External Sector

04

CHAPTER

A pick-up in growth in some large advanced economies, along with lower global commodity prices and relative financial stability amidst periodic turbulence, marked the external sector environment in 2015-16. The muted global growth recovery and outlook owed largely to a decline in emerging economies for the fifth consecutive year and particularly to rebalancing in the Chinese economy. Reflecting the weak global demand and trends, India's exports have been declining since December 2014. With imports falling in level due to lower global commodity prices, merchandise trade deficit continued at moderate levels in 2015-16 and, net surplus in the invisibles account remaining on an even keel, current account deficit was at 1.4 per cent of gross domestic product in April-September 2015.While the periodic global financial market turbulences led to some outflows under portfolio investment, the other capital/financial flows remained by and large supportive, leading to net reserve accretion of US$10.6 billion in the first half of this fiscal. The rupee remained resilient in the recent turmoil, testifying to a strong macroeconomic outlook for the country.

Global Economic Environment

4.2 One important positive outcome in 2015 was the modest pick-up in growth in some of the advanced economies. It might be recalled that after falling in 2009 due to the 2008 global financial crisis, growth in emerging and developing economies rebounded in 2010 and 2011. While advanced economies also exhibited a recovery in 2010 thanks to the large stimuli, global growth continued to be tepid relative to the average of the decade ending 2006, largely on account of the slowdown in advanced economies. Spillover effects of the crisis may have been large, prolonged and bi-directional, given that the global integration is far greater than in the prior decade. This has made the task of projecting global economic outlook arduous. This uncertainty has led to the International Monetary Fund (IMF) revising the global growth outlook in its World Economic Outlook (WEO) four times a year since 2009.

4.3 In its latest WEO Update, published on 19 January 2016, the IMF has projected growth in the global economy to go up from 3.1 per cent in 2015 to 3.4 per cent in 2016 and further to 3.6 per cent in 2017, slightly lower than the projection published in October 2015. Growth in advanced economies is revised by 0.2 percentage points in 2016 to 2.1 per cent, to continue through 2017. Growth in the US is expected to remain resilient owing to strengthening of the housing and labour markets. Growth in the euro area, is expected to increase due to stronger private consumption supported by lower oil prices and easy financial conditions is expected to outweigh the weakening in net exports. Growth in Japan is also expected to consolidate in 2016, on the back of fiscal support, lower oil prices, accommodative financial conditions, and rising incomes.

4.4 Overall global economic activity remained subdued in 2015, as growth in emerging market and developing economies (EMDE) declined for the fifth consecutive year and recovery in advanced economies was modest. This is also attributable to the changing composition of the global economy and relative point contributions to global growth. The fall in the contribution of the EMDEs is not being made good by the advanced economies. A recent feature is that the Chinese economy is gradually slowing down and is transitioning from investment demand to consumption demand and from manufacturing to services. The concern over the spillovers of subdued global growth to other economies through trade channels and weaker commodity prices is manifest in diminishing confidence and increasing volatility in financial markets. In addition, a dual monetary policy--a gradual tightening in monetary policy in the US in the backdrop of its resilient recovery and easy monetary policy in several other major advanced economies--has led to continued uncertainties and poses challenges for the year ahead. In the case of EMDEs, growth remained subdued at 4 per cent in 2015, but is projected to increase to 4.3 per cent in 2016 and 4.7 per cent in 2017. The slowdown and rebalancing of the Chinese economy, lower commodity prices, and strains in some large emerging market economies will continue to weigh on growth prospects in 2016–17. Assessments indicate that mixed inflation developments in EMDEs reflect the conflicting implications of weak domestic demand and lower commodity prices versus marked currency depreciations over the past year.

4.5 The 19 January WEO Update also indicated that India and the rest of emerging Asia are bright spots, albeit with some countries facing strong headwinds from China's economic rebalancing and global manufacturing weakness. The IMF's growth forecast for India is 7.5 per cent in 2016 and 2017 and this surpasses the projection of 6.3 per cent and 6.0 per cent respectively for China. The level of global economic activity has a significant and direct bearing on the growth prospects of the emerging economies through trade channels. As per the Update, world trade volume growth projections have been placed at 3.4 per cent and 4.1 per cent respectively for 2016 and 2017--lower by 0.7 percentage points to 0.5 percentage point respectively from WEO, October 2015. The World Bank's Report on Global Economic Prospects (January 2016) also estimated that India will grow by a robust 7.8 per cent in 2016 and 7.9 per cent in the following two years. Compared to other major developing countries, the report maintained that India is well positioned to withstand near-term headwinds and volatility in global financial markets due to reduced external vulnerabilities, a strengthening domestic business cycle, and a supportive policy environment.

India's Merchandise Trade

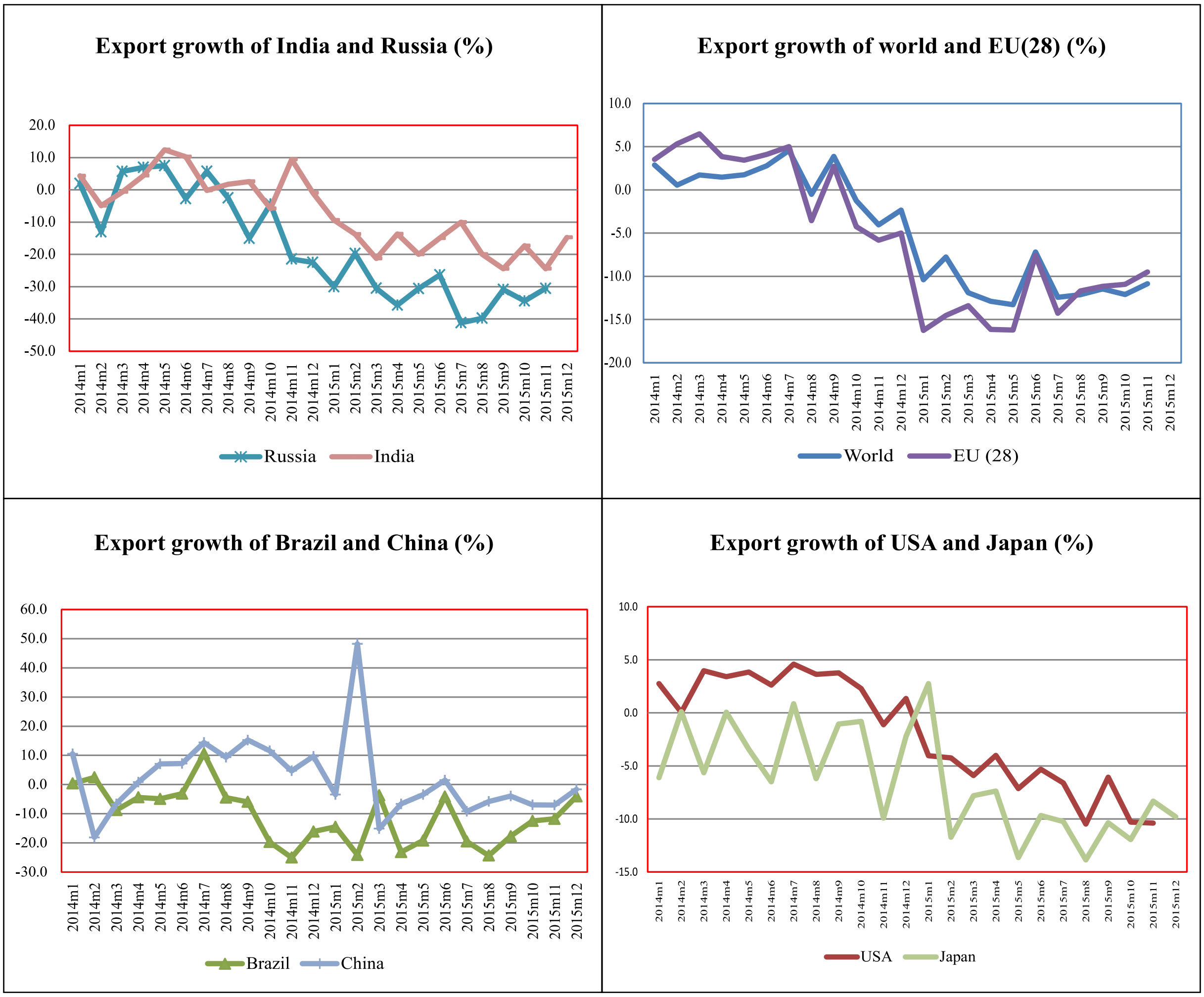
4.6 The rapid and over threefold rise in India's merchandise exports from less than US$100 billion prior to 2005-6 to over US$300 billion in 2011-12 was composed of a rather high growth in exports of petroleum, oil and lubricants (POL) as well as non-POL exports. Imports grew in the same period at a faster clip and the levels of merchandise trade deficit went up particularly precipitously in 2011-12 and 2012-13. A large part of the widening owed to global commodity price rise even in a milieu of tepid global economic growth. India's greater integration with the world economy was reflected by the trade openness indicator, merchandise trade to gross domestic product (GDP), which increased from 13.9 per cent in 1991-92, to 27.0 per cent in 2004-5 and further to 41.0 per cent in 2013-14. However, it moderated to 37.1 per cent in 2014-15 as a result of subdued exports and imports.

4.7 Since late 2014-15 (December 2014), India's merchandise exports have been declining continuously. Both developed and developing countries are also witnessing a fall in exports as a result of subdued economic conditions and a downward spiral in crude oil prices. Since the latter half of 2014, there has been a southward movement in the growth of exports from India and major countries of the world and export growth of different countries moves in tandem with the world economic situation (Figure 4.1).

4.8 During the current financial year (April-January), growth in India's exports declined year-on-year by 17.6 per cent and they stood at US$217.7 billion. The decline owed to sluggish global demand and low global commodity prices, particularly of petroleum. A decomposition of the decline indicates that it is POL exports which contributed to it by as much as 55.0 per cent and engineering goods by 24.0 per cent.

