REPORT OF THE COMMITTEE

TO STUDY THE STRUCTURE OF INTEREST RATES FOR EXPORT CREDIT IN INDIA.

DECEMBER 1986

RESERVE BANK OF INDIA
INDUSTRIAL & EXPORT CREDIT DEPARTMENT
BOMBAY.

CR382

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of Interest Rates for Export
Credit in India
Reserve Bank of India,
Industrial & Export Credit
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Camp : Pune

December 17, 1986

Shri Amitabh Ghosh,
Deputy Governor,
Reserve Bank of India,
Bombay.

Dear Sir,

We are pleased to present our Report on the study of the Structure of Interest Rates for Export Credit in India.

Yours faithfully,

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(Chair person)

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(Member)

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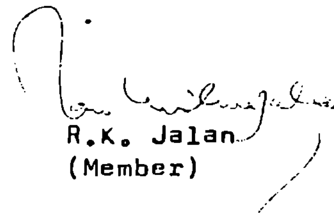

R.K. Jalan
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SUMMARY OF RECOMMENDATIONS

1. The timely and adequate availability of credit is crucial for creating and supporting a growing export sector. It is important that this aspect of export credit is given due importance and all necessary steps must be taken to ensure smooth flow of funds to the export sector. All avoidable delays in sanctioning the export credit limits and in the disbursement of the credit need to be removed by streamlining the existing procedures for the sanctioning and disbursement of credit. (Paragraph 4 1)

2. Exports are beset with a number of major problems. All of these cannot be solved by providing concessional export credit alone. In order to ensure efficient allocation of the scarce capital, finance must in general bear its true cost to the economy. The rigidities and handicaps arising from inefficient production, lack of access to raw materials at international prices, etc. should receive greater priority in our export efforts in the long run. Besides, a systematic cost-benefit assessment of the support measures, in the medium and long-run, including concessional export credit, is necessary to give a sound footing to our export efforts. (Paragraph 4.1 2)

3. An appropriate conceptual framework for determining the interest rate on export credit should consist of i) interest cost of funds excluding the loading factors on account of various concessional financing); ii) establishment and other related expenditure for mobilising deposits and administering advances; iii) a margin of minimum 1% over the total cost of funds to provide a cushion for loan losses and a modest profit to banks;and iv) the cost involved in the prudential and operating cash reserves totalling 5% (3% statutory minimum reserves and 2% cash in hand). On the above reckoning, a minimum interest rate of 12% per annum on export credit is warranted at present. (Paragraphs 5.9 & 5.10).

4. Since the interest rate on export credit has already been reduced to 9.5% per annum with effect from 1 August 1986, the Committee feels that there is no scope for any further reduction in the general export credit interest rate at present (Paragraph 5.11).

5. The promotional export finance scheme would be more fruitful and would achieve its objectives if the liberal finance is directed towards systematically identified and monitored thrust areas of exports and bulk contracts. Such financing facilities should form an integral part of an appropriate financing package. (Paragraph 5.13)

6. In the case of bulk contracts, involving a contract value of, say, Rs.5 crores and above in respect of a single order, it was felt that the prescribed rate of interest may need to be finetuned, if it can play a decisive role in securing the contract. For this purpose, a detailed scheme may be worked out by the Reserve Bank of India in consultation with the Government of India. The chief merit in this case is that the special concessional credit facilities, if utilised, would definitely lead to an increase in exports and also will not become a permanent feature of our export credit facilities. (Paragraph 5.13)

7. In the context of general interest rate structure in India and other competing developing countries and the specific conditions and limitations applicable on export credit in these countries, the export credit facilities in India are comparable with those in the competing countries. However, the Committee feels that there is scope for softening interest rate in specific cases. (Paragraph 5.24)

8. The Committee feels that all cases of cash exports where the proceeds are permitted by RBI, at the initial stage when the contract is entered into by the Indian exporter with the overseas buyer, to be realised beyond 180 days, should be deemed as extended cash exports and not

as deferred payment exports. Exporters availing of post-shipment credit against such exports should be eligible for concessional interest rate, as applicable in the case of cash exports (which is at present, 9.5% p.a.), for the entire extended period. In case the proceeds are not realised within the extended period, the prescribed ceiling rate on export credit (which is not exceeding 16.5% p.a., as at present) would be charged on such advances during the overdue period. The financing banks, in turn, should be eligible for all normal benefits, as in the case of advances against cash exports. (Paragraph 6.8)

9. Estimates based on current interest rate and average maturity period, based on 5 year historical average data for various categories of exports, reveal that taken together the recent reduction in export credit interest rate and also the extension of the maturity period of concessional pre-shipment credit may result in a decline of 0.73% in the rate of return (even after taking into account the subsidy of 3%) on export credit to the bank as compared to their earnings prior to August 1986. More significant is the fact that this additional burden is called for at a time when the profits and profitability of a large number of Indian banks are already under severe

pressure. On the basis of computation based on published figures, the Committee has observed that at the current profit performance, the entire profits of atleast one nationalised bank would not only be wiped out but the bank would incur actual losses. An additional 4 banks would register a decline of profits in the range of 51% - 90%, 6 banks in the range of 21% - 50% ; and 17 banks in the range of 9.20%. In the above context, the Committee is of the view that there is a strong case for mitigating the additional financial burden, on account of the recent reduction of export credit interest rate, by way of a further increase in interest subsidy by at least one percentage point to 4%. While it can be implemented without additional administrative costs as already a mechanism exists for disbursing and monitoring the export credit interest subsidy, the increased budget expenditure through interest subsidy is unlikely to impose a net burden on the budget. Moreover, it will confer benefits in proportion to the export financing efforts of banks. (Paragraphs 7.15, 7.16 & 8.2)

10. While the current refinancing eligibility, i.e., incremental export credits over the stipulated base period, may be continued, to facilitate the financing of bulk contracts exceeding say Rs.5 crores for single order, additional refinancing facilities to banks may be considered. (Paragraph 8.4)

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C H A P T E R - 1

Introduction

1.1 At the meeting with the members of the Standing Committee on Export Finance (a high powered Committee in the Reserve Bank of India to formulate policy guidelines on export credit) on 8 February 1985, Shri A.Ghosh, the Chairman of the Committee and Deputy Governor, Reserve Bank of India (RBI) suggested that, as there had been repeated requests from the exporting community for reduction in the rate of interest charged by banks on export credit, it would be ideal if a study could be made of the interest rate structure on export credit prevailing in our country.

1.2 In pursuance of the above suggestion, the Reserve Bank of India appointed on 11 January 1986, a Committee to study the structure of interest rates for export credit prevailing in India and to recommend appropriate changes, if considered necessary.

Terms of reference of the Committee

1.3 The terms of reference of the Committee were as under:-

a) To study the interest rates on credit extended for exports in India, taking into account the cost of funds and lending rate of commercial banks and other lending institutions.

b) To make a comparative study of the cost of export credit in India and a few selected countries, which are our competitors in foreign markets and where significant developments have taken place in the sphere of export credit.

c) To examine the back-up support in the form of subsidies/incentives provided by India and other countries, who are India's competitors in respect of major export products.

d) To study the impact of interest rates for export credit on the cost of production of certain major export items.

e) To consider whether any revision in the rates of interest for export credit is called for in general or in relation to some specified commodities and its financial implications for Government and banks.

f) Any other issue having a bearing on the interest rates on export credit.

1.4 As adequate financial infrastructure is already available for financing exports on deferred payment terms and these facilities are reviewed from time to time in the light of changes in the international competitive situation, the Committee felt that it was not necessary to go in depth in these aspects in our study. Besides, for deferred credits, the OECD consensus rates are kept in view.

Composition of the Committee

1.5 The composition of the Committee was as follows:

1.	Dr.(Miss) S.K.Verghese, Sr.Professor, National Institute of Bank Management, Pune.	Chairperson
2.	Ms. T.M.Vakil, General Manager, Export-Import Bank of India, Bombay.	Member
* 3.	Shri T.R.Venkatachalam, Adviser, Credit Planning Cell, Reserve Bank of India, Bombay.	Member
@ 4.	Shri O.P.Setia, General Manager, Domestic Operations, International Division, State Bank of India, Bombay.	Member
5.	Shri R.K.Jalan, Joint Controller, Exchange Control Department, Reserve Bank of India, Bombay.	Member
@@ 6.	Shri M.Sampangi, Dy.Economic Adviser, Ministry of Commerce, Government of India, New Delhi.	Member
7.	Shri P.P.Thakurta, Deputy Chief Officer, Industrial & Export Credit Department, Reserve Bank of India, Bombay.	Member-Secretary

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* Shri Ahmad Raza, Adviser, appointed as a member in place of Shri T.R.Venkatachalam vide Memorandum dated 28 June 1986.

@ Presently, General Manager, SBI Capital Markets Ltd., Bombay.

@@ Since promoted as Additional Economic Adviser.

1.6 The Committee was originally expected to submit its report by July 1986. As our work progressed, it became evident that the issues before us were rather complex and detailed examination could not be completed within the time limit. The delay was also partly due to the time taken in collecting the relevant material and obtaining response from knowledgeable individuals in the field. We, therefore, requested the Reserve Bank of India to allow us extension of time, which was granted, for which we are grateful to the Bank.

Methodology

1.7 The first meeting of the Committee was held at Bombay on 20 February 1986, when its deliberations were initiated by Shri A.Ghosh, Deputy Governor, Reserve Bank of India.

1.8 At this meeting, the Committee perceived the tasks before it and drew up a broad outline of its work plan.

1.9 As a first step, the Committee circulated questionnaires to the Export Promotion Councils/Commodity Boards, export organisations, major commercial banks including foreign banks and Export-Import Bank of India (Exim Bank) and requested them to give their comments and suggestions (Annexure I). The questionnaires were despatched during March-April 1986. After receipt of replies to the questionnaires, the Committee had discussions with representatives of various export organisations/banks in Bombay, Calcutta, Delhi and Madras.

Acknowledgements

1.10 The Committee is much obliged to Shri A.Ghosh, Deputy Governor of Reserve Bank of India, who spared his precious time to meet the Committee members in the first meeting in February 1986 and infused in them the sense of direction for accomplishing the task assigned to them.

1.11 The Committee places on record the valuable services rendered by Shri T.R.Venkatachalam, who served as a Member in the initial period, and Shri G.H.Deolalkar, who participated, as a special invitee, in some of the meetings with exporters/banks.

1.12 The Committee wishes to thank the Chairmen and senior executives of all the banks and export promotion councils/organisations/association of exporters for the valuable suggestions given by them in their replies to the questionnaires issued by the Committee. The Committee also had the benefit of discussions with them, from time to time, on the various issues covered by the terms of reference.

1.13 The Committee is grateful to Kum.V.Visvanathan, Chief Officer, and Shri P.K.Parthasarathy, then.Addl. Chief Officer, Industrial and Export Credit Department, Reserve Bank of India, Bombay for the active help and

co-operation extended by them for the Committee's work. The Committee is also thankful to the local Managers and other senior officers of the Reserve Bank of India at Calcutta, New Delhi and Madras and the Director, National Institute of Bank Management, Pune, for the facilities extended for the meetings of the Secretariat of the Committee.

1.14 The Committee places on record its deep appreciation of the excellent work done by Shri P.P.Thakurta, Member-Secretary, and his colleague, Shri R.M.Ghanekar, in organising the work of the Committee, collecting and analysing the material required for the preparation of the Report and in co-ordinating the work of the Committee through its various stages of deliberations.

1.15 The Committee also wishes to thank all the staff members of the Export Finance Division of Industrial and Export Credit Department of the Reserve Bank of India, who provided the secretariat; particular mention may be made of Miss.Maureen D'Souza, Mrs.Lakshmi Sundararajan and Mrs.Hema Krishnamurthy, for their total dedication to work.

CHAPTER - 2

Exports and export promotion measures in India

A Perspective

2.1 The need for increasing exports to finance the growing requirements for import of capital goods, components, raw materials, etc., for sustaining the process of economic development of India, has already been well recognised. Thus, reversing the "export pessimism" of the 1950s and the early 1960s, India embarked on a comprehensive export promotion effort since the second half of the 1960s. Export promotion until recently was intended to be a supplement to the import substitution-oriented economic development strategy. The growing diversification of the economic structure, together with the active export promotion measures, had helped, to a large extent, to diversify the composition and direction of our trade and also bolster the value and volume of exports. However, the convergence of several developments in recent years has made the issue of export promotion a matter of high national priority. The foreign exchange requirements of India have burgeoned recently on account of a) the repayments due on the borrowings of SDR 3.9 billion from the IMF; b) the reduced prospects for bilateral and multilateral aid; c) the bunching of servicing obligations on commercial borrowings; and d) the spurt in the imports due to the recent

liberalisation of imports. The large imports of bulk consumer items, such as, edible oils and sugar (necessitated by domestic scarcity conditions), have also increased the pressure on the balance of payments of India. On the other hand, increasing difficulties are being encountered on the export front due to unfavourable international and domestic developments. The recession in major developed countries, the sharp fluctuations and misalignments of currencies, the resurgence of protectionist tendencies in dominant economies and the acute competition from newly industrialised developing countries have made exports an uphill task. The emergence of a growing and highly lucrative domestic market and the accentuation of supply constraints of several inputs have reduced the incentives to export. The poor performance of exports in recent years is causing considerable concern to policy makers. The success of the new economic policy, obviously, hinges crucially on the performance of exports. It is in this context that special measures are being initiated in India in recent months to give a boost to exports.

<u>Trend of trade balance</u>

2.2 The value of exports of India increased from Rs.6,710.70 crores in 1980-81 to Rs.10,420 crores in 1985-86 (preliminary figures) and imports increased

from Rs.12,549.15 crores to Rs.18,371 crores during the same period. The trade deficit widened to the all time high level of Rs.7,951 crores in 1985-86. The earlier highest deficit was Rs.5,891 crores registered in 1983-84. The annual rate of growth of exports had shown large uneven trend and ranged from 20% to minus 12.1%, while import growth rate had been relatively more stable within a range of 9.8% to 5% during 1980-81 to 1984-85.

