Report of the Central Board of Directors on the working of the Reserve Bank of India for the year ended June 30, 2003 submitted to the Central Government in terms of Section 53(2) of the Reserve Bank of India Act, 1934

RESERVE BANK OF INDIA ANNUAL REPORT 2002-03

CENTRAL BOARD / LOCAL BOARDS

GOVERNOR
Bimal Jalan

DEPUTY GOVERNORS
Vepa Kamesam
Rakesh Mohan
K. J. Udeshi

DIRECTORS NOMINATED UNDER SECTION 8(1)(b) OF THE RBI ACT, 1934
Y. H. Malegam
Mihir Rakshit
K. Madhava Rao

DIRECTORS NOMINATED UNDER SECTION 8(1)(c) OF THE RBI ACT, 1934
Ratan N. Tata
Amrita Patel
K. P. Singh
V. S. Vyas
D. S. Brar
C. N. R. Rao
H. P. Ranina
N. R. Narayana Murthy
Suresh Krishna
Ashok S. Ganguly

DIRECTOR NOMINATED UNDER SECTION 8(1)(d) OF THE RBI ACT, 1934
S. Narayan

MEMBERS OF LOCAL BOARDS

WESTERN AREA
Y. H. Malegam
K. Venkatesan
Dattaraj V. Salgaocar
Jayanti Lal Bavjibhai Patel
Mahendra Singh Sodha

EASTERN AREA
Mihir Rakshit
P. D. Chitlangia
A. K. Saikia
Sovan Kanungo
Kiran Ghai

NORTHERN AREA
Ram Nath
Mitha Lal Mehta
Pritam Singh

SOUTHERN AREA
K. Madhava Rao
C. P. Nair
S. Ramachander
M. Govinda Rao

As on June 30, 2003

PRINCIPAL OFFICERS

(As on June 30, 2003)

EXECUTIVE DIRECTORS	R.B. Barman
....	Smt. S. Gopinath
....	Y.S.P. Thorat
....	P.K. Biswas
....	Smt. Usha Thorat
....	A.V. Sardesai
....	N. Sadasivan (on deputation)
PRINCIPAL LEGAL ADVISER	N.V.Deshpande *
* With status equivalent to that of the Bank's ED	
PRINCIPAL MONETARY POLICY ADVISER	D. Anjaneyulu **
** With status equivalent to that of the Bank's ED	
CENTRAL OFFICE	
Department of Administration and Personnel Management	G. K. Sharma, Chief General Manager-in-Charge
Department of Banking Operations and Development	M.R. Srinivasan, Chief General Manager-in-Charge
Department of Banking Supervision	P.V. Subba Rao, Chief General Manager-in-Charge
Department of Currency Management	V.R. Gaikwad, Chief General Manager
Department of Economic Analysis and Policy	Narendra Jadhav, Officer-in-Charge
Department of Expenditure and Budgetary Control	Radhe Shyam, Chief General Manager
Department of External Investments and Operations	T.C. Nair, Chief General Manager
Department of Financial Companies	–
Department of Government and Bank Accounts	V.S. Das, Chief General Manager-in-Charge
Department of Information Technology	R. Gandhi, Chief General Manager-in-Charge
Department of Non-Banking Supervision	C. S. Murthy, Chief General Manager-in-Charge
Department of Statistical Analysis and Computer Services	D.V.S.S. Sastry, Principal Adviser
Exchange Control Department	Smt. G.E. Koshie, Chief General Manager-in-Charge
Financial Institutions Division	–
Human Resources Development Department	N.P. Sinha, Chief General Manager
Industrial and Export Credit Department	Smt. R.K. Makhija, Chief General Manager
Inspection Department	M.K. Bhattacharya, Chief General Manager
Internal Debt Management Department	H.R. Khan, Chief General Manager-in-Charge
Legal Department	*
Monetary Policy Department	**
Premises Department	E.U. Khan, Chief General Manager
Rural Planning and Credit Department	Varughese John, Chief General Manager
Secretary's Department	H.N. Prasad, Chief General Manager & Secretary
Urban Banks Department	S. Karuppasamy, Chief General Manager-in-Charge
COLLEGES	**PRINCIPALS**
Bankers Training College, Mumbai	C.R. Gopalasundaram
College of Agricultural Banking, Pune	Smt. Phulan Kumar
Reserve Bank Staff College, Chennai	Smt. C. Chandramouliswaran
OFFICES	**REGIONAL DIRECTORS**
Chennai	B. Ghosh
Kolkata	V.K. Sharma
Mumbai	M.P. Kothari
New Delhi	Ramesh Chander
BRANCHES	**REGIONAL DIRECTORS**
Ahmedabad	Smt. Vani J. Sharma
Bangalore	Smt. D. Muthukrishnan
Bhopal	Kum. Uma Subramaniam
Bhubaneswar	S. S. Satchidananda
Chandigarh	D.P.S. Rathore
Guwahati	Surindra Kumar
Hyderabad	S. S. Gangopadhyay
Jaipur	Karunasagar
Jammu	J. B. Bhoria
Kanpur	B. K. Vasdev
Nagpur	P. Aravind
Patna	Murari Swarup
Thiruvananthapuram	G. Gopalakrishna
	CHIEF GENERAL MANAGER
Lucknow	P. Saran
Navi Mumbai, Belapur	R.M. Deole
	GENERAL MANAGER (O-in-C)
Kochi	S. Mohanty

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LIST OF ABBREVIATIONS

AP	–	Ashoka Pillar
ACE	–	Asset Care Enterprise Ltd.
ACU	–	Asian Clearing Union
ADs	–	Authorised Dealers
AFS	–	Available for Sale
AIBP	–	Accelerated Irrigation Benefit Programme
ALM	–	Asset-Liability Management
AMS	–	Aggregate Measure of Support
AoA	–	Agreement on Agriculture
APDRP	–	Accelerated Power Development and Reform Programme
APL	–	Above Poverty Line
APM	–	Administered Price Mechanism
ASCI	–	Administrative Staff College of India
ATMs	–	Automated Teller Machines
BCP	–	Business Continuity Plans
BE	–	Budget Estimates
BFS	–	Board for Financial Supervision
BFSI	–	Banking, Financial Services and Insurance
BIS	–	Bank for International Settlements
BPL	–	Below Poverty Line
BPO	–	Business Process Outsourcing
BRBNMPL	–	Bharatiya Reserve Bank Note Mudran Private Limited
BTC	–	Bankers Training College
CA	–	Certification Authority
CAB	–	College of Agricultural Banking
CACs	–	Collective Action Clauses
CAG	–	Comptroller and Auditor General
CBLO	–	Collateralised Borrowing and Lending Obligation
CBoT	–	Chicago Board of Trade
CBS	–	Consolidated Banking Statistics
CC	–	Cash Credit
CCA	–	Controller of Certifying Authorities
CCIL	–	Clearing Corporation of India Limited
CCP	–	Central Counter Party
CCTV	–	Closed Circuit Television Surveillance Systems
CD	–	Certificates of Deposit
CDBMS	–	Central Database Management System
CDR	–	Corporate Debt Restructuring
CEO	–	Chief Executive Officer
CFMS	–	Centralised Funds Management System
CFS	–	Consolidated Financial Statement
CFTS	–	Centralised Funds Transfer System
CGRA	–	Currency and Gold Revaluation Account
CIBIL	–	Credit Information Bureau of India Limited
CIP	–	Covered Interest Parity
CIS	–	Commonwealth of Independent States
CLA	–	Central Listing Authority
CLF	–	Collateralised Lending Facility
CoR	–	Certificate of Registration
COSMOS	–	Centralised-OSMOS
CPI–IW	–	Consumer Price Index for Industrial Workers
CPR	–	Consolidated Prudential Report
CP	–	Commercial Paper
CPSS	–	Committee on Payment and Settlement Systems
CPSUs	–	Central Power Sector Undertakings
CRAR	–	Capital to Risk-weighted Assets Ratio
CRM	–	Country Risk Management
CRR	–	Cash Reserve Ratio
CSGL	–	Constituents' Subsidiary General Ledger Account
CVPSs	–	Currency Verification and Processing Systems
DAD	–	Deposit Accounts Department
DAPM	–	Department of Administration and Personnel Management
DBOD	–	Department of Banking Operations and Development
DBS	–	Department of Banking Supervision
DCA	–	Debtor-Creditor Agreement
DCCBs	–	District Central Co-operative Banks
DCM	–	Department of Currency Management

LIST OF ABBREVIATIONS

DEAP	–	Department of Economic Analysis and Policy
DEBC	–	Department of Expenditure and Budgetary Control
DEIO	–	Department of External Investments and Operations
DESACS	–	Department of Statistical Analysis and Computer Services
DGBA	–	Department of Government and Bank Accounts
DICGC	–	Deposit Insurance and Credit Guarantee Corporation
DIT	–	Department of Information Technology
DNBS	–	Department of Non-Banking Supervision
DRDAs	–	District Rural Development Agencies
DRG	–	Development Research Group
DRI	–	Differential Rate of Interest
DRS	–	Disaster Recovery System
DRTs	–	Debt Recovery Tribunals
DTA	–	Domestic Tariff Area
DTL	–	Demand and Time Liabilities
D*v*P	–	Delivery *versus* Payment
DWCRA	–	Development of Women and Children in Rural Areas
ECBs	–	External Commercial Borrowings
ECD	–	Exchange Control Department
ECNs	–	Electronic Communication Networks
ECR	–	Export Credit Refinance
ECS	–	Electronic Clearing Services
EDI	–	Electronic Data Interchange
EDIFAR	–	Electronic Data Information Filing and Retrieval
EEFC	–	Exchange Earners' Foreign Currency
EFC	–	Eleventh Finance Commission
EFT	–	Electronic Funds Transfer
EKMS	–	Enterprise Knowledge Management System
EMU	–	European Monetary Union
EOUs	–	Export Oriented Units
ESCAP	–	Economic and Social Commission for Asia and the Pacific
EU	–	European Union
EXIM	–	Export Import
EXIM BANK	–	Export Import Bank of India
FCI	–	Food Corporation of India
FCNR(B)	–	Foreign Currency Non-Resident (Banks)
FCRA	–	Forward Contract Regulation Act
FDI	–	Foreign Direct Investment
FET–ERS	–	Foreign Exchange Transactions-Electronic Reporting System
FIs	–	Financial Institutions
FIIs	–	Foreign Institutional Investors
FIMMDA	–	Fixed Income Money Market and Derivatives Association of India
FMCG	–	Fast Moving Consumer Goods
FRAs	–	Forward Rate Agreements
FRBs	–	Floating Rate Bonds
FRBM	–	Fiscal Responsibility and Budget Management
FSSA	–	Financial System Stability Assessments
FT	–	Futures Trading
FTP	–	Financial Transaction Plan
G–20	–	Group of Twenty
GAAP	–	Generally Accepted Accounting Principles
GATS	–	General Agreement on Trade in Services
GB	–	Giga-bytes
GCF	–	Gross Capital Formation
GDCF	–	Gross Domestic Capital Formation
GDP	–	Gross Domestic Product
GDS	–	Gross Domestic Saving
GFCF	–	Gross Fixed Capital Formation
GFD	–	Gross Fiscal Deficit
GIC	–	General Insurance Corporation of India
GoI	–	Government of India
GRF	–	Guarantee Redemption Fund
HACCP	–	Hazard Analysis and Critical Control Points
HFCs	–	Housing Finance Companies
HFT	–	Held for Trading
HRDD	–	Human Resources Development Department

LIST OF ABBREVIATIONS

HTM	–	Held to Maturity
IAS	–	Integrated Accounting System
IASC	–	Inspection and Audit Sub-Committee
IBA	–	Indian Bank's Association
IBS	–	International Banking Statistics
ICA	–	Inter-Creditor Agreement
ICC	–	International Credit Card
ICDs	–	Inter-Corporate Deposits
ID	–	Inspection Department
IDBI	–	Industrial Development Bank of India
IDFC	–	Infrastructure Development Finance Company
IDMD	–	Internal Debt Management Department
IECD	–	Industrial and Export Credit Department
IFCI	–	Industrial Finance Corporation of India
IFIs	–	International Financial Institutions
IFRs	–	Investment Fluctuation Reserves
IFSC	–	Indian Financial System Code
IIBI	–	Industrial Investment Bank of India
IIP	–	Index of Industrial production
ILAF	–	Interim Liquidity Adjustment Facility
IMF	–	International Monetary Fund
IMFC	–	International Monetary and Financial Committee
INFINET	–	Indian Financial Network
IOSCO	–	International Organisation of Securities Commissions
IRs	–	Inflation Reports
IRS	–	Interest Rate Swaps
IS	–	Information System
IT	–	Information Technology
JCI	–	Jute Corporation of India
JPC	–	Joint Parliamentary Committee
KCCs	–	Kisan Credit Cards
KVIC	–	Khadi and Village Industries Commission
KYC	–	Know Your Customer
LAB	–	Local Area Bank
LAF	–	Liquidity Adjustment Facility
LAN	–	Local Area Network
LaR	–	Liquidity at Risk
LBS	–	Locational Banking Statistics
LCs	–	Letters of Credit
LD	–	Legal Department
LIC	–	Life Insurance Corporation of India
LIFFE	–	London Inter-Bank Financial Futures Exchange
LPA	–	Long Period Average
LPG	–	Liquefied Petroleum Gas
LVPS	–	Large Value Payment Systems
M&As	–	Mergers and Acquisitions
M_3	–	Broad Money
MA	–	Management Audit
MBs	–	Mega-bytes
MBS	–	Mortgage-Backed Securities
MG	–	Mahatma Gandhi
MICR	–	Magnetic Ink Character Recognition
MIFOR	–	Mumbai Inter-Bank Forward Offer Rate
MIS	–	Management Information System
MoU	–	Memorandum of Understanding
MPBF	–	Maximum Permissible Bank Finance
MPIs	–	Macro-Prudential Indicators
MRTP	–	Monopolies and Restrictive Trade Practices Act, 1969
MSP	–	Minimum Support Price
MTFRP	–	Medium-Term Fiscal Reforms Programme
NABARD	–	National Bank for Agriculture and Rural Development
NAFED	–	National Agricultural Co-operative Marketing Federation
NHB	–	National Housing Bank
NBFCs	–	Non-Banking Financial Companies
NCAER	–	National Council of Applied Economic Research
NCDs	–	Non-Convertible Debentures
NDA	–	Net Domestic Assets
NDS	–	Negotiated Dealing System
NDTL	–	Net Demand and Time Liabilities