4.9 Again in keeping with the global trend and the slowdown in nominal terms of domestic economic activity, imports have declined by 15.5 per cent in the current financial year (April-January) to US$324.5 billion. Lower levels of POL imports were the main reason for the decline in total imports

Figure 4.1 Export growth of world and some select countries



Source: **World Trade Organisation (WTO).**

this year so far. POL imports declined by 41.4 per cent to US$ 73.1 billion in 2015-16 (April-January) as against US$ 124.8 billion in 2014-15 (April-January), as a result of the steep fall in international crude oil prices. Correspondingly, non-POL imports at US$251.4 billion were 3.0 per cent lower than non-POL imports of US$259.1 billion. Gold and silver imports increased by 5.1 per cent to US$32.9 billion in 2015-16 (April-January) as compared to US$31.3 billion in the corresponding period of 2014-15. It may be instructive to note that this level of gold and silver imports appropriately indicates the market dynamics as even last year gold import restrictions were in place for about six months. During 2015-16 (April-January), trade deficit decreased to US$106.8 billion as compared to US$119.6 billion in the corresponding period of 2014-15.

Composition of Trade

4.10 Factor endowments, trade policies, technology, and movements in global commodity prices have had a strong bearing on the composition of India's trade over time. The global financial crisis of 2008 in conjunction with commodity price shocks significantly affected the composition. There was a rebound in 2010-11 in terms of robust global growth, relatively stable global commodity prices and a pick-up in trade. A comparison of the current composition with respect to 2010-11 may, therefore, be apposite. The top eight export sectors—petroleum products, gems and jewellery, textiles, chemicals and related products, agriculture and allied sector, transport equipment, base metals and machinery--continue to dominate India's export basket, accounting for nearly 86.4 per cent of total exports in 2014-15 (as compared to 78.1 per cent in 2010-11). Petroleum, crude and products occupy top position among the top eight export sectors with an 18.3 per cent share of total exports in 2014-15 (as against 14.6 per cent in 2010-11). The share of gems and jewellery exports declined from 17 per cent in 2010-11 to 13.3 per cent in 2014-15 (Table 4.1). The shares of agriculture and allied exports, chemicals and related products and transport equipment in total exports have increased from 7.1 per cent, 8.3 per cent and 6.6 per cent respectively in 2010-11 to 9.7 per cent, 10.2 per cent and 8.6 per cent in 2014-15.

4.11 Overall export growth declined by 1.3 per cent in 2014-15, but this was a mixed bag of a decline in exports of petroleum products, gems and jewellery and agriculture and allied products, which constituted 41.3 per cent of India's total exports in 2014-15, as against growth in exports of transport equipment, base metals and machinery which exhibited growth rates of 20.2 per cent, 10.6 per cent and 12.2 per cent respectively in 2014-15. Low growth rates of 0.5 per cent and 3.0 per cent were exhibited by exports of textiles and chemical and related products. Although the share of marine products and leather and leather manufactures is low in India's total exports, they registered high growth rates of 9.8 per cent and 8.3 per cent respectively in 2014-15. Data available on commodity wise performance this year (April-December 2015) indicates that the decline in export was broad-based.

4.12 Similarly imports into India declined by 0.5 per cent to US$448.0 billion in 2014-15 as compared to US$450.2 billion in 2013-14, on account of a fall in POL imports by 16.0 per cent. The decline in POL imports owed to a fall in international crude oil prices (Indian basket) from US$105.5 per barrel in 2013-14 to US$ 84.2 per barrel in 2014-15. Petroleum, crude and products, chemicals and related products, gold, electronic goods and machinery accounted for 62.5 per cent of India's total imports in 2014-15. Major items of imports like chemicals and related

Table 4.1: Sector wise share and growth rate of exports

	Share				Growth rate			
	2013-14	2014-15	2014-15 (Apr-Dec)	2015-16 (Apr-Dec)	2013-14	2014-15	2014-15 (Apr-Dec)	2015-16(P) (Apr-Dec)
Plantation	0.5	0.5	0.5	0.6	-11.7	-7.5	-6.1	3.4
Agri & allied products	10.5	9.7	9.6	9.2	0.9	-8.5	-4.4	-21.5
Marine products	1.6	1.8	1.8	1.9	44.8	9.8	15.4	-14.8
Ores & minerals	1.1	0.8	0.8	0.7	-2.6	-32.7	-30.1	-22.0
Leather & leather manufactures	1.8	2.0	2.0	2.1	17.2	8.3	13.5	-11.3
Gems & jewellery	13.2	13.3	13.0	14.6	-3.7	-0.3	1.4	-8.1
Chemicals & related products	9.8	10.2	9.9	12.2	6.5	3.0	5.6	0.3
Plastic & rubber articles	2.2	2.1	2.2	2.5	11.0	-3.6	1.7	-7.1
Base metals	7.1	8.0	7.7	7.3	4.2	10.6	13.8	-22.5
Electronics items	2.4	1.9	1.9	2.1	-5.2	-21.3	-21.7	-9.8
Machinery	5.6	6.3	6.1	7.2	5.8	12.2	15.1	-4.5
Transport equipment	7.0	8.6	8.5	8.1	15.2	20.2	28.4	-21.6
Textiles & allied products	11.8	12.0	11.4	13.6	12.4	0.5	4.3	-1.7
Petroleum crude & products	20.1	18.3	20.2	12.2	3.8	-10.1	1.1	-50.6
Others	5.3	4.5	4.4	5.8	-0.6	-16.0	-15.6	7.5
Total exports	**100.0**	**100.0**	**100.0**	**100.0**	**4.7**	**-1.3**	**3.5**	**-18.0**

Source: **Calculated from Directorate General of Commercial Intelligence and Statistics (DGCI&S), Kolkata data.**
Note: **Growth rate is in US dollar terms: P stands for provisional.**

products, electronic goods and gold registered growth rates of 8.2 per cent, 13.8 per cent and 19.9 per cent respectively in 2014-15 (Table 4.2). Imports of petroleum crude and products, transport equipment and pearls, precious and semi-precious stones witnessed a decline in growth rates by 16.0 per cent, 5.4 per cent and 5.8 per cent respectively.

4.13 During 2015-16 (April-December), total imports declined by 15.9 per cent to US$295.8 billion as against US$351.6 billion in 2014-15 (April-December). Detailed commodity breakup shows that imports of electronic goods, agriculture and allied products and fertilizers registered growth rates of 11.5 per cent, 6.9 per cent, and 19.4 per cent respectively. Machinery, an important item of capital goods import, registered low growth of 0.8 per cent while transport equipment imports witnessed negative growth of 12.6 per cent in 2015-16 (April-December).

Direction of Trade

4.14 The slowdown in terms of global economic growth and trade volumes was also manifest in the direction of trade statistics. The share of advanced economies that were adversely affected by the global slowdown in total Indian exports fell significantly. The shares of Europe (consisting of the EU, the European Free Trade Association [EFTA] and other European countries) and America (consisting of North America and Latin America) declined from 23.6 per cent and 20.1 per cent respectively in 2004-05 to 18.1 per cent and 19.0 per cent respectively in 2014-15. The share of the CIS & Baltics, which was 1.3 per cent in 2004-05, declined marginally to 1.1 per cent in 2014-15 while there was marginal increase in the share of Asia from 47.9 per cent in 2004-05 to 49.6 per cent in 2014-15. The export share of Africa in India's total exports increased from 6.7 per cent in 2004-05 to 10.6 per cent in 2014-15.

Table 4.2: Sector wise share and growth rate of imports

	Share				Growth rate			
	2013-14	2014-15	2014-15 (Apr-Dec)	2015-16 (Apr-Dec)	2013-14	2014-15	2014-15 (Apr-Dec)	2015-16(P) (Apr-Dec)
Plantation	0.2	0.2	0.2	0.2	3.5	-3.8	-3.2	-14.8
Agri & allied products	3.0	4.2	4.2	5.4	-19.6	40.9	46.4	6.9
Ores & minerals	5.5	6.0	5.7	5.3	-5.4	9.4	9.5	-21.0
of which								
coal, coke & briquittes, etc.	3.6	4.0	3.7	3.4	-3.5	8.5	6.4	-21.9
Gems & jewellery	13.0	13.9	13.6	15.2	-30.3	6.7	3.7	-5.7
of which								
Pearls, precious & semi-precious stones	5.3	5.0	5.1	4.9	5.7	-5.8	-2.1	-18.2
Gold	6.4	7.7	7.4	9.0	-46.7	19.9	10.7	2.4
Silver	1.0	1.0	1.0	1.1	129.9	-0.4	-7.7	-7.5
Chemicals & related products	7.9	8.6	8.6	9.9	-4.8	8.2	9.9	-3.4
of which								
Fertilizer	1.4	1.7	1.7	2.4	-28.5	18.1	8.1	19.4
Organic chemicals	2.5	2.5	2.6	2.6	9.6	2.5	9.4	-17.1
Plastic & rubber articles	2.8	3.2	3.2	3.6	2.1	12.2	18.3	-5.3
Base metals	4.8	6.0	5.8	6.5	-19.3	25.4	25.9	-6.7
Electronics items	7.2	8.2	7.9	10.4	-1.5	13.8	12.1	11.5
Machinery	6.9	7.1	6.8	8.1	-12.9	3.0	2.1	0.8
Transport equipment	3.6	3.4	3.1	3.2	-8.5	-5.4	-10.4	-12.6
Petroleum crude & products	36.6	30.9	33.1	23.1	0.4	-16.0	-4.6	-41.5
Others	8.5	8.1	7.7	9.0	5.9	-4.9	-2.4	-1.4
Total imports	**100.0**	**100.0**	**100.0**	**100.0**	**-8.3**	**-0.5**	**3.7**	**-15.9**

Source : **Calculated from DGCI&S data**
Note : **Growth rate is in US dollar terms: P stands for provisional.**

4.15 Exports to America grew by 8.9 per cent and Africa by 5.2 per cent in 2014-15 over the previous year while exports to some other destinations declined, for example Europe (by 3.5 per cent), Asia (by 1.0 per cent) and the CIS & Baltics (by 2.7 per cent). During 2015-16 (April-December), on the other hand, there was a broad-based decline in exports to all the five regions. In terms of major countries, India's exports to the USA, the UAE and Hong Kong (with shares of 13.7 per cent, 10.6 per cent and 4.4 per cent in India's total exports) increased by 8.4 per cent, 8.2 per cent and 6.8 per cent respectively in 2014-15. On the contrary, India's exports to China (3.8 per cent share), Saudi Arabia (3.6 per cent share), Singapore (3.2 per cent share) and the UK (3.0 per cent share) witnessed negative growth of 19.6 per cent, 8.7 per cent, 21.6 per cent and 4.8 per cent respectively in 2014-15. These seven countries together account for 42.3 per cent of India's total exports in 2014-15. During 2015-16 (April-December), all seven major destinations witnessed negative growth.

