SPEECH

INDIA INTEGRATING INTO WORLD ECONOMY*

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It gives me great pleasure this afternoon to be in the midst of this distinguished gathering and deliver the closing address of the Euromoney Conference. I must congratulate Euromoney for organising this Conference and selecting a theme which is highly appropriate at a time when a positive encouragement is being provided to foreign investment and incentives are being provided to improve access of the domestic entities to the global market. I notice from your programme that over these two days, nearly every segment of the Indian economy and the financial system has been covered. As a conclusion to the Conference, therefore, I would like to reiterate some of the recent significant developments which have taken place in the Indian system.

2. India has come a long way from the crisis years of 1990 and 1991. As you are well aware, there was a time in 1991 when India's foreign currency assets had fallen as low as US$ 975 million. Today, the foreign currency assets of the country stand at US$ 14.5 billion. This perhaps is the single most impressive aspect of the turn around in India's economy over the last two years.

3. India's response to the crisis faced in 1991 was to put in place policies aimed at stabilisation and structural reforms. While stabilisation policies were intended to correct the fiscal and external payment imbalances, structural reform policies were aimed at providing greater flexibility in the industrial, trade and financial sectors so that the pace of growth could be accelerated. Structural reform policies cannot succeed unless a degree of stabilisation is achieved, while stabilisation policies by themselves will not be adequate unless structural reforms are introduced to prevent the recurrence of the kind of problems the countrty had faced earlier. Stabilisation policies and structural reform policies need to go hand in hand. Fiscal correction and consolidation is the bed rock on which the reforms process is built and every effort will be made to ensure that fiscal discipline is maintained. The recent arrangement, limiting the extent of borrowing by the Central Government from the Reserve Bank should help in achieving this objective.

4. Structural reform policies initiated in the last two and half years cover a wide gamut of areas - industrial licensing, foreign trade and exchange rate regime, financial sector and public sector reforms. Let me briefly focus on the reform process relating to trade and exchange rate and the financial sector.

Exchange Rate and Balance of Payments: Recent Trends

5. The response to the balance of payments crisis in mid-1991 was rather orthodox in nature. A downward adjustment of the rupee was effected and severe import compression measures were also adopted. However, this was not all. Simultaneously, it was also decided to bring about substantial reforms in the foreign trade and exchange rate regime. The introduction of the EXIM scrip scheme immediately after the devaluation of the rupee was intended to bring about a closer alignment between imports and exports without having to resort to quantitative controls. The export-import policy was liberalised retaining only a short negative list of imports and exports. Simultaneously, efforts were made to cut down tariff rates. This reached its culmination in the recent Budget which has introduced a substantial reduction in customs duties. The EXIM scrip was soon replaced by a dual exchange rate system which was replaced later by the unified market determined exchange

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system in March 1993. Since then, the exchange rate of the rupee has shown remarkable stability at the level of Rs.31.37 per dollar. No similar period in recent history has seen the rate remained so stable for such a long period of time. In fact, the period has also been marked by a fairly substantial purchase of foreign exchange by the Reserve Bank, reflecting excess supply conditions in the market rather than any active intervention to influence the rate.

6. 1993-94 has seen a distinct improvement in India's balance of payments. Exports in dollar terms have grown at 21.41 per cent during April 1993 to January 1994. Imports during the first ten months of the current fiscal year have shown an increase of 0.7 per cent. During the current year the import growth has remained subdued. While the slow growth in industrial production is one of the reasons, there are also certain fundamental factors which are operating to slow down import growth. With greater confidence in the stability of trade policy, imports for inventory purpose have come down. The stability of the exchange rate has also reduced the propensity to import in anticipation of need. Besides, the market determined exchange rate has encouraged larger sourcing of domestic supplies. It appears that we might close the current financial year with a small surplus in the current account. Over the next several years, the viability of India's balance of payments will crucially hinge upon a vigorous export drive with exports growing by at least 15 per cent in US dollar terms.

7. The capital account has seen some remarkable changes in the current year. The inflow of portfolio investment in the form of investments of foreign institutional investors and Euro issues in the form of GDRs and Euro Convertible Bonds by Indian corporates abroad have been the major features of the capital account. Upto the middle of March 1994 these inflows amounted to US$ 1.46 billion and US$ 2.18 billion respectively. The Euro Bonds are however considered instruments of commercial borrowing until their conversion into equity. The interest of the institutional investors speaks for their assessment of the Indian economy. One hundred and fiftyfive foreign institutional investors (FIIs) have been given permission for investing in the Indian capital market. Definitely the markets are moving ahead of the credit rating agencies in their assessment.

8. The improved performance in the current account and the fairly large inflow in the capital account have led to a substantial accretion in the foreign exchange reserves of the country. Large purchases made by the Reserve Bank of India have prevented the appreciation of the rupee. While capital inflows do play an important part in the transformation process and to some extent reduce adjustment cost, its impact on the real exchange rate has also to be taken note of. The influx of funds has also an impact on money supply. These are factors need to be kept in view constantly.

9. In the recent past, we have taken a number of steps to liberalise exchange controls relating to current account transactions. In fact, we have gone a long way in relaxing such controls. We have already liberalised the limits for payment for personal and business travel, studies abroad, medical treatment abroad, donations, gifts, services such as legal fee, arbitration etc. as also remittances in connection with exports and imports (commission payments), quality claims etc. In his Budget Speech, the Finance Minister has mentioned that the time has come to move further towards convertibility on the current account. In pursuance of this statement, we are now taking steps to move towards attaining Article VIII status of the Articles of Agreement of the International Monetary Fund. The appropriate modalities are being worked out.