2.3 A part of the high growth rate of exports in certain years is attributable to ad-hoc factors, such as, export of petroleum from Bombay High for processing purposes and the export of gold jewellery, precious and semiprecious stones, etc. where the import contents are substantial. With the setting up of refining capacity in India for the Bombay High oil, the export of petroleum has tapered off from the substantial level of Rs.1,563 crores in 1984-85. If we make adjustment for these factors, the underlying exports in 1985-86 indicated a decline of 0.1%, whereas exports including petroleum registered a sharp decline of 12.1% in 1985-86 over the preceding year. However, the fact remains that the recent performance of exports, particularly the performance of engineering goods, has been unsatisfactory, (Table 1).

2.4 According to preliminary information, imports in the first half of 1985-86 increased by nearly 25% over the corresponding period of 1984-85. About two-fifth of this increase is attributable to bulk items, such as, fertilizer, fertilizer raw-materials, edible oils, iron and steel and sugar and two-fifths to imports by Government agencies and ONGC. A fifth of the total increase in imports is attributable to capital goods, components etc., under OGL. Besides, the import orders cleared upto January-July 1986 is reported to exceed the entire imports of the corresponding preceding period.

2.5 The high percentage growth rate in the rupee value of exports, during 1983-84 to 1984-85, is partly attributable to the depreciation of the rupee against all major currencies. Correspondingly, the decline in the export growth rate in 1985-86 is also partly due to the relative stability of rupee-dollar rate during the period as compared to 1984-85.

2.6 An interesting feature of imports is that, while in 1980-81 and 1982-83, the rise in imports was mainly due to the sharp rise in the price of petroleum, the increase in 1985-86 occured despite the sharp decline in oil prices. Non-oil imports have grown at the rate of about 12% during 1981-82 to 1984-85 as against about 1.3% growth rate in

Table: 1 - Trend of India's Foreign Trade

(Rs. crores)

Year	Exports	Exports adjusted for petroleum exports	Imports	Trade balance Col.2 - Col.4
(1)	(2)	(3)	(4)	(5)
1980-81	6711	6711	12549	-5838
1981-82	7806 (16.3)	7610 (13.4)	13608 (8.4)	-5802
1982-83	8803 (12.8)	7740 (1.7)	14293 (5.0)	-5490
1983-84	9872 (12.1)	8641 (11.6)	15763 (10.2)	-5891
1984-85	11855 (20.1)	10292 (19.1)	17173 (8.9)	-5318
1985-86*	10420 (-12.1)	10285 (-0.1)	18371 (7.0)	-7951
April 86* - June 86 (growth rate computed over April-June 1985)	2790 (2.6)		4414 (-7.2)	-1624

* Economic and Political Weekly

Note: Figures in bracket indicate rate of growth over preceding year

Source: Economic Survey, 1985-86

petrolsum imports. It is evident that the spurt in the value of imports in recent years emanated from large scale non-oil imports, particularly capital goods, sugar, edible oils, etc. Besides, according to preliminary data, the entire increase in imports in 1985-86 took place in the first half of the year, and there has been actually a decline of about 1.7%

in the imports in the second half of the year.

Export promotion schemes

2.7 The current export promotion schemes include: 1) duty drawback system; 2) cash compensatory support (CCS); 3) fiscal incentives for exports; 4) import policy for exports; 5) free trade zones and 100% export oriented units and 6) concessional export credit facilities, etc.

Duty drawback system

2.8 The aim of this scheme is to reimburse exporters of the excise duties on domestically produced inputs and customs duties paid on imported inputs. The rationale is that these duties on inputs are administrative imposts which raise the cost of production and thereby make exports uncompetitive in overseas markets. On the majority of products and product groups, "all-industry rates" have been fixed for reimbursement. While in others, specific brand rates are fixed.

2.9 The duty drawback disbursements increased steadily from Rs.42 crores in 1973-74 to Rs.204.0 crores in 1981-82. Since then, it declined to Rs.154 crores in 1984-85 due to the introduction of Advance Licensing System which facilitates imports of inputs for export production on a duty free basis.

Cash compensatory support (CCS)

2.10 Under this scheme, which is in operation since June 1966, exporters of selected products are granted cash subsidies specified as a percentage of the f.o.b. value of exports. The objective of cash subsidy is partly to enable exporters to meet competition in foreign markets, to develop marketing competence and mainly to neutralise the disadvantages arising from multiple taxes, levies, etc. The scheme has undergone several revisions both in terms of rates and coverage. The rates of subsidy currently range from 5 to 20% of the f.o.b. value of exports. The major product groups covered by the CCS include engineering goods, chemicals and allied products, plastic goods, processed foods, marine products, instant tea and tea bags, instant coffee extracts and essence, woollen carpets, rugs and druggets, jute products, leather and leather manufactures, handicrafts, silks, synthetic fabrics, made-up garments, cotton textiles, woollen and blended knitwear, etc. In certain cases, CCS upto 75% of physical exports is also given to "deemed" exports.

2.11 The proportion of total exports eligible for CCS has increased from 20% in the early 70s to more than 40% in the 80s. With effect from 1.7.1986 a new scheme of CCS has come into operation which will give stability of cash support for a period of 3 years upto 31.3.1989, except for cotton textiles which will be valid till 31.12.1988.

2.12 The highest proportion of cash compensatory support is enjoyed by engineering goods (about 45.6% to 42.8%) followed by finished leather and leather manufactures (about 11.9 to 11.7%) woollen carpets, rugs, druggets etc. (8.4% to 8.8%) and chemicals and allied products (8.7% - 8%) of the total CCS in 1982-83 to 1983-84.

Fiscal incentives for exports

2.13 In addition to 50% of profit attributable to exports, which may be allowed to be retained for purpose of business, a set off of 4% of the net foreign exchange earnings has been allowed for purpose of income tax.

Import policy for registered exporters

2.14 For providing easy access of imported inputs for export purposes, special import facilities for registered exporters have been provided. Import replenishment licences related to f.o.b. value of exports in the past provided not only access to inputs but also financial support, as the items covered by the scheme enjoyed a premium in the domestic market. With the liberalisation of imports in recent years, the special benefits arising from these facilities have practically disappeared.

Free trade zones and 100% export oriented units

2.15 Free Trade Zones (6 in number, viz., Kandla Free Trade Zone, Santacruz Electronics Export Processing Zone, Cochin Export Processing Zone, Madras Export Processing Zone, Falta Export Processing Zone and NOIDA Export Processing Zone) and 100% Export Oriented Units have been set up to provide duty free access to imported raw materials, intermediates, capital goods, technology, etc. without any licensing requirements to exporting units established in these zones. On the whole, exports from these zones are on par with international competitors in terms of price and availability of inputs.

2.16 The scheme of 100% export oriented units, introduced in 1980, was meant to be a further improvement over other existing schemes for boosting exports. These units have been exempted from the normal licensing provisions in the domestic tariff area and all other normal restrictions which impede exports. The 100% export oriented units are permitted duty free imports of machinery, components, spares, raw materials, etc. They are also exempted from payment of central excise. These units were under obligation to manufacture in bond and export their entire production.

2.17 Since 1983, these units have been permitted to sell 25% of their production in the local markets, in addition to the permissible rejects. As the scheme has not made any headway, there are reports that their export obligations are being reduced substantially.

Concessional export finance

2.18 As a part of the export promotion scheme, concessional export credit facilities on a liberal basis are made available to exporters both at the pre-shipment and post-shipment stages. From time to time, the concessional ceiling rates applicable to export credit are revised and the maturity period of the credit has also been extended.

2.19 In addition to all these schemes, there are other facilities to promote exports, such as, market development assistance, institutional support through export promotion councils, commodity boards, Export Credit Guarantee Corporation of India Ltd. (ECGC), and Export-Import Bank of India (Exim Bank).

Total expenditure on export promotion

2.20 Even prior to the recent intensification of the export promotion efforts, cash incentives, duty drawback and other facilities provided substantial financial support to exports. For instance, cash incentives and duty drawback alone, as a ratio of exports of 159 of the 269 sample companies, averaged to 13.2% during 1981-82 and 1982-83. It was as high as 21.9% for electrical equipment, 20.1% for automobiles and ancillaries, 15% for chemicals and petro-chemicals and 14.8% for ferrous metal products. (Financial Performance of Companies - ICICI Portfolio: 1982-83).

2.21 The total budget expenditure (bulk of which constitute subsidy) on foreign trade and export promotion measures increased from Rs.363.47 crores in 1977-78 to Rs.644.13 crores in 1986-87. As percentage of total exports (adjusted for imported inputs of precious and semi precious stones and petroleum exports for processing), the subsidy element averaged to about 6.28% in 1985-86. (Table 2) If we take the export value covered by the export assistance scheme alone, the duty drawback and the subsidy element would be even higher.

Table 2: Foreign Trade and Export Promotion Expenditure

(Rs. crores)

Year	Amount
1977-78	363.47
1978-79	434.87
1979-80	382.49
1980-81	425.26
1981-82	509.42
1982-83	542.09
1983-84	570.28
1984-85	580.26
1985-86	646.37
1986-87*	644.13

* Estimate

Source: GOI, Explanatory Memorandum of the Budget of the Central Government

2.22 The terms of reference of the Committee require it to examine the back-up support in the form of subsidies/incentives provided by India and its competing countries. However, due to time constraints and difficulties in getting precise information on subsidies/incentives available in other countries, this aspect could not be examined in greater details.

2.23 The foregoing review broadly indicates the magnitude of the problems encountered in achieving a significant increase in our exports and also a pointer of the policy trade-off, we need to consider in the future to manage our balance of payments. The export effort of India so far has been mainly directed towards achieving a certain target rate of growth through various ad hoc incentives; it is not, to the extent desirable, directed towards achieving the development and nurturing of a viable export capacity.

C H A P T E R - 3

The Role of Export Finance in the Export Promotion Efforts of India

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A Perspective

3.1 The importance of export finance in the export promotion efforts of India was duly recognised as early as in 1962. The entry of non-traditional items in our export trade and the growing competition in overseas markets, when the need for earning more foreign exchange for supporting the import requirements of our planned economic development became urgent, made it obvious that suitable export financing systems should be evolved as part of the export promotion efforts of the country. In the initial years, the focus was on ensuring increased availability of credit so that any exporter with capacity to produce and ability to secure export orders would not suffer from lack of finance. Soon the emphasis included also the cost of export credit to improve the price competitiveness of Indian exports through cheaper export credit. Thus, in the course of time, far reaching measures were introduced in India to enlarge the availability of credit and to reduce the effective cost of export finance. India was among the first group of countries to provide, through deliberately designed schemes, adequate export finance at concessional interest rate, both at the pre-shipment and post-shipment stages, to facilitate the production and export of goods.

Evolution of export financing system in India

3.2 An exporter requires finance to carry out an export order at two stages. In the first stage, termed in India as packing credit, finance is needed for producing or buying the goods, packing, transporting etc. until they are put on board a ship/air craft. The second stage, termed as post-shipment credit, the financing commences from the shipment until the receipt of the sale proceeds in rupees. Packing credits are given generally in the form of loans, the goods or materials against which the advance is made constituting the prime security for the bank. They are either pledged or hypothecated to the bank. In some cases, clean credits are also provided. On the other hand, post-shipment finance is provided by banks by the discount of the relative usance bills/purchase of sight bills/advance against bills accepted for collection. The proceeds of the post-shipment documents alone are permitted to be used for extinguishing the liabilities under the packing credits.

3.3 With a view to providing additional incentives to the export sector, and ensuring that the lending procedure are flexible to suit the specific requirements of individual export items, the Reserve Bank has relaxed the conditions relating to lodgement of letters of credit or sale contract in the case of as many as 17 categories of export items as also for 100% Export Oriented Units and units situated in Free Trade Zones.

3.4 Pre-shipment credit normally does not exceed the FOB value of the goods to be exported or the domestic value of such goods, whichever is less. However, relaxations are made in case of goods covered under cash incentives of Government of India and in the case of export of HPS groundnuts/ deoiled and defatted cakes. Other additional facilities include availability of running account facilities for specified commodities, sharing of pre-shipment credit facilities by manufacturer-exporters and trader-exporters, substitution of contracts.

Refinancing Schemes

3.5 To encourage the banks to extend adequate credit facilities for export purposes and to insulate, partially or entirely, export credit from general credit restrictions, refinancing schemes are used by the RBI to put funds at the disposal of the banks for export purposes. The scheme was first introduced in September 1962 under which the RBI purchased or discounted export bills maturing within 180 days. In March 1963, the cost of refinancing was slightly reduced by exempting from stamp duty (0.2%) promissory notes against export usance bills on which refinance was extended to the banks. To encourage rupee bills, a refinancing scheme at the Bank Rate in respect of rupee bills was introduced in 1963 and simultaneously, for the first time, a ceiling rate of interest applicable to rupee bills at

1.5% p.a. above the refinancing rate (Bank Rate) was also introduced. The scheme was extended in 1967 to bills drawn in foreign countries and a ceiling rate on export credits at 8% p.a. was stipulated. The essential elements of the scheme were modified from time to time in the light of emerging developments. The revisions include the extent of the refinancing and the interest rate applicable.

Medium-term export credit

3.6 Similarly, a brief mention may be made of the facility for refinancing of medium-term export credit, which was in existence as early as during January 1963 to August 1964, under the aegis of the Refinance Corporation of Industry Ltd. Under the scheme, operated by the Corporation for refinancing of medium-term export credit, granted to exporters in the private sector by banks authorised to deal in foreign exchange, refinance was available for period exceeding 6 months but not exceeding 5 years, in the case of export of certain specified capital and engineering goods. Refinancing of pre-shipment credit, where it was combined with post-shipment credit, was also provided. The rate of interest on refinance which initially was 5% p.a. (which was lower than the Corporation's prevailing refinance for industrial loans) was reduced to 4.5% p.a. in December 1963 in cases where the financing bank did not charge more than 6% p.a. to the exporter. Consequent upon the Industrial Development Bank of India taking over the Corporation on September 1, 1964, the Scheme came to be operated by the former.

3.7 At present, the Export-Import Bank of India (Exim Bank) provides 100% refinance of medium to long-term post-shipment credits extended by commercial banks to Indian exporters of capital goods, on a case by case basis.

