.9	-1539.9	-4555.8	-4296.7	-4343.8
of which :												
(a) Deficit in merchandise trade	-451	-317.7	-977.2	-3374.3	-5967.2	-6121	-5776.1	-5870.8	-6721.1	-9586	-9353.9	-9296.1
(b) Surplus on invisibles excluding interest payments	33.1	299.8	433.3	2883.5	4029.5	3664.4	3664.5	4477.9	5161	5001.7	5057.2	4952.3
4. Financing of (3) by												
(a) Net inflow of capital (1 minus 2)	375.6 (89.87)	339.4 (119.54)	362.5 (66.64)	348.5 (71.0)	647.9 (33.4)	631.5 (25.7)	640.1 (30.3)	1317 (94.54)	2077.8 (134.92)	3522.2 (77.31)	4366.1 (101.61)	5544.9 (127.05)
(b) Decline(+) or increase (-) in official reserves	59.3 (14.19)	88.7 (31.24)	-7.3 (-1.34)	-369.3 (-75.5)	516 (26.6)	1618.3 (65.8)	-624.5 (-29.5)	-772.9 (-55.49)	-925.9 (-60.12)	706.5 (15.5)	732.2 (17.04)	956.2 (22.01)
(c) Drawings from IMF less repurchases of rupees	-10.7 -(2.56)	-154 (-54.24)	484.8 (89.11)	374.7 (77.93)	811.3 (41.8)	602.3 (24.5)	1892.8 (89.6)	1338.5 (96.09)	64.4 (4.98)	-253 (-5.55)	-672.3 (-15.64)	-1209 (-27.83)
(d) Allocation of SDRs	-	75.4 (26.55)	-	126.3 (25.73)	120.5 (6.2)	-	-	-	-	-	-	-
(e) Uncovered gap(errors and Omissions	-6.3 (-1.50)	-78.7 (-27.72)	-296.1 (-54.4)	10.6 (2.15)	-158 (-8.1)	-395.5 (-16.0)	203.1 (9.6)	-490 (-35.17)	323.6 (20.97)	580.1 (12.73)	-129.3 (-3.01)	-947.7 (-21.81)

Note : Percentage in parantheses in (4) add upto 100; Figures in parentheses are expressed as percentages to (3) deficit in Trade.
Source : Economic Survey, 1983-84 and 1989-90.

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especially for the years 1984-85, 85-86 and 86-87 and 87-88. As a matter of fact, IMF drawals constituted a substantial source of finance upto the year 1983-84. Connecting the preceding observations, it is now possible to arrive at some generalisations on India's BOP over 80-81 to 1982-83 and 1983-84 to 1987-88. Thus, India has drawn heavily from the fund in years, 79-80 to 82-83 and that fund drawings, alongwith official reserves, provided the major sources of external finance to cover the real transfers to the domestic economy. One also notices a steep and continuous increase in the repurchase obligations of India, the sum outstanding rising from Rs.267.7 Crore at the end of 1980-81 to Rs.4443.7 crores by the end of 1983-84 and it increased to Rs.4887.7 Crores in 84-85 and to Rs.5285 crores in 85-86. Fund borrowing (under extended fund facility) was reflecteddin the Rs.1892.9 crores of net drawals from the fund over 1982-83. The level of official reserves strengthened, as a consequence, by more than Rs.6000 crore. Similarly, for years 85-86, 86-87 and 87-88, Reserves had fallen, partly because of absence of net drawals from IMF. It should be noted that the "errors and Omissions" item is inserted to make the accounts Balance. A negative value of errors and omissions would suggest that current account deficit would be that much larger or capital inflow that much smaller or a combination of the two.[3]

3. Williamson John(1983) Open economy and World economy, Harper international editions.

Looking back, if the financing of India's BOP over the last three years ending 1987-88 provides a pointer to the more recent developments, one can appreciate the official line of thinking in its current official observertaions regarding a "comfortable BOP". But it is difficult to make assertions for such a trend to continue since it is possible that latest trade data if available might indicate a reversal of the improvements achieved during 1984-85 to 1987-88. An important fact to note is that on our balance of payments, large current account deficits have continued; with these chronic large current account deficits, our foreign exchange reserves could easily be wiped out within a short time. If this does not happen, it is only because huge resources, acquired, through borrowings (net) are also added to these reserves. This means that under usual conditions prevailing in India, an increase in our foreign exchange reserves only means that we have succeeded in borrowing more than what is required to fill the gap in the current account balance of payments and a decline in reserves means that the borrowings were less than the requirements. It is no denying the fact that in recent period, despite large trade and current account deficits, our reserves have remained buoyant. This is partly explained by the drawals from the IMF under the Extended Fund Facility till 1984-85 and by the large flow of deposits from the NRIs(Non-Resident Indians) during the last four or five years. About three fourths of India's present foreign exchange reserves can be accounted

for by the deposits by NRIs in various accounts. Furthermore, usually an increase in reserves is often claimed to imply strengthening of India's external position; we believe that it is misleading to the extent it overlooks the heavy deficits on current account and massive borrowings which only add to India's debt burden.

In the recent years, the policy makers invariably refer to 'sound financial Management'(Budget documents of 1982-83 to 1986-87) and also express concern over excessive borrowing, both internal and external. Official decisions to 'limit' further commercial borrowing abroad and a voluntary termination of Fund borrowing under EFF(Extended Funds Facility) during 1984-85 characterize such official concerns. It is appropriate to note that IMF while granting extended fund facility in 1981, had laid down significant clauses in the EFF's Performance Criteria'(1)".... a phased ceiling on total domestic credit and a phased sub-ceiling on net credit permission to contract loans in private markets upto SDR 1.4 million when original maturity of such loans were between one and twelve years".

In this context, a rather conscious effort to conform and to obtain the Fund seal of approval is indeed apparent in the rather halting pace of borrowing in private capital markets by India(Table 7). Thus it is apparently intringuing

as to why external private market borrowing had to stay within limits which are but too modest by international standards, especially with the impression generated abroad that India is currently enjoying fairly high credit rating in private loan markets. It should be noted that private credits to developing countries are normally sanctioned with public guarantees, a fact which allows discretionary power to the host governments in approving the loan deals. In India, growth in commercial debt(most of which has been contracted by public sector units) has been rather modest (Table: 7). The government on its part has used the high cost aspect of the private loans as an argument to justify its reservations. However, we believe that it is not rational to under play the role of private sources of funds when they are available due to our high credit rating. Besides, depletion of reserves could not provide and continuous source of finance nor could private remittances constitute a permanent source of finance. As already seen, during 1980-81 to 1982-83, IMF drawals and depletion of reserves were major sources of finance while net inflow contributed on average not more than 27 percent of the total requisite finance. On the other hand, for the years 83-84 onwards, net inflow of capital constituted major source of finance for current account deficit contributing about 98 percent to the requirements. Hence we believe that avenue of commercial borrowings from abroad should be explored.