LIST OF ABBREVIATIONS

NEER	–	Nominal Effective Exchange Rate
NEFT	–	National Electronic Funds Transfer
NFBS	–	National Family Benefit Scheme
NGOs	–	Non-Government Organisations
NHAI	–	National Highway Authority of India
NHB	–	National Housing Bank
NMBS	–	National Maternity Benefit Scheme
NOAPS	–	National Old Age Pension Scheme
NOF	–	Net Owned Funds
NPAs	–	Non-Performing Assets
NPL	–	Non-Performing Loans
NRB	–	Nepal Rastra Bank
NRIs	–	Non-Resident Indians
NRO	–	Non-Resident Ordinary Accounts
NSAP	–	National Social Assistance Programme
NSC	–	National Statistical Commission
NSE	–	National Stock Exchange
NSE–MIBOR	–	National Stock Exchange-Mumbai Inter-Bank Offer Rate
NSS	–	National Settlement System
O&M	–	Operation and Maintenance
OBCs	–	Other Backward Classes
OBUs	–	Offshore Banking Units
OCBs	–	Overseas Corporate Bodies
OD	–	Overdraft
OMO	–	Open Market Operations
OMS	–	Open Market Sales
OPAC	–	Online Public Access Catalogue
OSMOS	–	Off-Site Monitoring and Surveillance
OTCEI	–	Over-the-Counter Exchange of India
OTS	–	One-Time Settlement
OWS	–	Other Welfare Schemes
PAS	–	Performance Appraisal System
PCA	–	Prompt Corrective Action
PCDs	–	Partial Convertible Debentures
PD	–	Premises Department
PDs	–	Primary Dealers
PDO	–	Public Debt Office
PDS	–	Public Distribution System
PIOs	–	Persons of Indian Origin
PKI	–	Public Key Infrastructure
PLR	–	Prime Lending Rate
PMGSY	–	Pradhan Mantri Gram Sadak Yojana
PMGY	–	Pradhan Mantri Gramodaya Yojana
PMRY	–	Prime Minister's Rozgar Yojana
PMS	–	Portfolio Management Services
PRD	–	Press Relations Division
PSBs	–	Public Sector Banks
PSRS	–	Prudential Supervisory Reporting System
PSUs	–	Public Sector Undertakings
QIS	–	Quantitative Impact Study
RBS	–	Risk-Based Supervision
RBSB	–	Reserve Bank Services Board
RBSC	–	Reserve Bank Staff College
RC	–	Reconstruction Companies
RDBMS	–	Relational Data Base Management System
RE	–	Revised Estimates
REER	–	Real Effective Exchange Rate
Repo	–	Repurchase Agreements
RIDF	–	Rural Infrastructure Development Fund
RNBCs	–	Residuary Non-Banking Companies
RPCD	–	Rural Planning and Credit Department
RPT	–	Risk Profile Template
RRBs	–	Regional Rural Banks
RTGS	–	Real Time Gross Settlement
RTP	–	Reserve Tranche Position
SAARC	–	South Asian Association for Regional Cooperation
SACP	–	Special Agricultural Credit Plans
SAFE	–	South Asian Federation of Stock Exchanges
SARFAESI Act	–	Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
SARS	–	Severe Acute Respiratory Syndrome
SBSs	–	Shredding and Briquetting Systems

LIST OF ABBREVIATIONS

SC	–	Securitisation Company
SCB	–	Standard Chartered Bank
SCBs	–	Scheduled Commercial Banks
SCGB	–	Standard Chartered Grindlays Bank Ltd.
SCs	–	Scheduled Castes
SDDS	–	Special Data Dissemination Standard
SDRM	–	Sovereign Debt Restructuring Mechanism
SDRs	–	Special Drawing Rights
SEBI	–	Securities and Exchange Board of India
SEB	–	State Electricity Board
SEFT	–	Special Electronic Funds Transfer
SERC	–	State Electricity Regulatory Commission
SEZ	–	Special Economic Zone
SFMS	–	Structured Financial Messaging Solution
SGSY	–	*Swarnajayanti Gram Swarozgar Yojana*
SHGs	–	Self-Help Groups
SHPI	–	Self-Help Promoting Institutions
SIDBI	–	Small Industrial Development Bank of India
SIPS	–	Systemically Important Payment Systems
SJSRY	–	Swarna Jayanthi Shahari Rozgar Yojana
SLR	–	Statutory Liquidity Ratio
SLRS	–	Scheme of Liberation and Rehabilitation of Scavengers
SMEs	–	Small and Medium-sized Enterprises
SMP	–	Statutory Minimum Price
SOR	–	States' Own Revenue
SPS	–	Sanitary and Phyto-Sanitary Standard
SPVs	–	Special Purpose Vehicles
SSIs	–	Small-Scale Industries
SSSs	–	Securities Settlement Systems
STP	–	Straight Through Processing
STRIPS	–	Separate Trading for Registered Interest and Principal of Securities
STs	–	Scheduled Tribes
SWIFT	–	Society for Worldwide Inter-bank Financial Telecommunications
TBT	–	Technical Barriers to Trade
TFCI	–	Tourism Finance Corporation of India
TFPG	–	Total Factor Productivity Growth
ToR	–	Terms of Reference
TPA	–	Tri-Partite Agreements
TPDS	–	Targeted Public Distribution System
UBD	–	Urban Banks Department
UCBs	–	Urban Co-operative Banks
UIP	–	Uncovered Interest Parity
UR	–	Uruguay Round
URIF	–	Urban Reforms Incentive Fund
VaR	–	Value at Risk
VAR	–	Vector Auto Regression
VAT	–	Value Added Tax
VECM	–	Vector Error Correction Model
VRS	–	Voluntary Retirement Scheme
VSNL	–	Videsh Sanchar Nigam Limited
WADR	–	Weighted Average Discount Rate
WAN	–	Wide Area Network
WCDL	–	Working Capital Demand Loan
WHO	–	World Health Organisation
WMA	–	Ways and Means Advance
WSS	–	Weekly Statistical Supplement
WTO	–	World Trade Organisation
ZTCs	–	Zonal Training Centres

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*For the Year July 1, 2002 to June 30, 2003**

PART ONE : THE ECONOMY : REVIEW AND PROSPECTS

I MACROECONOMIC POLICY ENVIRONMENT

Introduction

1.1 Cautious optimism characterised the stance of macroeconomic policies during 2002-03, notwithstanding the continuing slowdown in global economic activity and an environment riddled with several external shocks. The shocks impacting the domestic economy included border tensions, severe drought and the hardening of international crude oil prices towards the year's close. The drought situation necessitated swift responses in supply management. Food supply was bolstered by a drawdown of foodstocks for a substantial increase in targeted public distribution programmes. Coupled with reduction in issue prices and ease in the access to imports, these strategies were effective in containing potential inflationary pressures. In the event, inflation remained weak for the greater part of the year, edging up only in the last quarter in the wake of the firming up of international prices of crude oil.

1.2 The counter-drought stance was reflected in fiscal policy as spending on food and input subsidies rose even as other expenditures were reined in. Revenue shortfalls on account of the continuing slack in economic activity and the reduction of tax/duty rates resulted in modest slippages in fiscal consolidation. Nevertheless, there was a renewal of the commitment to improve the quality of fiscal adjustment through monitorable reform programmes and appropriate incentive structures, especially at the sub-national level. Simultaneously, debt consolidation was carried forward and continued attention was given to measures designed to bring back buoyancy to the tax-GDP ratio.

1.3 Cuts in key policy rates and the cash reserve ratio (CRR) signaled the fine-tuning of monetary-fiscal coordination for stimulating the revival of aggregate demand. The conduct of monetary policy was dominated by the need to contend with large inflows of foreign exchange. The surplus in the current account of the balance of payments for the second year in succession and sizeable capital inflows engendered a record accretion to foreign exchange reserves. Financial markets with overhang of liquidity experienced a distinct easing of rates which, in turn, impacted on monetary policy, necessitating continuous operations to modulate and balance market conditions. Financial sector reforms were carried forward with the objective of rapid convergence with international best practices. The environment for deepening these reforms improved considerably with the enactment of appropriate changes in the institutional architecture, particularly in respect of the recovery of problem assets. The technological infrastructure for the financial system continued to be upgraded.

1.4 Against this backdrop, growth strategies were put in place to propel the economy towards its full potential over the medium-term with emphasis on the quality of growth. Resumption of industrial activity and a robust export performance in the face of the global downturn set the tone for a strategic trade policy centred around doubling of exports from the current level and thereby raising India's share in global exports to 1 per cent by 2007. The Union Budget for 2003-04 aims at stepping up revenue mobilisation and persevering with expenditure management with an overall shift in emphasis to qualitative aspects of fiscal reform. The Monetary and Credit Policy for 2003-04 provided a stimulus to aggregate demand through reductions in the Bank Rate and the CRR, even while indicating the need for a continued vigil on the inflation front. Several steps were taken to strengthen financial soundness and the content of regulatory supervision. The resurgence of positive expectations regarding the near-term was greatly facilitated by the passage of landmark reform legislations, setting the stage for intensifying structural reforms.

THE MEDIUM-TERM GROWTH STRATEGY

1.5 The year 2002-03 marked the launch of the Tenth Five Year Plan covering the period 2002-07. The Plan sets an ambitious growth target of 8 per cent per annum over the Plan period and envisages conditions for a further acceleration over the subsequent five-year period (2007-

* While the Reserve Bank of India's accounting year is July-June, data on a number of variables are available on a financial year basis, *i.e.*, April-March, and hence, the data are analysed on the basis of the financial year. Where available, the data have been updated beyond March 2003. For the purpose of analysis and for providing proper perspectives on policies, reference to past years as also prospective periods, wherever necessary, has been made in this Report.

12) so that there is a doubling of per capita income over the decade. The Plan also adopts 'specific and monitorable' objectives in terms of crucial facets of human development – poverty, employment, education and demographic stability as well as ecological issues in sustainable development.

1.6 The Tenth Plan strategy accords to public expenditure the principal role in raising aggregate demand until private investment can be crowded in sufficiently so as to sustain the growth momentum. Accordingly, the gross investment rate is expected to be raised to about 28 per cent of GDP (from the current level of 24 per cent), primarily financed by a step-up in domestic saving and supplemented by a modest expansion in the inflow of external saving (to 1.6 per cent of GDP from less than 1 per cent during the Ninth Plan period). Other crucial elements in the Plan strategy are a reduction in the incremental capital-output ratio (ICOR) from 4.5 to 3.6, export volume growth of 12.4 per cent per annum, stabilising the variability of rural incomes and halting the dissaving of the public sector (Table 1.1).

1.7 Fiscal correction and diverting more resources to productive purposes are keys to achieving the Plan objectives and ensuring fiscal sustainability. The Tenth Five-Year Plan aims at reduction in deficits at both the Central and State level. To achieve the expected level of fiscal consolidation and the growth target, the Tenth Plan envisages an increase in the Centre's gross tax revenue to 9.9 per cent of GDP by the terminal year of the Plan (2006-07) from 8.2 per cent in the base year (2001-02). The corresponding ratios for the States' own tax revenue are 6.6 per cent and 5.9 per cent of GDP, respectively. On the expenditure side, the Tenth Plan visualises higher budget support to the Plan (Plan expenditure) by the Centre – on an average, 4.9 per cent of GDP during the Plan period as against 4.4 per cent in the base year. On the other hand, the non-Plan expenditure is anticipated to decline to 9.9 per cent of GDP in the terminal year of the Plan from 11.3 per cent in the base year. Similarly for States, Plan expenditure is envisaged to increase to 4.2 per cent of GDP and non-Plan expenditure is anticipated to decline to 11.5 per cent of GDP by 2006-07 from their respective levels of 3.8 per cent and 13.3 per cent of GDP during 2001-02. These anticipated trends in the revenue and expenditure are expected to improve Government saving and public investment.

Table 1.1 : Macro Parameters for the Tenth Plan

Item	Ninth Plan	Tenth Plan	Post Plan
1	2	3	4
ICOR	4.53	3.58	3.84
Per cent of GDPMP			
Domestic Saving Rate	23.31	26.84	33.01
Private Saving Rate	24.13	26.40	*
Public Saving Rate	-0.82	0.44	*
Current Account Deficit	0.91	1.57	3.13
Investment Rate	24.23	28.41	36.14
Private Investment Rate	17.08	19.97	*
Public Investment Rate	7.15	8.44	*
Per cent per annum			
GDP Growth	5.35	7.93	9.40
Export Growth	6.91	12.38	*
Import Growth	9.80	17.13	*

* Not Projected. GDPMP : GDP at current market prices.

Source : Tenth Five Year Plan (2002-2007), Government of India.

1.8 Critical to the Plan strategy are appropriate changes in policy and institutional settings which take due cognisance of the significant structural changes underway in the economy. Agriculture, construction, 'other transport' and 'other services' are specific sectors targeted for high growth in view of their potential for employment generation with relatively low capital intensity. Employment generation would be the driving factor in speeding up growth in segments within manufacturing. 'Agriculture and allied activities', 'mining and quarrying' and construction are likely to receive excess investment to meet the Plan objectives. Existing shortfalls in investment in 'electricity, gas and water supply', communication, financial services, public administration and community services are expected to be bridged by a significant improvement in private investment, and by removing fiscal constraints as well as generation of internal resources by the public sector. Balanced regional development, reduction in poverty across States, fiscal sustainability and further intensification of financial sector reforms are other notable elements of the Tenth Plan strategy (Box I.1).

Box I.1

Growth Strategy for Tenth Five Year Plan (2002-2007)

At the heart of the Tenth Plan strategy is a view of the development process in terms of efficiency. Considerable emphasis has been placed on policy and procedural reform and improved governance to achieve a significant improvement in overall efficiency. It is increased efficiency that is expected to make the acceleration in growth envisaged in the Plan feasible.

Typical of Plan models, the arithmetic of the Tenth Plan strategy is set in the standard neo-classical growth accounting framework, driven by a combination of capital accumulation and efficiency of resource use. In the tradition of the new innovation in growth theories in the 1980s, technological progress, productivity and efficiency are

(Contd....)

(Concld....)

regarded as endogenous to the process of growth. An important difference, thus, lies in the Tenth Plan's approach *vis-à-vis* its predecessors in the emphasis on efficiency, expressed in a 'faith in the latent potentialities of the economy'. Accordingly, high priority has been accorded to policies that will unfetter growth impulses from existing practices and institutional arrangements.

The Tenth Plan adopts a seven pronged approach in its policy framework: (i) enhancing the efficiency of capital use; (ii) greater openness; (iii) widening and deepening of capital markets; (iv) stepping up agriculture and rural development; (v) competitive industrial policy environment; (vi) building the social and economic infrastructure; and (vii) reforms in governance. In each of these areas, there is a conscious emphasis on policy changes which could involve reprioritisation and even a radical break from the past:

- Full productive use of the existing capital stock, energising idle capacity in the public sector through a moratorium on new infrastructure projects and privatisation of non-strategic public sector enterprises; legal and procedural changes covering bankruptcy and foreclosure for quick transfer of capital assets in the private sector.
- Lowering of tariffs on imports, creation of capacities specifically for export markets, rationalisation of the domestic tax structure and simplified access to export promotion incentives to correct for the anti-export bias in policies and to enable a greater integration with the international economy.
- In the financial sector, the Plan envisages regime changes to allow for the flow of long-term risk capital. Reforms in the debt and equity markets are regarded as central to the convergence of long-term saving and investment horizons in the economy.
- The Plan identifies the need to raise productivity of land and water resources for agricultural development. Accordingly, it aims for a major revival of public investment in irrigation and water management, rural infrastructure, research and development (R&D), product diversification and freer trade.
- Indian industry will shoulder a large share of the drive to accelerate overall growth by expanding at above-trend rates of 10 per cent per annum during the Plan period, extending external liberalisation to State-level industrial enterprises to make them internationally competitive.
- Human development through three critical dimensions, *i.e.*, longevity, education and command over resources – education for all, improvement in the health status of the population, 'shelter for all' by 2012, building the economic infrastructure by intensifying power sector reforms in States and empowering them with adequate legislation and financial support, expansion of hydro-electric and atomic power capacity, tariff fixation on commercial and technical grounds by an independent authority in order to improve the financial constraints on the performance of railways, upgradation of the road network to international standards, reform of State road transport operations, rural road connectivity, expansion in civil aviation and a telecommunication policy.
- Reform of governance is a 'cornerstone' of the Tenth Plan. Reform of the civil service, corporate governance and consumer protection are regarded as essential for increasing efficiency and accountability.

The tone of cautious optimism running through the Tenth Five Year Plan captures the mood of the nation. The imperatives for poverty reduction and employment generation impart an urgency to achieving an annual growth of the economy at 8 per cent as a necessary minimum. Available empirical evidence and independent assessment of the growth experience so far place India's potential growth rate in the range of 6-10 per cent. Thus, the goal of the Tenth Plan is ambitious but not infeasible. In this endeavour, a vision of transformation of the Indian economy driven by efficiency becomes increasingly credible.