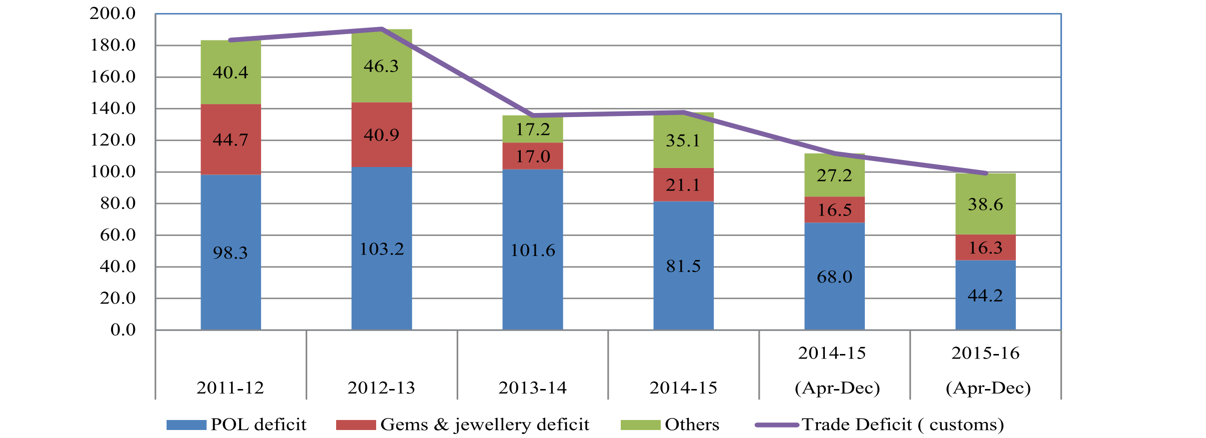
4.16 Similarly, India's import sources have also undergone change over time. India's imports from Europe (share) declined from 23.0 per cent in 2004-05 to 16.5 per cent of total imports in 2014-15. On the other hand, the import shares of Africa, America and

Asia in India's total imports increased during the same period. India's imports from Europe and Africa increased by 4.1 per cent and 5.5 per cent respectively in 2014-15 over the previous year, while imports from America and Asia declined by 2.7 per cent and 3.4 per cent respectively. Among the top countries for India's imports, China with a share of 13.5 per cent in total imports, registered a positive growth rate of 18.4 per cent in 2014-15. Imports from Switzerland, Indonesia and Korea, with shares of 4.9 per cent, 3.4 per cent and 3.0 per cent also registered positive growth rates of 14.6 per cent, 1.7 per cent and 8.5 per cent respectively in 2014-15. However, India's imports from Saudi Arabia (6.3 per cent share), the UAE (5.8 per cent share) and the USA (4.9 per cent share) declined by 22.8 per cent, 9.9 per cent and 3.1 per cent respectively in 2014-15. Imports from all five major regions (including CIS & Baltics) declined in 2015-16, with imports from America registering the highest decline (April-December). India's imports from China registered positive growth of 2.5 per cent in 2015-16 (April-December), while imports from other major countries registered negative growth rates.

Trade Deficit

4.17 India's trade deficit increased almost steadily from US$28.0 billion in 2004-05 to US$118.6 billion in 2010-11. It grew exponentially to reach unsustainable levels of US$183.4 billion and US$190.3 billion respectively in the next two years. However, it moderated to US$135.8 billion in 2013-14 as a result of measures taken by the government to contain trade and current account deficits. In 2014-15, the trade deficit was marginally higher at US$137.7 billion. Trade deficit continued to be at a lower level due to the decline in the value of POL imports by 16.0 per cent, caused by a fall in international oil prices by 20.2 per cent. Trade deficit can be decomposed into POL deficit and non-POL deficit. POL deficit (POL exports minus POL imports), the major component of trade deficit, which was hovering at around US$100 billion from 2011-12 to 2013-14, declined to US$81.5 billion in 2014-15 and to US$44.2 billion in 2015-16 (April-December) (Figure 4.2). Within non-POL deficit, gems and jewellery deficit (net exports of pearls, precious and semi-precious stones, gold, silver and other gold jewellery) declined sharply from US$40.9 billion in 2012-13 to US$17.0 billion in 2013-14, reflecting restrictions placed on these imports, but subsequently increased to US$21.1 billion in 2014-15. Trade policy has focused on promoting exports and thereby moderate the levels of trade deficit. The moderation in the levels of trade deficit had a salutary effect on sustaining the moderation in the overall balance-of-payments outcome in the current fiscal.

Figure 4.2: Decomposition of trade deficit (US$ billion)



Source: DGCI&S.

Box 4.1: Salient Features of the FTP 2015-2020

Merchandise Export from India Scheme: The six different schemes of the earlier FTP (Focus Product Scheme, Market Linked Focus Product Scheme, Focus Market Scheme, Agriculture Infrastructure Incentive Scrip, Vishesh Krishi and Gram Udyog Yojana and Incremental Export Incentive Scheme) which had varying sector-specific or actual user only conditions attached to their use have been merged into a single scheme, namely the Merchandise Export from India Scheme (MEIS). Notified goods exported to notified markets will be incentivized on realized FOB value of exports. Countries have been grouped into three categories--namely Category A: traditional markets, Category B: emerging & focus markets and Category C: other markets--for grant of incentives. The government has expanded the coverage of the MEIS on 29 October 2015 by adding 110 new items. The incentive rate/country coverage of 2228 items has been enhanced.

Service Export from India Scheme: The Served from India Scheme (SFIS) has been replaced with the Service Export from India Scheme (SEIS). The SEIS applies to 'service providers located in India' instead of 'Indian service providers'. Thus it provides for incentives to all service providers of notified services who are providing services from India, regardless of the constitution or profile of the service provider. The rates of incentivization under the SEIS are based on net foreign exchange earned. The incentive issued as duty credit scrip, will no longer carry an actual user condition and will no longer be restricted to usage for specified types of goods but be freely transferable and usable for all types of goods and service tax debits on procurement of services/goods.

Incentives (MEIS & SEIS) to be available for SEZs: FTP 2015-20 extends the benefits of the MEIS and SEIS to special economic zones (SEZ) as well, which will give a new impetus to the development and growth of SEZs.

Duty credit scrips are freely transferable and usable for payment of custom duty, excise duty and service tax: All scrips issued under the MEIS and SEIS and the goods imported against these scrips are fully transferable. Scrips issued under these schemes can be used for the following:

(a) Payment of customs duty on import of inputs / goods including capital goods, except items listed in Appendix 3A.

(b) Payment of excise duty on domestic procurement of inputs or goods, including capital goods as per notification of Department of Revenue (DoR).

(c) Payment of service tax on procurement of services as per DoR notification. Basic customs duty paid in cash or through debit under duty credit scrip can be taken back as duty drawback as per DoR rules, if inputs so imported are used for exports.

Other measures

(a) Under the Export Promotion Capital Goods (EPCG) scheme, in case capital goods are procured from indigenous manufacturers, specific export obligation has been reduced to 75 per cent. This is designed to help the indigenous capital goods manufacturing industry.

(b) Under the MEIS, export items with high domestic content and value addition have generally been provided higher levels of incentives.

(c) Hard copies of applications and specified documents which were required to be submitted earlier for incentive schemes and duty exemption schemes have now been dispensed with.

(d) Landing documents of export consignments as proof for notified market can now be digitally uploaded as specified.

(e) There will be no need to submit copies of permanent records/documents repeatedly with each application, once the same are uploaded in the exporter/importer profile.

(f) Dedicated e-mail addresses have been provided for faster and paperless communication with various committees of the Directorate General of Foreign Trade (DGFT), e.g. Norms Committee and Exim Facilitation Committee.

Trade Policy

Trade policy measures

4.18 In the wake of declining exports, the government took various measures to boost exports in the Union Budget 2015-16 and a new Foreign Trade Policy (FTP). A new FTP for the period 2015-20 was announced on 1 April 2015, with a focus on supporting both manufacturing and services exports and improving the 'Ease of Doing Business'. The new FTP aims to increase India's exports to US$900 billion by 2019-20. Its salient features are given in Box 4.1. It also provides the road map adopted by the government to align it with the 'Make in India' and 'Digital India' programmes and to ease trade. Box 4.2 lists some important trade facilitation measures undertaken by the government to improve ease of doing business.

Box 4.2: Recent Measures for Trade Facilitation

(a) The government has reduced the number of mandatory documents required for exports and imports to three each, which is comparable with international benchmarks. The trade community can file applications online for various trade-related schemes. Online payment of application fees through credit/debit cards and electronic funds transfer from 53 banks has been put in place.

(b) Customs single window initiative: The Union Budget 2014-15 announced an Indian Customs Single Window Project to facilitate trade. This project envisages that importers and exporters will electronically submit their customs clearance documents at a single point with customs. Any permissions required from other regulatory agencies (such as animal quarantine, plant quarantine, drug controller and textile committee) could be obtained online without the importer/exporter having to separately approach these agencies. The single window will thus provide importers/exporters a single point interface for customs clearance of import and export goods, thereby reducing personal interface with governmental agencies, dwell time and cost of doing business. With effect from 1 April 2015, an electronic exchange facility has been established between customs and the Food Safety and Standards Authority of India (FSSAI), the Department of Plant Protection, Quarantine and Storage (PQIS) at the Jawaharlal Nehru Port Trust (JNPT) (Nhava Sheva), inland container depot (ICD), Tughlakabad and ICD, Patparganj, for online message exchange, including no objection certificates (NOC) with/from these agencies. Other regulatory agencies such as animal quarantine, the textile committee, the drug controller of India and wildlife authorities are also being brought within the ambit of single window customs clearance.

(c) 24x7 customs clearance: With effect from 31 December 2014, the facility of 24x7 customs clearance for specified imports, namely goods covered under 'facilitated' bills of entry, and specified exports, namely factory stuffed containers and goods exported under free shipping bills, have been made available at 18 seaports. Similarly, the facility of 24x7 customs clearance for specified imports, namely goods covered by facilitated bills of entry and all exports, namely goods covered by all shipping bills has been extended at 17 air cargo complexes. This will help in faster clearance of such import and export goods, reduce dwell time and lower the transaction cost.

(d) One of the major objectives of the new FTP is to move towards a paperless 24x7 working environment. A new facility has been created to upload documents in exporter/importer profile so that exporters are not required to submit documents repeatedly.

(e) Attention has also been paid to simplifying various 'aayat niryat' forms, bringing in clarity in different provisions, removing ambiguities and enhancing electronic governance.