TABLE : 7 : APPROVALS OF EXTERNAL COMMERCIAL BORROWING 1980-81 to 1989-90

(Rs. Crores)

Year	Public Sector	Financial Institution.	Purchase of Ships	Private Sector	Total
1980-81	810	00	90	138	1038
1981-82	391	151	270	392	1204
1982-83	1544	133	109	240	2026
1983-84	459	119	344	162	1086
1984-85	1086	159	283	379	1906
1985-86	961	380	74	295	1700
1986-87	784	250	65	297	1396
1987-88	1598	809	32	215	2654
1988-89	2413	1353	198	350	4314
1989-90	2189	705	185	238	3317

Note : The figures have been rounded to the nearest crores.

The constituents may not therefore add upto the total.

Source : Economic Survey, 1989-90.

Till 1979-80, the commercial borrowings from abroad had aggregated only about Rs.600 crores. Even in the period from 1980-81 to 1986-87 government had rightly continued to adhere to its cautious policy in this respect. The government has kept the approvals of external commercial borrowings at around Rs.1500 crores, on an average, per year during 1980-81 and 1986-87. From 1987-88 with external aid falling considerably short of requirement, the government is obliged to resort to more commercial borrowings. The borrowings, approved by the government had risen markedly reaching an unprecedentedly high level of Rs.4314 crores in 1988-89. The cumulative commercial borrowings have reached very high figure. By March 1989, outstanding liabilities under commercial borrowings had already accounted for about 25.4% of India's total external debt outstanding. Such larger borrowings still further, which are of short duration carry high interest rates, would entail unbearable debt servicing liabilities. In this context, an additional element of concern is the fact that bulk of commercial borrowings have been raised by Indian public sector enterprises (Table:7).

It seems if the present trends continue, the balance-of payments position is likely to become more difficult and may even turn tobe critical in following years unless exports grow at a much faster rate. Acceleration of the rate of growth of exports in real terms has been recognized as a "key element

of the foreign trade and payments strategy retained in the 8th Plan. The Planning Commission has suggested a target rate of growth of exports of 7 percent per annum to meet the projected requirements of imports for the 8th Five-Year Plan Period without unduly aggravating the balance-of-payments positio

The critical need for steeping up the rate of growth of exports in real terms to 7 percent per annum (or more) can hardly be exaggerated. The World Bank in its 1988 report on the Indian economy has termed "export performance" as the most critical factor in maintaining a viable balance-of-payments position. The World Bank has calculated that if the growth of India's volume of exports were to grow only at the existing rate of 4.8 percent per annum(as achieved in the 1980-88 period) and all other requirements of foreign exchange projected by the 8th Plan remain valid, India would have to borrow approximately U.S. $6.1 billion more (making a total of U.S.$ 15.6 billion) in commercial markets upto 1995 to maintain the GDP growth rate of 5 percent per annum and industrial growth rate of 6.6 percent per annum. This would push up the current account deficit to GDP ratio to about 3.4 percent(compared to 2.2 percent at present) and the debt service ratio to 26.4 percent in 1990-91. This will adversely affected India's credit rating in the international capital markets. There is an imperative need for formulating innovative policy supportive programs which will help to achieve a minimum of 7 percent annual growth in exports in quantum terms. This would help in managing the external balance without further adverse effects on the Indian economy.

The present balance-of-payments scenario is difficult but manageable, although it has meant an increasing resort to commercial borrowing in international capital markets and now somewhat more expensive private capital inflows originating from nonresident Indians. The situation is likely to get much worse in the late 1990s. There is a further squeeze on bilateral, as also multilateral, concessional aid flows. The surplus on net invisibles other than transfer payments has all but disappeared and is likely to emerge as an increasing deficit as the burden of debt servicing mounts. It would be well nigh impossible to sustain the present level of remittances which are bound to decline with the economic slump in the oil exporting countries of the Middle East.

The option that remains is to manage the balance of trade, that is, step up exports or curb imports, or ensure that exports increase faster than imports. There is some room for maneuver in terms of trimming the import bill which has increased at least partly as a consequence of import liberalization. The scope for such economies is significant in the short run but limited in the long run, and beyond a point, curbs on the growth in imports would also curb investment, thereby leading to a sacrifice in terms of output. Hence, exports, which create the capacity to import, are essential to sustain the growth process in the economy. But that is not all. It is imparative that foreign exchange earnings derived from increased exports should finance the payments deficit as far as possible, if India is to keep the size of its external debt and the burden

of debt servicing within manageable proportions. The other alternative of a macroeconomic squeeze, often advocated as part of a typical International Monetary Fund (IMF) package of policies, would not only impose excessive social costs in terms of output, income and employment but would also be myopic in its search for external balance at the cost of economic growth.

The preceding analysis situates the issue in its wider context and highlight the role of exports at the present juncture. In this context, it is instructive and interesting to sketch a profile of the regime of export promotion policies to examine its impact on exports. It is also important to analyse the foreign and domestic constraints on export performance in an attempt to answer the question : What ails Indian exports.

6.4 Constraints on Export Performance :

It is quite possible that India's export performance since 1970 has been determined by a wide range of internal and external factors which affected the supply, of, and the demand for, her exports. While domestic economic policies in general, and trade policies in particular, exercised a significant influence it is misleading to suggest that the policy regime provides the main explanation of overall export performance. Any systematic analysis of the trends in India's exports reveals the complexity of the process. Indeed, given

the diverse commodity composition and the complicated structure of policies, it is exceedingly difficult to generalize about the relative importance of internal and external factors which varied across sectors and over time. Nevertheless, it is essential to distinguish between domestic and foreign constraints on export performance, at least for the purpose of analysis and diagnosis, if not prescription.