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REAL SECTOR POLICIES

Agriculture and Allied Activities

1.9 Mitigating the adverse impact of the drought emerged as an overriding priority in 2002-03 even as initiatives for ongoing institutional and structural reform in the agricultural sector were strengthened further.

1.10 The Central Government allotted 3.8 million metric tonnes of rice and wheat free of cost to the 14 drought affected States for various employment programmes. The Task Force on Drought approved a special package of drought assistance for Rajasthan under which people in the worst affected blocks in the State were provided relief employment for 10 days every month and received 8 kgs of foodgrains per day. Accordingly, Rajasthan was allocated 2.1 million tonnes of wheat free of cost from February to July 2003 for the purpose of providing employment to 6.6 million persons. Fodder of 30,000 tonnes was also allocated free of cost to Rajasthan, and 435 cattle camps were provided financial assistance amounting to about Rs.12 crore. The Task Force on Drought also approved allocation of 1,15,000 tonnes of foodgrains to Maharashtra for three months from February 2003 and 75,000 tonnes of rice to Himachal Pradesh for public distribution at Below

Poverty Line (BPL) rates. Fodder and water were freely transported by the railways to the affected areas up to June 30, 2003. One-time special drought relief prices were announced for various commodities ranging from Rs.20 per quintal for paddy, jowar, copra and sesamum, Rs.15 per quintal for sunflower seed, Rs.10 per quintal for bajra and soyabean and Rs.5 per quintal for various pulses. An increase of Rs.5 per quintal in the Statutory Minimum Price (SMP) was announced for sugarcane farmers in all States.

1.11 As part of drought relief measures, interest on *kharif* crop loans as well as on agricultural term loans during 2002-03 was deferred. The crop loans were rescheduled into term loans which would be recovered over the next five years in the case of small and marginal farmers and over three years in the case of other farmers. The first year's deferred liability of interest on *kharif* loans was waived completely as a one-time measure. The Government announced a grant of an input subsidy to small and marginal farmers amounting to Rs.1,490 crore. In view of the severity of the drought, the agricultural input subsidy was extended to cover all other farmers for both sown and unsown areas up to a ceiling of two hectares. All the 14 affected States received additional amounts of input subsidies, cumulatively in excess of Rs.555 crore, for tackling the drought. The Union Budget for 2003-04 expanded the *Antyodaya Anna Yojana* from April 2003 to cover an additional 50 lakh families, raising the total coverage to more than a quarter of all BPL families during the current year.

1.12 Futures trading is expected to help farmers and traders to hedge their risks and thereby lessen their dependence on Government procurement. Recently, all commodities were made eligible for futures trading. At present, there are 91 commodities under the purview of Section 15 of the Forward Contracts (Regulation) Act, 1952. Trading in these commodities would be conducted only in recognised exchanges regulated by the Forward Markets Commission. Notwithstanding the introduction of futures trading, Minimum Support Prices (MSPs) for these foodgrains and the procurement mechanism would continue to be in existence. The Food Corporation of India (FCI) was directed to open additional centres for procurement of paddy from non-traditional States like Madhya Pradesh, Bihar and Orissa.

1.13 The Agricultural Insurance Company of India Limited (AIC), which was proposed in the Union Budget, 2002-03, was constituted in December 2002 with the capital participation from General Insurance Corporation of India (GIC), National Insurance Company Limited, New India Assurance Company Limited, Oriental Insurance Company Limited, United India Insurance Company Limited and the NABARD. The National Agricultural Insurance Scheme will be transferred to AIC and would be the core business of the company. The new organisation will, in due course, cover other allied agricultural risks in addition to crop insurance.

Manufacturing and Infrastructure

1.14 In recent years, the objective of industrial policy in India has been to infuse competitive efficiency into Indian industry while promoting its restructuring with a focus on core competencies, organisational change and a growing exposure to the cutting edge of international competitiveness.

1.15 The Competition Act, 2002 was enacted in December 2002 to promote competition through prohibition of anti-competitive practices and abuse of dominance and through regulation of companies beyond a particular size. This Act will replace the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP).

1.16 A moderate rate structure and complete CENVAT chain to promote compliance and encourage modernisation in the textile sector is envisaged in the Union Budget, 2003-04. A special package for the power loom sector is likely to enlarge the Technology Upgradation Fund Scheme to cover the modernisation of the sector. The introduction of the revised Textile Sector Infrastructure Development Scheme is expected to improve working conditions, productivity and to provide insurance cover to weavers. A Centrally Sponsored Scheme 'Apparel Parks for Exports Scheme' was launched for setting up of apparel manufacturing units of international standards at potential growth centres. Under this scheme, nine Apparel Parks have been identified. A cluster-based approach to the implementation of schemes/ programmes in handlooms, powerlooms, sericulture and other decentralised industries has been adopted.

1.17 The Export Import (EXIM) Policy, 2003-04 exempted domestic sales undertaken by the units located in Special Economic Zones (SEZs) from levy of the 4 per cent special additional customs duty. Special purpose vehicles (SPVs) are proposed to be set up to develop industrial clusters. The SPVs, which have no identifiable revenue stream, will be funded entirely by the Central Government and beneficiaries. The SPVs are expected to create a world class physical infrastructure in industrial clusters with a high growth potential and convert static local efficiency into dynamic

competitiveness. Ten industrial clusters would be selected under the Industrial Infrastructure Upgradation Scheme announced in the Exim Policy 2002-07. The cap on the number of investment companies being floated by companies would no longer apply to SPVs set up to route funds into new ventures.

1.18 De-reservation of 51 items for the small scale industries (SSI) sector was effected in May 2002. For technology upgradation and quality improvement in the SSI sector, the scope of the on going ISO 9000 reimbursement scheme was enlarged to include reimbursement of expenses for ISO 14001 Environment Standard with effect from October 28, 2002. The Union Budget for 2003-04 announced de-reservation of 75 items for the SSI sector. The de-reserved items include laboratory chemicals and reagents, plastic, leather and paper products. The Government raised the SSI investment limit on 10 drugs and pharmaceutical items from Rs.1 crore to Rs.5 crore in June 2003. The composite bank loan limit for SSI was raised from Rs.25 lakh to Rs.50 lakh in June 2003 to meet their term loan as well as working capital requirements.

1.19 Noteworthy changes in the policy environment are expected to provide a strong impetus for the development of the physical infrastructure. The Union Budget, 2003-04 envisages innovative funding mechanisms principally in respect of roads, railways, airports and seaports. The objective is to leverage public money through private sector partnership, wherever possible. In February 2003, the Reserve Bank allowed banks to finance promoters' contribution to equity capital in infrastructure projects. Risk weight for the purpose of reckoning capital adequacy was halved to 50 per cent for core sector funding. This is applicable to banks' investments in securitised paper pertaining to an infrastructure facility. These measures are expected to give a boost to core sector funding.

1.20 The Electricity Bill, 2003 was approved by Parliament in 2003. The Bill seeks to delicense power generation and to permit captive power plants. It would help to facilitate private sector participation in the transmission sector and would provide open access to the grid sector. In April 2003, the Union Cabinet approved a six level intervention plan for the power sector involving a financial assistance of Rs.40,000 crore to State Electricity Boards (SEBs) in the next five years for power distribution reforms. The intervention strategy would encompass initiatives at the national level, State level, SEB and utility level, distribution circle level, feeder level and the consumer level to focus on accountability, deliverability and performance at all levels. The Ministry of Power, the Reserve Bank and States entered into a tripartite agreement in March 2003 for a one-time settlement plan of dues of Rs.42,000 crore payable by SEBs to central public sector undertakings.

1.21 In the telecommunications sector, the monopoly of Videsh Sanchar Nigam Ltd (VSNL) over long distance telephony ceased with its privatisation in 2002. Policies for opening up of international long-distance telephony, setting up of Universal Service Obligation, permitting a fourth operator in the cellular mobile segment and commissioning of internet backbone were put in place. In the Union Budget, 2003-04 the benefit of tax holiday to the telecom and domestic satellite service companies was extended till March 31, 2004. In June 2003, the Department of Telecommunication notified changes in the licence conditions of the cellular and basic service operators to enable greater consolidation in the telecom sector through merger, de-merger and acquisition.

1.22 In the road sector, private parties were allowed to apply for tenders either singly or through a consortium restricted to four members. The Ministry of Road and Surface Transport has short listed 23 build, operate and transfer (BOT) projects under this new bidding process. Airport handling was opened to foreign direct investment up to 49 per cent.

EXTERNAL SECTOR POLICIES

EXIM Policy (2002-07)

1.23 The ongoing strength and buoyancy in the external sector set the tone for an ambitious trade policy stance with continued emphasis on correction of the anti-export bias in the economy. Buoyed by a robust export performance in 2002-03 in the face of sluggish external demand and the burgeoning international reserves, the modified EXIM Policy for 2002-07 seeks a greater integration of international trade into the development strategy of the Tenth Plan.

1.24 The Policy intends to consolidate and accelerate India's export growth by capitalising on agricultural and allied products as areas of core competence and focusing on special economic zones (SEZs) and exports of services as engines of growth. Removal of export restrictions, modification of norms for fixing duty entitlement pass book (DEPB) rates, promotion of corporate participation in agri-export zones and export infrastructure are envisaged. Besides, agricultural extension, processing, packing, storage, R&D and other facilities in these zones, and transport assistance for exports of agricultural products are emphasised. The policy also contains a special focus on exports of cottage industries, handicrafts, gems and jewellery through market

access initiative schemes, duty free imports and appropriate adjustments in value addition norms.

1.25 In recognition of the importance of SEZs, major steps were taken for simplification and codification of rules, regulations and procedures applicable to the SEZs and Export Oriented Units (EOUs). External Commercial Borrowings (ECBs) for tenure of less than three years are allowed to units in SEZs. Sales from the Domestic Tariff Area (DTA) to SEZs are treated as exports and entitle the DTA suppliers to Drawback/DEPB benefits. Special steps are drawn up to promote exports of gems and jewellery and electronic hardware from the SEZs.

1.26 In view of the growing importance of services, the EXIM policy has accorded a special thrust to these exports. Apart from software, a host of traditional (tourism) and non-traditional (health care, entertainment and professional services) services have been identified for promotion. For these sectors, import of consumables, office and professional equipments, spares and furniture up to 10 per cent of the average foreign exchange earning in the previous three years was allowed. The tourism sector was allowed to avail the benefits under the Export Promotion Credit Guarantee (EPCG) and advance licensing schemes. For entertainment and education services, sector-specific Working Groups are set up for framing action plans to achieve export potential within a specified time schedule.

Trade Policy Measures in the Union Budget for 2003-04

1.27 The Union Budget for 2003-04 contains several measures to facilitate foreign trade, such as, reduction/ rationalisation of customs duties, simplification and modernisation of customs clearance procedures, and strengthening export infrastructure. The peak rate of customs duty has been reduced from 30 per cent to 25 per cent, excluding agriculture and dairy products.

1.28 The report of the Task Force on Indirect Taxes (headed by Dr. Vijay Kelkar) submitted to the Ministry of Finance in December 2002 contained various recommendations relating to Drawbacks, SEZs, EOUs and Advance Licensing Scheme. Some of the recommendations of the Task Force have been accepted and implemented by the Government, subsequent to the Budget announcements. These include acceptance of self-declaration certificate of non-availment of CENVAT credit for grant of drawback, release of an amount equivalent to all industry drawback entitlement in cases of shipments under brand rate of drawback, acceptance of exporters' declaration regarding the weight of constituent material in case of composite item and payment of interest in cases of delayed sanction of drawback beyond one month.

Policies for External Capital Flows

1.29 Significant easing of payments restrictions were effected in respect of current and capital remittances abroad. Domestic entities were allowed to retain significant proportions of their earnings abroad to meet future foreign exchange requirements. Relaxations were effected in the movement of inward and outward capital flows in the form of foreign direct investment, foreign portfolio investment, NRI deposits and external commercial borrowings. Notable among them were:

- Norms on release of foreign exchange for purposes such as medical treatment abroad, private visits abroad, use of payment cards abroad, procurement of books and other items through internet liberalised including use of funds held in Non-Resident Ordinary (NRO) accounts for educational and medical purposes.
- Repatriation of proceeds from sale of immovable properties allowed after a minimum of 10 years lock in period and subject to annual limits and existing taxation. Repatriation of assets of foreign nationals and assets of non-resident Indians (NRIs)/persons of Indian origin (PIOs) by way of inheritance/legacy allowed up to a yearly limit.
- Up to 100 per cent of export earnings can be credited to Exchange Earners' Foreign Currency Account (EEFC).
- Norms for prepayment of external commercial borrowings (ECBs) simplified.
- Foreign institutional investors (FIIs) allowed to hedge the market value of their entire investment in equity.
- Rules for issue of ADRs/GDRs simplified to allow sponsoring, listing on overseas exchanges, retention of proceeds abroad and free conversions and repatriability.
- Listed Indian companies permitted to invest in companies abroad under conditions; ceiling for mutual funds' overseas investment raised to US $ 1 billion; banks' investment abroad enhanced to 50 per cent of Tier I capital; improvement in the automatic route for Indian joint ventures/ wholly owned subsidiaries abroad.
- Resident individuals permitted to open domestic foreign currency accounts.

International Finance

Financial Transaction Plan

1.30 From September 2002 India became a member of the IMF's Financial Transaction Plan (FTP) in view of its strong balance of payments and comfortable reserves. Effective participation in FTP would amount to India becoming a creditor member of the IMF. Depending on the extent of its participation in the FTP, India's Reserve Tranche Position (RTP) in the Fund would increase on which the IMF would pay remuneration at market related rates. The IMF prepares a quarterly FTP indicating the expected total amount that all creditor countries may have to provide during any quarter. In the quarters September-November 2002 and December 2002-February 2003, planned transfers indicated in the FTPs were SDR 6.6 billion and SDR 6.0 billion. Actual transfers effected by all the creditors taken together were about SDR 1.8 billion and SDR 3.3 billion, respectively. In those two quarters, India was allocated SDR 156 million and SDR 128 million, respectively. Since actual transfers under the FTP were far less than the planned transfers, India was not required to effect any actual transfer during those two quarters. This situation changed in the subsequent quarters. India was allocated SDR 140 million under the FTP for March-May, 2003 quarter out of a total planned transfer of SDR 6.2 billion (by all creditor members) and was requested to effect an actual transfer to the IMF for the first time, amounting to SDR 5 million. For June-August 2003, India was allocated SDR 303 million out of a total planned allocation of 13 billion for all FTP members, and actual transfers effected by India during this period amounted to SDR 200 million.

G-20 Initiatives

1.31 In March 2002, India assumed the leadership of the Group of Twenty (G-20). During India's leadership, the G-20 Deputies deliberated on a range of issues of common concern to the G-20 members including measures for extending the benefits of globalisation, Sovereign Debt Restructuring Mechanism (SDRM), domestic policy requirements for regeneration of international capital flows, combating financing of terrorism, standards and codes, and enhancing the effectiveness of aid (Box I.2).

Box I.2

G-20 during the Leadership of India

The creation of G-20 on September 25, 1999 in Washington D.C. was the result of the commitment made by the G-7 leaders at the June 1999 summit at Koln " to establish an informal mechanism for dialogue among systemically important countries within the framework of the Bretton Woods institutional system". The G-20 aims at promoting international financial stability through informal discussions, preparation of case studies and reviews of policy issues of relevance to the members. The forum comprises 19 member countries (Argentine Republic, Australia, Brazil, Canada, France, Germany, Italy, Japan, Kingdom of Saudi Arabia, Mexico, People's Republic of China, Republic of India, Republic of Indonesia, Republic of Korea, Republic of South Africa, Republic of Turkey, Russian Federation, United Kingdom and United States of America) and the European Union. The Managing director of the IMF and the President of the World Bank as well the Chairpersons of the International Monetary and Financial Committee (IMFC) and the Development Committee (DC) also participate in the discussions.