(f) The Directorate General of Foreign Trade (DGFT) has launched a new-look website, making it more user-friendly and easy to navigate. The DGFT website has a large dynamic component whereby the trade community can file applications online for importer exporter code (IEC) and various other schemes of the DGFT. Exporters can also see the status of their electronic bank realization certificates almost in real time. The website is rich in content with all documents related to FTP along with a responsive online grievance redressal system.

(g) The DGFT launched a 'DGFT' mobile application in June 2015. The application allows exporters/importers to access foreign trade policy and other related documents in an easy-to-use searchable format and check status of transmission of various authorizations and shipping bills, etc.

(h) Training/outreach programmes for exporters:

- The Niryat Bandhu Scheme has been galvanized to achieve the objectives of Skill India. Outreach activities are being organized at MSME (micro, small and medium enterprises) clusters with the help of export promotion councils (EPCs) and other willing 'industry partners' and 'knowledge partners'. More than 20,000 entrepreneurs have been given exposure by DGFT regional offices under the Niryat

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Bandhu Scheme. In September 2015, the DGFT in collaboration with the Indian Institute of Foreign Trade (IIFT) has launched 'Niryat Bandhu at Your Desktop', an online certificate programme in export import business. The programme has elicited very good response. Four programmes have been completed.

- An ambitious outreach programme has been launched by the Department of Commerce (DoC) for exporters located in the major export clusters/cities. The programme focuses on:
  - Training exporters to utilize free trade agreements (FTA).
  - Taking inputs from exporters on FTAs under negotiation, for example the Regional Comprehensive Economic Policy (RCEP).
  - Promoting awareness about the contents of the www:indiantradeportal.in launched by the DoC.

(i) **Other important measures**

- A Council for Trade Development and Promotion has been constituted in July 2015 to ensure continuous dialogue with the governments of states/ union territories (UT) on measures for providing an international trade-enabling environment and for making the states active partners in boosting India's exports. The first meeting of the council was held on 8 January 2016.
- The state/UT governments have been requested to develop their export strategy, appoint export commissioners, address infrastructure constraints restricting movement of goods, facilitate refund of value-added tax (VAT)/octroi/state-level cess, address other issues relating to various clearances and build capacity of new exporters in order to promote exports. States and UTs have also been issued user-ids and passwords to facilitate access to the foreign trade database maintained by the Directorate General of Commercial Intelligence & Statistics (DGCI&S) to extract the export data relating to their states.

WTO Negotiations and India

4.19 The Tenth Ministerial Conference of the WTO was held in Nairobi, Kenya during 15-19 December 2015. This was the first such meeting to be hosted by an African nation. The outcomes of the Conference, referred to as the 'Nairobi Package' include Ministerial Decisions on agriculture, cotton and issues related to least developed countries (LDCs). These cover public stockholding for food security purposes, a Special Safeguard Mechanism (SSM) for developing countries, a commitment to abolish export subsidies for farm exports particularly from the developed countries and measures related to cotton. Decisions were also made regarding preferential treatment to LDCs in the area of services and the criteria for determining whether exports from LDCs may benefit from trade preferences.

4.20 The divergence in viewpoints as regards the fate of the Doha Round continued during the Conference. The Nairobi Ministerial Declaration reflects divergence amongst the WTO membership on the relevance of reaffirming the Doha Development Agenda (DDA) as the basis of future negotiations. This was despite the fact that India, along with many other developing countries, from groups such as the G-33, LDCs, and the Africa Group, wanted a reaffirmation of the mandate of the Doha Round. India pointed this out in a written submission to the Director General, WTO and the Chair of the Tenth Ministerial Conference, the Kenyan foreign minister as well as in a statement at the closing ceremony on 19 December 2015. While reflecting that there are divergences, the Ministerial Declaration also notes the "strong commitment of all Members to advance negotiations on the remaining Doha issues." It records that WTO work would maintain development at its centre. It also reaffirms that provisions for special and differential treatment shall remain integral.

4.21 As regards the introduction of other new issues for discussion, the Declaration acknowledges the differences in views and states that any decision to launch negotiations multilaterally on such issues would need to be agreed by all Members. As the future of the Doha Round appeared in doubt, India sought and succeeded in obtaining a re-affirmative Ministerial Decision on Public Stockholding for Food Security Purposes honouring both the Bali Ministerial and General Council Decisions. The decision commits members to engage constructively in finding a permanent solution to this issue. Similarly, a large group of developing countries has long been seeking a SSM for agricultural products. In order to ensure that this issue remains on the agenda of future discussion in the WTO, India negotiated a Ministerial Decision which recognizes that developing countries will have the right to have recourse to an SSM as envisaged in the mandate. Members will continue to negotiate the mechanism in dedicated sessions of the Committee on Agriculture in Special Session. The WTO General Council has been mandated to regularly review progress of these negotiations.

4.22 WTO Members also agreed to the elimination of agricultural export subsidies subject to the preservation of special and differential treatment for developing countries such as a longer phase-out period for transportation and marketing export subsidies for exporting agricultural products. Developed countries have committed to removing export subsidies immediately, except for a few agricultural products, and developing countries will do so by 2018. Developing countries will keep the flexibility to cover marketing and transport subsidies for agriculture exports until the end of 2023, and the LDCs and net food-importing developing countries would have additional time to cut such export subsidies. The Ministerial Decision contains disciplines to ensure that other export policies are not used as a disguised form of subsidies. These disciplines include terms to limit the benefits of financing support to agriculture exporters, rules on state enterprises engaging in agriculture trade, and disciplines to ensure that food aid does not negatively affect domestic production. Developing countries, such as India, will have a longer implementation period. One of the Decisions adopted extends the relevant provision to prevent 'evergreening' of patents in the pharmaceuticals sector. This decision would help in maintaining an affordable and accessible supply of generic medicines. India supported outcomes on issues of interest to LDCs including enhanced preferential rules of origin for LDCs and preferential treatment for LDC services providers. India already offers duty-free, quota-free access scheme to all LDCs, which provides a comprehensive coverage with simple, transparent and liberal rules of origin. India has also recently made available substantial and commercially meaningful preferences in services to LDCs.

4.23 Another area under negotiation in Nairobi dealt with the rules on fisheries subsidies. Several countries, such as China, Egypt, South Africa, Korea and Saudi Arabia, were opposed to disciplining rules on fisheries subsidies due to the lack of clarity. The overwhelming opposition to this item on the agenda was in tune with India's position. There was no outcome in this area of the negotiations. On the issue of rules on Anti-dumping, India strongly opposed a proposal that would give greater power to the WTO's Anti-Dumping Committee to review Members' practices. There was no convergence in this area and, hence, no outcome was achieved. At the Ministerial Conference, a group of 53 WTO members, including both developed and developing countries, agreed on the timetable for implementing a deal to eliminate tariffs on 201 Information Technology products. Duty-free market access to the markets of the members eliminating tariffs on these products will be available to all WTO members. Though not a party to the Agreement, India can also avail of such duty-free market access.

Bilateral and Regional Cooperation

4.24 Multilateral trade agreements are the first best solutions for deepening global trade and development as they are founded on the core principles of non-discrimination. Regional trade agreements (RTAs) are efforts by nations aimed at deepening economic relations, usually with neighbouring countries, and tend to be largely political in nature. With the multilateral trade negotiations process under the WTO being a painfully slow one requiring broad-based consensus, RTAs have progressively assumed greater importance and a growing share in international trade. While RTAs are broadly compliant with WTO mandates and remain broadly supportive of the WTO process, they remain second-best solutions that are discriminatory in nature against non-members and are inefficient as low cost producing non-members lose out to members. While bilateral RTAs have no equity considerations, mega-regional trading groups may not necessarily be equitable if membership is diverse and small countries may lose out either way—if they are part of it they may not have much say and if they are not, they may stand to lose. India has always stood for an open, equitable, predictable, non-discriminatory and rule-based international trading system and views RTAs as building blocks in the overall objective of trade liberalization as well as complementing the multilateral trading system under the WTO. The Trans-Pacific Partnership (TPP) agreement is one new mega-regional block that has become a reality and has implication for India.

4.25 The 12 Pacific Rim nations (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US and Vietnam) signed the TPP agreement on 5 October 2015. It is likely to set higher standards for goods and services trade. It is considered a mega regional FTA which can be a pioneer in many ways. The TPP is likely to be a game-changer for the world economy and global trade. The 12 members of the TPP account for around 40 per cent of global GDP and around 60 per cent of merchandise trade. In terms of economic size, the TPP is larger than the existing North America Free Trade Area (NAFTA). The TPP trade agreement is very comprehensive and not only encompasses the scope of tariff-eliminating mega regional trade pacts, but also aims at setting higher global standards for international trade through lower benchmarks for non-tariff barriers, more stringent labour and environment regulation, higher intellectual property rights (IPR) protection, greater transparency in government procurement and limiting advantages to state-owned enterprises (SOE) and transparency in health care technology, competitiveness and supply chains. It includes new and emerging trade issues and cross-cutting concerns such as internet and digital economy and participation of SOEs in global trade and investment. In the short run, the trade impact of the TPP may not be seriously adverse but careful analysis is required for adapting and responding to the challenges in the long run. Many institutional analyses have focused on the implications for India, and the results are summarized in Box 4.3.

4.26 So far, India has signed 10 FTAs and six preferential trade agreements (PTAs) and these FTAs/PTAs are already in force. The net impact of the RTAs on export performance and trade outcome is a mixed bag and requires detailed analysis. A gradual approach of widening the process of negotiating 19 FTAs (including review) is under way. An update of the progress of RTAs is given in Box 4.4.

Box 4.3: The TPP and Its Implication for India

Bergsten (2015) estimated that India could experience huge export gains of more than US$500 billion per year--a 60 per cent increase--from joining an expanded TPP or participating in a comprehensive Free Trade Area of the Asia Pacific (FTAAP), now being considered by the Asia-Pacific Economic Cooperation (APEC), and Indian national income would expand by 4 per cent (over US$200 billion). The estimates show that India's exports would rise by around US$5.3 billion annually; however, imports into India would rise by US$10.4 billion, leaving a net deficit in balance of trade of US$5.1 billion (Banga and Sahu 2015). India is most competitive in services trade and reduction of trade barriers in services among TPP members will result in growth in India's services exports (Kumar and Das 2015).