Available research on the subject clearly shows that the basic determinants of India's export performance are to be found in the realm of domestic economic factors and policies. In our view, the domestic factors which constrain India's exports are the costs of production, the pressure of domestic demand and the infrastructural or sectoral supply bottlenecks which, coupled with nonprice factors such as quality, have adversely affected the competitiveness of exports. It is possible that domestic policies may have accentuated these problems in the period before 1970 and may not have done enough to alleviate such constraints thereafter.[4]

(1) India's competitiveness in the world market, is inter alia, dependent on export prices which, in turn, are closely related to the costs of production in export industries. The main determinants of costs are the prices of inputs which derive from the structure of costs in the economy, and the levels of productivity which are a function of the scale of output, the technology in use, managerial efficiency and labor skills, India is often at a disadvantage in the world market because its costs of production and

4. Report of the Committee on trade policies (New Delhi: Government of India, Ministry of Commerce, December, 1984).

hence export prices, are higher than in competing countries. This is attributable in part to the higher prices of importable or nontraded inputs and in part to much lower levels of productivity; to some extent, the origin of both may lie in the failure to realize economies of scale. It is hardly surprising that such problems reduce competitiveness particularly in the sphere of manufactured exports. While these constraints on exports are often perceived as a consequence of the management of the economy at a macro level, they are as much a consequence of the management of firms at amicro level.

(2) A large proportion of India's exports, whether consumer goods or intermediate goods, are exportables that enter into domestic consumption and use. Given the relatively slow growth in output, the pressure of domestic demand squeezes the surplus available for exports and worsens the price competitiveness of exports. There are two basic factors underlying the pressure of domestic demand. First, the rapid growth in population leads to a rapid increase in consumption. Second, the income elasticity of demand for most exportables is quite high in the domestic market. In any case, the gigantic size of the home market means that even small increase in per capita consumption have serious repercussions on the supplies available for export. Available evidence suggests that, for many exportables, domestic absorption has tended to increase faster than domestic production, and this has often constituted a dominant constraint on the possibilities of

export growth, particularly in the sphere of primary commodities and agro-based manufactures where a significant proportion of the total output is exported. In so far as such a domestic demand pull improves the relative profitability of sales in the home market vis-a-vis exports, it has a further adverse effect on export performance.

(3) Infrastructural constraints in the economy at large and supply bottlenecks in specific sectors influence exports just as much as the performance of the economy. Frequently enough, export supplies are restricted by the inadequate infrastructure or the nonavailability of domestic and imported inputs at the right time. While some scarcities directly affect competitiveness through higher input pirces which are reflected in the costs of production, other bottlenecks simply limit the output available for exports. Such supply constraints are common enough in India and examples of how they constrain export performance abound.

(4) The competitiveness of exports also depends, to a significant extent, upon factors which are not reflected in prices. In fact, nonprice factors such as quality and marketing have an important bearing on export performance. This is particularly true for nontraditional manufactured exports where the ability to compete in the world market is, in important part, a function of these nonprice attributes of exports. Apropos quality, Indian exports have been

constrained by failures on two counts; the maintenance of quality control at any given point of time and the improvement of quality over a period of time; the former has sometimes tarnished the reputation of Indian firms as reliable exporters, while the latter has often taken away the competitive edge from Indian exports in the world market. It is also possible to discern a serious constraint on export performance in the realm of marketing. There has been little systematic effort to develop products or markets for exports so that, as a rule, India has attempted to sell what it produces rather than produces what it can sell. What is more, the development of brand names, the improvement in designing and packaging, the execution of export orders in accordance with promised delivery dates and the provision of an adequate after sales service, all of which are an integral part of success at exports, have simply not received the necessary attention.

(5) many of these constraints were beyond the reach of policy; some others were, or could have been, alleviated by compensatory policies; a few may even have been accentuated by inappropriate policies. The export promotion regime sought to compensate the export sector for the disincentives implicit in domestic economic policies largely by providing access to importable inputs at world prices and reimbursing taxes paid on inputs that entered into export production; it also provided

some incentives for product and market development. This constituted a vast improvement over the discrimination against the export sector associated with the pessimistic neglect of exports during the 1950s, and a rationalization of the inappropriate export promotion during the 1960s which concentrated attention on a narrow range of nontraditional exports while it neglected traditional exports and other promising new exports. All the same, given the level of tariffs on imports and the degree of compensation or incentive implicit on the gamut of export promotion policies, it is likely that the effective exchange rate for import-competing production was significantly higher than that for export production, even during the period under review. Export performance may also have been influenced by the policy framework in its wider context. Industrial policies which placed limits on capacity expansion or capacity creation may have preempted the realization of scale economies or erected barriers to entry for new firms, thus increasing the degree of monopoly and creating an environment where there was no pressure on manufacturers to reduce costs or improve quality. The fiscal regime, which opted out of the difficulties associated with domestic resource mobilization through direct taxes, relied more and more on indirect taxes, both import tariffs and excise duties, so that an escalation of costs across-the-board was inevitable given the cascading effect of such levies, and the export sector was not quite immune.

A study of past Indian experience confirms that the factors outlined above have always acted as constraints on export performance. It is not as if these constraints vanished in the period 1970-71 to 1977-78. It is simply that an unusual combination of internal and external factors, discussed earlier in the chapter, neutralized their impact and led to a rapid growth in exports not witnessed before or after. Obviously, it is difficult to generalize because the relative importance of each factor, or the dominant constraint, can only be determined by sector-specific analysis. Nevertheless, in retrospect, it is clear that export performance in primary commodities and agro-based manufactures (particularly in sectors where a significant proportion of output is exported) was constrained by the pressure of domestic demand, sometimes exacerbated by supply bottlenecks. On the other hand, industrial exports were constrained by the lack of price and nonprice competitiveness, attributable perhaps to the limited size of, the absence of competition in, the domestic market. In the manufacturing sector, the failure to realize economies of scale has meant high costs while the absence of competitive pressure has meant poor quality. It has not been possible to circumvent the problem by isolating production for exports from production for the home market, because exports are the end of, rather than the beginning of, the typical market expansion path for most firms in India.