Concessional ceiling interest rate on export finance

3.8 An important change in the official export finance scheme occured in March 1968 when a concessional ceiling rate of interest was applied on export credit to improve the competitiveness of Indian exports. Under this scheme, banks were not permitted to charge more than 6% p.a. on export credit. Initially, a differential interest rate scheme was adopted under which lower interest rate was applied to engineering goods with a view to providing greater incentive for their exports and a slightly higher rate was applied for other exports. Subsequently, the scheme was modified and a uniform concessional rate for all exports for specified periods, at the pre-shipment and post-shipment stages, was applied. In addition, an interest subsidy scheme was introduced to remove the disincentive effects of concessional ceiling rate of export credit and also as a positive measure of encouragement to commercial banks to extend adequate credit for export purposes. Under this scheme, an interest subsidy of 1.5% p.a. was given to the banks on their outstanding export credit, both at the pre-shipment and post-shipment stages, which amounted to as much as one-fourth of the interest earned by the banks from credit extended for export purposes.

Credit Insurance and
<u>Guarantee facilities</u>

3.9 Export credit insurance is designed to protect exporters from the consequences of the payment risks, both political and commercial, and to enable them to expand their overseas business, without fear of loss. Export credit insurance also seeks to create a favourable climate in which exporters can hope to get timely and liberal credit facilities from banks at home. For this purpose, export credit insurance (Export Credit Guarantee Corporation of India Ltd. - ECGC) provides guarantees to banks to protect them from the risk of loss inherent in granting various types of finance facilities to exporters.

The covers issued by ECGC could be divided broadly into four groups.

1) Standard policies issued to exporters to protect them against payment risks involved in exports on short-term credit;

2) Specific policies designed to protect Indian firms against payment risk involved in (a) exports on deferred terms of payment, (b) services rendered to foreign parties and (c) construction works and turnkey projects undertaken abroad;

3) Financial guarantees issued to banks in India to protect them from risks of loss involved in their extending financial support to exporters at the post-shipment as well as pre-shipment stages.

4) Special schemes, viz. transfer guarantees meant to protect banks which add confirmation to letters of credit opened by foreign banks, insurance cover for buyers credit, lines of credit, overseas investment insurance and exchange fluctuation risk insurance are other facilities introduced to take care of the changing needs of the exporter-customers.

Current interest rate and other facilities relating to export credit

3.10 Until August 1986, exporters in India were charged interest rate on export credit at 12% p.a. which has been reduced to 9.5% p.a. w.e.f. 1 August 1986. The commercial lending rate of banks, however, continue to remain between 16.5 to 17.5% p.a. In other words, the differential in favour of Indian exporters, which was 5.5% p.a. till 1 August 1986, has been widened to the extent of 8% p.a. (17.5% - 9.5%). A chart showing the interest rates on export credit which are effective from August 1986 is furnished in Annexure II. To compensate the banks for the loss of earnings, the Government of India has simultaneously raised the subsidy from 1.5% to 3% p.a. To ensure that the margins available to banks on export finance supported by RBI refinance remains unaffected, RBI has also reduced the rate of interest on export refinance from 10% p.a. to 9% p.a. with effect from 1 August 1980. Accordingly, banks would continue to be provided export refinance equivalent to 100% of the increase in export credit over the monthly average level

of credit in 1984. The concession of not bringing forward the base to average level of credit for 1985 would mean that banks' access to the export refinance facility would be about Rs.200 crores higher than what it would be if the base had been brought forward.

3.11 Interest free credit for 90 days, under the Duty Drawback Credit Scheme 1976, is another significant feature of the export promotion measures. Under this scheme, banks are enabled to grant advances to exporters against their entitlements of duty drawback on export of goods, free of interest charges.

3.12 Besides the facilities for financing normal export operations, commercial banks authorised to deal in foreign exchange extend deferred credit to an Indian exporter, against supplier's credit offered by the exporter to overseas buyer. This, in turn, is refinanced by Exim Bank upto a contract value of Rs.2 crores. Contracts valued above Rs.2 crores attract participation finance from Exim Bank. Besides, Exim Bank provides export bills rediscounting facilities to commercial banks for a period not exceeding 90 days against short-term usance export bills that have unexpired usance of a maximum of 90 days, at the rate of interest of 7.50% p.a. Refinance is provided at a concessional rate which is currently 7.65% p.a. (the rate charged to exporter is 8.65% p.a.) In addition, there is Exim Bank's scheme for direct financial assistance to the

exporter, under which the exporter gets matching rupee credit from the Exim Bank and the participating banks, against shipments of capital and producer goods. Under this scheme, Exim Bank's interest rate, applicable to exporters, is at present 8.5% p.a. for rupee credit. Rate charged by commercial banks is at present 8.65% p.a. Banks can avail interest subsidy to the extent of 1.5% p.a. for the portion of credit directly extended to the exporters, provided refinance has not been availed of from Exim Bank. Similarly, export credit can be made available to overseas buyer, both by commercial banks and Exim Bank, by way of 'Buyer's Credit', to enable purchases from India on deferred payment terms.

3.13 When a borrower has an aggregate cash credit limit exceeding the cut-off point for working capital finance, under the Credit Authorisation Scheme (CAS), which is currently Rs.6 crores, sanction of any fresh packing credit, on a regular basis, by his bank will require the prior authorisation of RBI. However, banks have been given general permission to sanction, under exceptional circumstances, packing credit to CAS borrowers upto 25% of the existing packing credit limit (subject to a ceiling of Rs.2 crores), for a period not exceeding three months without coming to RBI. This enables the borrowers to obtain bank finance quickly to meet unexpected export orders which have to be executed within a stipulated time schedule.

3.14 The Reserve Bank have also permitted banks not to insist upon the exporter in bringing in the required additional contribution (of 25% of current assets) from long-term sources, in respect of additional credit limits sanctioned for executing specific export transactions, if he is not in a position to do so. This margin contribution is insisted upon in domestic business so as to ensure that the borrower has a sufficient stake in the business.

3.15 In the case of credit relating to export of sensitive commodities, which are covered by the Reserve Bank's Selective Credit Control Directives, complete exemption from the operation of the relevant directives, including exemption from the minimum margin stipulations, has been provided to the banks.

3.16 Yet another facility extended to export credit by RBI is the exemption from application of penal rates of interest (except where packing credit has been availed of by the exporter and the export has not materialised). Likewise, ad hoc additional packing credit limits, sanctioned by banks for exports, do not attract additional interest of one per cent per annum over the applicable rate, which is required to be charged on ad hoc limits given for other purposes.

3.17 Further, service charges relating to borrowal accounts, representing the costs incurred by banks in the appraisal and management of advances, do not apply to export credit accounts.

3.18 More importantly, the Credit Authorisation Scheme is not applicable to sanction of post-shipment credit limits to borrowers. Such limits have, however, to be added up to the other credit limits enjoyed by the borrower in order to determine whether the borrower comes within the purview of the scheme. In other words, post-shipment credit limits have to be reckoned only for the purpose of the CAS cut-off point, and do not require the Reserve Bank's prior authorisation. The reason for not exempting pre-shipment credit in this manner is because this is production credit and it is necessary to ensure that the total credit limit enjoyed by the borrower for working capital is related to the total estimated production for both domestic business and exports.

3.19 For both manufacturer exporters and trader exporters (defined as those whose annual average export turnover during the preceding three calendar years is more than 25% of their total turnover in the goods manufactured/traded by them and the export turnover in the following years is not likely to fall below 25% of their total turnover), a higher cut-off point of Rs.7 crores has been laid down under the CAS as compared to the cut-off point of Rs.6 crores for other borrowers. Further, for CAS parties who are predominantly exporters and comply with certain financial criteria, banks have been permitted to release upto 75% of their additional credit requirements and thereafter come to RBI for authorisation for the entire increase sought in the limits.

3.20 In a developing economy, there are many claimants for the available quantum of credit. As loanable funds have, of necessity, to be rationed, it becomes necessary to apply certain norms to determine the priority of the claims of certain sectors of the economy. Within the prioritisation of credit allocation, exports have all along been getting their due share of credit from the banking sector.

3.21 From the set of statistics presented in Annexure III, it may be seen that the export sector has been getting a fair share of bank advances at concessional rates of interest. Export Credit outstanding moved up from Rs.706 crores at the end of March 1975 to Rs.2609.00 crores as at the end of March 1986, registering more than three fold increase over a period of eleven years. Export credit, as percentage of total bank advances, however, has declined from 8.6 as at the end of 1974-75 to 4.7 as at the end of 1985-86 presumably because of the availability of lucrative domestic market. Bank advances in general grew at a faster rate during the period, from Rs.8,762 crores in 1974-75 to Rs.55,916 crores as at the end of 1985-86. In absolute sense, the export credit, taking a share of 4.70% of the total bank advances, may be considered substantial; in fact, the growth in export credit generally outpaced the growth

in exports during the last 3 years as will be evident from the data indicated below:

Table-3: Total exports and average export credit outstandings

Year	Exports (Rs. in crores)	Variation over previous year (per cent)	Average export credit outstandings (Rs. in crores)	Variation over previous year (per cent)
1983-84	9,872.10	+ 11.75	1906.00	+ 11.15
1984-85	11,656.93	+ 18.08	2347.00	+ 23.14
1985-86	11,005.91	- 5.59	2408.00	+ 2.59

3.22 In the context of promotion of exports at a faster rate, exporters demand that a further reduction in interest rate on export credit to the level of international money markets will have significant impact on export competitiveness. This has been examined in Chapter 4.

CHAPTER - 4

Significance of interest cost on export competitiveness

4.1 There are two important aspects to export finance, viz., (a) the timely and adequate availability of credit and (b) the cost of credit. The timely and adequate availability of credit is crucial for creating and supporting a growing export sector. It is important that this aspect of export credit is given due importance and all necessary steps must be taken to ensure smooth flow of funds to the export sector. All avoidable delays in sanctioning the export credit limits and in the disbursement of the credit need to be removed by streamlining the existing procedures for the sanctioning and disbursement of credit.

4.2 The cost of credit is also important in making exports competitive but its significance varies from product to product depending on the proportion of interest costs in the total f.o.b. cost. The interest factor in the f.o.b. cost depends, to a great extent, on the interest rate and the period for which the credit is availed of for executing an export order. Interest rate is also important at the post-shipment stage. In the case of exports involving sight and short usance period, normally interest rate is loaded on the price but in the case of usance period exceeding one year, interest rate is separately quoted from f.o.b. or c.i.f. price, as the case may be, and it is payable by the

importer. Obviously, matching credit terms, both in terms of credit period and interest rate, are important for securing export orders.

4.3 An important point brought to the notice of the Committee, by exporters and export organisations, is that though technically the credit period is deemed as short, in practice exporters are compelled, by reasons beyond their control, to avail of the credit for much longer periods and when such delays occur, interest at normal commercial rates are payable by them. Delays occur at various stages, for instance, in securing raw materials, transporting goods due to non-availability of wagons, at the customs, at the shipment stage, etc. Thus, the actual interest cost incurred by exporters is much more than the generally accepted pre-shipment and post-shipment period. The problems arising from such delays are partly alleviated now with the extension of concessional export credit uniformly for a period of 180 days (maximum for all export items at the pre-shipment stage).

4.4 From the information obtained by the Committee, through questionnaire and discussions with exporters and banks, it is observed that for the large majority of export items, interest cost constitutes around 3% of the f.o.b. cost. In the case of a few items, it may go up to 5% and in a few others, interest cost exceeds 5% of the f.o.b. cost.

4.5 It is to be recognised that no direct relationship can be established between interest rate reduction and export performance. Cheaper export credit is one of the several facilitating measures.

4.6 However, for formulating the policies relating to export credit in a realistic context,it is important to have an idea of the impact of a reduction in interest rate on the f.o.b. cost of exports.

4.7 There is no consensus among exporters, export associations and banks about the significance of interest rate reduction on export competitiveness. While some exporters maintain that interest rate is important, others are of the view that, interest cost may not be significant in improving price competitiveness. There is, however, a consensus that exports from India are handicapped by a number of other sdrious problems,such as,high prices of raw materials and components, lack of quality consciousness, low productivity, innumerable procedural problems at various stages of transport, customs clearance, port formalities, etc. Unless they are tackled,concessional export credit by itself can hardly have a significant impact on export performance. It has also been indicated by some exporters that the relatively high domestic profitability is also an additional factor standing in the way of export performance. Since there is a lucrative domestic market for most manufactured goods

and domestic consumers are undiscerning as far as quality is concerned, sales in India is easier than exporting.

4.8 The banks, in their reply to the questionnaire, as well as in the course of discussions, reiterated their view that concessional export finance would have only marginal significance on export price competitiveness and hence, on export performance. On the basis of the information on production costs available with the banks on a wide range of export items, they were of the view that there is no ground for a further general reduction in interest rate on export credit. According to the banks, in cases where the interest cost is significant and price disadvantage is marginal, interest rate may be reduced on a case by case basis and an 'across-the-board' reduction is not necessary nor desirable. Most banks are of the view that what is more important is the adequacy and promptness of credit and not the cost of credit.

4.9 Obviously, the items that stand to gain in terms of price competitiveness are those where interest cost is significant and the price disadvantage is marginal. In the absence of reliable information on the extent of price disadvantage of various items, it is difficult to assess the scope for improving price competitiveness through concessional export credit. In cases where the price disadvantage is significant, as in the following items,

concessional interest rate hardly serves any useful purpose, unless it is accompanied by commensurate support schemes, such as, cash compensatory support, reduction of octroi and other taxes, provision of raw materials at international prices, etc. If the disincentive to exports arises from high profits from domestic sales, none of these measures may prove effective.

Table - 4: Price disadvantage of certain items

(Rs in per cent)

Commodity	Extent of price dis-advantage	Proportion of interest cost in total cost
Garments	30%	1% - 10%
Basmati Rice	20% - 40%	12% - 15%
Aluminium Foils	10 -100%	4%
Cotton cloth	10%	5.01% (including interest on funds from other sources which account for around 2.01%)
Polyester cloth	25%	
Tyres	15 - 20%	3.50 - 4.14%
Paints	12.5%	4.93%

4.10 For instance, if interest cost constitutes around 3% of the f.o.b. cost of an item, a reduction of interest rate from 12% to 9.5% will improve the f.o.b. cost only by 0.6%. This means a reduction of over 20% in the interest rate will lead only to a negligible improvement of 0.6% in the f.o.b. cost. Even if we take interest rate

as constituting 5% of the f.o.b. cost, a reduction of 20% in interest rate will help to improve the f.o.b. cost by only 1%. On the other hand, price competitiveness of Indian exports can be improved substantially if further relief is provided in respect of these items, particularly raw materials and other inputs that constitute a larger proportion of the f.o.b. cost. Besides, a direct and immediate impact can be made on profitability from export business, if further fiscal reliefs are provided for export performance in excess of a selected base period. In such cases, the relief being contingent on export performance there would be greater incentive to achieve greater exports.