In the meeting of Deputies held in July, 2002 in New Delhi, Australia presented the key findings of the G-20 workshop held in Sydney on "Globalisation, Inequality and Living Standards". In the Ministerial Meeting held on November 23, 2002, discussions essentially focused on domestic and international crisis prevention and resolution initiatives, globalisation, combating financing of terrorism and strengthening the link between aid and development. In the Ministerial *Communiqué*, the Ministers recognised that inter-dependence among national economies and increased integration of financial markets have brought significant advantages and enormous opportunities for enhanced growth in many countries. Countries have, however, have become more exposed to external shocks and susceptible to the consequences of inappropriate domestic policies. The *Communiqué* emphasised the need to strengthen capacity to prevent financial crises and to develop efficient, expeditious, and socially and economically effective responses to a financial crisis when it occurs.

The Ministers noted that effective and accountable International Financial Institutions (IFIs) and worldwide surveillance are essential for a healthy global financial system. Sustainable exchange rate regimes, prudent asset-liability management, and implementation of agreed standards and codes are important components of an effective strategy for crisis prevention. The Ministers emphasised the importance of sound national financial systems, effective supervision, and corporate governance in line with global best practices and also agreed that capital account liberalisation should proceed in an appropriately sequenced manner.

It was noted that globalisation has generally been delivering rising living standards including to many of the world's poor. The benefits of globalisation can be maximised, and associated risks mitigated, through the

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pursuit of appropriate domestic policies and a healthy external environment. The experience of G-20 members as presented in the country case studies on globalisation as well as the findings of the Globalisation Workshop in Sydney were highlighted to suggest that strong institutions, a climate that fosters savings and investment, transparency, and the rule of law, coupled with increased investments in infrastructure and human capital in developing countries are essential ingredients for promoting growth and reducing poverty. The Ministers recognised that the process of globalisation has not yet delivered in reducing poverty in some of the world's poorest countries. In that context they felt that reduction in the remaining trade related barriers and phasing-out of trade-distorting subsidies would contribute to spreading further the benefits of globalisation, including to the poorest developing countries. They also recognised that development assistance can enable poorer nations to build capabilities for exploiting the benefits of more integrated markets.

At the end of the Ministerial Meeting, the leadership was transferred to Mexico.

FISCAL POLICY

1.32 The stance of fiscal policy set out in the Union Budget for 2003-04 was indicated in a renewal of commitment to five basic objectives ("*Panch Priorities*"): poverty eradication, infrastructure development, fiscal consolidation, development of agriculture including irrigation and enhancing manufacturing sector efficiency. The process of fiscal consolidation is being carried forward through tax reforms and progressive elimination of budgetary drags, including reform of the additional excise duty and expansion of service tax. Debt restructuring and the cash management as part of expenditure management are envisaged as integral elements of fiscal consolidation.

Expenditure Management and Debt Consolidation

1.33 Cash management has been proposed to be initiated on a pilot basis in some major spending ministries so as to facilitate the release of budgetary allocations in a phased manner to permit convergence with the availability of resources within the year. Improvement in cash flow matching is expected to have salutary effects on expenditure management.

1.34 Debt restructuring would be undertaken on three fronts, *viz*., pre-payment of external debt, buy-back of illiquid high interest rate loans from banks, and allowing State Governments to swap high cost Central Government debt with lower cost new borrowings. With regard to external debt repayment, the Union Budget expressed the intention to continue with the policy of prudently managing external liabilities and proactively liquidating relatively higher cost components of the external debt portfolio. As regards domestic debt, Government would offer to buy back high interest loans from banks on an entirely voluntary basis. The buy back scheme would enable the banks to improve their liquidity position. Furthermore, better NPA management is being encouraged through tax incentives if the banks make profits from the buy back for provisioning. Under the debt-swap scheme between the Central Government and the States, all State loans from Government of India bearing coupons in excess of 13 per cent would be swapped over a three-year period ending in 2004-05. The States are expected to save an estimated Rs.81,000 crore in interest and deferred loan repayments over the residual maturity period of the loans. The scheme would also help restrain the debt build-up in States through the small saving schemes.

Tax Reform

1.35 Tax reforms proposed in the Union Budget emphasise six important aspects: (i) Value Added Tax (VAT) for States; (ii) integration of services into the tax net; (iii) improvements in tax administration through greater application of information technology (IT); (iv) rationalisation of excise duties; (v) reduction in customs duty; and (vi) fiscal consolidation through expenditure reprioritisation and revenue augmentation.

1.36 Under direct taxes, measures taken to provide relief to taxpayers and to improve tax compliance include raising of standard deduction for salaried employees; relief to employees by exempting voluntary retirement scheme (VRS) payments from income tax up to Rs.5 lakh; rebate for education expenses up to Rs.12,000 per child for two children made eligible for rebate under Section 88 of the Income Tax Act; and tax rebate for senior citizens is increased to Rs.20,000, thereby making their income up to Rs.1.53 lakh fully exempt from income tax. For individuals, the surcharge is removed entirely; however, for incomes above Rs.8.5 lakhs, a 10 per cent surcharge on the tax has been imposed. On pension, the effective exemption limit becomes Rs.1.83 lakh per annum. The measures for simplification and rationalisation of tax regime include general deductions for individuals tax payers under

section 80L on income from dividends, interest *etc.* up to Rs.15,000. In order in give a boost to investment, the corporate tax rate is left unchanged and the 5 per cent surcharge has been halved. The tax deductibility of interest on housing loans for construction or purchase of a self-occupied house property has been retained at Rs.1,50,000.

1.37 On the indirect tax front, rationalisation of excise rate structure and reduction of the multiplicity of rates are the main planks of tax reforms. In addition, more services have been put under the tax net and the general service tax rate has been enhanced from 5 per cent to 8 per cent. The peak rate of customs duty has been reduced to 25 per cent. In the case of excise duties, a three-tier excise duty structure - 8 per cent, 16 per cent and 24 per cent - has been implemented except for petroleum and tobacco products, *pan masala* and items attracting specific duty rates. The excise duty rate of 32 per cent, which applied to tyres, aerated soft drinks, polyester filament yarn, air-conditioners and motor cars has been reduced to 24 per cent.

1.38 With the objectives of minimising the cost of tax collection, encouraging voluntary compliance and to give better treatment to the existing taxpayers so as to encourage those outside the tax net to become taxpaying citizens, the budget announced certain measures to strengthen the tax administration, mainly drawing on the recommendations of the Kelkar Committee. Some of the principal measures announced in the budget are:

- outsourcing of non-core activities of the Income Tax Department;
- immediate abolition of present discretion-based system for selection of returns for scrutiny;
- expanding the scope of taxpayer services;
- direct crediting of all refunds to the bank account of the taxpayer through electronic clearance system,
- reduction in the compliance cost to the taxpayer - the Income Tax Act is being amended to enable electronic filing of returns; abolition of tax-clearance certificates for certain categories; and
- simplifying the procedures and methods employed during search and seizure, and during survey by the Income Tax department.

Social Security and Insurance

1.39 At present, primary health care, emergency life saving services, services under National Disease Control Programmes and National Family Welfare Programmes are being provided free of cost to all irrespective of their ability to pay. For a large majority of less advantaged citizens, however, access to good health services is still inadequate. In this regard, attempts are being made for utilisation of funds from Centrally Sponsored Schemes to improve functioning of primary health care institutions and minimise inter-State and inter-district differences.

1.40 A 100 per cent Centrally Sponsored Scheme called National Social Assistance Programme (NSAP) has been in existence since 1995 for providing social assistance benefit to poor households affected by old age, death of primary bread earner and maternity care. The programme has three components, *viz*., National Old Age Pension Scheme (NOAPS), National Family Benefit Scheme (NFBS) and National Maternity Benefit Scheme (NMBS). A scheme, *viz*., *Annapurna* was introduced on April 1, 2000, aimed at providing food security to meet the requirement of those senior citizens who though eligible for pensions under the National Old Age Pension Scheme, are not getting the same. Foodgrains are provided to the beneficiaries at subsidised rates of Rs.2 per kg of wheat and Rs.3 per kg of rice. The scheme is operational in 25 States and 5 Union Territories and more than 6.08 lakh families have been identified and are getting benefits of the scheme.

1.41 Public sector general insurance companies have been encouraged to design a community-based universal health insurance scheme during 2003-04. Under this scheme, a premium equivalent to Re.1 per day (or Rs.365 per year) for an individual, Rs.1.50 per day for a family of five, and Rs.2 per day for a family of seven will provide eligibility to get reimbursement of medical expenses up to Rs.30,000 towards hospitalisation, a cover for death due to accident for Rs.25,000 and compensation due to loss of earning at the rate of Rs.50 per day up to a maximum of 15 days. To make the scheme affordable to BPL families, the Government has decided to contribute Rs.100 per year towards their annual premium. In the first phase, at least an additional 50 lakh BPL families will be covered during 2003-04.

1.42 In order to provide relief to senior citizens and others, the Life Insurance Corporation of India (LIC) has introduced a special pension policy, following the announcement made in the budget, guaranteeing an annual return of 9 per cent in the form of a monthly pension scheme called *Varishtha Pension Bima Yojana*. Any citizen above the age of 55 years of age is eligible for the scheme which envisages a monthly

return in the form of a pension for life. The difference between the actual yield earned by the LIC on the funds invested under the scheme and the assured return of 9 per cent, would be reimbursed to the LIC annually by the Government.

1.43 The 2001-02 budget had announced the restructuring of pensions for new Central Government employees and a scheme for the general public. The Union Budget, 2003-04 announced a new pension scheme, containing a basket of pension choices, which will be applicable to new entrants to Government service, except to the armed forces. The scheme will also be available, on voluntary basis, to all employers for their employees, as well as to the self-employed. The new scheme, when introduced, will be based on defined contributions and the contribution will be shared equally by the employees and the Government in case of Government employees. In case of individuals, who are not Government employees, there will be no contribution by the Government. The new pension scheme will allow transfer of benefits in case of change of employment, and will go into individual pension accounts with Pension Funds. The Ministry of Finance will oversee and supervise the Pension Funds through a new and independent Pension Fund Regulatory and Development Authority.

MONETARY POLICY FRAMEWORK

1.44 The monetary policy framework has undergone changes over the recent period in response to reforms in the financial sector and the growing external orientation of the economy. The endeavour of the policy has been to enhance the allocative efficiency of the financial sector, preserve financial stability and improve the transmission mechanism of monetary policy by moving from direct to indirect instruments. The stance of the monetary policy has been to ensure provision of adequate liquidity to meet credit growth and support investment demand in the economy while continuing a vigil on the movements in the price level, to continue with the present stance on interest rates including preference for softer interest rates and to impart greater flexibility to the interest rate structure in the medium-term.

1.45 Bank Rate changes, combined with CRR and repo rate changes, have emerged as important tools of liquidity and monetary management. The liquidity adjustment facility (LAF) has evolved as an effective mechanism for absorbing and/or injecting liquidity on a day-to-day basis in a more flexible manner and, in the process, providing a corridor for the call money market. In alignment with its accommodative stance in the context of stimulating industrial activity, a policy bias for soft interest rates and a flexible interest rate structure was indicated and in consonance, the CRR was reduced from 5.5 per cent to 5.0 per cent in June 2002, to 4.75 per cent in November 2002 and further to 4.5 per cent in June 2003, augmenting the lendable resources of banks by about Rs.13,500 crore. The Bank Rate and the LAF repo rate were reduced by 25 basis points each in October 2002 followed by a 50 basis point cut in the LAF repo rate on March 3, 2003. Comfortable liquidity conditions engendered by large capital inflows enabled a general reduction in market interest rates with varying sensitivity to policy signals across the maturity spectrum. Lending rates of banks exhibited, however, somewhat sluggish downward movements. The softening of interest rates was enabled by the benign inflation environment.

1.46 Monetary policy formulation for 2003-04 is based on conditional expectations of real GDP growth at about 6.0 per cent, inflation in the range of 5.0 to 5.5 per cent, projected expansion in broad money (M_3) at 14.0 per cent and non-food bank credit (including investments in commerical papers, shares/ debentures/ bonds of PSUs and private corporate sector) at 15.5-16.0 per cent. The overall stance of monetary policy for 2003-04 re-affirmed preference for a soft and flexible interest rate environment within a framework of macroeconomic stability and centred on a close monitoring of inflation. In pursuit of its stance, the Reserve Bank would continue to modulate market liquidity to meet the economy's requirements of bank credit. The stance of monetary policy was indicated through a 25 basis point cut each in the Bank Rate and the CRR. The policy preference in regard to the Bank Rate is to keep it stable in the near-term. Measures were taken to increase the efficacy of LAF operations. This was accompanied by gradual phasing out of sector-specific refinance facility and rationalisation of interest rate structure at which liquidity is available from the Reserve Bank. Strengthening of credit delivery mechanisms continued to be a concurrent priority.

FINANCIAL SECTOR REFORMS

1.47 Strengthening of the financial sector and improving the functioning of the financial markets are the core objectives of financial sector reforms in India. The central plank of financial sector reforms is a set of prudential norms aimed at imparting strength to banks and financial institutions as well as inculcating greater accountability and market discipline. These

norms include not only capital adequacy, asset classification and provisioning but also accounting standards, exposure and disclosure norms, investment and risk management as well as asset-liability management guidelines. The approach has been to benchmark the norms against international best practices. Financial sector reforms were carried forward during 2002-03 with the announcement of measures for streamlining banking operations, upgradation of risk management systems, operationalisation of consolidated accounting practices and enactment of a new Act to improve the recovery of non-performing loans.

Prudential Norms

1.48 The Reserve Bank's approach to the institution of prudential norms has been one of incremental convergence with international standards and best practices. The internationally accepted 90-day norm for recognition of loan impairment would be applicable to commercial banks, co-operative banks and regional rural banks with convergence set for the year ending March 2004. For State Co-operative Banks and District Central Co-operative Banks, the convergence is set for the year ending March 2006. Beginning April 2002, banks began to move over to charging interest at monthly rests in order to achieve smooth convergence. The transition time for a sub-standard asset to be classified as a doubtful asset has been shortened from 18 months to 12 months with effect from March 31, 2005. The consequent additional provisioning is to be phased over a four-year period with a minimum of 20 per cent each year. The Reserve Bank participated in a Quantitative Impact Study (QIS) conducted by the Basel Committee to assess the impact of the new Capital Accord. A broader internal process of preparing banks for the complexity of the new Accord and the costs involved in adherence is also underway. The Reserve Bank forwarded its comments on the Third Consultative Paper of the New Basel Capital Accord to the Basel Committee of Banking Supervision in July 2003. The Reserve Bank has emphasised the need to take into account the structural characteristics of different economies as also preserving the spirit of simplicity and flexibility to ensure universal application of the New Accord. India has also shared the international concern on money laundering and financing of terrorism. “Know Your Customer” procedures have been put in place to prevent the misuse of the financial system.

1.49 In January 2002 banks were advised to build up Investment Fluctuation Reserve (IFR) of a minimum of 5 per cent of the investment portfolio within a period of 5 years. IFR should be computed with reference to investment in two categories, *viz.,* ‘Held for Trading’ and ‘Available for Sale’. It is not necessary for banks to include the investment under ‘Held to Maturity’ category while computing IFR. IFR was treated as Tier II capital up to a maximum of 1.25 per cent of total risk-weighted assets. Effective from March 31, 2003 this ceiling was removed. For capital adequacy purposes, Tier II capital including IFR would be considered up to a maximum of 100 per cent of Tier I capital.