The possible risks of not joining the TPP are difficult to quantify, but some of the research has highlighted the possibility of trade diversion and raised concerns about erosion of India's share in exports to the US and Europe. The TPP is expected to make around 11,000 tariff lines duty free for its members, which may result in loss of competitiveness of Indian exports in these markets. This will lower India's export share to the US and the EU, shifting it to the TPP developing countries instead. Some of the export sectors such as textiles and clothing industry are likely to face stiff competition from Vietnam, and it may lead to trade diversion. However, the implementation of stringent non-tariff measures is likely to increase the cost of production and will erode the competitiveness of exports of TPP member countries which will reduce the extent of trade diversion from India (RIS Report 2015 and Das 2015). There is also the concern of investment diversion, particularly as countries like Vietnam would offer more robust investor protection.

Some analysts have cautioned that India has to give due consideration to the costs if it is desirous of joining the TPP, as it will be required to comply with provisions relating to tariffs, SoEs, agriculture and IPR protection. Some of the major concerns are as follows:

Openness of market: TPP economies on average are more open than the Indian economy. The average applied most favoured nation (MFN) tariff rate in TPP economies is 4.5 per cent, which is lower than the Organisation for Economic Co-operation and Development (OECD) average of 5.7 per cent. The service trade restriction index of the World Bank indicates that the TPP economies are less stringent about entry of services than India with a score of about 65.7 in 2008-10, which is 2.5 times greater than the TPP economies' average score of 25.1. India needs to work significantly in terms of openness of market as its tariff rates are significantly higher than those in the TPP countries (Kumar and Das 2015).

Import competition: Domestic industries will face severe import competition due to tariff elimination on some of the products. Indian industry is already battling infrastructure deficiency and implementation of stringent measures may raise the cost of production, threatening the survival of domestic manufacturing.

SoEs: Membership of the TPP would prevent the government from using SoEs and government procurement as vehicles for achieving social and economic objectives, including employment generation. India would have to compromise on the Make in India policy (Das 2015, RIS Report 2015, Kumar and Das 2015 and Palit 2015).

IPRs: The TPP agreement on IPRs does not prevent a party from taking measures to protect public health and, in particular, to promote access to medicines for all. However, the prices of pharmaceutical products can be expected to rise due to implementation of IPR agreements which will give more protection to patented medicine and may lead substantially to elimination of generic drugs from the market. Nobel laureate Joseph Stiglitz has expressed concern that 'the efforts to raise drug prices in the TPP take us in the wrong direction. The whole world may come to pay a price in the form of worse health and unnecessary deaths'. Implementation of patent term adjustment rules significantly delays entry of generic medicines and restricts access to affordable medicines.

Government procurement: Apart from stressing non-discriminatory, fair and transparent procurement procedures, the TPP specifies timely publication of complete information on the procuring entity, the specific procurement, the time frame for submission of bids, and a description of conditions for participation of suppliers. As the agreement curtails the flexibility available to signatory countries to impose export restrictions on food, it will jeopardize India's endeavour to ensure food security (USTR 2015, RIS Report 2015 and Das 2015).

Contd....

Labour standards: The RIS in World trade and Development Report 2015 on 'Mega Regionals, WTO and New Issues' indicated that the TPP has gone beyond core labour standards to include 'acceptable conditions of work' within its ambit. These bind the members to adopt and maintain laws and practices governing acceptable conditions of work relating to minimum wages, hours of work, and occupational health and safety determined by each party (RIS Report 2015 and USTR 2015). These labour standards may increase the labour cost in the developing countries as they raise the issue of enforceable commitments which require the member countries to pass legislation in line with the TPP labour standard and put effective implementation agencies in place.

Environment standard in TPP agreement: The TPP agreement goes beyond the provisions in other FTAs to include new ones that will address wildlife trafficking, illegal logging and illegal fishing practices. The TPP members acknowledge that inadequate fisheries management, fisheries subsidies that contribute to overfishing and overcapacity, and illegal, unreported and unregulated (IUU) fishing can have significant negative impacts on trade, development and the environment and 'thus recognize the need for individual and collective action to address the problems of overfishing and unsustainable utilization of fisheries resources'. This is in contradiction to India's current policy of subsidizing the fishery industry. It may severely affect special governmental assistance programmes for around 15 million poor fishermen in India. Fishery subsidies rule has been incorporated for the first time in an FTA agreement and this will set the standard for other countries in the WTO arena. Hence these TPP rules are likely to affect the multilateral process and impact India, independently of whether it joins the TPP or not (Meltzer, 2015).

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Box 4.4: India's Proposed new RTAs: A progress update

India-Thailand Comprehensive Economic Cooperation Agreement (CECA): Early Harvest Scheme has been implemented on 82 items. So far 29 rounds of India-Thailand Trade Negotiation Committee (ITTNC) meetings have been held. The 29th round was held in Bangkok in June 2015.

India- New Zealand FTA/CECA: Ten rounds of negotiation have been held so far. The 10th Round was held in New Delhi on 17-18 February 2015.

India–SACU (South Africa, Botswana, Lesotho, Swaziland and Namibia) PTA: Five rounds of negotiations have been held so far. The Ninth Joint Ministerial Commission (JMC) meeting was held at Durban on 19 March 2015.

BIMSTEC (Bangladesh, India, Myanmar, Sri Lanka, Thailand, Bhutan and Nepal) FTA: Twenty meetings of the Trade Negotiating Committee (TNC) have taken place. The 20th meeting was held during 07-09 September 2015 in Khon Kaen Province, Thailand.

India-Canada FTA: Nine rounds of negotiation on the India-Canada Comprehensive Economic Partnership Agreement (CEPA) have so far been held. The ninth round was held in Ottawa, Canada on 1 March 2015.

India–Australia CECA: Nine rounds of negotiations have been held so far. The ninth round was held between 21 and 23 September 2015 in New Delhi, India.

Regional Comprehensive Economic Partnership (RCEP) Agreement among ASEAN + Six FTA Partners (Australia, China, India, Japan, South Korea and New Zealand): Based on the Declaration of the Leaders during the ASEAN Summit in November 2012, negotiations for a comprehensive economic partnership between the 10 ASEAN member states and its six FTA partners commenced in May 2013. Ten rounds of negotiations have so far been held. The 10th round was held from 8 to16 October 2015 in Busan, Korea. The negotiations cover a number of areas like trade in goods, services, investment, intellectual property, economic and technical cooperation, competition, e-commerce and legal and institutional issues.

Balance of Payments Developments

Overview of Balance of Payments

4.27 The external sector outcome in 2014-15 and the first half (H1) of 2015-16 indicates continued moderation in levels of trade and current account deficits with broadly adequate financing. This owed largely to the fall in global crude oil and commodity prices. The sluggish global growth not only adversely impacted merchandise exports but also caused the invisibles surplus to grow only marginally during this period. Under the capital/finance account of balance of payments (BoP), foreign investment reached a peak level of US$73.5 billion in 2014-15. Adjusting for the exceptional special swap facility offered by the government to finance the current account deficit (CAD) in 2013-14, the level of net NRI deposits in 2014-15 is broadly comparable to the peak normal level of 2012-13. Capital/finance flows (net) were US$88.2 billion in 2014-15, driven largely by investment flows. Higher capital/financial flows with low CAD resulted in large accretion to reserves (US$61.4 billion) in 2014-15.

4.28 During H1 of 2015-16, despite a decline in merchandise exports the India's external sector situation remained comfortable. Some of the salient external sector developments were as follows: (i) lower trade deficit and modest growth in invisibles resulted in lower CAD; (ii) the increase in FDI inflows and NRI deposits continued; and (iii) there was net outflow of portfolio investment. Although there was a net outflow under portfolio investment, capital/financial flows were in excess of CAD and their absorption by the Reserve Bank of India (RBI) led to an accretion in reserves.

Current account developments in 2014-15 and the H1 of 2015-16

4.29 Merchandise exports (on BoP basis) declined by 0.6 per cent and 17.6 per cent respectively in 2014-15 and H1 of 2015-16. Decline in POL exports was the major reason for the overall decline in exports. POL exports declined by 10.2 per cent in 2014-15 and 50.0 per cent in H1 of 2015-

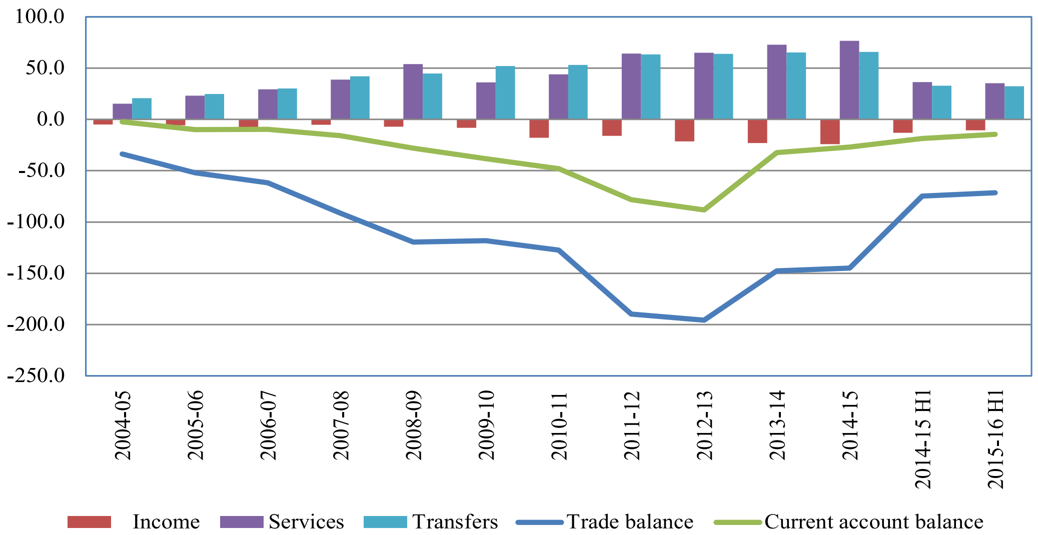
16 on account of a fall in the international prices of petroleum crude products by 20.2 per cent in 2014-15 and 46.6 per cent in H1 of 2015-16. Similarly, merchandise imports also declined year on year by 1.0 per cent and 13.4 per cent respectively in 2014-15 and H1 of 2015-16. Here again, lower levels of POL imports were the main reason for the decline in total imports. POL imports fell by 16.0 per cent in 2014-15 and 41.5 per cent in H1 of 2015-16. As a result of decline in both exports and imports, trade deficit fell from US$147.6 billion in 2013-14 to US$144.9 billion in 2014-15 and US$71.6 billion in the first half of 2015-16. As a proportion of GDP, the trade deficit was 7.1 per cent in 2014-15, the lowest since 2006-7. During the first half of 2015-16, trade deficit as a proportion of GDP was 7.2 per cent as against 7.5 per cent in the first half of 2014-15.