As for the significance of foreign constraints in India's export performance, it is widely accepted, as also established by existing research on the subject, that external factors have not constrained the growth of Indian exports in the past. Indeed, our analysis of the trends in exports since 1970 shows that external factors had a very favorable impact on export performance during the period 1970-71 to 1970-78. However, in the context of the changed situation in the world economy, it is necessary to reexamine the accepted perception about foreign constraints. In our judgement, external factors, which have always been significant for a few categories among Indian exports, probably became significant for the export sector as a whole during the 1980s when there was a near stagnation in international trade flows. This view deserves some elaboration.

The orthodox literature assumes that, in principle, external factors should not constrain export performance wherever India is a small or marginal supplier in the world market, which is the case for a large proportion of India's exports. On this presumption, it is often argued that it should be possible for India to increase her share of world exports in such cases irrespective of the growth in world import demand. This proposition is open to question, for it needs to be recognized that restrictions on international trade flows in certain products do impose an external constraint

on Indian exports. For example, quantitative restrictions embodied in the Multi Fiber Agreement (MFA) limit the growth in export of clothing. Similarly, nontariff barriers in importing countries constitute a foreign constraint on many of India's exports such as oil cakes to the European Economic Community (EEC), marine products to the United States and meat to the Middle East. But that is not all. The increasing incidence of protectionism in the industrialized countries, embodied in the escalated tariff structure and a range of unquantifiable nontariff barriers, also places a limit on the growth of manufactured exports, even where India is a marginal supplier in the world market because, in practice, such restrictions constrain exports from countries which are either not established as suppliers in the importing country or are new entrants in the world market for a product.

These are, of course, the familiar limits to market access which impose foreign constraints on the export performance of developing countries in general. But countries from the developing world do not have equal access to the markets of industrialized countries. The problem of market access is often compounded for some because international trade flows, which constitute transactions between countries, are intrafirm transactions within transnational manufacturing or trading firms. In many of these sectors, the export performance of individual countries is determined not so much by their competitive ability as it is by the sourcing decisions of transnational corperations.

What is more, market access is determined not only by the economics of competitiveness but also by the politics of international relations. In an international trading system where the principles of multilateralism are increasingly violated, the resort to bilateralism means that some countries benefit from a preferential market access as compared to others; this is easily done through a manipulation of non-tariff barriers or gray area measures. These are manifestations of foreign constraints which may have exercised an important influence on India's export performance but are seldom recognized or discussed in the literature on the subject. Such external factors may also constitute a part of the explanation for why Brazil, China or South Korea have succeeded in the sphere of exports but India has not;

While it is difficult to provide conclusive evidence, it is plausible to suggest that external constraints on India's export performance have acquired greater significance in the 1980s as there has been a steady increase in protectionism in the industrialized countries and as the near stagnation in international trade flows has led to fierce price and nonprice competition in major markets. The pressure of external factors on manufactured exports from India has continued to mount as Indian firms have been unable to offer the generous terms of export credit or the large price discounts which have become increasingly necessary to circumvent existing market channels. It is likely that these problems would only be accentuated in the remaining years of this decade. Therefore,

an assessment of India's export prospects must extend beyond domestic economic factors or policies and also consider the influence of the international trade environment.

6.5 The Impact of Export Promotion :

The regime of export promotion policies in India performs two basic roles: First, it seeks to provide compensation for disincentives implicit in domestic economic policies and, second, it attempts to provide an incentive for products and market development. Its principal components are the duty drawback system, cash compensatory support, an interest subsidy on export credit, fiscal concessions on exports, and the import policy for exports. We here attempt to examine these promotional measures influenced export trends since 1970.

(1) The duty drawback system endeavors to reimburse exporters for tariffs paid on imported raw materials or intermediates and central excise duties paid on domestic inputs that enter into export production. While we do not have data on the actual value of exports eligible for it, the duty drawback disbursed, on an average, amounted to approximately 2.4 percent of the free on board(FOB) value of total exports over the period 1973-74 to 1981-82, but this proportion dropped to a level of about 1.4 percent in the subsequent years of the early 1980s as the import policy enlarged the access of duty-free imports for export production.

Table: 8 Cash Compensatory Support As a Percentage of the FOB Value of Exports for Major Commodity Groups: 1974-75 to 1983-84

(Per cent)

Commodity Groups	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84
Engineering products	16.1	14.8	15.3	14.4	15.3	16.1	14.2	15.1	14.1	14.8
Woollen carpets, rugs and druggets	5.7	11.0	15.1	17.5	16.9	17.3	16.9	15.9	14.6	14.0
Instant tea, packet tea and tea bags etc.	...	10.0	9.9	10.4	9.6	11.3	13.4	12.3	12.7	13.0
Sports goods	19.4	16.2	14.9	14.1	14.5	14.6	14.8	15.2	14.6	12.6
Finished leather and leather manufactures	5.6	5.2	6.1	2.4	12.9	11.2	11.0	12.3	11.9	11.3
Chemicals & allied products	14.9	13.3	12.7	12.8	13.1	11.4	10.2	10.1	10.0	9.8
Plastic goods	9.2	9.7	10.1	9.5	10.0	9.3	9.5	10.1	11.5	9.6
Processed food, fresh fruits, vegetables etc.	8.0	13.8	12.8	11.9	10.9	10.0	7.0	8.4	8.3	9.2
Handicrafts	5.1	8.7	12.1	13.1	14.7	13.1	6.9	9.9	9.4	9.1
Natural silk fabrics, garments and made-ups synthetics fabrics & garments etc.	7.6	9.9	12.6	13.1	13.9	13.1	12.4	11.4	10.8	8.5
Cotton handlooms	...	...	...	...	...	...	8.3	9.1	9.6	8.3
Woollen/blended knitwear	...	15.0	12.1	10.1	9.8	10.7	14.3	...	...	7.0
Instant coffee etc.	...	...	10.0	10.0	10.0	10.0	10.0	9.9	10.0	5.6
Fish & fish products	...	6.1	4.9	5.6	5.4	5.0	6.5	6.0	6.6	5.1
Jute products	...	9.8	9.2	9.9	10.0	7.4	7.4	7.5	7.2	4.7
Total of above products	14.1	13.2	12.2	9.1	13.7	13.2	11.8	12.7	11.9	11.2

SOURCE: Government of India, Ministry of Commerce, Report of the Committee on Trade Policies (Chairman Abid Hussain), December 1984.