4.11 From the foregoing assessments, it is evident that concessional export credit by itself will have only a marginal impact on export performance. Because of the complexity of production problems and production conditions of different products and the changing overseas market environment, it is not possible to establish any close relationship between concessional export credit and export performance. In fact, the role of export interest cost is to be visualised in conjunction with other supportive export assistance measures. Not all export items require special subsidy to improve their competitiveness.

4.12 Exports are beset with a number of major problems. All of these cannot be solved by providing concessional export credit alone. We are of the view that in order to ensure efficient allocation of scarce capital, finance must, in general, bear its true cost to the economy. The rigidities and handicaps arising from inefficient production, lack of access to raw materials and other inputs at international prices, etc. should receive greater priority in our export efforts, in the long run. Besides, a systematic cost-benefit assessment of the support measures, in the medium and long run, including concessional export credit, is necessary to give a sound footing to our export efforts. Without such a cost-benefit analysis, export promotion measures through financial incentives may not serve the purpose in the long run.

C H A P T E R - 5

Renewed demand for further reduction in export credit interest rate

5.1 In recent years, there has been a renewed demand, from exporters and export associations, for a further reduction in interest rate applicable to export credit. This demand has been prompted by the configuration of several developments, such as, the recent decline in the interest rates in major developed countries, the unsatisfactory performance of Indian exports in the face of sharply rising imports, the intensifying competition among exporting countries to retain market shares in stagnant international markets, the resurgence of protectionist tendencies in major developed countries, delays at various stages resulting in longer production cycle, etc.

5.2 In this context, the issue of what should be the proper framework and criteria for determining export credit interest rate assumes importance. Policy measures will have greater stability and realism if they are guided by an appropriate export financing framework.

5.3 A close examination of the policy evolution and policy implementation of the export financing system of India reveals that the following had been the broad guiding principles: a) a recognition that export financing system must be consistent with the broad monetary and interest rate objectives of India; b) the export financing system,

being an integral part of the overall export promotion measures, must be evolved and implemented with flexibility to meet the changing requirements of the export sector; c) the recognition of the importance of adequate finance to facilitate export production and export sales and d) the recognition that unless concessional export financing facilities are complemented by special measures to provide a reasonable return to banks on funds employed in the export sector, the objective of ensuring increased availability of credit to the export sector cannot be achieved.

5.4 It has been suggested in the context of export promotion measures that all major inputs, including export finance, should be provided to Indian exporters at rates that are available to overseas competitors. The logic seems to be that Indian exporters should be on par with their competitors in the matter of prices of raw materials and interest rate on finance. In this context, it is important to note that the prices of various inputs used in the production of exports, including finance, should reflect their relative domestic supply-demand conditions or their scarcity element. However, there is a rationale for supplying major inputs at concessional prices to exporters under the following circumstances :(1) until the exporting units have sufficient time to develop their production and marketing capabilities, the supply of inputs at international prices is justifiable as a temporary measure; (2) administrative

imposts such as import controls, import duties and unrealistic exchange rates unduly increase the prices of imported inputs or make them inaccessible to exporters and (3) there are also a large number of cumulative taxes and local levies at central, state and local government levels which, being administrative imposts, can make Indian goods uncompetitive in international markets. Hence, these taxes and levies should be reimbursed through appropriate compensatory measures. Such measures may include cash compensatory support, provision of major inputs at concessional rates, etc. Similarly, if any administratively imposed loading factor is incorporated on interest rate, it should be eliminated from export credit so that the interest rate reflects only the true cost of funds to the economy.

5.5 If the problems of export competitiveness arise from the second group of factors, liberalisation of imports and reduction of customs duties to give free access to raw materials at international prices, which is already being done, is more efficient in the long run than subsidies or provision of concessional export finance.

Framework for determining
<u>interest rate for export credit</u>

5.6 Interest rate on export credit should reflect the cost of funds, including a reasonable profit margin to banks. India has an administered interest rate structure both for deposits and advances. The policy on interest rate

structure is formulated and implemented with the twin objectives of promoting savings and channelling the savings to various sectors of the economy according to national priorities. It is necessary to note in this context that the bulk of the savings in India takes the form of deposits in the banks and therefore, the rate of interest on deposits have an important role in promoting savings and investment in the country. The commonly held view among analysts is that the rate of interest should be positive in real terms (inflation adjusted) to provide sufficient incentive to savers. Since the latter half of the 70s, interest rates on deposits in India have been adjusted upward to give a boost to savings. This policy has helped to increase the domestic savings rate to about 23% of the GNP. However, the current interest rate structure on deposits still fails to give even a modest real rate of return (inflation adjusted interest rate) to the savers, except those sections of the savers who can take advantage of the income tax incentives. This means that for the large majority of the savers, the nominal rate of interest on their deposits is less than the inflation rate. Under these circumstances, the scope for any reduction in the interest rates on deposits is extremely limited and the current cost of funds to the banks can be expected to continue.

5.7 The administered structure of interest rates on banks' asset portfolio is much more complex. Varying rates are prescribed by the monetary authorities for different sectors or borrowers. A substantial part of banks' available funds is pre-empted by cash reserve requirements, investment in Government securities and lending to priority and other essential sectors. Earnings on resources so deployed are lower or barely above the cost of funds to banks. Only around 20 - 23% of banks' working funds are lent at commercial ceiling rate, currently between (16.5% and 17.5%). Thus, commercial advances, by and large, bear a part of the financial burden arising from concessionary credit to other sectors.

5.8 On the same principle as the reimbursement of taxes and levies on other inputs used for export production, the cross concessionality inherent in the pattern of deployment of resources of banks should not be loaded on the export interest rate.

5.9 An appropriate conceptual framework for determining the cost of funds (excluding the loading factor on account of various concessional financing) should consist of only the following main elements:

1) the interest cost of funds, taking into account the prevailing interest rates on deposits (taking also into account the refinance available for export credit), currently costs 7.5% per annum based on the deposit mix of 18% current account and at nil interest rate, 25% savings accounts at 5% and 57% fixed deposits at rates ranging from 8-11%;

2) establishment and other related expenditure for mobilising deposits and administering advances (here the concept of establishment expenses to an average bank is relevant. As a proxy, the average establishment cost of the group of nationalised banks given in RBI's Statistical Tables Relating to Banks in India can be used). Currently establishment and other related cost is about 3% of the working funds;

3) a margin of minimum 1% per annum over the total cost of funds, to provide a cushion for loan losses and a modest profit to banks; and

4) the cost involved in the prudential and operating cash reserve requirements totalling 5% (3% statutory minimum reserves and 2% cash in hand). The rationale is that a bank cannot lend all the deposits it mobilises. It has to keep a minimum reserve for undertaking normal banking business which is 5% under Indian conditions. The main source of funds of commercial banks constitutes deposits and market borrowings are very limited.

5.10 On the above reckoning (interest cost at 7.5%, establishment expenses at 3% of the working funds, cost involved for maintaining cash reserves of 5% of working funds, a minimum margin of 1% over total cost), the interest rate applicable to export credit works out to about 12.1% p.a. at present. The above computation does not take into account the loading factor on account of concessional pre-emptions.

5.11 Since the interest rate on export credit has already been reduced to 9.5% p.a. with effect from 1 August 1986, the Committee feels that there is no scope for any further reduction in the general export credit interest rate at present. The minimum interest rate applicable to export credit should vary, from time to time, depending on the variations in the interest rate structure on deposits.

5.12 As already explained earlier, it is also important that export credit interest rate should not contain any loading factor other than those indicated above. It appears that, at present, the interest rate for commercial lending has a loading factor to enable the banks to recoup atleast a part of the loss in return arising from concessional lending to various priority sectors and SLR investment at rates near or below the actual cost of funds.

Special liberal export credit for identified thrust export items and areas

5.13 The promotional export finance scheme would be more fruitful and would achieve its objectives if the liberal finance is directed towards systematically identified and monitored thrust areas of exports and also bulk contracts, keeping in view the dynamic comparative cost advantage for our export products in international markets, opportunities for penetrating new markets and export transactions for the purpose of market retention. Such financing facilities should form an integral part of an appropriate financing package. In the case of bulk contracts, involving a

contract value of, say, Rs.5 crores and above in respect of a single order, it was felt that the prescribed rates of interest may need to be finetuned, if it can play a decisive role in securing the contract. For this purpose, a detailed scheme may be worked out by the RBI in consultation with the Government of India. The chief merit in this case is that the special concessional credit facilities, if utilised, would definitely lead to an increase in exports and also will not become a permanent feature of our export credit facilities. Prompt decision and appropriate flexibility to meet the specific requirements of individual bulk contracts are important for the success of this scheme.

Shadow price of foreign exchange as basis for determining export interest rate

5.14 It has been suggested that shadow price of foreign exchange is an appropriate determinant of interest rate applicable to exporters. The argument is that since exchange rate of the rupee does not reflect the real worth of foreign exchange to the economy, some appropriate quantification of this worth is required. It is suggested that once the 'shadow price' of foreign exchange is determined through an acceptable measure, the interest rate on export credit can be adjusted to the extent of the differential between the actual exchange rate and the shadow price. Apart from the practical difficulties of determining the shadow price

and also its variability from time to time, there are far more significant allocation problems involved in this approach. Efficiency in allocation of resources is best realised through a mechanism in which both the prices of inputs as well as outputs reflect their underlying cost to the economy. Foreign exchange being a scarce resource, the exchange rate should reflect its value to the economy. Therefore, suitable adjustment of exchange rate is the best course of action to ensure efficiency in its utilisation. The inputs of exports also should reflect their cost to the economy. In the case of India, the objective of realising the real value of foreign exchange is partly sought to be achieved by a system of rationing of foreign exchange according to national priorities, in addition to the adjustment of nominal exchange rate. If the rationing of foreign exchange is broadly determined by well conceived national priorities, the realisation of true value of foreign exchange can be achieved, perhaps to a much greater degree than an allocation of foreign exchange achieved through price mechanism, because market prices themselves are distorted by the serious distortions in income distribution and hence, the demand pattern. By pricing the funds on the basis of their actual cost as suggested earlier, the real value of savings to the economy is also taken care of.

Interest rate prevailing in
other countries not relevant

5.15 Some exporters and export organisqtions have suggested that export credit interest rate in India should be related to interest rates in foreign market. The recent demand for reduction of interest rate applicable to exports is partly prompted by this perception. The Committee, after considering all the relevant aspects, has come to the conclusion that there is no theoretical rationale or practical advantage in linking interest rates applicable to Indian exporters to interest rates prevailing in major developed countries.

5.16 The nexus between interest rates, forward exchange rates, inflation rates, etc., of major countries, where there are no barriers to fund movements or exchange restrictions, is not always adequately recognised by Indian exporters. Interest rate in these countries is used as an important tool not only for maintaining price stability and income growth but also for achieving exchange rate objectives. Another aspect is that interest rates in foreign countries are influenced to a great extent by inflationary expectations, although the mechanism of the transmission of inflationary expectations on interest rates is often modulated through monetary policy in accordance with other important policy objectives. The interest rates of all major countries are closely linked together through the spot and forward exchange markets.

5.17 Besides, interest rates of these countries are also highly volatile and the stability in the cost of production, which Indian exporters most require, cannot be achieved by linking export interest rates in India to overseas interest rates. Even if the interest rate in a country is relatively low, the advantages arising from that low rate are cancelled out by the premium on the forward exchange market. In other words, the currency with the low interest rates is at a premium in the forward market to the same extent as the interest differential. Therefore, under normal circumstances, for short period exports or imports, no special advantages are derived from interest differential, unless the traders are prepared to take foreign exchange risks from their currency exposure.

5.18 However, special export credit facilities incorporating concessional interest rates provided by competing developing countries, particularly the newly industrialised developing countries, such as, South Korea, Taiwan and Singapore are relevant for Indian exporters, as such facilities would place Indian exporters at a comparative disadvantage. Therefore, the Committee has examined the export financing facilities in these countries in order to assess whether any special measures are necessary to place Indian exporters on par with their counterparts in these countries.

Comparison of export credit facilities
in India and other developing countries

5.19 Interest cost is a component of the total f.o.b. cost of exports; therefore, a price advantage can be conferred on exports through lower interest rates, provided the financial market of the country concerned is not integrated with international markets. The extent of price advantage, achieved through lower interest rates, depends on the magnitude of the concessional element in interest rate on the one hand, and the proportion of interest cost in the total f.o.b. cost, on the other. Apart from price competitiveness, post-shipment credit extended at lower interest rate can help in improving export sales.

5.20 The two relevant aspects in this respect are:

1) What is the magnitude of concessional element in the export interest rate as compared to normal lending rate in other developing countries who are our major competitors?

2) Is the cost of export credit in India comparable to major competing developing countries?

5.21 The comparison of concessional element in export credit as compared to interest rate on normal commercial credits in different countries is not conceptually realistic if the commercial rates themselves are determined on extraneous basis rather than their underlying cost. In the case of most developing countries, including India, extraneous reasons have a significant role in determining interest rates. However, from the comparative picture presented in

Table-5, it is evident that in countries like Pakistan and Bangladesh, the differential in favour of export credit is, by and large, as much as in India; the eligibility of concessional export credit is limited to a few selected items in these countries. On the other hand, in India the entire export credit, at the pre-shipment and post-shipment stages, are covered by concessional interest rate scheme. Only non-traditional export items and certain types of borrowers are eligible for subsidised export credit in both these countries. Besides, in Bangladesh concessional credit is linked to increase in exports over the sector targets. It has also been brought to the notice of the Committee that in Srilanka, the concessional component/incentives on the export credit is given at the stage of realisation of export proceeds. Detailed information on facilities available to exporters in different countries is given in Annexure IV.