4.30 On the invisibles account, services exports grew by 4.0 per cent to US$157.7 billion in 2014-15. During H1 of 2015-16, services exports increased by 0.7 per cent to US$77.0 billion as against US$76.5 billion in H1 of 2014-15. Services imports grew by 3.3 per cent to US$81.1 billion in 2014-15. They grew by 4.2 per cent to US$41.7 billion in H1 of 2015-16 as against US$40.0 billion in H1 of 2014-15. Net services exports, which act as a cushion to moderate the trade deficit, increased from US$73.0 billion in 2013-14 to US$76.6 billion in 2014-15. However, net services exports declined to US$35.3 billion in H1 of 2015-16 as against US$36.5 billion in H1 of 2014-15, mainly due to lower growth of services exports than that of services imports.

4.31 Net income, which is the net outgo on account of the interest/dividend of the stock of capital flows that have come to India, has been increasing steadily from US$8.0 billion in 2009-10 to US$24.1 billion in 2014-15. During the first half of 2015-16, it moderated to US$10.5 billion as against US$13.0 billion in the first half of 2014-15. As a result of subdued global growth and falling crude oil prices, net private transfers, mostly in the form of remittances, increased marginally by US$0.8 billion to US$66.3 billion in 2014-15. During the first half of 2015-16, they declined marginally to US$32.7 billion as compared to US$33.1 billion in the corresponding period of the previous year.

4.32 Net invisibles surplus has increased by around US$3.0 billion to US$118.1 billion in 2014-15. As compared to the first half of

Figure 4.3: Components of current account balance (US$ billion)



Source: **RBI**

2014-15, net invisibles increased marginally by around US$1.0 billion to US$57.2 billion in the first half of 2015-16. Moderate growth in the invisibles surplus, coupled with lower trade deficit, resulted in lower CAD of US$26.8 billion (1.3 per cent of GDP) in 2014-15 and US$14.4 billion (1.4 per cent of GDP) in H1 of 2015-16 (Figure 4.3).

4.33 The RBI has presented BoP numbers in both the revised format provided in the IMF's Balance of Payment Manual 6 (BPM6) and in the old format. There is some difference in the level of CAD in the two sets. For the sake of understanding and comparison, the salient features of BoP developments from 2011-12 to 2014-15 and the first half of (H1) of 2014-15 and 2015-16, are given in Table 4.3 according to the old format.

Table 4.3: Balance of Payments: Summary

(US$ billion)

		2011-12	2012-13	2013-14	2014-15 (PR)	2014-15 H1 (Apr-Sept 2014) (PR)	2015-16 H1 (Apr-Sept 2015) (P)
I	**Current Account**						
i	Exports	309.8	306.6	318.6	316.5	164.6	135.6
ii	Imports	499.5	502.2	466.2	461.5	239.4	207.2
iii	Trade Balance	-189.8	-195.7	-147.6	-144.9	-74.7	-71.6
iv	Invisibles (net)	111.6	107.5	115.2	118.1	56.3	57.2
	A. Services	64.1	64.9	73.0	76.6	36.5	35.3
	B. Transfers	63.5	64.0	65.3	65.7	32.8	32.4
	C. Income	-16.0	-21.5	-23.0	-24.1	-13.0	-10.5
	Current Account Balance	-78.2	-88.2	-32.4	-26.8	-18.4	-14.4
II	**Capital Account**						
i	External Assistance	2.3	1.0	1.0	1.7	0.7	0.2
ii	ECBs	10.3	8.5	11.8	1.6	0.8	-0.9
iii	Short-term Debt	6.7	21.7	-5.0	-0.1	-1.4	-1.2
iv	Banking Capital of which:	16.2	16.6	25.4	11.6	-0.5	18.3
	Non-Resident Deposits	11.9	14.8	38.9	14.1	6.5	10.1
v.	Foreign Investment	39.2	46.7	26.4	73.5	37.3	7.9
	A. FDI	22.1	19.8	21.6	31.3	15.1	16.7
	B. Portfolio Investment	17.2	26.9	4.8	42.2	22.2	-8.7
vi.	Other Flows	-7.0	-5.1	-10.8	1.0	-0.4	1.0
	Capital Account Balance	67.8	89.3	48.8	89.3	36.4	25.4
III	**Errors and Omissions**	-2.4	2.7	-0.9	-1.1	0.1	-0.4
	Capital Account Balance (including errors & omissions)	65.3	92.0	47.9	88.2	36.5	24.9
IV	**Overall Balance**	-12.8	3.8	15.5	61.4	18.1	10.6
V	**Reserves Change** (-) indicates increase, (+) indicates decrease	12.8	-3.8	-15.5	-61.4	-18.1	-10.6

Source: **RBI**

Capital/finance account developments in 2014-15 and the first half of 2015-16

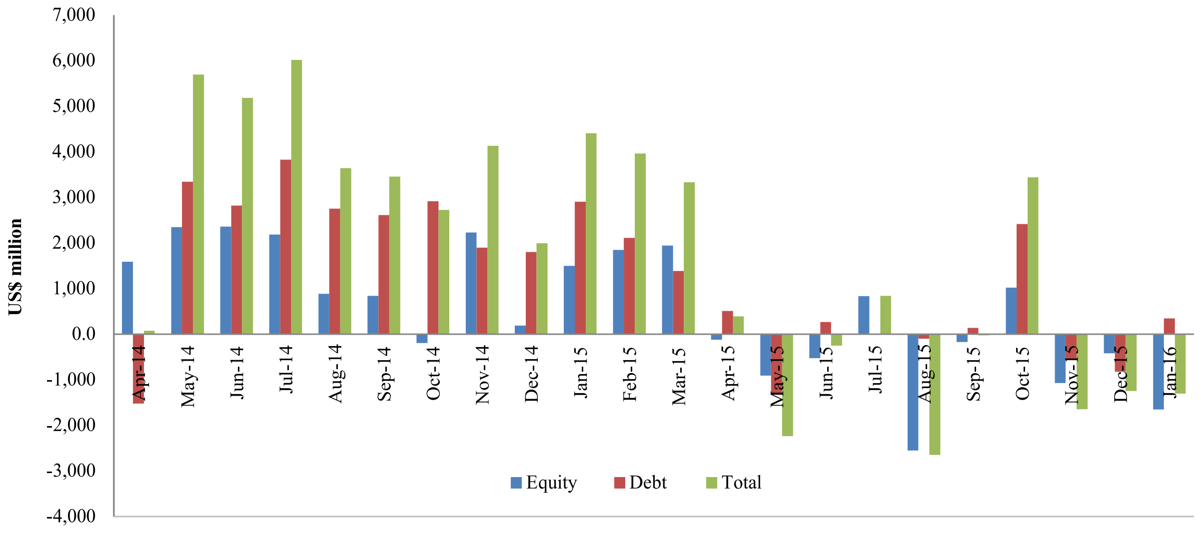
4.34 Under the capital/finance accounts of the BoP, foreign investment is an important component which consists of foreign direct investment (FDI) and portfolio investment. During 2014-15, there was huge surge in net foreign investment to US$73.5 billion as compared to US$26.4 billion in 2013-14.

4.35 The huge increase in foreign investment was due to increase in both FDI and portfolio investment. In gross terms, inflows under FDI were at US$35.2 billion in 2014-15. Net FDI (Net FDI into India and net outward FDI) reached an all-time high of US$31.3 billion in 2014-15 (US$22.4 billion in 2008-09). Similarly, net portfolio investment also reached their highest level so far of US$42.2 billion in 2014-15 (US$32.4 billion in 2009-10). During the first half of 2015-16, net foreign investment fell to US$7.9 billion as against US$37.3 billion in the first half of 2014-15, mainly due to outflows of portfolio investment. Net portfolio investment logged an outflow of US$8.7 billion in H1 of 2015-16 as against net inflow of US$22.2 billion in H1 of 2014-15. Foreign institutional investor (FII) investment is the major component of portfolio investment and Figure 4.4 shows month-wise movements of FII. It might be instructive to note that notwithstanding frequent bouts of volatility and risk aversion, flows have remained bi-directional. Net FDI reached US$16.7 billion in H1 of 2015-16 as against US$ 15.1 billion in H1 of 2014-15.

4.36 External commercial borrowings (ECB) are another item of capital/finance account and are relatively less volatile than foreign investment. Net ECBs were US$1.6 billion in 2014-15 as compared to US$11.8 billion in 2013-14. During H1 of 2015-16, net ECBs logged an outflow of US$0.9 billion. Non-resident Indian (NRI) deposits reached a peak level of US$38.9 billion in 2013-14, on account of the special swap facility of the RBI as an exceptional measure to boost capital flows. NRI deposits moderated to US$14.1 billion in 2014-15. During H1 of 2015-16, they reached US$10.1 billion as against US$6.5 billion in H1 of 2014-15.

4.37 Net capital flows in 2014-15 were at their second highest ever at US$88.2 billion. The highest was US$107.9 billion in 2007-08. Net capital inflows were 4.3 per cent

Figure 4.4 : Trend in FII investment from April 2014 to January 2016 (US$ million)



Source: SEBI

of GDP during 2014-15 (as against 2.6 per cent during 2013-14). During the first half of 2015-16, net capital/finance flows were US$24.9 billion as against US$ 36.5 billion in H1 of 2014-15. Low levels of CAD, coupled with a huge surge in capital inflows, resulted in high accretion of US$61.4 billion in foreign exchange reserves in 2014-15. This briefly continued through the initial parts of the current fiscal before the onset of global financial market turbulence on concerns over China's economic, financial sector and currency developments and outlook. Thus in H1 of 2015-16 too there was an accretion in foreign exchange reserves of US$10.6 billion.

Foreign Exchange Reserves

4.38 The level of foreign exchange reserves can change due to change in reserves on BoP basis as well as valuation changes in the assets held by the RBI. As is evident from Table 4.4, which shows the break-up of changes in foreign exchange reserves, with the exception of the crisis-hit years of 2008-09 and 2011-12, forex reserves have been in accumulation mode, reflecting excess of financial flows over the requirements of current account. In H1 of 2015-16, India's foreign exchange reserves increased by US$10.6 billion on BoP basis (i.e. excluding valuation effect) while in nominal terms (i.e. including valuation effect), the increase was only to the tune of US$8.7 billion. The valuation loss mainly reflects the appreciation of the US dollar against major currencies and fall in international prices of gold.