(2) Cash compensatory support (CCS) is a phase used to describe cash assistance, in effect a subsidy, specified as a proportion of the FOB value of exports for selected products. It has been estimated that two-thirds to three-fourths of CCS is simply a compensation for unrebated indirect taxes which are not reimbursed through the duty drawback system, while the rest of it is an incentive for product and market development. The proportion of total exports eligible for CCS rose from about 20 percent in the early 1970s to a little more than 40 percent in the early 1980s. The rates of CCS, as a proportion of the FOB value of exports, for most of the eligible commodity groups ranged from 5 percent to 15 percent. On an average, the total CCS disbursed, during the period 1974-75 to 1983-84, added up to approximately 12 percent of the FOB value of exports eligible for it; over the same period the total CCS disbursed amounted to about 5 percent of the FOB value of total exports (Table: 8).

(3) In keeping with the practice in most other countries of the world, export credit is made available at a concessional interest rate. During the period under review, the commercial banking system provided preshipment and postshipment credit for 90 and 180 days respectively, at a concessional rate of 12 percent per annum, for which it received an interest subsidy from the Government at the rate of 1.5 percent per annum; of course, a part of the cost was also borne by commercial banks in terms of interest foregone. The total resource cost of

subsidizing export credit, hence the implicit benefit for the export sector, was the equivalent of 0.5 percent of the FOB value of total exports.

(4) Ever since the early 1960s, the regime of fiscal concessions for exports has provided income tax rebates related to export earnings in one way or another; the form has changed on several occasions but the substance has not. In the first half of the 1980s, 1 percent of the FOB value of exports and 5 percent of the incremental export turnover as compared to the preceding year was deductible from taxable income. Assuming that the average rate of income tax paid by exporters was 50 percent and that the average rate of growth in exports was 10 percent per annum(a reasonable approximation of the actual figures), the subsidy equivalent of this concession, in terms of revenue forgone, works out at 0.75 percent of the FOB value of exports.

(5) The import policy allows special facilities for exporters to provide them access to importable inputs at world prices. The system of import replenishment licenses (REP), which are related to the FOB value of exports, is in large part, a facility insofar as it enables exporters to import inputs where the domestic substitutes are not adequate in terms of price, quality or delivery dates; it is also,

TABLE :9 Trends in the Import Intensity of Exports

		1972-73	1977-78	1980-81	1984-85
1.	Import replenishment licenses[a] for exports[b] as a percentage of the value of total exports (excluding gems and jewelery)	6.9	13.7	21.2	23.5
		(4.4)[c]	(8.3)	(15.7)	(15.3)
2.	Import replenishment licenses[a] for exports[b] as a percentage of the value of exports eligible for such licenses (excluding gems and jewelery)	10.4	18.6	29.5	35.5
		(6.8)[c]	(11.7)	(22.7)	(24.5)

a The figures on the value of import replenishment licenses include all import licenses issued on the basis of export performance: REP licenses, Advance licenses, Imprest licenses, Special imprest licenses, and Additional licenses.

b It is assumed that all exports except for tea, coffee, sugar, rice, raw cotton, oil cakes, iron ore, jute manufactures and crude oil and petroleum products are eligible for import replenishment facilities.

c The estimated percentages in parentheses exclude gems and jewelery both from the numerator and the denominator as the import intensity of these exports is much higher than the average for exports.

Sources: Report of the Committee on Trade Policies (New Delhi: Government of India December 1984).

in part, an incentive insofar as there is a premium on those REP licenses that are transferable. The replenishment rate and the range of items importable on a REP license are functions of the import content of export production. There are two main categories of licenses in the import replenishment regime. First, there are REP licenses for registered exporters which are issued ex post, after exports have been shipped, where the licenses as also the goods imported are transferable in the marketplace. Second, there are REP licenses such as duty-free advance licenses and imprest licenses which are issued ex ante, in anticipation of export production, and cannot be sold in the market as they are nontransferable. During the period under review, at least two-thirds if not a higher proportion of total exports were eligible for import replenishment facilities. The data in Table 9.1 show that the total value of REP licenses as a proportion of the FOB value of total exports rose from a mere 6 percent in 1973-74 to almost 24 percent in 1984-85, and much of this increase occurred in a relatively short period during the late 1970s. We can infer that as a proportion of the FOB value of exports eligible for these facilities the corresponding figures rose from around 10 percent to about 35 percent. Over the same period, the proportion of ex ante nontransferable import licenses in the total value of REP licenses increased from a negligible level in the early 1970s to almost half in the early 1980s.