1.50 In adherence to the Core Principles of Banking Supervision, guidelines on country risk management and provisioning thereof were provided to banks to encourage internal assessment of country risk. These guidelines are applicable only in respect of countries where a bank has net funded exposure of two per cent or more of its total assets. Depending on the risk category of the country of exposure, banks were directed to make provisions, with effect from the year ended March 31, 2003, on the net funded country exposures on a graded scale ranging from 0.25 to 100 per cent. Provisions held for country exposures are allowed to be treated on par with the ‘provisions held for standard assets’ for being reckoned for Tier II capital, subject to the ceiling of 1.25 per cent of the risk weighted assets.

1.51 Subordinated debt issued by banks in the nature of unsecured redeemable bonds currently qualify for inclusion in Tier II capital. Banks were able to utilise long-term resources raised from the market through subordinated debt to enable them to realign their portfolios for asset-liability management.

1.52 Several measures were taken to strengthen the financial position of the urban co-operative banking sector by extending the capital adequacy standards to urban co-operative banks (UCBs), prescribing an asset-liability management framework for the scheduled UCBs, enhancing the proportion of holding of Government and other approved securities by UCBs for the purpose of SLR, besides restriction on bank finance against the security of corporate shares and debentures.

1.53 Management and internal control systems are weak areas in the functioning of UCBs. New urban banks are required to have at least two Directors with requisite professional qualifications or adequate experience in banking. This requirement was extended to the existing UCBs as well. It has been proposed to impose a complete ban on advances by UCBs to

Directors and their specified relatives and to concerns in which the Directors are interested effective October 1, 2003. UCBs which have fully/partially computerised their operations are required to introduce an electronic data processing (EDP) audit system and set up audit committee of the Board for overseeing and providing directions to internal audit/inspection machinery of the UCB. The Audit Committees would examine and follow up observations and suggestions made in the Reserve Bank's inspection report and Statutory Audit reports.

NPA Management

1.54 A broad framework has evolved for the management of NPAs under which a menu of options are provided for debt recovery and restructuring. Banks and financial institutions have the freedom to design and implement their own policies for recovery and write-off incorporating compromise and negotiated settlements. The menu of options available to banks included : (a) reschedulement/restructuring done at bank level; (b) reschedulement/restructuring done through the corporate debt restructuring (CDR) mechanism; (c) resolution/recovery through *Lok Adalats*, civil courts and debt recovery tribunals (DRTs); (d) compromise settlement as per management's own schemes and the Reserve Bank's guidelines for public sector banks; (e) sale of assets to reconstruction companies/ securitisation companies and (f) recovery through powers available under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002.

1.55 The quality and performance of advances have a direct bearing on the profitability and viability of banks. While several measures have been undertaken towards preventing the accumulation of non-performing loans, in the absence of creditor rights, the problem has persisted, despite the credit appraisal and disbursement mechanism in place. To address this aspect, the final guidelines and directions on SARFAESI Act issued in April 23, 2003 cover all aspects relating to asset reconstruction and securitisation. These include, *inter alia*, registration, owned funds, permissible business, operational structure for giving effect to the business of securitisation and asset reconstruction, deployment of surplus funds, internal control systems, prudential norms and disclosure requirements for asset reconstruction/securitisation companies. The Act empowers secured creditors to enforce any security interest created in its favour without any intervention of court or tribunal. The secured creditor may require the borrower to discharge the liabilities within a stipulated time frame from the date of notice, failing which the secured creditor is entitled to take possession or management of the secured assets. In addition to the guidelines and mandatory directions, the Reserve Bank also issued guidance notes of recommendatory nature covering aspects including acquisition of assets and issue of security receipts. It is envisaged that banks would be able to sell their non-performing loans (NPLs) to securitisation/ reconstruction companies at a considerable discount and the resultant shortfall, if any, in the net book value (total assets of banks *less* provisions held), would be required to be debited to the profit and loss account. Banks were accordingly advised to build up provisions, significantly above the minimum regulatory requirements for their NPAs, particularly for those assets which they propose to sell to securitisation/ reconstruction companies.

1.56 Yet another opportunity was provided to borrowers for compromise settlement of chronic NPLs of public sector banks/ FIs up to Rs.10 crore. Fresh guidelines were issued which provide a simplified, non-discretionary and non-discriminatory mechanism for compromise settlement of chronic NPLs. Public sector banks were directed to uniformly implement these guidelines in order to achieve maximum realisation of dues from the stock of NPLs. The processing under the revised guidelines would have to be completed by December, 2003.

1.57 Banks were advised to consider introduction of a new asset category of "special mention accounts" in between "standard" and "sub-standard" accounts for their own internal monitoring and follow-up for assets with potential weaknesses which deserve close attention for resolution through timely remedial action.

Issues in Regulation and Supervision

1.58 The limitations of traditional supervisory practices in the swiftly changing financial environment has provoked supervisors the world over to continuously refine their approaches in consonance with advances in technology, innovations and globalisation. The Reserve Bank's move towards risk-based supervision (RBS), which entails the allocation of supervisory resources and focus in accordance with risk profiles, is part of a forward-looking refinement of the supervisory function which will help in aligning supervised institutions with the New Basel Capital Accord when it is adopted. Drawing on assistance from international consultants and a study of the country-specific requirements as well as the cross-country experience, management processes were initiated in

2002-03 for a smooth switchover to RBS. They covered a discussion paper and analysis of responses thereon, risk profiling, preparation of manuals, training and other requirements. RBS was introduced during April-June 2003 for a few select banks on a pilot basis. Based on the experience gained, RBS would be extended to all banks in a phased manner.

1.59 The scheme of prompt corrective action (PCA), developed as a tool with trigger points for prompt supervisory response was put in place in December 2002 initially for a period of one year. The PCA framework includes structured action by the Reserve Bank when banks hit the trigger points (capital adequacy, NPAs, return on assets). It does not, however, preclude other discretionary corrective steps by the Reserve Bank.

1.60 As a step towards consolidated supervision, guidelines were issued to banks on consolidated accounting and quantitative methods for compliance from the year ended March 31, 2003. Initially, consolidated supervision would be mandated for all groups where the controlling entity is a bank. Over time, entities in mixed conglomerates would be brought under its purview. A critical requirement for supervised entities would be the setting up of appropriate management information systems (MIS) to support compliance with the consolidated accounting and reporting requirements.

1.61 The Reserve Bank, in its endeavor to ensure convergence of its supervisory norms and practices with the international best practices and to align standards adopted by Indian banks with the global standards, constituted a Working Group to eliminate/ reduce gaps in compliance with the Accounting Standards issued by the Institute of Chartered Accountants of India. Based on the recommendations of the Working Group in respect of certain Accounting Standards where there were gaps in compliance, detailed guidelines were issued to banks.

1.62 To enable the regulated entities to manage their exposure to interest rate risk, scheduled commercial banks (excluding Regional Rural Banks (RRBs) and Local Area Banks (LABs), Primary Dealers and specified All India Financial Institutions were allowed to deal in exchange traded interest rate derivatives. In the first phase, these entities are allowed to transact only in interest rate futures on notional bonds and Treasury Bills for the limited purpose of hedging the risk in their underlying investment portfolio.

1.63 Other supervisory initiatives during the year included development of macro-prudential indicators, managing the transition to risk-based internal audit, and computer and information systems audits for inspection in a computerised environment.

1.64 With a view to strengthening supervision of UCBs, the Reserve Bank introduced a system of off-site surveillance. A new system of grading UCBs based on their level of capital to risk weighted assets ratio (CRAR), level of net non perfroming loans (NPLs), record of losses and compliance with liquidity requirements was introduced. A system of supervisory rating for urban co-operative banks under the CAMELS (Capital, Assets, Management, Earnings, Liquidity and Systems) model is envisaged. In order to bring transparency in their balance sheets effective from the year ending March 31, 2003 all urban co-operative banks with deposits of Rs.100 crore and above are required to disclose in notes to their accounts additional specified information. They should also indicate the position of payment of deposit insurance premium to the Deposit Insurance and Credit Guarantee Corporation (DICGC) in their Directors' Report.

1.65 Considerable progress has been made in consolidating the existing payment systems and in upgrading technology with a view to establishing an efficient, integrated and secure system functioning in a real-time environment. Major projects under implementation are electronic clearing, centralised funds management, structured financial messaging solutions and the Indian Financial Network (INFINET). Facilities under Electronic Funds Transfer (EFT) have been upgraded and their spatial reach expanded with multiple settlements in a day. Foreign exchange clearing has been initiated through the Clearing Corporation of India Limited (CCIL). Adequate security features are being incorporated into the EFT. Preparatory work for the real time gross settlement (RTGS) is complete. The live run of RTGS is scheduled towards the end of 2003.

Policies for Financial Markets

1.66 A number of steps were taken during 2002-03 to ensure balanced development of various segments of the financial market with a forward-looking perspective. The Reserve Bank's endeavour has been to develop a competitive and diversified financial market structure catering to various classes of instruments and participants of varying risk profiles, and with different market segments merging seamlessly into a continuum. A key priority is the development of the technological and institutional infrastructure for efficient financial intermediation.

The operationalisation of the CCIL and the negotiated dealing system (NDS), introduction of collateralised borrowing and lending obligation (CBLO), collateralised repo transactions and interest rate options would increase the depth of the financial markets and prepare them for the operationalisation of RTGS.

Money Markets

1.67 A basic objective of money market reforms in the recent years has been to facilitate the introduction of new instruments and their appropriate pricing under orderly market conditions. A crucial prerequisite in this regard is the development of market segments which exclusively deal in specific assets and liabilities as well as participants. Accordingly, the call/notice money market is being transformed into a pure inter-bank market. Systemic stability is being ensured through prudential limits on exposures to the call money market. This was supported during 2002-03 through the rationalisation of standing liquidity support to banks from the Reserve Bank and facilities for exceptional liquidity support.

Government Securities Market

1.68 Initiatives for developing and deepening the government securities market were carried forward alongside a strengthening of regulation and surveillance. An enabling environment for proper investment planning by market participants was fostered by transparent dissemination of prospective issuances of government securities, introduction of new instruments to deal with risks associated with unanticipated market movements, and institution of anonymous screen-based order-driven trading in government securities on the stock exchanges.

Foreign Exchange Market

1.69 Orderly development of the foreign exchange market was pursued in the form of easing of entry restrictions, expanding the freedom of market participants and by creating greater space for the market in general by ongoing liberalisation of international current and capital transactions. Authorised dealers (ADs) in foreign exchange were allowed to offer foreign currency – rupee options and to undertake swaps with residents with unlimited hedging of exchange risk. Forward cover was allowed in respect of a number of capital transactions with greater freedom in the booking of forward contracts.

Capital Market

1.70 Policies for the capital market during 2002-03 were directed towards enhancing market efficiency and achieving better investor protection through greater transparency and improved trading and settlement systems. Important legislative changes with far reaching implications for the functioning of the capital market were initiated by the Government of India. The Securities and Exchange Board of India (SEBI) was vested with search and seizure powers in cases relating to insider trading and market manipulations. The penalties to be imposed by the Adjudicating Officer were enhanced so as to serve as effective deterrents. The Companies (Second Amendment) Act, 2002 was enacted to provide for a new, modern, efficient and time-bound insolvency law for both rehabilitation and winding up of sick companies within a maximum time frame of two years.

1.71 The SEBI introduced compulsory rolling settlement on a T+3 basis effective April 1, 2002. The settlement cycle was further shortened to T+2 basis effective April 1, 2003 with a view to reducing risks in the market and protecting the interest of investors, in line with the international best practices.

1.72 The SEBI accepted the recommendations of the Group on Corporatisation and Demutualisation of Stock Exchanges which recommended, *inter alia*, a uniform model of corporatisation and demutualisation to be adopted for all stock exchanges. With the issue of the SEBI (Central Listing Authority) Regulations, 2003 and formation of Central Listing Authority (CLA), companies are now required to obtain recommendation from the CLA prior to their listing in stock exchanges. The existing list of stocks on which derivatives are traded was enlarged. With a view to developing the derivatives market further, interest rate derivatives were introduced on National Stock Exchange (NSE) with effect from June 24, 2003. Initially, the contracts have been introduced on a notional Government Security with a 10 year maturity and a Notional Treasury Bill with a maturity of 91 days or three months which would be cash settled. The SEBI put in place the risk containment measures to be adopted for such derivatives contracts. With a view to obviating the need for manual entry and re-entry of data on trade particulars which is time consuming and prone to errors, the Straight Through Processing (STP) for electronic trade processing with a common messaging standard was introduced. Based on the recommendations of the Bhagwati Committee, the SEBI made certain amendments to the Takeover

Regulations which include *inter alia* removal of automatic exemption for acquisition through preferential allotment, increased frequency in disclosure of shareholding when it crosses 5 per cent, 10 per cent and 14 per cent. In order to enable the retail investors to participate in trading in government securities, the screen-based retail trading in government securities was launched on January 16, 2003. With this initiative, a major segment of the Indian fixed income securities market, which until recently was dominated by the wholesale investors like banks and insurance companies, was made accessible to the retail investors.

Corporate Governance

1.73 As part of the broader set of reforms aimed at improving the functioning of the securities market, the SEBI has initiated several measures to improve information flow from listed companies. It has also been the endeavour of SEBI to improve corporate governance practices for listed companies so as to infuse a sense of discipline and accountability in the Indian corporate sector.

1.74 During 2002-03, the SEBI amended the Listing Agreement to tighten disclosure norms for companies opting to publish audited results for the entire year within three months instead of publishing unaudited results for the last quarter within 30 days. Norms with regard to disclosure by listed companies in respect of loans/advances and investments, disclosure of audit qualifications and actions thereon, were strengthened. A clause was incorporated in the Listing Agreement requiring the companies to furnish statements and reports for the Electronic Data Information Filing and Retrieval (EDIFAR) system maintained by SEBI.

Mutual Funds

1.75 Various measures have been undertaken to improve the operations and governance of mutual funds. These include, *inter alia,* disclosure of performance of benchmarks, guidelines for valuation of unlisted equity shares, distribution of realisation from non-performing or illiquid assets to old investors after redemptions, emphasis on following the code of conduct and insider trading regulations, uniformity in calculation of sale and repurchase price, increasing the frequency of meeting of trustees, guidelines on risk management norms, increase in the investment limit on foreign securities and mandatory registration of intermediaries engaged in selling and marketing of mutual funds units.

Changes in the Legal Framework

1.76 In the recent period, the progress of financial sector reforms has encountered impediments in the form of the inadequacy of the existing legal infrastructure and its incompatibility with the evolving environment. Changes in financial markets, diffusion of financial innovations and the information technology revolution have sharpened the mismatch between the developments in the financial system and the ambit of regulatory authority of the Reserve Bank. A review of the laws relating to the regulatory responsibilities of the Reserve Bank suggests the way forward in the deepening of reforms in the legal architecture (Box I.3).

Box I.3

Progress in Legislative Reforms

Acts Enacted by the Parliament

- The Negotiable Instruments (Amendments and Miscellaneous Provisions) Act, 2002 effective February 6, 2003 introduces the concepts of 'Electronic Cheque' and 'Cheque Truncation' by expanding the definition of 'Cheque', enhances the punishment for dishonour of cheques, *etc.*
- The SARFAESI Act, 2002 effective June 21, 2002 regulates, *inter alia,* securitisation and reconstruction of financial assets and enforcement of security interest. The Act has also been extended to co-operative banks.
- The Prevention of Money Laundering Act, 2002 effective from January 17, 2003 provides for the legal framework and machinery for combating the menace of proceeds of crime, its circulation, use, attachment, adjudication and confiscation.
- The Multi-State Cooperative Societies Act, 2002 effective from August 19, 2002 in replacement of the Act of 1984 gives more functional autonomy to the Multi-State Co-operative Societies.
- The Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 provides for transfer to and vesting of the undertaking of the Unit Trust of India into a specified company to be formed and registered under the Companies Act, 1956.