5.22 Foreign currency loans raised by exporters in all these countries carry interest rate with a spread added to LIBOR or SIBOR and hence, no concession is available for such funding. In the case of foreign currency borrowing, though the interest rate may be low relative to domestic interest rate, exchange risks are enormous. We may recall that during the last 18 months, deutschemark and yen, which carried low interest rates, had appreciated more than 40%.

Table-5: Concessional element in export credits in selected developing countries

(in per cent)

Sr. No.	Country	Interest-rates of general advances or commercial lending rate	Export credit interest rate	Interest Differential Col.3 - 4
(1)	(2)	(3)	(4)	(5)
1.	India	17.5	9.5	8.0
2.	Pakistan	14 - 16	a) 6(non-traditional items)	8 - 10
			b) 10-20 (but generally 13-15 for 25 specified commodities)	1.0 - 3
3.	Bangladesh (with stipulation of shipment within 120 days of the drawal)	16-18 (maximum lending rate)	a) 12 (Traditional items)	4 - 6.0
			b) 9 (non-traditional items)	7.0 - 9.0
			c) 7 (over sector target)	9.0 - 11.
4.	South Korea	Local currency rates	Pre-shipment rates Local currency	
		10 - 11.5 (for short term)	10.0	0 - 1.5
			Foreign currency + 1.5% spread LIBOR/ SIBOR	
			10-12(over 1 year period)	
			Mainly for export of capital goods under co-financing scheme of Export Import Bank of Korea.	
			Post-shipment	
			(short term LIBOR/ SIBOR + spread at the discretion of bank.)	
			Medium/Long term (only Korea Exim Bank provides credit)	

(1)	(2)	(3)	(4)	(5)
5.	Indonesia	20-24 based on 1-4% spread	Under Government programme 85% of pre-shipment finance at normal interest rate for a period not exceeding 5 months. Interest in excess of 9% is reimbursed to the exporter by Government.	
6.	Taiwan	Local currency		
		Short term 5.5-9	5.75% (only at pre-shipment stage for 180 days	Maximum of 3.25
		Foreign currency	Programme of Export Import Bank of China	
		LIBOR/SIBOR + spread decided by lending bank	Medium & Long term The rates vary depending on the prevailing international market rates. Currently the rates for U.S. dollar borrowings are around 2 years 7.00 2-5 years 7.75 5-7 years 8.00 over 7 years 8.25 Fixed foreign lending facility to foreign importer through foreign correspondent bank. 2 years 7.00 2-5 years 7.75 Short-term financing Export Promotion Loans 5.75	
7.	Malaysia	1.5-2% spread over the cost of funds	Cheapest form of credit under the Export-Credit Refinancing Scheme (ECR) and restricted to short term credit at 6.5% Medium or long term post-shipment credit is not available.	-

(1)	(2)	(3)	(4)	(5)
8. Singapore		N.A.	Funding against policy issued by the Export Credit Insurance Corporation of Singapore (ECICS) for 180 days. Cost of credit is subject to negotiation. Prime rate is stated to be 8-8.5%. But pre-shipment cover has been discontinued by ECIC. Instead funding for raw material purchases now available for 90 days back to back L/Cs of exporters.	

Hence, heavy financial losses have been incurred by those who borrowed in these currencies. Due to the large movements in exchange rates of major currencies, borrowing in low interest rate currencies, unless accompanied by efficient management of exchange risks through timely currency swaps, may turn out to be more expensive.

5.23 In all the countries we have analysed, it was observed that the lending rates were based on deposit rates. For instance, in Indonesia, the interest rates on deposits are as high as 15.5% - 16.5%, depending on the maturity period. The interest rates on general advances in Indonesia range between 20% - 24%. In the case of Pakistan, the interest rate on advances is around 16% as compared to profit rate on deposits of one year maturity at 12.24%.

5.24 In the context of general interest structure in India and other competing developing countries and the specific conditions and limitations applicable on export credit in these countries, the export credit facilities in India are comparable with those in the competing countries. However, the Committee feels that there is scope for softening interest rates in specific cases. In this context, a special note submitted by one of the Members of the Committee is furnished in Annexure V.

5.25 One of the banks pointed out that the basic interest rate in most of the countries is lower than India. Perhaps, the most appropriate comparison would be with interest rates in Korea. Besides, in Korea much greater incentives are provided to banks to extend more credit to the export sector. The main features of Korean export financing system are:

(i) Differences between interest rates for export finance and for other loans is only 1.5%;

(ii) Refinance upto 70% of total loans;

(iii) Refinance rate provides for a spread of 5% compared to 2% in India (since reduced to 0.5% in view of the recent downward revision in export credit interest rate and export credit refinance rate, from 1 August 1986) which is also on the portion refinanced.

5.26 It is to be noted that in some of these countries, the need for maintaining the profitability of banks in export credit, for the purpose of ensuring adequate finance to the export sector, is recognised.

CHAPTER - 6

Other related issues

Provision of credit for both domestic purposes as well as for exports, at the concessional rates of interest, where the manufacturer exports a set/ designated portion of production

6.1 A request has been made to the Committee by some exporters that if an exporter undertakes to export a definite percentage of his total production, not only the finance required for his exports but also that required for his production for internal marketing must be provided to him at the same concessional rates. The Committee did not find any rationale for this suggestion. If the suggestion is accepted, the burden of interest loss would have to be borne either by the banks (which are not in a position to bear it due to reasons explained in Chapter 7) or by the Government through subsidy. The differential at the present rates viz. 16.5% - 17.5% p.a. on domestic credit and 9.5% p.a. on export, is asmuch as 7 to 8% p.a. The subsidy from Government will have to be at the same rate viz. 7% or 8% p.a. so as to ensure that banks' earnings do not suffer further. On export finance alone, subsidy paid at 1.5% p.a. amounted to Rs.24.70 crores during the period 1 April 1985 to 31 March 1986. It is expected that with the higher rate of subsidy (at 3% p.a.) with effect from 1 August 1986, the subsidy amount payable by the Government during the current year will be about Rs.41 crores. The quantum of domestic credit availed of by those who export a part of their production,

not being known, it is not possible to even make an estimate of the amount of interest subsidy that would be required.

6.2 Even if the demand for concessional rates of interest on domestic advances is also acceded to, there is no guarantee that exports would increase beyond the prescribed level. Inasmuch as, the manufacturers would stop exporting once the level is reached and the concessional interest provided for the purpose of increasing exports would continue to be used for domestic activity, which would bring in an element of discrimination among two categories of borrowers viz. exporter manufacturers and non-exporter manufacturers.

6.3 The Committee feels that the benefit of a lower rate of interest also on the domestic segment, to those who undertake an export obligation, would amount to an individious discrimination against those who do not export at all, as they may be producing goods vital to the economy and are thus performing an equally important economic function. Also, the differential between the interest rates on exports (9.5% p.a.)and on domestic sales (16.5% - 17.5% p.a.) being as it is, it would create a substantial incentive for misuse of concessions.

6.4 Another suggestion has been made to the Committee by some of the exporters that export credit should be made available for the total capital employed by them and not merely for their working capital requirements. The Committee is convinced that the existing financial arrangements are adequate to meet the genuine credit requirements of exporters,

both short term and long term. The rates of interest in India for long term credit requirements is lower than the normal cash credit rates.

Packing credit should be kept outside the framework of CAS and should be granted as additional financing facilities

6.5 The Committee has noted that commercial banks assess the total working capital requirements of their borrowers on the basis of their projected production and sales including export-sales, taking into consideration the borrower's production capacity, pattern of current assets build-up, available net working capital, etc. In the case of exporters, the overall limits so allowed would include packing credit limits as well. Moreover, a bank can always accommodate an exporter for his additional requirement, on an adhoc basis, under discretionary powers vested in the banks by RBI. The Committee, therefore, feels that export credit limits cannot be kept outside the purview of overall credit assessment because in that case banks will not be able to enforce proper credit discipline.

Rates of interest for post-shipment credit against export of consumer durables and other goods (which are usually exported on 'cash' terms), the proceeds of which are permitted to be realised beyond the statutory time-limit of 180 days

6.6 The Committee has been requested to determine an appropriate rate of interest for post-shipment credit

a) against exports, the proceeds of which are permitted to be realised within 365 days as against 180 days, allowed in case of 'cash exports' as per the existing exchange control regulations; and

b) against export of consumer durables and miscellaneous engineering goods when exported on deferred payment terms, say, upto 2-3 years, and not on 'cash' terms.

6.7 According to the existing instructions, concessional rate of interest is applicable in both the cases to the extent it is admissible in the case of short-term exports, i.e. upto the initial maximum period of 180 days at the rate of 9.5% p.a. and for the period beyond 180 days, an overdue rate of interest not exceeding 15.5% p.a. is to be charged.

6.8 The Committee has examined the issues and it is of the view that all cases of cash exports where the proceeds are permitted by RBI, at the initial stage when the contract is entered into by the Indian exporters with the overseas buyer, to be realised beyond 180 days, should be deemed as

extended cash exports and not as deferred payment exports. Exporters availing of post-shipment credit against such exports should be eligible for concessional interest rate, as applicable in the case of cash exports (which is at present 9.5% p.a.), for the entire extended period. In case the proceeds are not realised within the extended period, the prescribed ceiling rate on export credit (which is not exceeding 16.5% p.a., as at present), would be charged on such advances during the overdue period. The financing banks, in turn, should be eligible for all normal benefits, as in the case of advances against cash exports.

C H A P T E R - 7

Effects of reduction in interest rates and other changes in export credit on Indian banks

7.1 The recent reduction in the interest rate and the extension of the maturity period of export credits are likely to have significant adverse impact on the profits and profitability of Indian banks. The main issues that need to be examined in this respect include the following:

(i) What are the trends and outlook for the profits and profitability of the banks?

(ii) What is the magnitude of the financial burden imposed on the banks by the recent changes in export credit interest rate and other terms?

(iii) What is the magnitude of the subsidy extended by the banks to the export sector and whether the banks have the capacity to absorb the burden? and

(iv) What impact the low yield on export credit has on the motivation of the banks to provide increased volume of credit to the export sector?

Trend of profits and profitability of the banks

7.2 It is widely acknowledged that published P & L statements do not reflect the actual picture of the financial position of Indian banks. Under the Banking Regulation Act, 1949, banks in India are permitted to present their

financial position in broad terms. Therefore, it is not adequate to rely entirely on published P & L statements to ascertain the effects of recent export credit interest rate changes on the profits and profitability of the banks. Further, direct and authentic assessments, by discussions with executives of individual and groups of banks, are necessary.

7.3 From information pieced together from the discussions, the Committee had with banks and also the information obtained through questionnaires, the Committee believes that, with the exception of two or three banks, the profits and profitability of public sector banks, as well as private Indian banks are generally declining and unsatisfactory. The financial position of a few banks is even precarious. The declining profits and profitability arising from domestic reasons are now being compounded by problems in overseas operations to some of the Indian banks. In the past, profits from overseas operations helped some banks to boost their overall profits.

7.4 While one or two public sector banks may be able to absorb the financial burden of low yield export credits, the large majority of Indian public sector banks and private Indian banks are unable to absorb the additional burden arising from the reduction in interest rates and the elongation of the maturity period of export credits, without impairing their already unsatisfactory financial position.

In the case of atleast one public sector bank, this additional burden may even result in the bank not only wiping out its profits but actually making losses.

7.5 A related fact revealed by a few banks in this respect is that those banks that had gone in an aggressive way in the past to increase their export business now stand to be adversely affected because the proportion of their export credits to total advances is larger than that of their peers.

7.6 The foregoing unsatisfactory profit and profitability picture is corroborated by the results of the data available from published sources. The profits and profitability of all Indian banks have declined in recent years. For instance, the profitability, as measured by ratio of profits to working funds, of the State Bank of India declined sharply from 0.11% in 1983 to 0.09% in 1984. The increase in its absolute profits was also negligible. As many as 6 of the nationalised banks, 5 SBI associates and 4 private Indian banks reported less profits in 1984 than in 1983. Their profitability also declined sharply. Only the foreign banks in India registered significant gains in their profits and profitability in recent years.

Outlook for profits

7.7 Interest income (including earnings from investment) accounts for about 92% of the total income to Indian banks, while non-interest income from commission, fees, etc. accounts for less than 9% of total income. Expenditure on

interest (60 - 65%), and salaries and allowances (20 - 24%), accounts for nearly 86-88% of the banks' total expenditure. Profits and profitability of Indian banks can increase only if there is an improvement in interest income or increase in non-fund related earnings or by a reduction in interest expenditure or improvement in manpower productivity or a combination of all these elements. However, the scope for gains in the immediate future on any of these fronts appears rather dim.

7.8 Interest expenditure on deposits (the general purpose financial resources for the banks) depends on the interest rate structure on deposits and the composition of deposits (current, savings and fixed). The interest rate structure is determined by the monetary authorities. Among other policy considerations, the promotion of savings in the community is one of the major considerations influencing interest rate structure. It is generally recognised that interest rate on fixed deposit should be positive in real terms (inflation adjusted return) to encourage savings. With inflation as well as inflation expectations continuing to be high, the scope for a reduction in interest rates on deposits is rather limited in the immediate future. Individual banks do not have much control over the composition of their deposits, as it is influenced, to a large extent, by the interest differential as between different types of deposits and the liquidity preferences of the customers.

It is only the larger banks with greater funding abilities that can attract a large proportion of interest free current account deposits, which helps them to reduce the cost of deposits.

7.9 Refinancing facilities from RBI for various specified purposes are available but for computing the cost of loanable general purpose funds, the funds obtained from refinancing facilities should be excluded. The scope for reducing interest expenditure is, on the whole, limited.

7.10 Interest earnings remain depressed due to the large pre-emptions on account of CRR, SLR, concessional credit to small-scale and priority sectors, etc. Only about 20-23% of the total working funds of the banks are, at present, lent at commercial interest at or around the ceiling rate of 17.5% p.a. As 20-23% of the total funding operations already incorporate the financial burden of low yield pre-emptions and priority sector financing, the scope for any further increase in the interest rate on the non-priority sector advances is extremely limited. Any such increase may also meet with resistance from the borrowers. An increase in the interest rate applicable for priority sector also looks rather difficult. In view of the hike in the interest rate on government borrowing in 1985, the scope for further increase in the interest rate on government borrowing is limited, at least in the immediate run. Such an increase in interest rate would also increase the debt service burden

of the Government. Such an increase is unlikely to benefit the banks significantly due to the already large accumulated holdings of government securities and the potential capital loss arising from the interest rate hike.