The Foreign Exchange Market

10. The foreign exchange market is also responding to changes in the exchange rate regime. With market determined exchange rates, an issue which will assume increasing importance in the near future is currency risk management. At present, forward cover is the only instrument for hedging exchange risk vis-a-vis the

Indian rupee. This cover is available to Indian residents for their exposure in foreign exchange. A forward contract can be cancelled by a customer without assigning any reason and he is free to book fresh contracts for the same exposure. It is also available to non-residents for their dividend repatriation in respect of their direct foreign investment and on a case to case basis for the direct foreign investment itself.

11. To evolve suitable instruments for currency risk management, from January 1994, another hedging instrument namely, cross currency option has been made available to Indian corporates. Banks are permitted to offer cross-currency options on fully covered basis. We have thus allowed Indian corporates to access the currency options market overseas. Banks can also buy options from overseas and sell them to other banks in India. Though customers are not allowed to write options, option purchased can be sold back to the Authorised Dealers. This however can be done only once in respect of each exposure. We are considering giving further relaxations after banks and customers gain some experience in handling of this new product.

12. A crucial element in the development of the domestic foreign exchange market is the market infrastructure. In this connection, an important issue relates to the desirability of having a separate clearing house for settlement of foreign exchange transactions. At present, inter-bank foreign exchange transactions are settled by individual banks by giving instructions to the correspondent banks abroad to debit or credit the *nostro* accounts of the counter party bank with the same or another bank abroad. In an ideal situation, a system should exist whereby payments due from and due to each bank in India, on each day, are netted out through a clearing system and only the net amounts due are transferred from bank to bank. This will enable faster settlement, reduce the problems attendant with reconciliation of the relative payments and receipts and lower the transaction costs for the authorised dealers. *The Reserve Bank is considering a proposal for the setting up of such a clearing system.* Foreign Exchange Dealers Association of India (FEDAI) has been asked to work out the modalities concerning the legal and other operational aspects of such a clearing system.

Financial Sector Reforms: Recent Developments

13. In recognition of the fact that financial intermediation is an important factor contributing both to stabilisation and economic development and that the market for financial services has to deepen and strengthen further, an aggressive structural reforms programme in the financial sector is currently underway. The programme recognises that successful and sustainable adaptation by the financial sector would be significantly conditioned by the nature of the financial sector reform policies. The financial sector reforms fall broadly in three categories (a) removing the external constraints operating on the profitability of banks (b) improving the financial health of public sector banks and introducing greater transparency in their balance-sheets and (c) injecting a greater element of competitiveness in the system.

14. The external constraints in the form of high levels of cash reserve requirements and statutory liquidity requirements have been considerably relaxed in the last two years. The administered structure of interest rates has also been simplified with only 2- 3 rates being determined. In improving the financial health of banks, an aggressive recapitalisation programme has been started; stringent norms relating to income recognition, provisioning for bad and doubtful debts and capital adequacy have been put in place. In introducing greater competition in the system, 'in principle approvals' have been given to nine private sector banks and one of them is commencing operations early next month. Foreign and NRI equity participation is also being encouraged in the banking and financial sectors. In the more recent period banks have been given more operational freedom through the relaxation of lending norms and lending arran-

gements. The Banking Regulation Act has been amended so as to enable banks to appoint a non-executive part-time Chairman and a full time Managing Director, to enhance the restriction on voting rights from the existing one per cent to ten per cent of total voting rights, permit appointment upto three Directors from the promoting institutions to be Directors of the new banks and to raise the quantum of penalties for violation/contravention of the provisions of the Act. While some of these changes are already in operation some others, such as those relating to the setting up of the new Supervisory system, the Tribunals for recovery of bank overdues, circulation of the list of defaulters among bank borrowers are in the process of being implemented.

15. Public sector banks are to achieve the capital to risk asset ratio of 8 per cent latest by 31 March 1996. Attainment of these minimum capital levels has been affected by the simultaneous adoption of new norms on income recognition, asset classification and provisioning. In order to protect the viability and financial health of Indian banking system, a large capital contribution of Rs.57 billion to nationalised banks to meet the gap created by the application of first stage of provisioning norms was made in the budget for 1993-94. A similar contribution of Rs.56 billion is proposed to be made in 1994-95.

16. While undertaking such a large injection of capital into the banks, specific commitments have been taken from each bank with reference to its position as on 31st March 1994. This is to ensure that their future management practices ensure a high level of portfolio quality and that the problems of the past did not recur. Commitments have been made by the nationalised banks in respect of improvement in qualitative as well as quantitative aspects of their functioning.

Conclusion

17. These are thus, some of the ways in which we are trying to improve the country's structural flexibilities in the trade, exchange rate and the financial sector. Serious efforts have been made at stabilising the economy. Improved productivity, increased efficiency and enhanced growth are the three key desired strategic thrusts which are being currently provided for India's further progress. The objective is to create a more competitive economic environment. A major element is the improvement in the international competitiveness of the system as a whole. Considerable priority has been attached to economic growth.

18. I sincerely hope that your deliberations over the last two days have been informative and stimulating and you are leaving the Conference with a better understanding of our efforts. I hope, this Conference has succeeded in bringing closer India and the global business and investing community.

Thank you.