4.39 Among the major economies with CAD, India is the second largest foreign exchange reserve holder after Brazil. India's foreign exchange reserves at US$351.5 billion as on 5 February 2016 mainly comprised foreign currency assets amounting to US$328.4 billion, which accounted for about 93.4 per cent of the total. Gold at US$17.7 billion was the second largest component of foreign exchange reserves. Special drawing rights (SDR) and the reserve tranche position in the IMF were at US$4.0 billion and US$1.3 billion, respectively. With increase in reserves in 2015-16 (H1), all traditional reserve-based external sector vulnerability indicators have improved. For instance, the ratio of short-term external debt to reserves has declined marginally from 25.0 per cent at end-March 2015 to 24.6 per cent as at end-September 2015. The reserves cover for imports also

Table 4.4: Summary of Changes in Foreign Exchange Reserves (US$ billion)

S. No.	Year	Foreign Exchange reserves at the end of financial year (end March)	Total Increase (+)/ decrease (-) in reserves	Increase /decrease in reserves on a BoP basis	Increase/decrease in reserves due to valuation effect
1	2006-07	199.2	47.6	36.6	11.0
2	2007-08	309.7	110.5	92.2	18.3
3	2008-09	252.0	-57.7	-20.1	-37.6
4	2009-10	279.1	27.1	13.4	13.7
5	2010-11	304.8	25.8	13.1	12.6
6	2011-12	294.4	-10.4	-12.8	2.4
7	2012-13	292.0	-2.4	3.8	-6.2
8	2013-14	304.2	12.2	15.5	-3.3
9	2014-15	341.6	37.4	61.4	-24.0
10	End-Sept. 2015	350.3	8.7	10.6	-1.9

Source: **RBI**

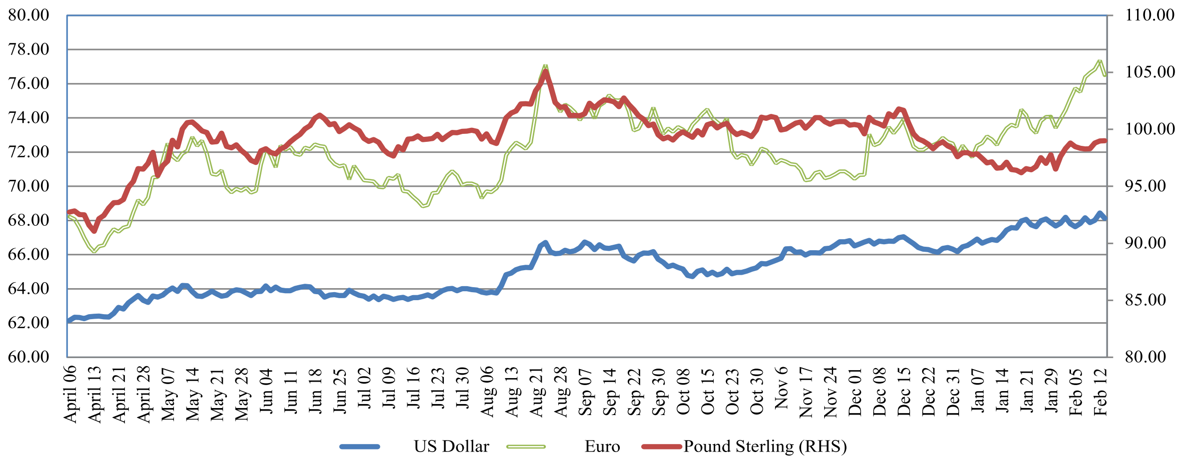
increased from 8.9 months at end-March 2015 to 9.8 months as at-end September 2015.

Exchange Rate

4.40 The average annual exchange rate of the rupee depreciated sharply from ₹54.4 per US dollar in 2012-13 to ₹60.5 in 2013-14 and was broadly stable at ₹61.1 per US dollar in 2014-15. The rupee had depreciated to its lowest level of ₹68.4 per US dollar on 28 August 2013. In 2014-15, although the rupee declined in value against the dollar by 1.0 per cent, it became stronger against other currencies. It appreciated, for example, against the Japanese yen and the euro by 8.2 per cent and 4.7 per cent respectively.

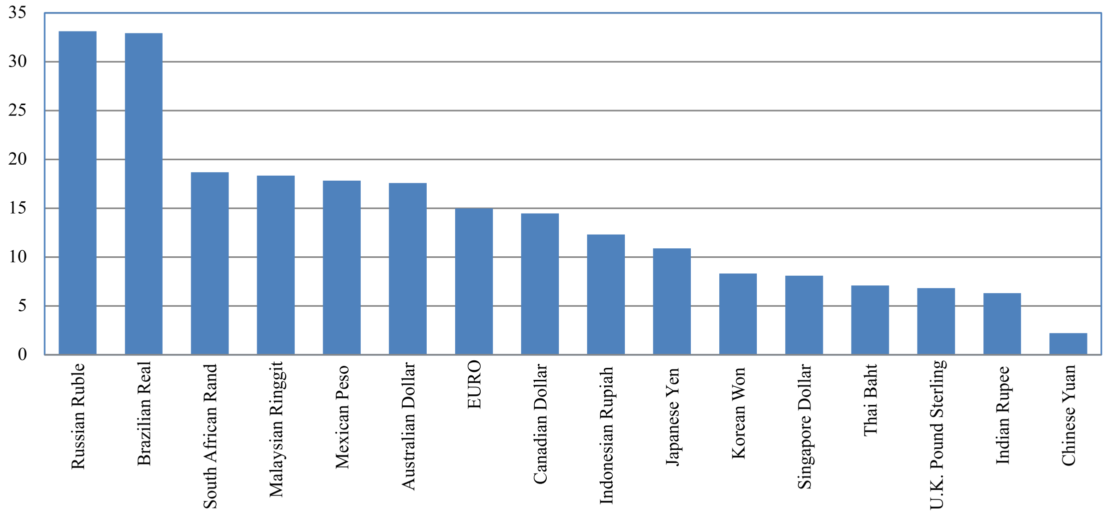
4.41 During 2015-16 (April-January), the average exchange rate of the rupee depreciated to ₹65.04 per US dollar as compared to ₹60.92 per US dollar in 2014-15 (April-January). The Indian rupee depreciated against the dollar as the dollar strengthened against all the major currencies owing to stronger growth in the USA and also because China's growth and currency developments this year deteriorated, impacting the outlook on other emerging market and developing economies (EMDE) owing to risk aversion perceptions of global investors. The rupee witnessed bouts of volatility, taking cues from a combination of domestic and global developments which included contraction in exports; portfolio outflows on concerns about outlook and other concerns; and the gradual process of normalization of monetary policy in the US and global bond market sell-off. The rupee remained in a narrow range of ₹62.16 to ₹64.17 per US dollar till early August 2015. However, it came under pressure, breaching the level of ₹65 per US dollar by mid-August to rise above ₹66 per US dollar by end-August, triggered by devaluation of the Chinese RMB on 11 August and the Chinese stock-market meltdown on 24 August. The rupee stabilized in September 2015 and traded in a narrow range but again depreciated in October to December 2015. In fact, the rupee slumped to as low as ₹68.44 per dollar on 12 February 2016, its lowest since end-August 2013. Thus, during 2015-16, the general tendency of appreciation of the US dollar against major currencies and uncertainty and volatility in the international financial market resulted in depreciation of the rupee-dollar exchange rate. However, the rupee appreciated against the euro and the pound sterling from September 2015 onwards (Figure 4.5). It is also instructive to note that in 2015-16 so far, the rupee has performed

Figure 4.5: Movements of Rupee against US Dollar, Euro and Pound Sterling during 2015-16



Source: **RBI**

Figure 4.6: Depreciation of currencies against US dollar in 2015-16 (April-January) over 2014-15 (April-January)



Source: **IMF**

better than the currencies of most of the other emerging market economies (except the Chinese yuan) (Figure 4.6).

4.42 The real effective exchange rate (REER) is an important indicator of export competitiveness as it takes into account the level of inflation differences across countries apart from the basket of nominal exchange rates of partners.

Box 4.5: Impact of Exchange Rate Volatility on some Select Sectors

Empirical evidence on the effects of the exchange rate and exchange rate volatility on trade in India from some recent research studies is at best ambiguous. In fact, research results which find positive, negative or no effect of exchange rate volatility on the volume of international trade are based on varied underlying assumptions and only hold in certain cases.

However, there is some evidence that volatility in exchange rate has impact on different sectors and firms at different levels. Dhasmana (2013) used the industry-specific real exchange indices to study the impact of real exchange rate changes on the performance of Indian manufacturing firms from 2000 to 2012. The main findings of the study are that real exchange rate changes affect firm-level performance through the import cost channel but not the export competitiveness channel in the short run. The fact that the import cost channel is dominant in the short run indicates that episodes of real depreciation are likely to result in a contraction in real output growth at least in the short run. This study also calculated the elasticity of output growth with respect to real exchange rate for different industries. A positive sign of elasticity of output indicates a decrease in output growth in response to a real depreciation on account of increased cost of imported inputs. The study observed that the chemicals industry has the highest elasticity of output growth with respect to real exchange rate (a 1 per cent real depreciation causing output growth to decline by 12.5 basis points for an average firm) while the footwear industry has the smallest elasticity (0.38). The elasticity of output of some other sectors as per the study were: rubber (9.8), textile (4.8), plastic (5.4), and metal and metal products (5.1).

Movement in exchange rate has different impact on different sectors. High-import-intensity sectors like petroleum products (86.2 per cent imported raw materials consumed), and chemical and chemical products (77.4 per cent) are more impacted by rupee depreciation as a weaker rupee increases the value of imported inputs. Low-import-intensity sectors remain in an advantageous position especially in price-sensitive international markets.

An RBI working paper (2014) titled ‘Impact of Real Exchange Rate Volatility on Use-Based Industrial Production in India’ found that components of the index of industrial production (IIP) like the capital goods, basic goods, and intermediate goods sectors are adversely affected by significant movements in the 36 country REER. The impact of real exchange rate volatility on the basic goods sector is small. Moreover, the consumer goods sector,

Contd....

with items such as passenger cars, apparel, antibiotics and sugar having large weights in the group, is also not much affected by REER volatility due to low import content and production supported by sufficiency of domestic demand. On the other hand, capital goods are dependent on imports and therefore are more impacted by unexpected changes in both exchange rate and relative prices. Thus, periodic review of the 'neutral' (or equilibrium) REER is an imperative.