7.11 Efforts for reduction in establishment expenditure through mechanisation and rationalisation may yield results only in the medium-term. On the other hand, the recent hike in salaries and allowance has already imposed a heavy additional burden on the banks. If,at all, improvement in productivity is realisable, it may at best help to off-set the effects of the recent hike in the salaries and allowances.

7.12 Efforts for improving earnings from non-funding activities are already under way. The recent hike in service charges is a step in this direction. Consumer resistance is already gathering momentum. Whether a significant hike in the service charges on retail banking services is desirable,at a time when banking habits are still to be cultivated in the country, is a moot point. Any way, to some extent, the response of customers to rationalise and resort to cash payments can be expected. What would be the net effect of these developments on the banks' earnings is difficult to say,at this stage. Non-funding activities like, merchant banking, leasing etc., may help bigger banks with larger fund-base to improve their non-interest earnings. But these opportunities are not open to small and medium-size banks,without exposing them to greater risks.

7.13 Thus, it is reasonable to conclude that in the immediate run, there is no discernible development in the Indian banking scene that indicates an improvement in the profits and profitability of the banks. Some of the opportunities arising from merchant banking, non-resident capital flews, foreign equity investments, increased foreign borrowings, etc. may accrue mainly to foreign banks in India or to the bigger banks.

The magnitude of the financial burden imposed on the banks by recent changes in export credit interest rate and other terms

7.14 As already indicated in the preceding sectien, there have been important revisions in 1986 in the maturity period as well as interest rate applicable to short-term export credits. Until March 1986, the concession in export credit was available to exporters for varying periods, depending on the category of goods involved. Certain heavy engineering items were eligible for export credits at 12% p.a. for 180 days, and a further period of 90 days at 14% p.a. Similarly, some of the specified items enjoyed interest rates at 12% p.a. for 180 days and for subsequent extended period, interest rate at 16.5% p.a. was applied. The large majority of the items exported from India were eligible for credit at 12% p.a. for the initial period of 90 days and 14% p.a. for a further period of 45 days and 16.5% p.m. for further spillover periods. The multiplicity of varying maturity periods for determining the eligibility for concessional export credit

was eliminated since March 1986, when it was decided that all export credits should be eligible for interest at the ceiling rate of 12% p.a. (since reduced to 9.5% p.a. w.e.f. 1 August 1986) for a uniform maturity period of 180 days at the pre-shipment stage.

7.15 Estimates based on current interest rate and average maturity period, based on 5 year historical average data for various categories of exports, reveal that taken together the recent changes may result in a decline of 0.73% in the rate of return (even after taking into account the subsidy of 3 %) on export credit to the bank as compared to their earnings prior to August 1986 (Table-6). This means that the hike in interest subsidy by 1.5%, from 1.5% p.a. to 3% p.a., only partially compensated the banks. Besides, the elongation of the maturity period to a uniform 180 days in the case of all pre-shipment financing necessarily means larger fund requirement for financing the same export volume.

7.16 The effects of the decline in the yield from export financing activity vary from bank to bank. But what is important for policy consideration is the likely effects on average and marginal banks. More significant is the fact that this additional burden is called for at a time when the profits and profitability of a large number of Indian banks are already under severe prèssure. Some of the banks have indicated to the Committee in the course of our discussions that they were not able to absorb the additional

burden of the net effects of the recent changes in the export credit scene without impairing their financial position. Our computation based on published figures also show (summary given in Table-7) that at the current profit performance, the entire profits of atleast one nationalised bank would not only be wiped out but the bank would incur actual losses. An additional 4 banks would register a decline of profits in the range of 51% - 90%, 6 banks in the range of 21%-50% and 17 banks in the range of 9-20%. The pervasive adverse effects of the recent reduction in interest rates on export credits on the profits and profitability of Indian banks have to be recognised.

Subsidy extended by the banks on export credit - the relationship between cost of funds and the return on export credit

7.17 Another related aspect is the relationship between the cost of funds to the banks and the yield from export credit to an average or marginal bank in India, in order to assess the subsidy extended by the banks to the export sector. The cost of deposit vary from bank to bank, depending on the composition of each bank's deposits and also the magnitude of administrative and other costs. Information furnished by the banks to the Committee through the questionnaire and follow up through personal discussions with the banks revealed that average interest cost of deposits amounts to about 7.5% p.a. If we add another 3.20% on account of

Table - 7 Net effects on banks of changes since March 1986 in the terms and rates of export credit financing.

% effect on published profits	No. of banks
0 - 8	9
9 - 20%	17
21 - 30%	5
31 - 40%	-
41 - 50%	1
51 - 60%	1
61 - 70%	1
71 - 80%	1
81 - 90%	1
91 - 100%	-
100 & above	1
	37

Note : Net effects are worked out on the average export credit outstanding wherever available or outstanding export credits at the end of 1985, published profits in 1985 and assuming a reduction in earnings on export finance of atleast 0.73% as compared to August 1986 earnings.

establishment and other operating expenses, the total current cost of funds may rise to around 10.75%. The recent wage revisions in the banking industry are likely to raise the average establishment costs still further.

7.18 What is more relevant from the point of view of assessing the subsidy element extended by the banks in the cost of loanable funds. A bank engaged in deposit and lending operations in India at present necessarily has to maintain the statutory CRR (9%), additional Cash Reserve on incremental net DTL over a base date i.e. 11 November 1983* (10%), cash in hand (2%), and SLR (37%). Taking into account the average total cost of deposit funds, the earnings on CRR in excess of the statutory minimum (3%) and additional cash reserve on incremental net DTL (10%) and the average yield on SLR (total Rs.3.85 for Rs.50 of such pre-emptions) the cost of the loanable funds approximating about Rs.50/-, out of the total deposit of Rs.100/- works out to Rs.6.90 or 13.8%. This pool of Rs.50/- carries a loanable cost of 13.8% (Table 8).

7.19 Export credit has to be extended by the banks from this loanable pool. But unlike other commercial lendings at the ceiling rate of about 17.5% p.a., export credits in normal situation bring a total yield of 12.5% p.a. consisting of interest rate of 9.5% p.a. and interest

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* and also the impounded portion of additional cash reserves on incremental net DTL introduced in 1977 (which was withdrawn in 1980.

Table 8 : Cost of loanable funds
(per Rs.100/- of deposit funds)

			Cost (per cent)
I.	Total cost of funds		10.75
II.	Earnings on pre-emptions		
	a) Minimum statutory CRR (3%)	Rs.3 Nil	-
	b) Cash in hand (2%)	Rs.2 Nil	-
	c) CRR in excess of statutory minimum (9%-3%) and Additional cash reserve on incremental DTL over the base date 11.11.83 which together with the impounded amount from out of additional cash reserves introduced in 1977, roughly constitute 4% of total DTL - at 10.5% p.a.	Rs.10 at Rs.1.05	
	d) SLR (37%) (i.e. Rs.37 less Rs.2 cash in hand) at average yield 8% p.a.	Rs.35 at Rs.2.80	
III.	Total earnings from pre-emption of Rs.50 loanable funds	Rs.3.85	3.85
			Rs.6.90
			or
		=	13.8%

subsidy at the rate of 3% p.a. The difference between the cost of loanable funds at 13.8% and yield on export credit at 12.5% constitutes, the subsidy extended by an average or marginal bank to the export sector. If we take the commercial yield available to the banks from non-priority commercial sector at 17.5%, the subsidy extended by the banks to the export sector works out to 5%.

Motivation to finance exports

7.20 It is important to recognise that more than the rate of interest applicable to credit, availability of adequate credit is crucial to promote exports. At the branch and regional levels, bank personnel are very much concerned with the profits they can show in their books, because finally it is the profit level that constitutes the main yardstick of their efficiency. It is unrealistic to expect bank branches to have greater motivation to enlarge their export financing operations, when yield on such business is decreasing or less than non-priority sector yield. If the yield on export credits is narrowed and those banks with large export credit outstandings are penalised by lower profitability, then all the efforts for extending concessional export credit may become counter-productive. The choice between concessional export credit and larger availability of export credit is real enough unless the concessional export interest rate is fully compensated either by commensurate interest rate subsidy or

refinancing facilities at lower interest rates or a combination of both. There is already considerable resistance at the branch and regional levels of the banks to increase export credit any further. The credit requirements of small and medium exporters may be particularly affected by the reluctance of banks to extend increased credit.

7.21 The extra profits that the banks could earn from their complementary foreign exchange business was an attraction to extend larger export credit in the past. With the sharp fluctuations in exchange rates and the stipulated reduction in the margin of profits on 'base' exchange rates, only the bigger banks with foreign exchange trading capabilities can now benefit from exchange business. For the smaller banks, the profit margins from foreign exchange business hardly provide an adequate cushion to absorb the potential losses from exchange trading.

CHAPTER - 8

Policy options to mitigate the additional burden on the banks

8.1 It is evident from the foregoing analysis that a number of Indian banks would find it difficult to absorb the additional financial burden imposed by the recent reduction in export credit interest rate and also the extension of the maturity period of concessional pre-shipment credit. The Committee is of the view that there is a strong case for mitigating this additional financial burden. Among others, the following policy options have been examined.

(1) a further increase in export interest subsidy;

(2) increased refinancing facilities at lower interest rate;

(3) inclusion of export credit for purpose of computing SLR compliance;

(4) inclusion of export credit within the stipulated credit allocation to the priority sector; and

(5) increase in the interest rate applicable for non-priority sector advances.

A further increase in export interest subsidy

8.2 As already indicated, the recent increase in export interest subsidy, by 1.5 percentage points to 3%, did not compensate fully the banks for the additional burden they have to bear on account of the reduction in interest rate on export credit, coupled with the extension

of the maturity period of the concessional pre-shipment credit. A further increase in interest subsidy by atleast one percentage point, to raise the interest subsidy to 4%, is necessary to offset the additional financial burden on the banks. The main advantages of a further hike in interest subsidy are: (1) it can be implemented without any additional administrative costs as already a mechanism exists for disbursing and monitoring the export credit interest subsidy; (2) the rationale for removing the disincentive effects of lower yield from export credit has been officially recognised; (3) the budget implications of an increase by one percentage point in the interest subsidy is only Rs.25 - Rs.30 crores per annum, while the beneficial effects of it on medium and small Indian banks' profits and profitability is significant. The improvement in the profits of Indian banks will enable them to make adequate provisions for bad and doubtful assets and also bolster their capital in course of time. If such improvement is not achieved, in any case, the public exchequer will have to bear the brunt through either decreased profits, or even making good the losses and making further allocation for increasing the capital of the banks. Hence, the increased budget expenditure through interest subsidy is unlikely to impose a net burden on the budget.

Increased refinancing facilities for exports at interest rates that provide larger margins

8.3 At present, refinance of 100% increase in the export credit over the outstanding credit during the stipulated base period (1984) is provided at 9%. The total margin available to the banks (including the subsidy element of 3%) would be about 3% taking into account the cost of general pool funds. It has been suggested by some banks that, in view of the recent decline in the profitability of export credits to the banks, the entire outstanding export credits should be eligible for refinancing, instead of the incremental credit. The impact of this increase on credit creation and fulfilment of monetary policy objectives need to be carefully weighed. Since the vast majority of the banks do not face any liquidity problem and in fact one of the biggest banks is normally a net supplier of funds to the interbank market, the demand for 100% refinance facilities for export credit arises not from any crunch in liquidity faced by the banks but from their anxiety to improve their profitability. Besides, this would mean that the additional reserve money injected into the banking system would be around Rs.2,000 crores. Therefore, the Committee feels that the current refinancing eligibility, i.e. incremental export credits over the stipulated base period, may be continued. There are other more direct and effective options available to policy makers to enable

the banks to improve the profitability of their export business without impinging on monetary policy measures and policy objectives.

8.4 However, to facilitate the financing of bulk contracts exceeding Rs.5 crores, additional refinancing facilities to banks may be considered. Such additional refinancing will have no significant adverse effect on monetary policy objectives.

Inclusion of outstanding export credit in the SLR

8.5 Some banks have suggested that, in order to soften the rigours of concessional export credit, it could be included for computing the SLR which is currently 37% of the net DTL of the banks. The underlying idea is that the average yield on SLR being less than that of commercial lending rates, the inclusion of export credit in the SLR would release at least 3-4% of the total DTL of the banks, now lent for export purposes, (total yield 12.5%), for lending at commercial rates of interest of 16.5 - 17.5% p.a. This would improve the overall profitability of banks. The Committee does not favour the suggestion for a number of reasons: (1) First, inclusion of export credit in SLR will necessarily blunt the efficacy of SLR as an instrument of monetary policy; (2) secondly, if accepted, it will become increasingly difficult to resist demand for inclusion of lending for other equally important sectors in computation

of SLR. Ultimately we may end up with not having any SLR at all; (3) Thirdly, the suggestion has very serious implications for Government programme; and (4) Lastly, SLR being a major instrument of monetary policy, the Committee would not like to impinge on matters relating to formulation of monetary policy which is the legitimate prerogative of the Reserve Bank. However, if the objective of the above suggestion is only to improve the profitability of banks, the same can as well be served, as already indicated, by increasing the export credit interest subsidy by 1 percentage point to 4%.

Inclusion of export credit
in priority sector financing

8.6 As an alternative measure to improve the profitability of banks' export credit business, some of the banks suggested that export credits could be included in the stipulated 40% credit allocation of total advances to the priofity sector. Similar to the inclusion of outstanding export credits in SLR, this measure would release 5-6% of the total loanable funds of the banks for lending to customers at the commercial rates of 16.5-17% p.a. and thereby enable the banks to improve their overall profitability and profits. It has the added merit that those banks whose profitability is under strain due to their social financing obligations would be the chief beneficiaries of this measure.