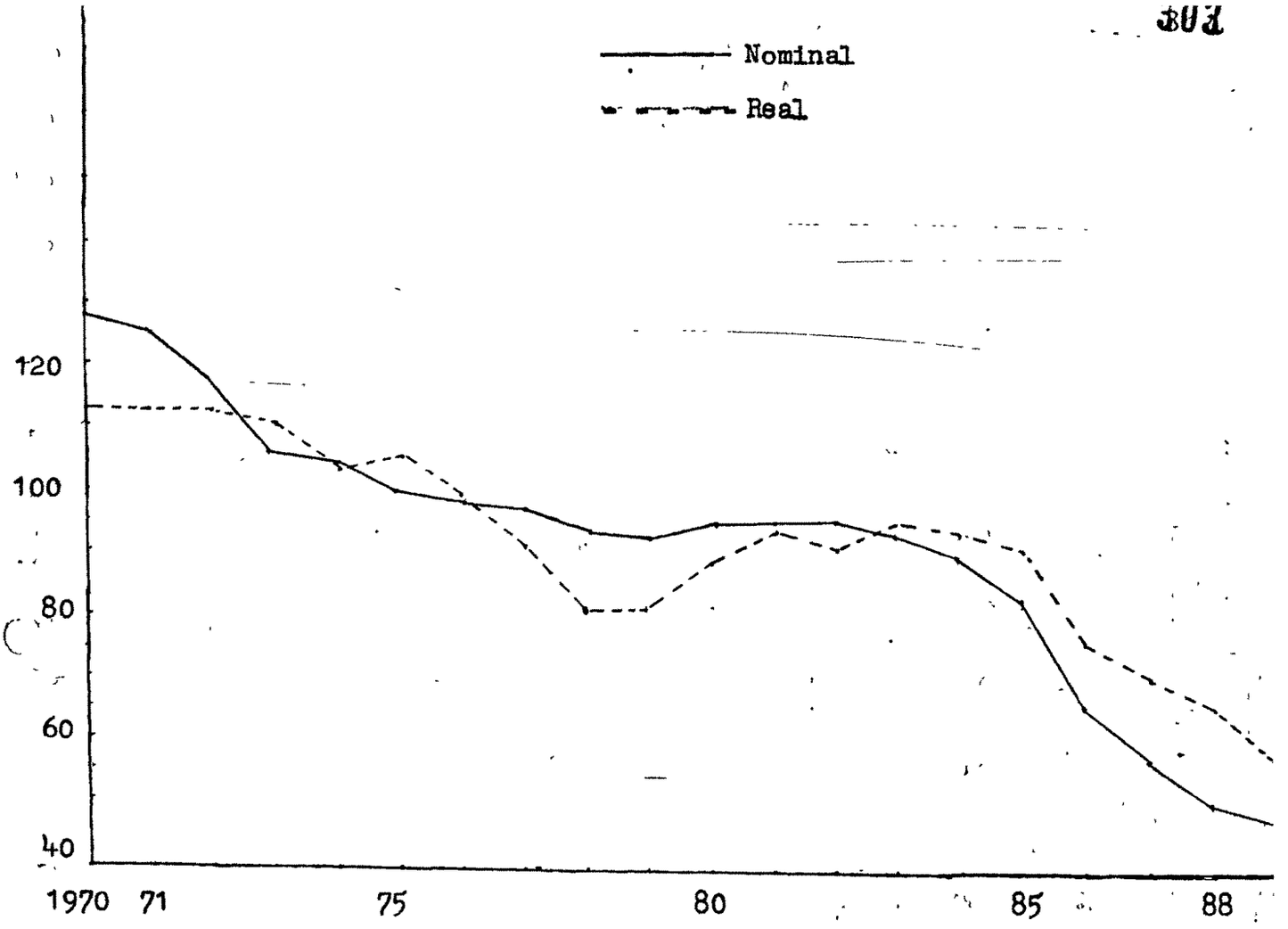
It is exceedingly difficult to provide a quantitative assessment of the incentive implicit in the market premium realizable on import replenishment licenses because the proportion of the transferable REP licenses, as also the premium thereon, veried significantly across sectors and over time. At a macrolevel, we can only guess at broad orders of magnitude on the basis of some plausible assumptions. Let us assume that : (1) in the early 1970s (a) the average market premium on REP licenses was 60 percent, and (b) all REP licenses were transferable and sold: (2) in the early 1980s (a) the average market premium on transferable REP licenses was 20 percent, and (b) all the transferable REP licenses, which accounted for half the total in terms of value, were sold while none of the non-transferable REP licenses were. In a sense, these assumptions represent a reasonable approximation of reality. The implicit subsidy equivalent then works out at 5.2 percent of the FOB value of exports eligible for REP facilities or 3.5 percent of the FOB value of total exports during the early 1970s, and 3.5 percent or 2.3 percent respectively during the early 1980s. It is worth nothing that there was no similar decline, or even change, in the implicit subsidy equivalent over the period under review if it is measured as a proportion of the net foreign exchange earnings derived from exports rather than the gross FOB value of exports. It needs to be stressed, however, that these estimates are, at best, a crude aggregate measure of the export incentive implicit in import policy which cannot claim any precision.

The preceding paragraphs have attempted to assess, in quantitative terms, the significance of the export promotion regime. This brief assessment leads to three conclusions. First, the assistance provided through the duty drawback system, cash compensatory support, the interest subsidy on export credit, fiscal concessions on exports and the import policy for exports, taken together added up to a little more than 10 percent of the FOB value of total exports during the period under review; if we assume that, on an average, exports eligible for such assistance contributed two thirds, or one-half, of total export earnings, it can be inferred that the subsidy implicit in the export promotion regime added upto somewhat more than 15 percent, or at the outside a little more than 20 percent, of the FOB value of eligible exports. Second it would appear that there was little, if any, change in this subsidy equivalent of export promotion over the period under review; the incidence of CCS may have been smaller in the early 1970s, as compared with the early 1980s, but the incentive implicit in import policy was correspondingly larger. Third, it is quite clear that a significant portion of the regime of export promotion policies, at least three fifths of the implicit subsidy, sought to compensate the export sector for the competitive disadvantage arising out of domestic economic policies; the element of incentive, at most two-fifths of the implicit subsidy, was less important in quantitative terms.

How did this regime of export promotion policies influence export trends in the period 1970-85? Insofar as such policies compensated for, or offset, disincentives implicit in other domestic economic policies, ceteris paribus, it is plausible to argue that their presence should have increased the competitiveness of Indian exports just as their absence would have decreased competitiveness, thus affecting export performance. However, it is important to recognize that there were no significant qualitative or even quantitative changes in this regime during the period under review; most of changes were in the nature of marginal variations which could not, by themselves, have led to any departures from the trend in exports. Therefore, in our judgement, the substantial difference between export performance in the period 1970-71 to 1977-78, as compared with 1977-78 to 1984-85, cannot be explained in terms of th e export promotion policies alone.

It would be reasonable to ask if there is a satisfactory explanation in the wider context of the policy framework, which considers the possible impact of exchange rate depreciation on export trends since 1970.

The changes in the exchange value of the rupee, the nominal effective exchange rate and the real effective exchange rate, during the period 1970-85, are outlined in



Index of
Nominal and Effective Exchange rate of the Rupee (1975=100)

FIGURE : 1

Table :10 : NOMINAL AND REAL EFFECTIVE EXCHANGE RATES OF INDIAN RUPEE AND REAL EXPORTS

	Nominal exchange rate (NER)	Real effective exchange rate (RER)	Exports at 1970-71 prices (Rs.Crores)
1970-71	100	100	1535
1971-72	98	100	1576
1972-73	92	98	1744
1973-74	83	93	1828
1974-75	82	95	1924
1975-76	78	89	2165
1976-77	77	80	2597
1977-78	77	80	2425
1978-79	74	73	2591
1979-80	72	73	2878
1980-81	70	73.6	3442
1981-82	69.1	70.4	2870
1982-83	66.6	71.5	3057
1983-84	62.1	70.3	3413
1984-85	58.4	68.4	3998
1985-86	49.6	61.9	4012
1986-87	44.2	57.8	4111
1987-88	38.3	52.9	4188

Note : For methodology of deriving nominal exchange rates and real effective exchange rates, see Vijay Joshi (1984) and CMEI (Centre for Monitoring Indian Economy), Vol.1, August, 1989.