Legal Initiatives at Different Stages

- The Fiscal Responsibility and Budget Management Bill, 2000 introduced in the Parliament in December

(Contd....)

(Concld....)

2000 was passed by both the houses of the Parliament. It includes provisions for legal and institutional framework, to bring down the fiscal deficit, contain the growth of public debt, and stabilise the debt-GDP ratio, *etc.*

- The Financial Companies Regulations Bill, 2000 introduced in Lok Sabha on December 13, 2000 includes provisions for regulation of financial institutions, protecting the interests of the depositors, ensuring monetary stability and economic growth and rationalising credit system. The Bill was referred to the Standing Committee on Finance which has submitted its report in June 2003.
- The Banking Companies (Acquisition and Transfer of Undertakings) and Financial Institutions Laws (Amendment) Bill, 2000 was introduced in the Lok Sabha on December 13, 2000 and is pending consideration of the Standing Committee on Finance. The Bill amongst others includes provisions for enabling the Government to supercede the Board of Directors and to appoint Financial Restructuring Authority for the weak banks, reduction of the Government stakes to 33 per cent, introduction of the principles of corporate governance *etc.*
- The draft Payment and Settlement Systems Bill, 2002 for regulation and supervision of the payment and settlement system in the country has been forwarded by the Reserve Bank to the Government.
- The Banking Regulation (Amendment) and Miscellaneous Provisions Bill, 2003 suggesting comprehensive amendments to the Banking Regulation Act, 1949 has been introduced in the Parliament.
- The draft Bill suggesting amendments to the Reserve Bank of India Act, 1934 was forwarded by the Reserve Bank to the Government. The Bill suggests among others, separation of the debt management of the Government from the monetary management, streamlining the CRR, empowering the Bank for electronic transfer of fund and multiple payment system.
- The proposed draft Bill on 'Credit Information Bureau Regulation' envisages that all banks and financial institutions and other institutions as specified by the Reserve Bank or Government, shall become member of at least one Credit Information Bureau.
- The Bank Deposit Insurance Corporation' Bill based on the decision taken by the Bank in the light of recommendations of the joint team of the Government, the Reserve Bank and the DICGC has been forwarded to the Government for their consideration.
- A Bill on Factoring of Debts Due to Industrial and Commercial Undertakings forwarded in April 2002 is under consideration of the Government.

Working Groups on Legislative Reforms

- A Working Group was constituted in the Reserve Bank to examine the provisions of the Negotiable Instruments Act and propose amendment for enabling the banks to make the payment of the cheque to the extent of balance available in the drawers' account. The Group has submitted its report in July 2003.
- A Working Group was formed by the Reserve Bank to examine the existing models of cheque truncation, e-cheques in other countries and to recommend the models for India to lay down the standards and procedures and provide broad rules and regulations for issue of e-cheques, processing, clearing and settlements and other related issues. The Group has submitted its report in July 2003.
- A Working Group was set up to examine the modalities for encouraging bank's investments in Mortgage Backed Securities (MBS) of Housing Finance Companies and widening the investor base, improving the quality of assets and creating liquidity for trading in assets. The Group has submitted its report in December 2002.

1.77 Macroeconomic policy settings for 2003-04 imbibe the positive expectations generated by the strengthening of the fundamentals and the resilience acquired by the economy despite being beset by significant shocks during the year gone by. The prospects for the economy are sanguine with real GDP growth expected to shrug off the loss of momentum and set the stage for a surge to full potential. In the wake of a reasonably good progress of monsoon till July, agricultural output is poised to register a recovery and join industry and services in resumption of trend growth. The smart rebound in exports of merchandise and invisibles in 2002-03 is expected to get entrenched during the year ahead. The experience of the early months of 2003-04 suggests that capital inflows would remain strong. The consequent accretion to international reserves would test the conduct of monetary policy, given its aggressive stance on holding wholesale price inflation. Nevertheless, financial markets would continue to experience ample liquidity conditions and a softening of interest rates. Ongoing fiscal consolidation would be supported by a renewed thrust to intensify and broaden the ambit of structural reforms in pursuit of the goals of the development strategy.

II THE REAL ECONOMY

MACROECONOMIC SCENE

2.1 A broad-based revival in industrial activity and a resurgence of growth in the services sector sustained economic activity in 2002-03. Real GDP originating in industry recovered steadily from the first quarter onwards, surging up towards trend levels on the strength of a rebound in manufacturing. The improvement in services sector GDP growth emanated from construction, 'financing, insurance, real estate and business services' and 'community, social and personal services'. While the return of growth momentum in industry and services augured well for the economy, severe drought conditions impacted on the farm sector in several States, producing a contraction in real GDP originating from 'agriculture and allied activities'. The loss of agricultural output was pronounced from the second quarter onwards, reflecting the full effects of the drought. Moisture stress was of a scale and intensity comparable to the severe drought of 1987 which had resulted in real GDP growth slowing down to 3.8 per cent in 1987-88. Despite the intensity of the supply shock to agriculture, the growth of real GDP at 4.3 per cent in 2002-03 was symptomatic of resilience and a degree of weather-proofing of the economy (Table 2.1, Appendix Tables II.1 and II.2).

AGGREGATE SUPPLY

2.2 Absolute declines in agricultural activity have invariably dragged down overall GDP growth. Although the share of agriculture in real GDP has declined over the years, the share of non-food items in rural expenditure has been increasing. Consequently, compression of rural income in years of poor agricultural performance has delayed effects on aggregate demand. Furthermore, in terms of the backward linkages, the demand from the agriculture sector for industrial inputs are becoming

Table 2.1 : Growth Rates of Real GDP

(Per cent)

Sector	2002-03#	2001-02*	1992-93 to 2000-01 (Average)	2002-03				2001-02			
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9	10	11	12
1. Agriculture and Allied Activities	**-3.2 (22.1)**	**5.7 (23.9)**	**3.0 (27.9)**	**2.7**	**-3.5**	**-7.6**	**-2.8**	**2.6**	**5.6**	**5.9**	**8.3**
2. Industry	**5.7 (21.8)**	**3.2 (21.5)**	**6.6 (22.0)**	**4.3**	**6.2**	**6.2**	**6.2**	**2.4**	**3.0**	**3.5**	**4.0**
2.1 Manufacturing	6.1	3.4	7.2	3.8	6.5	6.7	7.1	2.9	3.1	3.4	4.1
2.2 Mining and Quarrying	5.0	1.0	4.1	7.6	6.0	3.8	3.2	-2.5	-0.2	3.6	2.7
2.3 Electricity, Gas and Water Supply	3.9	4.3	5.9	4.4	4.0	5.0	2.4	3.5	5.0	3.4	5.1
3. Services	**7.1 (56.1)**	**6.5 (54.6)**	**7.7 (50.1)**	**6.8**	**7.8**	**6.4**	**7.5**	**6.0**	**5.8**	**7.7**	**6.3**
3.1 Trade, Hotels, Restaurants, Transport and Communication	7.8	8.7	8.3	6.9	8.1	7.2	8.8	7.7	9.0	8.4	9.7
3.2 Financing, Insurance, Real Estate and Business Services	6.1	4.5	8.1	6.7	7.0	6.3	4.4	4.5	5.0	4.8	3.8
3.3 Community, Social and Personal Services	6.8	5.6	7.3	6.9	7.8	4.6	7.7	6.8	3.1	10.3	3.1
3.4 Construction	7.2	3.7	5.5	6.2	8.6	6.7	7.5	0.3	1.3	5.5	7.5
4. GDP at factor cost	**4.3 (100.0)**	**5.6 (100.0)**	**6.1 (100.0)**	**5.3**	**5.2**	**2.3**	**4.9**	**4.4**	**5.1**	**6.3**	**6.3**

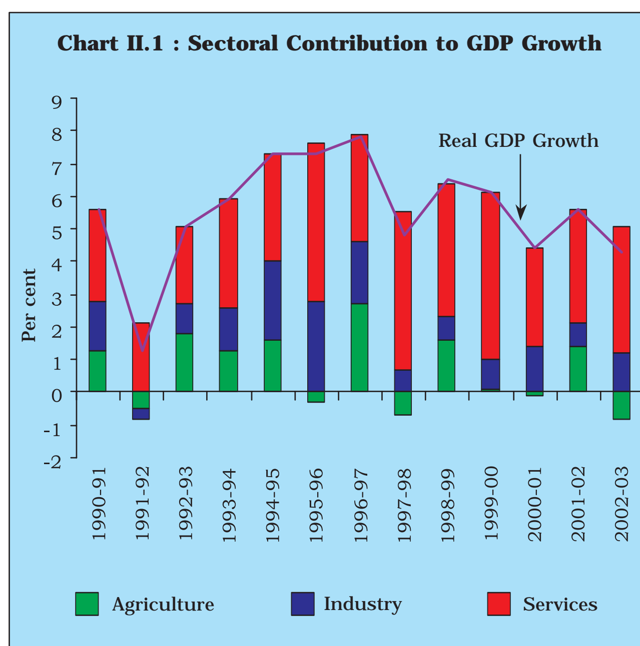
* Quick Estimates. # Revised Estimates.

Notes : 1. Figures in brackets denote shares in real GDP.
2. Q1 : First Quarter (April-June); Q2 : Second Quarter (July-September); Q3 : Third Quarter (October-December); Q4 : Fourth Quarter (January-March).

Source : Central Statistical Organisation.

progressively significant. The marginal and small farmers have also substantially increased their usage of purchased inputs such as HYV seeds and pesticides, irrigated water and fertilisers. Moreover, the ratio of net irrigated area to the net sown area is around 40 per cent for marginal holding brackets. Nearly two-third of the area operated by the marginal and small farmers is treated with fertilisers, which is less than 50 per cent for the medium farmers and roughly 39 per cent for the large farmers. Under the circumstances, sustainability of the momentum of growth in industry and services depends upon stabilisation of rural demand and recovery in agricultural activity. The share of industry in GDP has stagnated since 1997-98, bound by the downswing in the business cycle and manifested in inventory accumulation, unutilised capacity, restructuring and organisational change. Services have been the principal engine of growth (Chart II.1).

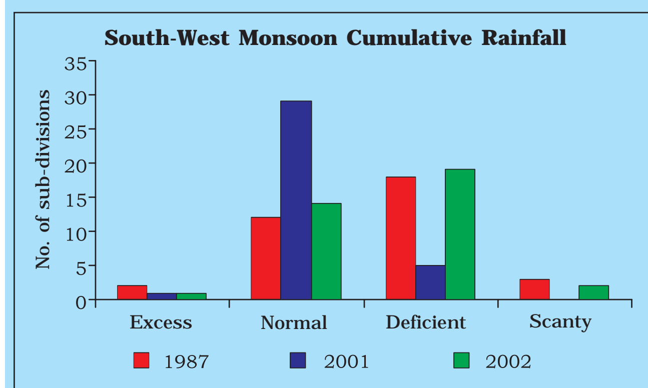
Chart II.1 : Sectoral Contribution to GDP Growth

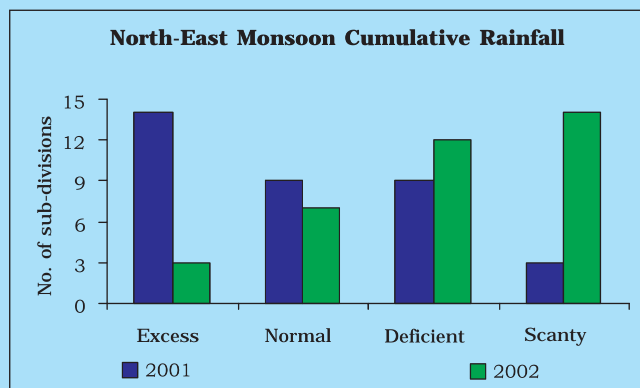


Agriculture

2.3 Indian agriculture experienced one of the worst droughts in 2002-03. A long, dry spell beginning in July 2002, a crucial month for sowing and plant growth, culminated in rainfall during the South-West monsoon season being at only 81 per cent of the Long Period Average (LPA). Acute moisture scarcity prevailed in various parts of the country with the failure of the South-West monsoon after a spell of 14 years. The sowing month of July, which normally receives 30 per cent of the season's rain, suffered a shortage of about 49 per cent. Only 15 out of 36 meteorological sub-divisions in the country received normal to excess rainfall, a situation last experienced in the drought of 1987. The live storage level in the 70 major reservoirs across the country was less than 50 per cent of the designed storage levels at the end of the season. The retreating monsoon (North-East monsoon) was delayed and inadequate with the cumulative rainfall in 26 sub-divisions being deficient to scanty (Chart II.2). The Government quickly initiated several policy measures to mitigate the severity of the drought. A Task Force on Drought was set up to oversee the relief measures. Additional quantities of foodgrains were allocated to various States as part of the food for work programme, besides ensuring supplies of fodder for cattle. Measures were initiated to provide employment and purchasing power for the drought affected people. Furthermore, waiver of interest on *kharif* loans and rescheduling of crop loans into terms loans were announced. In addition, specific fiscal measures were initiated in the form of a grant of input subsidy to small and marginal farmers.

Chart II.2 : Rainfall Conditions





Production

2.4 The production of foodgrains and non-foodgrains was adversely affected almost across-the-board with the fall in *kharif* output sharper than that of *rabi* (Appendix Table II.3). Rice and coarse cereals were particularly affected by drought conditions. Oilseeds production declined mainly on account of dip in the production of groundnut, rapeseed/mustard and soyabean. The index of agricultural production (base: triennium ending 1981-82 = 100) recorded the steepest decline since 1979-80 (Table 2.2).

2.5 India is the second largest producer of rice and wheat in the world, first in the production of pulses and fourth in coarse grains. A distinct bias in agricultural price support policies in favour of rice and wheat has, however, distorted cropping pattern and input usage. The market for farm output continues to be subject to heavy procurement interventions. While the minimum support price policy needs to be assessed in terms of the producer equivalents that it generates in the face of the adverse terms of trade confronting the farmer, the distortion in relative prices of crops in favour of rice and wheat has induced a highly skewed cropping pattern, adverse distribution of rural incomes and ecological damage to arable land resources. In the post-reform period, the terms of trade have moved favourably, reducing the implicit tax on agriculture and creating the pre-conditions for a withdrawal of these interventions. The need for developing an institutional framework for agricultural product markets as a concurrent requirement for phasing out the MSP assumes critical importance on the agenda for future reforms in agriculture.

Table 2.2 : Agricultural Production

Crop	2002-03 AE	2001-02	2000-01
1	2	3	4
1. **Growth Rate $** (Per cent)			
All Crops	**-12.6**	**7.0**	**-6.3**
a) Foodgrains	-14.6	8.4	-6.7
b) Non-foodgrains	-9.5	4.8	-5.7
2. **Production** (Million Tonnes)			
a) Foodgrains	**182.6**	**212.0**	**196.8**
i) Rice	75.7	93.1	85.0
ii) Wheat	69.3	71.8	69.7
iii) Coarse cereals	26.2	33.9	31.1
iv) Pulses	11.3	13.2	11.1
b) Non-foodgrains			
i) Oilseeds + +	15.8	20.8	18.4
ii) Sugarcane	278.6	300.1	296.0
iii) Cotton @	9.3	10.1	9.5
iv) Jute & Mesta +	10.8	11.6	10.6
v) Tea *	N.A.	847.3	848.4
vi) Coffee *	275.3	300.6	301.2

AE Advance estimates as on July 1, 2003.
$ Based on Index of Agricultural Production with base: triennium ending 1981-82 = 100.
++ For nine oil seeds out of eleven in all.
+ Million bales of 180 kg. each.
@ Million bales of 170 kg. each.
* Million kilograms and data for tea on a calendar year basis.
N.A. Not Available.
Source : Ministry of Agriculture, Government of India; Tea Board; and Coffee Board.