8.7 However, the inclusion of export credit in the stipulated priority sector financing, without a simultaneous increase in the volume of the total priority sector allocation, would reduce correspondingly the flow of funds to other purposes within the category. In view of the national priority attached to the weaker section financing and also due to the fact that if export credit is included in the priority sector, once the 40% ceiling is reached the banks will not have an obligation to extend further credit to the export sector, hence the flow of credit to the export sector may get adversely affected. Therefore, the Committee considers that it is not desirable to include export credits within the stipulated priority sector credit allocation. On the other hand, if there is a simultaneous increase in the credit allocation to the priority sector, the objective of improving the overall profitability of the banks would not be realised.

Increase in the ceiling rate of interest applicable to commercial lending

8.8 Already the interest rate for non-priority commercial lendings is high. Any further hike in the ceiling rate may not only distort the interest rate structure for industrial activity and thereby the allocation of funds for industrial activity but also will be strongly resisted by the affected customers. In fact, after reviewing

the interest rate structure for advances, RBI has actually reduced the ceiling rate of interest for non-priority purposes from 18% p.a. to 17.5% p.a. in April 1985. The Committee feels that there is no justification for increasing the ceiling rate for this segment as an option to compensate the banks of interest loss as a result of recent interest rate changes on export credit.

8.9 Taking into account all these factors, the Committee favours an increase in the interest subsidy by 1 percentage point due to (1) its administrative and procedural flexibility and ease in administering (2) it has no effect on monetary policies, procedures and objectives (3) its direct effect on the profits and profitability of the banks (4) its ability to confer benefits in direct proportion to the export financing efforts of the banks (5) the financial burden on the Government can be estimated with greater certainty and limited to a maximum amount of Rs.25 - Rs.30 crores per annum.

ANNEXURE -I

Information will be kept secret.

Committee to study the structure
of interest rates for export credit
(Reserve Bank of India)

Questionnare*

Part A : Banks

Name of the bank :

Address :

Q. 1 Statistics of export credit granted by your bank during the last three years.

(Rs. in lakhs)

	1983	1984	1985
a) Average outstanding bank credit			
b) Average outstanding export credit			
c) Proportion of (b) to (a)			

Q. 2 Commodity-wise break-up of outstanding export credit

(Rs, in lakhs)

Commodity	1983	1984	1985

* The questionnaire should not be taken to reflect in any manner the opinion of the Committee in respect of matters contained therein.

Q.3 If interest on export credit is reduced by 2%/3% what impact it will have on the bank's profitability? Please indicate in terms of percentage.

Q.4 Please indicate the proportion of interest cost in the cost of production of major items of exports -

The data for last 2 years may please be given. Where no such data is readily available with the bank, you are requested to call for the same from some of your major exporters.

(Rs. in lakhs)

Commodity	1984	1985
i) Interest cost of export finance:		
ii) Cost of production:		
a) Raw materials		
b) Other spares		
c) Power and fuel		
d) Direct labour		
e) Repairs & maintenance		
f) Other manufacturing expenses.		
g) Depreciation		
h) Others		
Total cost of production		

Q.5 From the date furnished in 4(ii) which item/s do you think offers greater scope for cost reduction of export items? Please give details, commodity-wise, on the basis of data available with you on different units engaged in exports.

Q.6 From the actual results and projections furnished by the exporter borrowers at the time of sanction of limits last, please indicate whether the borrowers have achieved their pre-set targets in exports. If the performance was not satisfactory, please indicate the factors which affected the operations of the exporters. (The replies to this may be given on the basis of scrutiny of data of 4 to 5 exporters).

Q.7 Do you consider that the cost of export credit is a major constraint on exports in terms of its price competitiveness. If so, for which items? how?

Q.8 Please furnish details on:

(Percent)

	1983	1984	1985
a) Average cost of deposits (including servicing cost of Rs.100 of deposits)			
b) Cost of Rs.100 of loanable funds from deposits i.e., cost of deposits after taking into account income from deposits invested in statutory reserve assets:			

Q.9 Please indicate your earnings(other than interest) out of foreign exchange business(in terms of percentage)

Q.10. Taking into account the replies to Q.8(a), (b) and 9 above to what extent, your bank can lower interest on export credit.

Q.11. If the rate of interest on export credit is reduced by, say 2% or 3% do you think that there will be significant increase in export?

Do you consider that the availability of credit for export purposes is satisfactory(a) at pre-shipment stage,(b) at post-shipment stage. At what stage you face problems in timely provision of adequate credit to export sector particularly with reference to reported delay in sanction of credit limits?

Q.12. Do you consider the interest on export credit in India is higher than that obtaining in competing countries like S. Korea, Singapore, Taiwan, Hongkong, Bangladesh, Pakistan, Japan. Could you indicate the rates offered on export credit by banks in these countries?

Q.13. Please indicate the net benefits accruing to your bank out of the subsidy received under the Export Credit (Interest Subsidy) Scheme 1968 after taking into account the cost involved in operation of the Scheme. Please give detailed working.

Q.14. In view of what has been stated against Q.No.13, please give your general observation on the utility of the above scheme. Do you have any alternate suggestion in this regard.

Q.15. The seventh Plan aims at 7% increase in exports annually. This will require provision of additional bank finance. Will you briefly mention your bank's planning to meet the additional bank finance to your exporters during the seventh Plan.

Q.16. Any other issues which you expect the Committee to consider may please be indicated.

Part B: Exporters

1. Name and address

2. Items exported by your organisation during the last 2 years.

Major exports

Item	Year 1983-84		Year 1984-85	
	Quantity	Value	Quantity	Value

3. Please indicate your major export markets.

Q.4 Please indicate the names of major competitors

Item	Country

Q.5 In which of the following areas your competitors enjoy advantages:

Cost (extent of price advantage may be indicated)

Quality : (Nature of advantage)

Marketing: (Nature of advantage)

Supply (Please specify)

Q.6 What official support is received by your major competitors in the matter of -

a) Concessional export credit

b) Other monetary benefits

c) Fiscal incentives

d) Marketing advantages

e) Any other (please specify)

Q.7 Is the quantum of credit provided by your bank considered adequate? If not, why and for which items?

Q.8 Is there any item/commodity for which you have already paid ceiling rate of interest (i.e. , presently 16.5 % p.a.) on export credit because export could not take place within the stipulated period? If so, please give the reasons for which the export could not take place within the stipulated period.

Q.9 Is there any item/(s) in your export basket for which you need extended pre-shipment credit period? For how long and why?

Q.10 What is the proportion of interest cost in the total cost (FOB) of your export items? Please furnish figures for the last two years.

Export item	Interest cost	Cost of * production	Proportion of interest cost to total cost

Q.11 Suppose the interest rate is reduced to (a) 10% or (b) 9% what impact in percentage terms it will have on the FOB cost of export items (please furnish separately for (a) and (b)

* Please give break-up of major components of cost of production like raw materials, power, fuel, direct labour, repairs and maintenance etc.

Q.12. Suppose the interest rate is reduced as above, do you think it will be possible to increase your export? If so, how and to what extent, particularly keeping in view the proportion of interest costs in the total cost of exports as indicated at 10 and 11 above.

Q.13. What are the other major constraints faced by you in export performance?

a) High cost of raw materials
b) High labouf charges
c) Non-availability of regular electricity supply
d) Other infrastructural bottlenecks
e) Others, please specify

Q.14. In which of the above areas you are in a position to reduce cost and to what extent?

Q.15. Extension of post-shipment credit.

Is there any need for extending credit period at post-shipment stage? Please specify the instances, markets, commodity and nature of credit that you consider necessary for improving competitiveness in the international market. Please furnish details about the terms and conditions offered by your competitors.

Q.16. To what extent trade credit serves as a source of short-term finance for your exports? Please give in terms of percentage of the total cost as also period for which such credit is available.

Q.17. In respect of a few major commodities exported by you, please give the following information:

a) Domestic cost of production
b) International cost of production (Domestic in the importing country - converted in rupees)
c) Domestic sale price
d) International sale price (converted in Rupees)
e) Sale price quoted to the importer (with terms of payment such as FOB, CIF, etc.)
f) Please indicate the proportion of various overheads in the (i) cost of exports) (ii) Export sales

Q.18. Could you suggest some new methods of financing exports keeping in view the resources and lending priorities of the banking system in the Indian context?

Q.19. Please give your considered suggestions for improving compeititiveness of Indian products in international market which deserve to be considered by the Committee. Please substantiate your answer with facts and figures on the basis of the orders which could not materialise on account of competitive terms offered by other countries.

Part C : EPCs/Commodity Boards/
Trade and Ind. Assns. etc

1. Name and address

2. Role of the institution relative to exports promotion.

3. Main items coming within your purview (in the case of EPCs/Commodity Boards etc.) Give a list of the export performance in terms of quantity and value of these items during the last 10 years in a separate annexure .

	Items	Short-fall	Reasons
4. Items in which exports increased but below expectations			

	Items	Short-fall	Reasons
5. Items in which exports declined			

	Items	Extent of price advantage	Competitors
6. Items in which Indian exporters have currently competitive price advantage			

	Items	Extent of price disadvantage	Competitors
7. Items in which Indian exporters have price disadvantages			

8. Items in which Indian exporters have competitive quality advantage	Items	Nature of advantage	Competitors	
9. Items in which Indian exporters have quality disadvantage	Items	Nature of quality disadvantage	Competitors	
10. Suggestion for improving price advantage	Items	Suggestions		
11. Suggestion for removing quality disadvantage	Items	Suggestions		
12. Items in which Indian exporters face competition on credit terms at the post shipment stage or any financial package.	Items	Extent of credit competition	Competitors	Markets
13. In which items do you consider the current period of credit is too short.	Items	Current period	Recommended period	

a) Pre-shipment stage

1.

2.

3.

b) Post-shipment stage

1.

2.

3.

	Items	Interest cost as % f.o.b. cost
14. What is the element of interest cost in % terms in the total f.o.b. cost of major export items under your purview.	1.	
	2.	
	3.	

	a	b
15. What rate of interest do you recommend a) at pre-shipment stage and what period. b) at post-shipment stage and what period.		

16. According to the information available are there any instances when Indian exporters lost export orders due to inability to compete on credit terms. Give specific instances if any.

ANNEXURE II

Chart on Interest Rates on Export Credit
(With effect from 1 August 1986)

	(% per annum)
A. PRE-SHIPMENT CREDIT	
i) Upto 180 days	9.5
ii) Beyond 180 days & upto 270 days (in cases where the extension of period has been approved by RBI)	11.5
iii) Beyond 270 days	Not exceeding 16.5
iv) Against cash incentives, etc. covered by ECGC guarantee	
i) Upto 90 days	9.5
ii) Beyond 90 days	Not exceeding 16.5
B. POST-SHIPMENT CREDIT	
I. i) Demand bills: Upto the transit period as specified by FEDAI ii) Usance bills: Upto 180 days	9.5
iii) For the overdue period	Not exceeding 16.5
II. i) Deferred credit(for period beyond one year)	8.65
ii) For the overdue period	Not exceeding 16.5
III. Other post-shipment advances	
i) Cash incentives, etc. covered by ECGC guarantee -(Upto 90 days)	9.5
ii) Undrawn balances(Upto 90 days)	9.5
iii) Against retention money (for supplies only) payable within one year from date of shipment (upto 90 days)	9.5
iv) Beyond 90 days in all the cases	Not exceeding 16.5

IV. Against Duty Drawback entitlement as provisionally certified by Customs authorities, under Duty Drawback Credit Scheme

i) Upto 90 days	Free of interest
ii) Beyond 90 days	Not exceeding 16.5

C. EXPORT CREDIT NOT OTHERWISE SPECIFIED	Not exceeding 16.5

Note: Export bills not realised within 180 days from the due date thereof will not be eligible for interest at 9.5% p.a. and shall attract interst at a rate not exceeding 16.5% p.a. from the date of post-shipment advance.

ANNEXURE III

Export Credit vis-a-vis total bank advances for the period from 1974-75 to 1985-86

(Rs. in crores)

Year	As at the end of March		
	Total Bank advances outstanding@	Export Credit outstanding*	Export Credit as percentage of total Bank advances
1975	8,762.0	706.0	8.6
1981	25,371.0	1,741.0	6.9
1982	29,681.0	1,847.0	6.2
1983	35,493.0	1,827.0	5.1
1984	41,294.0	2,186.0	5.3
1985	48,953.0	2,438.0	5.0
1986	55,916.0	2,609.0	4.7

Source@ Currency & Finance 1984-85 and RBI Bulletin May 1986

* Data peported by banks to IECD

ANNEXURE IV

Rates of interest on export finance obtaining in certain other countries including our competitors like, Pakistan, Bangladesh, South Korea, Indonesia, Singapore, Taiwan, Japan, etc.

The information called for by the Committee from reliable sources on credit and other facilities available in competing countries is summarised below:

1. Pakistan

(i) Interest rate structure

Lending rates have generally been 4% to 6% above the State Bank of Pakistan's discount rate which has been 10% since the last 8 years.

(ii) Interest on pre/post-shipment finance

Export refinance is granted for export of non-traditional products, list of which is amended from time to time. State Bank of Pakistan lends to commercial banks at 3% and banks in turn recover 6% from the customer. There are as many as 25 commodities as per list enclosed which are not eligible for concessionary export finance. Commercial banks can charge any rate, in respect of these specified commodities between 10 to 20% per annum. The rates generally hover around 13 to 15% and would as a rule depend upon the nature of security and credit worthiness of the exporter rather than the nature of commodity itself.

Refinance is available at above rates for upto:

a) 360 days for export of machinery under pre-shipment finance

b) 180 days pre-shipment/post-shipment refinance for other non-traditional items.

c) 12½ years post-shipment for export of local machinery.

iii) Deposits

Under the Islamic Banking System, which has been in force since last year, the interest (profit) rates on deposits vary half year to half year, depending on the bank's profitability. The average profit rates paid by the bank for the half year July- September 1985 were as under:

7 days call	5.85%
30 days call	6.75%
Savings account	9%
3 months	10.35%
6 months	11.70%
12months	12.24%

While the rates of profit are slipping under Interest free Banking (IFB), the cost of credit is going up. The rate of interest previously charged was 14% on general advances. Now called mark-up, the rate has gone up and ranges from 14% to 15.7%. In case of repayment defaults, the mark-up can shoot upto 20% a year. All advances have to be fully settled at the end of each six months and defaults brought to the special banking tribunal 90 days after the expiry of the clearing date.