References

Dhasmana, Anubha (2013) 'Transmission of Real Exchange Rate Changes to the Manufacturing Sector Performance', Working Paper No. 435, IIMB.

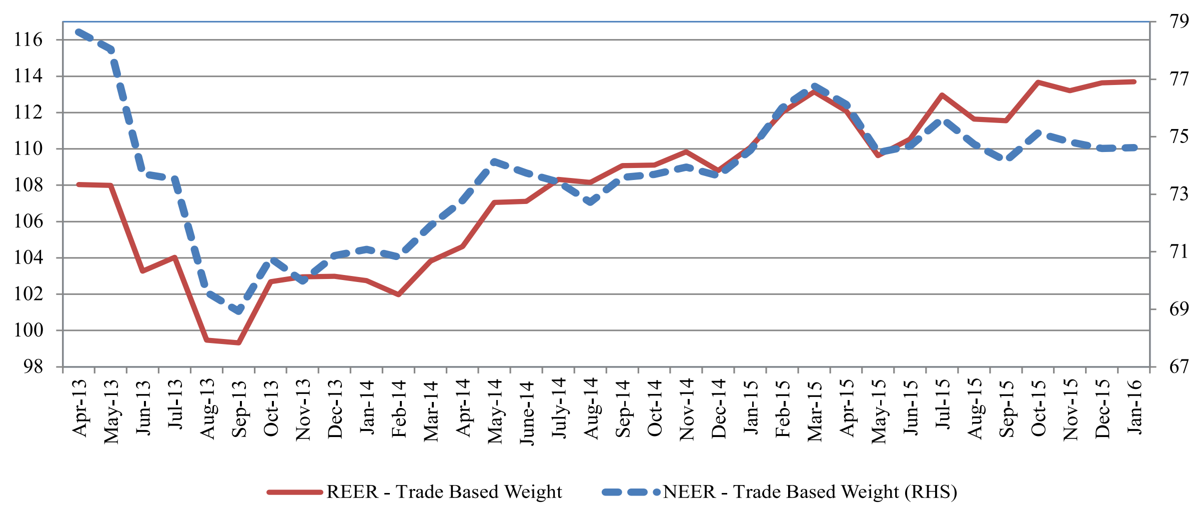
RBI Working Paper series no WPS (DEPR) 05 / 2014, ' Impact of Real Exchange Rate Volatility on Use-Based Industrial Production in India'.

4.43 During 2015-16 (April-January), NEER (Trade weighted--36 currencies) and REER (Trade weighted--36 currencies) appreciated by 1.7 per cent and 3.7 per cent respectively over 2014-15 (April-January). The rupee in real effective terms appreciated continuously from the early 2014 onwards and the movement in nominal effective terms does not exhibit any noticeable upward or downward pattern (Figure 4.7). REER is also a common measure of the alignment of a currency to its true value which is usually indicated by excess or shortfall by +/- 5 per cent of base year level of the index (Box 4.5).

External Debt

4.44 In a globalized economic environment, India's prudent external debt policies and management with emphasis on sustainability, liquidity and solvency have successfully limited the rise in magnitude of external debt to a modest level. The composition of external debt also reflects a well-maintained longer maturity profile and broad balance in terms of sources. On financial-year basis, India's aggregate external debt stock at end-March 2015 stood at US$475.2 billion, showing a rise of US$29.2 billion (6.5 per cent) over end-March 2014. The increase in external debt at end-March 2015 was due to higher levels of commercial borrowings, particularly commercial bank loans and securitized borrowings, and NRI deposits. ECBs have been a crucial determinant of the magnitude of India's external debt and its single largest

Figure 4.7: Movements in the indices of NEER and REER (Trade Based-36 currencies)



Source: RBI

component. The trend in ECBs can be ascribed significantly to the recent policy changes. These include an increase in access to rupee denominated borrowings, liberalization of the process of allocation of limits, steps taken by the RBI to monitor unhedged currency exposure, the RBI's issuance of guidelines on capital and provisioning requirements for exposure to entities with unhedged foreign currency exposure and simplification of the procedure for ECBs. Long-term external debt at US$389.7 billion at end-March 2015 registered an increase of 10.0 per cent over the end-March 2014 level while short-term debt declined by 6.7 per cent. Appendices 8.4(A) and 8.4(B) present the disaggregated data on India's external debt outstanding in Indian rupee and US dollar terms respectively.

4.45 In the current financial year as per latest data available, India's external debt stock increased by US$8.0 billion (1.7 per cent) to US$483.2 billion at end-September 2015 over the end-March 2015 level. The rise in external debt during the period was again on account of long-term external debt particularly commercial borrowings and NRI deposits. However, on a sequential basis, total external debt at end-September 2015 declined by US$291 million from the end-June 2015 level. The maturity pattern of India's external debt shows the predominance of long-term borrowings. At end-September 2015, long-term debt accounted for 82.2 per cent of India's total external debt, as against 82.0 per cent at end-March 2015. The proportion of short-term debt to total external debt decreased from 18.0 per cent at end-March 2015 to 17.8 per cent at end-September 2015. The composition of India's external debt is given in Table 4.5.

4.46 The currency composition of India's total external debt indicates that the proportion of US-denominated debt in total external debt continued to be the highest at 57.7 per cent at end-September 2015, followed by Indian rupee-denominated debt (28.3 per cent), SDRs (5.8 per cent), Japanese yen (4.0 per cent), and euro (2.4 per cent). The currency pattern of government (sovereign) debt shows the dominance of SDR-denominated debt (31.7 per cent) which is ascribed to borrowing from the International Development Association (IDA), the soft loan window of the World Bank under the multilateral category and SDR allocations by the IMF. At end-September 2015, government

Table 4.5: Composition of India's External Debt

(Per cent to total external debt)

Sl. No.	Component	March 2013	March 2014 PR	March 2015 PR	September 2015 QE
1	**2**	**3**	**4**	**5**	**6**
1	Multilateral	12.6	12.0	11.0	11.0
2	Bilateral	6.1	5.5	4.6	4.5
3	IMF	1.5	1.4	1.2	1.2
4	Export credit	4.3	3.4	2.7	2.4
5	Commercial borrowings	34.2	33.5	38.0	37.7
6	NRI deposits	17.3	23.3	24.2	25.2
7	Rupee debt	0.3	0.3	0.3	0.2
8	**Long-term debt (1 to 7)**	**76.4**	**79.4**	**82.0**	**82.2**
9	**Short-term debt**	**23.6**	**20.6**	**18.0**	**17.8**
10	**Total external debt (8+9)**	**100.0**	**100.0**	**100.0**	**100.0**

Notes: **PR: Partially Revised; QE: Quick Estimates.**
Source: **Ministry of Finance and RBI**

(sovereign) external debt stood at US$88.8 billion. The share of government debt in total external debt at end-September 2015 was 18.4 per cent as compared to 18.9 per cent at end-March 2015. Non-government external debt stood at US$394.3 billion at end-September 2015.

4.47 Over the years, the composition of India's external debt stock has undergone structural transformation. The proportion of concessional debt in total external debt came down from an average of 42.9 per cent during 1991-2000 to 28.1 per cent in 2001-10 and further to 12.4 per cent during 2011-14. It stood at 8.7 per cent at end-September 2015 as compared to 8.8 per cent at end-March 2015. Non-government external debt has been predominant in total external debt and its proportion has been going up over the years. Non-government debt went up from 45.3 per cent of total external debt in the 1990s to 65.6 per cent in the decade of 2000s. In the last five years it has been at an annual average of 79.0 per cent and at end-September 2015, it stood at 81.6 per cent. The main external debt indicators are given in Table 4.6.

4.48 India's foreign exchange reserves provided a cover of 72.5 per cent to total external debt stock at end-September 2015 vis-à-vis 71.9 per cent at end-March 2015. The ratio of short-term external debt to foreign exchange reserves was 24.6 per cent at end-September 2015 as compared to 25.0 per cent at end-March 2015. The ratio of concessional debt to total external debt decreased steadily and stood at 17.8 per cent at end-September 2015 as against 18.0 per cent at end-March 2015.

4.49 India's external debt has remained in safe limits as shown by the external debt to GDP ratio of 23.7 per cent and debt service ratio of 7.5 per cent in 2014-15. The prudent external debt policy of the Government of India has resulted in external debt remaining within safe and comfortable limits and in containing its rise. The external debt management policy followed by the Government of India continues to emphasize monitoring of long- and short-term debt, raising sovereign loans on concessional terms with long-term maturities, regulating ECBs through end-use and all-in-cost restrictions and

Table 4.6: India's Key External Debt Indicators

(per cent)

Year	External Debt (US$ billion)	Total External Debt to GDP	Debt Service Ratio	Concessional Debt to Total External Debt	Foreign Exchange Reserves to Total External Debt	Short term External Debt* to Foreign Exchange Reserves	Short term External Debt to Total Debt
1	2	3	4	5	6	7	8
2011-12	360.8	20.5	6.0	13.3	81.6	26.6	21.7
2012-13	409.4	22.3	5.9	11.1	71.3	33.1	23.6
2013-14 PR	446.0	23.6	5.9	10.4	68.2	30.1	20.6
2014-15 PR	475.2	23.7	7.5	8.8	71.9	25.0	18.0
End-September 2015 QE	483.2	-	-	8.7	72.5	24.6	17.8

Notes: **PR: Partially Revised; QE: Quick Estimates**

- : Not worked out for the part of the year

*** Short term debt is based on original maturity.**

Debt –Service Ratio is the proportion of gross debt service payments to external current receipts (net of official transfers)

Source: **Ministry of Finance and RBI.**

rationalizing interest rates on NRI deposits.

International Comparison

4.50 Cross-country comparison of external debt based on the World Bank's 'International Debt Statistics 2016', which contains data on external debt for the year 2014, indicates that India continues to be among the less vulnerable countries on this account. India's key external debt indicators compare well with those of other indebted developing countries. The ratio of India's external debt stock to gross national income (GNI) at 22.7 per cent was the fourth lowest. In terms of the cover provided by foreign exchange reserves to external debt, India's ranked fifth at 65.5 per cent. (Further details can be accessed at http://www.finmin.nic.in/reports/ind_Ext_debt.asp)