Table:10as also in Figure:1. The Neer depreciated throughout the 1970s, particularly from 1971 to 1975 when the rupee was pegged to the pound sterling and afloat; it was stable from 1979 to 1982 and, once again, declined sharply thereafter. The REER depreciated very sharply from 1974 to 1979, not so much because of conscious exchange rate policy but because of the lower rate of inflation in India as compared to the outside world; it appreciated significantly between 1979 and 1981, remained stable thereafter at around the 1977 level, dropping once again in late 1985 and for later period. We here examine the relationship between India's exports and exchange rate measures.

6.6 The relationship between India's Exports and Exchange Rate Measures.

Recently, increasing attention is being paid currently to discussing the question whether India should consider devaluating the rupee in response to its current(and even more the impending) balance-of-payments problems. In order to examine the desirability or otherwise of such a measure, it is important to examine the role that changes in exchange rates can play in promoting India's exports. The protagonists of the devaluation measure mainly base their case on the beneficial effect this measure would have for increasing India's (real) exports. We examine this very limited question in a partial equilibrium framework using an OLS technique two exchange rate measures are explored: (1) nominal effective

TABLE : 11 : DATA ON INCOME AND PRICE INDICES

	GDP at 70-71 prices. (Rs CRORES)	Price index for India	Price Index for world	Indian Prices / World prices	Index of World income	Quantum index of exports (78-79=100)
1970-71	36736	100	100	1.00	100	59.0
1971-72	37312	105	104	1.01	104	59.2
1972-73	36940	114	99	1.15	110	66.5
1973-74	38722	133	112	1.19	116	69.5
1974-75	39080	171	171	1.00	118	73.7
1975-76	42890	178	219	0.81	119	81.7
1976-77	43160	174	177	0.98	125	96.8
1977-78	46920	187	203	0.92	131	93.2
1978-79	49619	187	246	0.76	136	100.0
1979-80	47191	208	236	0.88	141	106.2
1980-81	50705	251	275	0.91	144	108.1
1981-82	53469	281	298	0.94	145	110.1
1982-83	55032	288	255	1.13	145	116.7
1983-84	59319	311	224	1.39	148	113.0
1984-85	61473	338	239	1.41	148	120.8
1985-86	64260	357	248	1.44	151	111.3
1986-87	66805	376	257	1.46	152	121.0
1987-88	69211	395	262	1.51	153	128.3

Sources : Directorate General of Commercial intelligence and statistics; Reserve Bank of India Bulletin (various issues); Economic Survey, 1988-89 (New Delhi: Government of India, 1989).

TABLE : 12 : INDIA'S TOTAL EXPORTS AND EXCHANGE RATES

Dependent variable	Interecept	Independent Variables	R^2
Ln(X)	13.37	Ln(NER) -1.29 (10.92)	0.88
Ln(X)	15.81	Ln(RER) -1.82 (15.72)	0.94
Ln(X)	-5.19	Ln(NER) -0.26 (1.06)	0.95
		Ln(GDP) 1.31 (4.36)	
Ln(X)	1.95	Ln(RER) -0.84 (1.98)	0.94
		In(GDP) 0.89 (2.36)	
Ln(QX)	-4.82	Ln(PIPW)-0.016 (0.15)	0.93
		Ln(GDPWLD) 2.08 (12.32)	

Notes : X denotes exports at constant (1970-71) prices.
QX denotes Quantum index of Exports

NER denotes real effective exchange rate.

GDP denotes Gross Domestic Product at 1970-71 prices.

PIPW denotes Indian price over World Prices.

GDPWLD denotes index of World income.

Figures in brackets under the estimated coefficients are respective t-values.

exchange rate (NER) and (2) the real effective exchange rate (RER)[5]. Two alternative dependent variables are also explored, namely, exports measured in constant prices and a quantum index of exports. The regression results, which include other independent variables besides the exchange rate, are presented in table:12.

As may be seen from Table:10 the nominal effective exchange rate as well as the real effective exchange rate with base year (1975=100), on the whole, declined to numbers below 100 during the years 1975 to 1989 showing a policy-induced "depreciation" of the Indian rupee. Thus, we would a priori expect the sign of the coefficients of NER and RER to be negative since India's (real) exports have been going up throughout the period from 1970 to 1988. The results presented in Table:12 indeed confirm this. The results in Table:12 show that other things remaining constant.

1. India's (real) exports are highly elastic with respect to the NER with a coefficient of elasticity of 1.30.
2. Similarly, India's exports with respect to the RER are highly elastic with a coefficient of elasticity of 1.80.
3. When India's exports are regressed on both GDP and the RER, the elasticity coefficient with respect

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5. The real effective exchange rate is an index of relative domestic and world prices expressed in terms of a common currency (that is, the index of the number of units of domestic currency per unit of foreign currency multiplied by the ratio of a domestic price index to a foreign price index.

TABLE : 13 : IMPACT OF NOMINAL EXCHANGE RATE AND REAL EFFECTIVE EXCHANGE RATE ON INDIA'S NOMINAL EXPORTS OF SELECTED PRODUCTS.

Commodity (exports) (Nominal Values)	Intercept	In NER	In RER	R^2
1. In Cotton Fabrics	15.21	-2.30 (7.93)		0.80
2. In Cotton Fabrics	18.58		-3.02 (9.15)	0.84
3. In Engineering Goods	19.30	-3.14 (7.65)		0.79
4. In Engineering Goods	24.70		-4.31 (11.97)	0.90
5. In Coffee	18.62	-3.25 (6.77)		0.75
6. In Coffee	24.65		-4.57 (11.42)	0.89
7. In Fish and Preparations	19.78	-3.43 (7.79)		0.80
8. In fish and Prelarations	25.74		-4.72 (13.48)	0.92
9. In Handicrafts	27.12	-4.91 (8.76)		0.83
10. In Handicrafts	35.58		-6,73 (16.41)	0.94

to RER comes cut to be 0.84 though this estimate is not statistically significant, and the elasticity coefficient with respect to GDP turns out tobe 0.89. Corresponding elasticity with NER is found to be 0.26 and that for GDP 1.31.