2. Bangladesh

(i) Interest rate on export credit
Pre-shipment stage

a) Interest on export of traditional items (jute, jute goods, loose tea)	12% p.a.
b) (i) Non-traditional items (Other than jute, jute goods, tea)	9% p.a.
(ii) On the excess amount over sector target (Rates do not differ with change in period)	7% p.a.

Shipment must be completed within 120 days from the date of their draw.

Refinance available from Central Bank

a) Pre-shipment advance

For Jute -upto 30% of O/S.	8.5% p.a.
For Tea (Other than packet tea) -100% of pre-shipment finance	8.5% p.a.
Non.tradition items - 100%	5.5.% p.a.

b) Post-shipment advance

(1) Usance export bills for traditional items 50% of O/S.	8.5% p.a.
(2) Non-traditional item 100% of O/S	5.5.% p.a.

ii) Deposit rates

Short deposits	4.5% p.a.
Savings (with chequing)	8.5%. p.a.
Without chequing	10 % p.a.
Savings (Rural Area-with chequing)	11 % p.a.
Without chequing	10.5% p.a.
Fixed 3 months and over but less than 6 months	12 % p.a.
6 months and over but less than one year	13% p.a.

1 year and over but less than 2 years	14% p.a.
Fixed 2 years and over but less than 3 years	14.5% p.a.
3 years and over	15 % p.a.
Maximum lending rate	18 % p.a.

3. South Korea

(i) Interest Rate structure

Local currency

General loan	:	Less than 1 year 10-11.5% p.a.
Over 1 year	:	10-12%
EPL(Export Promotion Loan)	:	10% p.a.

Foreign currency loan/LIBO/SIBO+Maximum 1.5%

(ii) Interest rate on Export Credit

Pre-shipment stage

EPL is financed at 10% p.a. upto approximately 80% of L/C, D/A, D/P for 90 days in principal. Extension is allowable subject to the Central Bank's approval. Lending bank can have access to the Central Bank's rediscount facilities upto 70% of EPL amount at 5% p.a. until the EPL is liquidated.

Post-shipment stage

1. Short-term finance

Discount of usance/D/A bills by commercial banks.

Until the maturity of the bills,
D/A, LIBO/SIBO is used with spread
at bank's own discretion depending
on exporters credit.

2. Mid/LT Finance only Korea Exim Bank can handle this finance;currently prevailing rates are

Ship building	8% p.a.
Plant export (less than 5 years)	8.8% - 10.95%p.a.
Over 5 years	8.8% - 11.2 %p.a.

iii) Interest on Deposit

Pass book account	1% p.a.
Savings account	6% p.a.
Term deposits 1-3 months	4%
3months - 1 year	6%
1 - 2½ years	10%
Current deposits	Nil

4. Indonesia

(i) Interest rate structure

Interest rates range between 20-24% based on a 1-4% spread over the bank's base rate. There is no exception with reference to export related financing.

(ii) Interest rate on export credit

Besides lenient treatments in formalising permits, etc. the Government provides for an export credit financing programme under the following arrangements.

a) A Forex Bank will provide the exporting customer with a Central Bank approved line based on expected turnover. The bank will provide 85% pre-shipment financing at the bank's normal market lending rate for a limited tenor not exceeding 5 months.

b) ?Upon shipment and subsequent negotiation of documents (discount in the case of usance), the loan is repaid and the bank refunds all interest previously paid in excess of 9% back to the exporter. Based on the negotiations and with appropriate documents the bank will acquire 6 months funding at 3% p.a. from the Central Bank to compensate its interest loss and some profits depending on the length of tenor during pre-shipment financing

(iii) Interest on deposits

1 month	15.5%
3 months	16%
6 months	16.5%
12 months	16.5%

5. Taiwan

(i) Interest rate structure

Lending rates(local currency)

a) Long and medium term

Highest	9.75% p.a.
Lowest	6.00% p.a.

b) Short -term

Highest	9.00% p.a.
Lowest	5.50% p.a.

Foreign currency

Prime rate (LIBO/SIBO) plus spread decided by lending bank.

(ii) Interest rate on export credit

a) Interest rate at pre-shipment stage

Export Promotion loan, maximum 180 days (in local currency by local banks) @ 5.75% p.a.

Export Promotion loan maximum 180 days in foreign currency (mostly US $) to be repaid from Export proceeds of foreign banks.

Floating rate : Base rate plus spread - adjustable weekly.

b) Interest rate at post-shipment stage - N.A.

Export Import Bank of China -
Programmes provided by

1. Medium and long term instalment payment within

2 years	7.00% p.a.
2-5 years	7.75% p.a.
5-7 years	8.00% p.a.
Over 7 years	8.25% p.a.

2. Fixed relending facilities are provided to foreign importers through a foreign correspondent bank.

Within 2 years	7.00% p.a.
2-5 years	7.75% p.a.

3. Short term financing Export Promotion Loan (181-360 days)	5.75% p.a.

(iii) Interest on deposits

Local currency

1. Checking account	Nil
2. Demand deposit account	2%p.a.
3. Savings accounts	3.75% p.a.

4. Time deposits (within one year)	6.25% p.a.
5. Time deposits account (over one year)	6.75% p.a.

Foreign currency

1. Demand deposit	-
2. Savings deposit account	2.00% p.a.
3. Time deposits account	4.56 - 5.56% p.a.

6.. Japan

(i) Since Japan has substantial trade surplus, there is no Government incentive for export promotion any more. Banks do not provide exporters with special finance at less expensive rates. Normally interest rates on finance for usance bills are provided with spread plus the funding cost which is the Euro-dollar rate.

(ii) Interest rates on Export Credit

Short term	@ 4.5%-5.5% p.a.
Long/medium term	6.5% p.a. as per OECD Consensus guidelines.

(iii) Deposit rates

	Yen	US $
Savings	0.5%	3.0%
3 months	2.5%	4.75-4.875
6 months	3.75%	4.875-5%
12 months	4.50	4.937-5.068%

7. Singapore

The organisation responsible for export credit guarantees is Export Credit Insurance Corporation of Singapore (ECICS). The two main programmes of ECICS are: Suppliers credit and buyers credit.

i) Suppliers credit

Short term cover upto 180 days for exporters in respect of Singapore manufactured goods, against payment of an agreed premium, the exporter is issued with a policy covering commercial and political risk, for a period upto 180 days. The policy then can be assigned to the exporters banker who will provide funding against the policy as security. Funding cost is subject to negotiation between the exporter and his banker. As an indication, prime rate in Singapore is currently 8 to 8.5% p.a.

Pre-shipment cover has been discontinued ECICS instead will now fund exporters for material purchases for 90 days backed by L/Cs opened by exporters.

ii) Apart from ECICS, the other Government supported programmes in aid of exporters are :

Interest Subsidy Scheme :

This scheme is administered by the Economic Development Board of Singapore(EAB). Under the scheme, Singapore manufacturers are able to obtain 50% subsidy for interest payments under loans approved by EAB. The scheme is basically aimed at promotion of capital investment in 'productive' machinery.

Various tax incentives are offered to Singapore manufacturers such as 100% first year allowance for capital investment and additio al investment tax credits.

8. Malaysia

i) Interest rate structure

Banks are permitted to charge 1.5%-2% spread over cost of funds for overdraft. The interest rates on export bills depends on the currency of the bill.

ii) Interest rate on export credits

The cheapest form of financing for the exporter is available under the Export Credit Refinance Scheme (ECR). Under ECR, the Government aims to boost exports through export refinanci g at preferential interest rates(currently 5% with maximum spread of 1.5% to commercial banks).

Pre-shipment and post-shipment export refinance under ECR are both available for a period of 90 days.

Medium or long-term post-shipment credit is not available

Export Credit Refinancing Scheme:

The Government provides concessionary financing for a wide range of manufactured exports through its bills rediscounting facility.

(iii) Interest on deposits

1 month to 6 months	7.25% p.a.
12 months	7.5% p.a.

Financing arrangements in some of the major exporting countries are briefly mentioned below(The position pertains to September 1985)

1. United Kingdom

Short term export credit is advanced by the London and Scottish clearing banks under a 100% ECGD bank guarantee at a rate based on the bank's base lending rate.

Medium and long term export credit is sterling for two years and more is the subject of a long standing agreement between the clearing banks and the Government . Under this, the banks charge the consensus fixed rates of interest.

ECGD makes up to the banks the difference between these rates and the average cost of the banks' funds. A 'Reference rate' to calculate this cost is agreed by a panel of banks, based on sterling LIBOR for three months.

Once a month an average rate is agreed and published in a number of newspapers, in order that the participants can calculate the exact amount of interest equalisation due to them. This grant is based on the reference rate plus a margin of 0.875% and is paid on all fixed rate bank lending for exports outstanding at the monthly make-up day. For credits of 12years or more the maximum margin is 0.875% for the first 12 years and 1% thereafter. The banks for their part have been dissatisfied with both the margin and the frequency of settlement days.

Interest rate for short term (less than two years); the commercial banks base lending rate plus a margin of 0.625% plus 0.125% for collecting bills or a maximum fee of £ 5.00 for handling each promissory note.

2. West Germany

The discount rate of the Bundesbank is 4.0% and the Lombard rate is 5.5%. The rate for three months inter bank money is 4.6%. Short-term bank credit(upto 1 year) for prime customers carries a rate of around 7.5%. The rate of interest for medium-term credit(5 years) is around 8%, but rates vary depending on maturities and borrowers.

3. Belgium

The rate for short-term (upto 2 years) export credit is 9.75%. For medium and long term (2-12 years) export credits, current export rate is 11.05% plus banks' 0.45% commission +11.50% Outside the EEC, and for matching purposes only, subsidy is provided to bridge the gap between credit - export rate and the relevant consensus rate.

The National Bank's discount rate is 9.50%. The rate for discounting prime bills of exchange at the rediscount and guarantee institutions is 9.4%. The commercial banks' prime overdraft rate is 12%.

4. France

Commercial banks' base lending rate is 10.85%. Effective short term rates are 1.5 -2% above this level.

5. Italy

The discount rate of the Bank of Italy is 15.5%. Short term credit(upto 18 months) rates vary but range upto 3% points over the discount rate.

6. Canada

Most of the medium and short-term export finance by the banks is done in US dollar with margins of 0.5% over LIBOR when EDC guarantee is available.

CONSENSUS RATES

The consensus rates under the International arrangements, as indreased from July 1986 are as follows:

(per cent)

	2 - 5 years	Above 5 years
Relatively rich countries	9.55	9.80
Intermediate countries	8.25	8.75
Relatively poor countries	7.4	7.4

Prime Lending rates etc.

Prime lending rates and 3 months' Deposit rates of commercial banks in some of the developed countries were as under during the first half of July 1986.

	Interest rates % p.a.	
	Prime lending	Deposits 3 months
Australia	17.00	14.60
Canada	10.25	8.45
France	9.60	7.25
West Germany	7.00	4.28
Italy	13.50	11.50
Japan	4.13	2.13
Switzerland	6.75	4.25
U.K.	11.00	9.84
U.S.A.	8.50	6.15

Enclosure to Annexure IV

List of commodities not eligible for concessionary export finance in Pakistan

Sr.No.	Commodity
1.	Raw Cotton.
2.	Cotton Yarn.
3.	Fish other than frozen and preserved.
4.	Mutton and Beef.
5.	Petrolum Products.
6.	Crude Vegetable Minerals.
7.	Wool & Animal Hair.
8.	Crude Animal Material.
9.	Feed stuff for Animals.
10.	All Grains including Grain flour.
11.	Stone, sand and Gravel.
12.	Waste and Scrapof all kinds.
13.	Fertilizer crude.
14.	Oil-seeds, Nuts and Kernels.
15.	Pearls and Precious Stones.
16.	Jewellery exported under the Entrustment scheme.
17.	Live Animals.
18.	Hides and Skins.
19.	Leather Wet Blue.
20.	Inorganic Elements, Oxides etc.
21.	Crude Minerals.
22.	Works of Arts and Antiques
23.	All Metals.
24.	Fur Skins.
25.	Wood in rough or Squared.

ANNEXURE - V

A special note submitted by Shri M.Sampangi, a Member of the Committee and Additional Economic Adviser, Ministry of Commerce, Government of India, New Delhi.

The Government of India through various policy measures are making constant efforts to make exports competitive in the world markets. Several decisions have been announced recently to enable the exporters to obtain capital goods, raw materials and intermediates at international prices with a view to make export production cost efficient.

One of the crucial factors that has been effecting the competitiveness of our products in the world markets is the interest rate at which exporters have to borrow funds from the commercial banks at the pre-shipment and post-shipment levels. The data on interest rate structure prevailing in the other developing countries which compete with India in international markets such as Pakistan, Taiwan and Malaysia show that the interest rates for export items are much lower as compared to India. For instance, in the case of Pakistan, it is 6% for non-traditional items, Taiwan, it is 5.75% and Malaysia, it is 6.5%. Indian exporters should get export credit at this kind of low rates so that they will be able to compete with these countries in the international market.

It has been argued that the commercial banks in view of their financial commitments to other priority areas have only about 20-23% of their total working funds to lend at commercial interest rates at around 17.5%. I strongly feel that export sector will have to be given national priority in view of the utmost need not only to bridge our balance of

payments gap but also finance our essential imports which are required to cater to the developmental needs of the economy. Besides, one of the major objectives of the 7th Five Year Plan is to increase the overall levels of efficiency and productivity in the industrial sector. One of the important ways by which this could be achieved is by gearing up the domestic enterpreneurs to meet the rigours of international competition which warrant higher levels of efficiency and maximum productivity. In view of these national commitments, there is certainly a very strong case for the export sector to be treated as a very special one and all facilities will have to be given to make this sector competitive.

It must also be noted that the existing export incentive schemes such as CCS, duty drawback do not fully compensate for the domestic economic rigidities and texation. In order to make the production of goods for exports competitive efforts have been made to supply certain capital goods, intermediates and raw materials at international prices. In keeping with this objective, it is necessary that credit and working capital which is one of the major factors which enters the production process is provided at a competitive level. I am, therefore, of the view that the commercial banks should provide credit at levels comparable to those prevailing in competing countries. We may leave it to the Government whether the "losses", if any, incurred by any banks should be borne by the banks, by the Government, or recouped through adjustment of interest rates.

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