2.6 In recent years, there has been considerable emphasis on crop diversification in favour of horticulture (fruits, vegetables, ornamental crops, medicinal and aromatic plants, spices), plantation crops (coconut, cashew nut and cocoa) and allied activities. This process has been facilitated by the creation of critical infrastructure for cold storage, refrigerated transportation, rapid transit, grading, processing, packaging and quality control. India is the largest producer of coconut, areca nut, cashew nut, ginger, turmeric, black pepper and the second largest producer of groundnut and fruits and vegetables. India accounts for about 10 per cent of the world fruit production with the country ranking first in the production of mango, banana, sapota and acid lime. Milk production estimated at 84.6 million tonnes is the highest in the world. India is also the fifth largest producer of eggs and seventh in the production of meat. It is important to explore new frontiers in technology focusing on evolving location-specific and economically viable varieties of agricultural and horticultural crops by leveraging developments in the field of bio-technology.

2.7 Sharp fluctuations in agricultural activity in India have characterised the past decade with agriculture making a negative contribution to real GDP growth (17 per cent in 2002-03) for the fifth year since 1990-91. Gross domestic capital formation in agriculture has undergone a secular decline brought about by a steady erosion in the share of public investment. The increase in private sector capital formation has been concentrated in areas where water, power and other inputs are available uninterruptedly and with large subsidy. The inadequacy of private investment in filling capital requirements of agriculture has raised concerns about the widening gaps in rural infrastructure which could become binding constraints on growth. Irrigation coverage remains distinctly lower than the potential in terms of the gross cropped area. Village electrification has been inadequate in its coverage and this has affected the expansion of irrigation coverage, processing industries and cold storages. Poor rural road connectivity and insufficient rural markets are other major infrastructure constraints (Box II.1).

Box II.1
Building Rural Infrastructure

High variability in agricultural output and low productivity levels are symptomatic of the widening gaps in the rural physical and social infrastructure. Rural economic infrastructure, which includes irrigation structures, agricultural research and extension, transport infrastructure, electricity, storage structures, telecommunication services and market yards directly enhances the productivity of physical resources. Social infrastructure, *viz.,* drinking water supply systems, sanitation systems (drainage and sewerage), health care services and education improve the efficiency of human capital and also are desirable *per se*.

The current scenario of rural infrastructure is far from encouraging on account of the fact that only about 40 per cent of the net cultivated area is irrigated; technology adoption in agriculture is hampered by the 'weak' quality of research effort and extension systems; only about 60 per cent of our villages are connected by all-weather roads; rural markets are still inadequate and lead to delays in selling the farm produce; 100 per cent 'village electrification' is evident in only ten states with nearly 13 per cent of villages without electricity; only about 75 per cent of the rural habitations had 'full' access to drinking water supply; and rural literacy is still low.

The State Governments, vested with the jurisdiction of most of the rural infrastructure, have adopted a supply-oriented approach to 'public provision' of rural infrastructure services using budgetary resources. The Operation and Maintenance (O & M) of such investments is mostly vested with public agencies. The charges levied for the services have been low (or nil in some cases). Furthermore, the decentralisation of provision of infrastructure services to local bodies, as envisaged in the 73rd Constitutional Amendment Act 1992, is yet to be implemented by some of the States.

Key issues identified in building some of the rural infrastructure are:

- *Irrigation Infrastructure* - increasing public investments, higher allocation for quicker completion of ongoing projects, promoting private initiatives, encouraging users' participation in irrigation management and effective pricing of water so as to recover at least the O&M cost.
- *Agricultural Research and Extension* - privatisation of the agricultural extension system through the promotion of agri-clinics and agri-business centres for enhanced technology dissemination.
- *Electricity* - identification of feasible alternative sources of power, promoting private participation in the production and distribution, appropriate pricing and reducing the transmission and distribution (T&D) losses.
- *Transport Infrastructure* - connecting every village by all-weather roads through higher investments for developing roads and providing adequate funds for the operation and maintenance of all roads.
- *Marketing Infrastructure* - modification of the State Agricultural Produce Marketing Act to promote private initiative in providing such infrastructure.
- *Storage Structures* - stepping up initiatives for setting up of cold chain storage and warehousing.
- *Drinking Water Supply Systems* - greater community participation in the process of selecting, financing and operating systems that meet demand and willingness to pay.
- *Education Infrastructure* - establishing more number of rural schools, devolving the maintenance and the regulation of the schools on the local institutions of self-government, linking Government grants to performance, facilitating private initiatives, and promoting independent and competing agencies for rating, certification, accreditation and examination.
- *Rural Housing* - legal and regulatory reforms to facilitate higher housing acitivity by the private and the co-operative sector to achieve the National Housing and Habitat Policy 1998 objective of 'housing for all' by 2010.

Tapping technological and organisational innovations such as the 'unbundling of services', and 'low-cost supply options' to make the investments in the rural infrastructure commercially viable, privatisation as one of the instruments of commercialisation, promoting users' participation to ensure 'optimal' use and maintenance of resources and appropriate pricing are some of the critical issues. Priority to investments in (new and upgradation of existing) rural roads, agricultural research and development, education, and creation of additional irrigation facilities, in that order, would have the greatest impact on productivity, growth and poverty alleviation.

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2.8 Private participation in food processing and extension services could provide insurance against risks to the farmers through longer-term supply contracts. Development of futures markets in agricultural commodities enables hedging of price risks faced by farmers (Box II.2).

Box II.2
Futures Trading in Agricultural Commodities

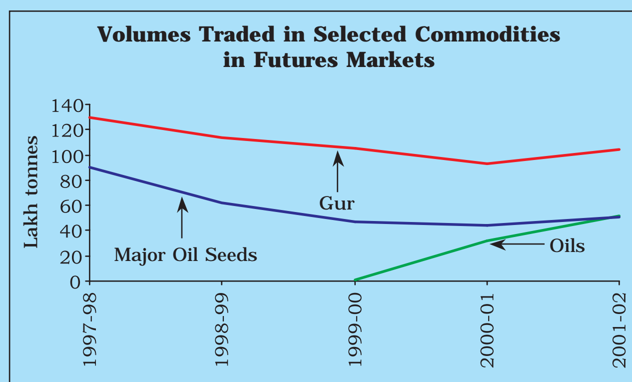
Commodity futures hedge the risks faced by farmers and agricultural trade functionaries from seasonal and cyclical fluctuations in the prices of agricultural commodities. Futures markets perform the two important functions of price discovery and price risk management, facilitating rational production and distribution decisions. They act as a price barometer, helping to stabilise the amplitude of price variations and create an integrated price structure throughout the country.

Internationally, FT is allowed in a range of commodities and even in a number of non-commodities such as a weather indices and pollution permits. In some major derivative exchanges such as the Chicago Board of Trade (CboT) and the London Inter-Bank Financial Futures Exchange (LIFFE), there is a convergence of futures markets with freedom to trade in all types of derivatives. Some of the best practices followed internationally include daily clearing, margining, creation of trade guarantee fund, transparency in trade and management practices to ensure market integrity and strict monitoring and surveillance of the trade in the exchange. With the globalisation of financial markets, significant developments are taking place in the international arena in terms of electronic trading, internet based commodity exchanges and electronic communication networks (ECNs) using multiple products and combination of networks as competitors to exchanges. There are increasing alliances, often international, to compete effectively with exchanges and ECNs.

The first ever organised futures market in India evolved with the setting up of the Bombay Cotton Trade Association Limited in 1875. The Forward Contract Regulation Act (FCRA) was enacted in December 1952, providing an institutional framework for the evolution of futures markets in India. During the 1960s and 1970s, however, FT was either suspended or prohibited. The Khusro Committee (June 1980) recommended the reintroduction of futures trading in major commodities. On the recommendations of the Kabra Committee in 1993, the Government of India permitted futures trading in a large number of commodities. There are, at present, 22 exchanges in the country and all commodities have been permitted to be traded in futures. International futures markets in pepper and castor oil were developed by upgrading the existing exchanges at Kochi and Mumbai, respectively. A Multi-commodity Nationwide Exchange has also been started in Ahmedabad. There has been a good response in terms of volumes traded, price discovery and evening out of price fluctuations in 2001-02 (Chart).

Indian commodity futures markets are still at a nascent stage. They are dispersed and fragmented with small turnover and catering to separate trading communities in different regions. Apart from physical/ infrastructural constraints such as limited online trading, online surveillance and monitoring, the non-availability of a fool proof legal system of contracts relating to the warehouse receipt system is impeding the development

Volumes Traded in Selected Commodities in Futures Markets



of futures markets in India. Furthermore, the hawala markets, which have been operating since decades, trade 20-30 times the volume of official future exchanges. They are often localised, operating with low transaction costs and hence attract many speculators and small hedgers. Efforts are being made to bring informal forward trading into the ambit of the Forward Markets Commission to ensure their orderly integration with the formal marketing structure. Efforts have also been made by the Government and Forward Markets Commission to improve the infrastructure and trade practices in commodity exchanges. Some of the exchanges have been encouraged to adopt screen-based on-line trading systems and best international trade practices. Convergence of markets for commodity derivatives and security derivatives is a recommended objective, with all existing restrictions under the Essential Commodities Act (1955) removed.

Effective co-ordination and interface between the exchanges, banks and the warehousing agencies is crucial in evolving the necessary framework for a mature warehousing system based on legally enforceable contracts and supporting transferability and negotiability. There is need to calibrate proper incentive structure by minimising the stamp duties imposed by the State Governments and changing the income tax laws suitably as is being felt in several corners. Granting industry status to commodity futures can improve access for participants to institutional funds for their working capital. Participation in commodity futures market needs to be enlarged by including mutual funds, financial institutions and foreign institutional investors under appropriate regulatory supervision.

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2.9 The World Trade Organisation (WTO)'s Agreement on Agriculture (AoA) sets specific implementation periods for developed and developing countries regarding various commitments for reducing trade-distorting subsidies and improving market access. The Fourth WTO Ministerial Conference held in November 2001 in Doha, Qatar reconfirmed these commitments, enjoining members to firm up modalities before March 31, 2003 for final negotiations to be concluded by January 1, 2005. At the Tokyo Summit in March 2003, however, members failed to reach an agreement on the modalities for agriculture, underscoring the wide differences among the negotiating parties which impede the progress towards a multilateral system of trade in agriculture The final deadline for reaching a consensus is January 1, 2005 (Box II.3).

Box II.3

WTO and Agriculture : The Road Ahead

Under the market access provisions of the Agreement on Agriculture (AoA), members are required to reduce the total Aggregate Measure of Support (AMS) - by 20 per cent for the developed countries over a period of six years and 13.3 per cent for the developing countries over a period of ten years - so as to reach the AMS levels of the base period (1986-88). For most developing countries including India, however, base AMS levels were negative, while base AMS for most of the developed countries was high. Consequent upon the WTO bindings, there was some reduction in AMS. Nonetheless, the support to agriculture remains high, particularly in many of the industrialised countries. This has hindered market access for developing countries. The Doha declaration provided a fresh impetus to the negotiations on agriculture on these issues. The success of these negotiations, however, depends heavily on the willingness of major Organisation for Economic Co-operation and Development (OECD) countries to undertake trade liberalisation.

Another contentious issue is the structuring of subsidies. Export subsidies, input subsidies for fertilisers and electricity, concessional interest rates and market price support are deemed to be trade distorting by the AoA and hence are to be reduced. The organisation of subsidies in various Boxes under the AoA favours developed countries. For instance, direct payments to farmers in the USA in the form of deficiency payments are considered to be minimally trade distorting and do not attract reduction commitments. On the other hand, input and export subsidies in India are subject to reduction commitments. India is gradually reducing input subsidies, such as those on fertilisers. The USA, however, has substantially increased farm support by passing the Farm Security and Rural Investment Act in 2002.

The implementation of Sanitary and Phyto-Sanitary (SPS) and Technical Barriers to Trade (TBT) provisions of WTO are being utilised to create trade barriers for the developing countries by some of the developed countries. For instance, the official norm of WTO for aflatoxin content in groundnut of 15 parts per billion (ppb) is superceded unilaterally by the European Union's (EU) requirement of 4 ppb. Thus, even if Indian production matches the WTO norms, the EU norm will act as a barrier to trade for Indian groundnut. Furthermore, conforming to the EU norms entails massive investments in Hazard Analysis and Critical Control Points (HACCP) methods which are highly capital intensive and automatically preclude many small exporters from developing countries. The Doha declaration makes Special and Differential (S&D) treatment for developing countries an integral part of the negotiations. India attaches the highest priority to Special and Differential (S&D) provisions and wants early discussions on such crucial issues as Sanitary and Phyto-Sanitary (SPS) and Special Safeguard Measures (SSM). In a recently held mini-Ministerial meeting in Egypt, India made a strong pitch for special window under the AoA to provide for S&D treatment by way of SSM and other such measures which would be paramount in safeguarding the interest of Indian farmers. India is of the view that if these negotiations are to progress, the high levels of ambitions in terms of market access have to be tempered and special windows in terms of effective S&D measures have to be provided.

There are sharp differences relating to the modalities to be adopted for negotiations. India, along with EU and at least 75 other countries, prefer the Uruguay Round (UR) formula of request-offer approach under which countries could adopt a wait-and-watch approach and take their decisions based on the offers made by the developed countries in the area of market access. It is felt that this approach can take care of the special needs of the developing countries. The US and the Cairns group (Australia, New Zealand, *etc.*), on the other hand, back the Swiss formula which calls for steeper reduction in commitments wherever the existing tariff levels are higher than the norm.

In an attempt to bridge the *impasse*, the chairperson of WTO Committee on Agriculture, Mr.Stuart Harbinson, prepared a Draft Paper on modalities in February 2003, which separated commodities into three categories for tariffication broadly in agreement with the Swiss proposals. The Draft Paper also proposed that the domestic support in the form of Blue Box payments – which EU liberally uses – be reduced to 50 per cent in five years. Furthermore, the aggregate support including input and price subsidies are to be cut by 60 per cent over a similar period and export subsidies are to be phased out completely in nine years. Members, however, failed to agree on the Draft Paper.

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Given the present state of the negotiations under the WTO, it is believed that India should aim at improving agricultural export competitiveness vigorously to compensate for the slow progress on market access and AMS. In the interregnum, domestic agricultural production will continue to require support under a judicious mix of public policy intervention and incentives for private participation in the modernisation of Indian agriculture.

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Food Management: Procurement, Off-take and Stocks

2.10 Foodgrain procurement was lower in 2002-03, reflecting the drought conditions. Wheat procurement was highest in Punjab (9.86 million tonnes), followed by Haryana (5.89 million tonnes) and Uttar Pradesh (2.29 million tonnes). Rice procurement was highest in Punjab (7.82 million tonnes comprising 2.61 million tonnes by the Food Corporation of India and 5.21 million tonnes by the State agencies), followed by Andhra Pradesh (1.69 million tonnes), Haryana (1.30 million tonnes) and Uttar Pradesh (1.23 million tonnes).

2.11 Off-take, on the other hand, was significantly higher, mainly on account of Open Market Sales (OMS) including exports, 'food for work' schemes and other welfare schemes (OWS). Higher off-take through the PDS and OWS was facilitated by lowering of issue prices under Targeted Public Distribution System (TPDS) for Above Poverty Line (APL) families, and by increasing the monthly allocation for APL, Below Poverty Line (BPL) families and Antyodaya families. As part of drought relief measures, the Central Government allocated 8.3 million tonnes of foodgrains to the drought affected States; of this 4.7 million tonnes were lifted during 2002-03.

2.12 Foodgrain stocks (including coarse grains) with the FCI went down rapidly as a result of the higher off-take. The decline in foodgrains stocks resulted in lower levels of food credit availed by the FCI. Substantial expansion in off-take entailed higher food subsidies (Table 2.3 and Appendix Table II.4).