4. If the quantum index is adopted as dependent variable instead, and its logarithm regressed onworld income as well as the price index for India relative to world price level, the resultant price elasticity is -0.016 which is insignificant statistically but correct in sign; the elasticity with respect to world income significant and relatively higher.

We have also tried to examine the impact of the exchange rate of India's export performance at a more disaggregate level for a few products. We report the results, in elasticity form, for five products, namely: (1) cotton fabrice; (2) engineering goods; (3) coffee; (4) fish and fish preparations; and (5) handicrafts. (The additional data are reported in Table **11**. The results for other products were found not to be worth reporting at this stage.

Table:**13** presents the econometric results of the exercise relating the nominal effective exchangerate (NER) to the nominal values of exports. These results confirm that exchange rate depreciation has an important effect in increasing India's exports of all five selected products,

including both traditional products and the nontraditional the NER are all much above unity and are of appropriate sign and statistically significant at a 5 percent level of significance. These lead to the conclusion that India's exports of these selected products are highly elastic with respect to the nominal effective exchange rate.

The econometric results in Table 14 are based on similar data but for the real magnitudes of the variables involved. Thus we examine the impact of the real effective exchange rate (RER) on the value of exports of five selected product measures in constant prices. The results in Table confirm that for the five selected products, exports in real terms are highly elastic with respect to both the RER. The signs of the coefficients are correct and are also much above unity. We therefore conclude that the real effective exchange rate doesdoes influence the growth of real exports of the selected products. We presume that this result would hold for most of the nontraditional products exported by India.

A look at the simple econometric results presented in Tables 13 and 14 reveals that there is definite role which depreciation of the Indian rupee can play, subject to other things being constant, in increasing India's exports in real terms in line with economic theory.

It would be naive to suggest from the above analysis that the exchange rate instrument should be considered in

TABLE : 14 : IMPACT OF NOMINAL EXCHANGE RATE AND REAL EFFECTIVE EXCHANGE RATE ON INDIA'S REAL EXPORTS OF SELECTED PRODUCTS.

Commodity (Exports) (Real values)	Intercept	In NER	In RER	R^2
1. In Cotton Fabrics	6.65	-0.47 (2.04)		0.20
2. In Cotton Fabrics	7.68		-0.67 (2.31)	0.25
3. In Engineering Goods	10.75	-1.31 (4.55)		0.56
4. In Engineering Goods	13.71		-1.96 (7.10)	0.77
5. In Coffee	10.07	-1.42 (3.55)		0.45
6. In Coffee	13.64		-2.21 (5.41)	0.66
7. In Fish and Preparations	11.23	-1.60 (4.70)		0.58
8. In Fish and Preparations	14.75		-2.37 (7.31)	0.78
9. In Handicrafts	18.66	-3.08 (7.00)		0.76
10. In Handicrafts	24.59		-4.38 (14.54)	0·93

Figures in brackets below estimated coefficients are t-values

NER - Nominal Exchange Rate

RER - Real Exchange Rate.

isolation, or without regard to the several other preconditions which economic theory itself lays down for the success of devaluation, namely;

1. The sum of the relevant demand elasticities for exports and imports be greater than unity;
2. There should be no supply bottlenecks in the domestic economy so that exportable output does go up on response to the change in the exchange rate;
3. The domestic price level does not rise relative to the international price level;
4. That exports are not much affected by nonprice factors (such as nontariff barriers; quality, delivery schedules, brand loyalties, terms of export credit and the like) and affected largely by the price factor;
5. That there is no retaliatory exchange rate change from competing exporting countries(no competitive devaluation).

It is debatable whether all these conditions can be satisfied in the case of India exports for deriving maximum benefit from the decision to devaluate the Indian rupee. With the changing composition of India's exports more and more in favour of manufactured goods and price-elastic

non-traditional goods, the chances of devaluation producing the desirable effect on India's exports have increased today compared to say, 1966. In any case, through a managed exchange rate, the Reserve Bank of India has gradually and with some regularity effected substantial depreciation of the Indian rupee during the last few years without any disastrous effects and, if anything, some beneficial effects on the price competitiveness of India's manufactured exports. However, the decision to devalue the Indian rupee in a single step by say 20 percent (over and above the existing arrangement gradually to depreciate the rupee against leading currencies) cannot be taken only by considering its effects on India's exports. An in-depth and comprehensive study of the costs and benefits of such a policy decision needs to be launched.

Policy Options

While examining the policy options available to Indian economy to manage its balance of payments problems and the debt problem, it is important to bear in mind the following facts. First, our analysis in preceding sections seems to indicate that Indian economy is already heading towards a debt trap, in the sense that a minimum of $8000 million will have to be borrowed from external sources at present to service the debt and to finance the non-compressible and policy induced imports. Second, international financial markets today are highly vulnerable and are liable to change swiftly in terms of

instruments and intermediation techniques. The use of short term money market instruments to raise long term funds can create problems of roll over if market conditions change for the worst. Third, foreign bank managements and supervisory authorities are highly sensitive to over-exposures to individual countries are monitored closely and widely publicised. With accumulation of greater and greater amount of debt burden, India's credit standing might further deteriorate. In view of all these, immediately in the near future, the authorities have no option other than to go in for further financial market borrowing to avoid an external liquidity problem and also to bolster the foreign exchange reserves. At the domestic level, the official approach should be to lean on export promotion to generate more export earnings. In addition to the substantial benefits conferred by the depreciation of the rupee, export industries deserve to be given a number of financial and fiscal incentives. While the need for promoting exports cannot be over emphasized one must be realistic about what can be achieved in this respect. This is because over more than two and half decades of continuous and vigorous export promotion efforts we have not been able to succeed in creating durable and dynamic export capability. As already emphasized in earlier sections there are both external and internal factors that inhibit Indian exports. It seems in the highly competitive international

markets success can be achieved only by countries with an inherent domestic compulsion to export for survival. Besides technological upgradation and productivity increases are not transient efforts to be achieved in isolated export industries. To import continuous competitiveness to our industries, there must be condusive and dynamic research and development effort spread over a wide spectrum of industries. In view of the present magnitude of external resource gaps our exports have to treble for generating a surplus adequate enough to service the already contracted external debt. On the other hand India will have to exercise the option of reducing the imports. A careful sieving of all imports to identify those items which will have the least impact on the economy has to be undertaken. The axe must fall on those items for which import substitutes are already available or can easily be developed.