Table 2.3 : Management of Food Stocks

(Million Tonnes)

Month	Opening Stock of Food-grains	Buffer Stocking Norm $	Food-grains Procure-ment	Foodgrains off-take				Closing Stock	Food Credit @	Food Subsidy #
				PDS	OWS	OMS (excluding Exports)	Exports			
1	2	3	4	5	6	7	8	9	10	11
April 2002	51.0	15.8	14.3	1.2	0.4	0.2	1.0	62.6	52,484	1,754
May	62.6		6.1	1.5	0.8	0.2	1.2	64.8	60,669	1,632
June	64.8		2.5	1.6	1.3	0.2	0.9	63.1	61,008	1,703
July	63.1	24.3	0.2	1.5	0.6	0.4	1.1	59.9	59,077	2,490
August	59.9		0.2	1.8	0.5	1.1	1.5	55.4	56,400	1,734
September	55.4		0.6	1.5	0.5	0.7	1.4	51.4	53,362	2,283
October	51.4	18.1	7.1	1.8	1.2	0.7	0.9	53.6	52,705	2,601
November	53.6		1.3	1.5	0.8	0.4	0.8	51.5	54,346	1,924
December	51.5		1.3	2.0	1.2	0.4	0.9	48.2	51,947	2,653
January 2003	48.2	16.8	2.0	1.8	1.3	0.8	0.8	40.1	49,784	2,261
February	40.1		1.4	2.1	1.1	0.4	0.9	36.2	50,227	23
March	36.2		0.9	1.9	1.7	0.3	1.1	32.8	49,479	3,117
April	32.8	15.8	13.1	1.4	0.9	0.2	0.6	41.3	44,589	1,462
May	41.3		3.6	1.8	1.6	0.1	0.9	39.8	51,047	2,209
June	39.8		1.0	1.2	2.5	0.2	1.1	35.2	50,066	2,830

$ Represents the total minimum stocks to be maintained by public agencies on the first day of the quarter under buffer stocking policy with effect from October 30, 1998.
@ Outstanding in Rupees crore as on the last reporting Friday of the month.
# Monthly expenditure on food subsidy in Rupees crore.
PDS : Public Distribution System. OWS : Other Welfare Schemes. OMS :Open Market Sales.
Source : Ministry of Food, Consumer Affairs and Public Distribution; Ministry of Finance, Government of India.

2.13 The system of procurement at assured price, buffer stocking and public distribution has locked up large resources - in the form of both explicit and implicit subsidies - which in turn has affected public sector capital formation in agriculture. Recognising the associated fiscal costs, the Expenditure Reforms Commission recommended that all input subsidies be phased out and a buffer stock of 10 million tonnes, comprising four million tonnes of wheat and six million tonnes of rice be maintained, as adequate from the stand point of national food security. As against the quarterly norms for buffer stocks at 15.8 million tonnes at end-March as recommended by 4th Technical Group appointed by the Government of India, the actual stocks averaged at 35.9 million tonnes in the last five years.

Industry

2.14 A modest revival in industrial activity which set in by March, 2002 permeated all segments during 2002-03, with manufacturing contributing more than 80 per cent of the overall growth of industrial production. Strengthening signs of resumption of investment demand were evident in a sharp rise in the production and imports of capital goods. The industrial recovery enabled a robust expansion in exports of manufactures in spite of the slack in global demand, and triggered a coincident upswing in non-food credit from the banking system. Business confidence improved in all sectors against the backdrop of a distinct improvement in the financial performance of the corporate sector, slowing down of inventory accumulation, and an expansion in capacity utilisation and order books. Industrial activity was broadly insulated from the impact of the drought, except in the durable consumer goods segment where the compression of income affected production.

2.15 The Index of Industrial Production (IIP) rose through the first half of 2002-03 boosted by rural demand in the wake of the *rabi* harvest, before levelling off in the second half of the year. The growth of manufacturing peaked in September 2002, driven up by resumption of export demand in a wide range of industries. The growth in mining and quarrying reached a high in July 2002. The growth of electricity remained broadly unchanged, despite the persistence of demand-supply gaps (Chart II.3 and Appendix Table II.5).

Manufacturing Sector

2.16 Industrial performance is dominated by the behaviour of manufacturing. In 2002-03, it was the distinct improvement in manufacturing which led the industrial recovery, contributing as much as 86.2 per cent of the growth of overall industrial production. Improvement in manufacturing activity was diffused across most of the constituent 17 two-digit industry groups (Table 2.4).

Chart II.3 : Sectoral Growth of IIP

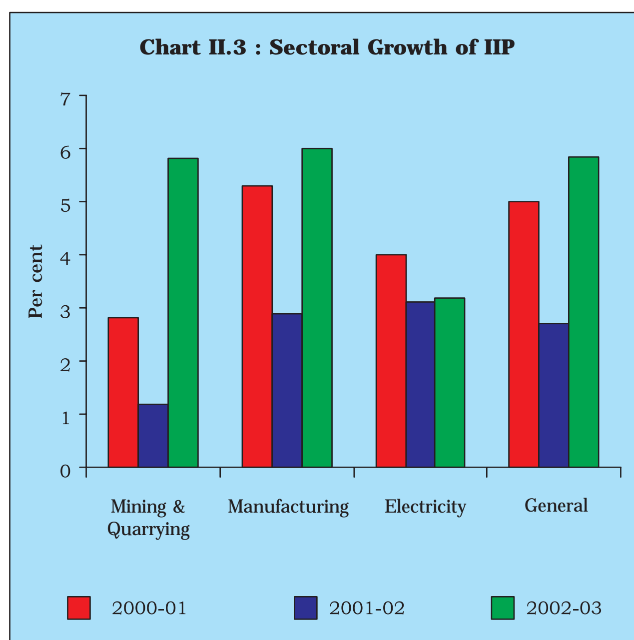


Table 2.4 : Growth Performance of Two-digit Manufacturing Groups

Performance	2002-03		2001-02	
	No. of Groups	Weight * (per cent)	No. of Groups	Weight * (per cent)
1	2	3	4	5
Acceleration	10	45.45	5	20.87
Deceleration	4	24.55	7	37.79
Negative	3	9.36	5	20.70

* Refers to weight in IIP

Source : Based on data from the Central Statistical Organisation.

2.17 Leading the upsurge in manufacturing were five industry groups comprising 'beverages, tobacco and related products', 'basic chemicals and chemical products', 'food products', 'transport equipment and parts' and 'basic metal and alloy' industries (Appendix Tables II.6 and II.7). These industry groups contributed 75.3 per cent of the growth in the manufacturing sector. The improvement in the production of 'beverages, tobacco and related products', 'basic chemicals and chemical products' as well as 'food products' was mainly export-driven. These industries benefited from policy initiatives for the setting up of food parks to foster entrepreneurial

activity in areas relating to cold storage, warehousing, quality control laboratories, effluent treatment plants and other ancillary activity. Food processing, vegetable oils and vanaspati industries exhibited a distinct pick-up in credit demand. The improvement in the performance of basic metals and alloy industries mainly reflected the turnaround in the steel industry during the year. The domestic steel industry received a stimulus from the increase in international prices as well as from the highway construction under the National Highway Authority of India (NHAI) for the 'golden quadrilateral'. Exports of iron and steel increased by 100.3 per cent during 2002-03, reversing the decline of 12.7 per cent in the previous year. Competitive reductions of interest rates on automobile loans combined with buoyant external demand enabled an expansion in the production of transport equipment industries.

2.18 The expansion in export orders also had a salutary effect on the moderate performers in the manufacturing sector such as readymade garments, man-made yarn, fabrics, made-ups and textiles products. The surge in construction activity on account of increased demand for cement from housing and highway construction buoyed up activity in non-metallic mineral products industries and led to improved capacity utilisation. Paper and paper products and printing, publishing and allied industries also increased capacity utilisation in response to increased demand in the upstream market. Foreign equity participation up to 100 per cent under the automatic route is allowed in these industries. Production levels in leather and fur products industries suffered due to a decline in export demand. Other industries which experienced decline in activity were ‘wood and wood products, furniture and fixtures’ and ‘cotton and cotton textiles’.

2.19 The financial performance of the companies also markedly improved during 2002-03. Abridged financial results of sample companies showed a pick up in sales and a sustained decline in interest burden, leading to a surge in post tax profits (Table 2.5).

Table 2.5 : Growth Rates of Select Indicators of Financial Performance

(per cent)

Item	Quarter 1		Quarter 2		Quarter 3		Quarter 4	
	2002-03	2001-02	2002-03	2001-02	2002-03	2001-02	2002-03*	2001-02
1	2	3	4	5	6	7	8	9
Number of Companies	1,236	1,372	1,214	1,257	1,264	1,335	1,010	1,185
Sales	7.6	7.4	9.6	-0.8	10.8	0.3	15.2	3.6
Total Expenditure	7.6	6.8	9.2	-0.8	9.9	1.1	14.6	5.2
Gross Profits	8.5	5.5	9.4	3.0	17.6	-5.5	18.4	0.1
Interest	-8.2	5.6	-9.5	-0.1	-11.2	-2.5	-12.5	-15.2
Profits After Tax	17.9	4.6	18.7	2.8	41.7	-13.6	34.0	14.5

* Provisional

Use-based Classification

2.20 The demand composition of industrial production reveals that consumer non-durables production rose sharply and accounted for nearly half of the growth in the IIP, followed by basic goods (Appendix Table II.8). A positive development in 2002-03 was the significant turnaround in capital goods production after an absolute decline in the preceding year. Along with the accompanying expansion of 29.0 per cent in the import of capital goods, this improved the prospects of fresh capital infusion and strengthening of demand after a hiatus covering the second half of the 1990s up to the preceding year. Intermediate goods shared in this expansion *albeit* on a more moderate scale. Production in the consumer durables segment declined reflecting weak demand, particularly the slowdown of rural demand (Table 2.6). Industrial outlook surveys pointed to the domestic economic scenario as being the principal limiting factor on consumer expectations in this segment.

Table 2.6 : Growth of IIP (Use-based Classification) and Sectoral Weighted Contribution to IIP

(Per cent)

Sector	Growth Rate		Weighted Contribution to IIP Growth	
	2002-03	2001-02	2002-03	2001-02
1	2	3	4	5
Basic Goods	4.9	2.6	27.1	31.9
Capital Goods	10.5	-3.4	15.9	-11.6
Intermediate Goods	3.9	1.5	19.6	16.1
Consumer Goods	7.1	6.0	37.4	63.7
i) Consumer Durables	-6.3	11.5	-8.7	31.4
ii) Consumer Non-durables	12.0	4.1	45.9	32.4

Source : Based on the data from the Central Statistical Organisation.

Infrastructure Industries

2.21 A larger number of infrastructure industries achieved their production targets set for 2002-03 than in 2001-02. Performance remained below targets in power, finished steel, crude petroleum, fertilisers and petroleum refinery products. The domestic civil aviation sector operated significantly below capacity (Table 2.7).

2.22 Despite some shortfalls *vis-a-vis* the targets in key infrastructure industries, there was an overall

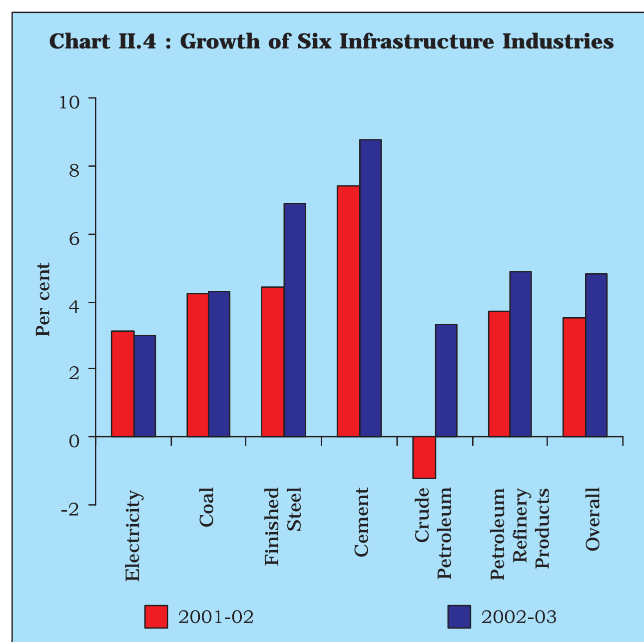
Table 2.7 : Targets and Achievements of Infrastructure Industries

Sector	Unit	2002-03			2001-02		
		Target	Achieve -ment	Gap (%)	Target	Achieve -ment	Gap (%)
1	2	3	4	5	6	7	8
1. Power	Billion Unit	546	531	-2.6	540	515	-4.5
2. Coal	Million Tonnes	332	337	1.5	323	323	-0.1
3. Finished Steel (Main and Secondary Producers)	Thousand Tonnes	36,885	34,377	-6.8	35,079	31,625	-9.8
4. Railways	Million Tonnes	515	518	0.7	489	493	0.7
5. Shipping (Major Ports)	Million Tonnes	296	313	5.9	289	288	-0.5
6. Fertilisers	Thousand Tonnes	16,435	14,440	-12.1	16,589	14,628	-11.8
7. Cement	Million Tonnes	115	116	0.8	105	107	1.8
8. Crude Petroleum	Million Tonnes	33.3	33.1	-0.6	33	32	-1.4
9. Petroleum Refinery Products	Million Tonnes	117	113	-3.7	114	107	-5.5
10. Civil Aviation (International)*	Lakh No.	112	123	9.9	112	117	4.5
11. Civil Aviation (Domestic)*	Lakh No.	215	170	-20.6	215	155	-27.9

* Refers to capacity in the column for 'Target'.
Source : Ministry of Statistics and Programme Implementation, Government of India.

improvement in production conditions in infrastructure during 2002-03 (Chart II.4 and Appendix Table II.9). Improved growth in the finished steel industry was facilitated by strong external demand. On the other hand, the acceleration in the cement sector was mainly driven by domestic demand emanating from the growth in construction and housing. Electricity, on the other hand, continued to show low growth.

Chart II.4 : Growth of Six Infrastructure Industries



2.23 A significant element of the Central Government's initiative towards infrastructural development is the implementation of Central Sector Projects (CSPs). CSPs have been initiated in the power, petroleum and coal sectors, although most of these projects relate to the railways and, in the more recent period, to the surface transport sector. The total number of delayed CSPs increased in June 2003 (Table 2.8). According to the Ministry of Statistics and Programme Implementation, the major reasons for delays in the completion of projects are absence of proper techno-economic studies before sanctioning projects, inadequacy of financial resources, delays in acquisition of land, problems relating to award of contracts, poor performance of consultants, vendors and contractors, delays in obtaining clearances, inadequate infrastructure support and poor law and order situations in certain parts of the country. Railway projects, in particular, were affected by inadequate pre-project surveys, funds shortages and problems relating to civil works and acquisition of land. There was also a substantial

Table 2.8 : Performance of Central Sector Projects

	June 2003	June 2002	June 2001
1	2	3	4
Ahead	42	77	5
On Schedule	70	71	54
Delayed	93	61	56
Without O.D.C and D.O.C	59	69	74
Total	**264**	**278**	**189**
Cost Overruns of Delayed Projects (Rupees crore)	26,258	24,326	21,957
Cost Overruns of Delayed Projects (as % of Original Cost of such projects)	59.0	60.2	76.0

Notes : ODC : Original Date of Commissioning.
DOC : Date of Commissioning.
Source : Ministry of Statistics and Programme Implementation, Government of India.

setback in the progress of the projects under the NHDP since February 2003 (particularly in Uttar Pradesh, Orissa, Tamil Nadu and Karnataka). Of the total cost overrun in respect of delayed projects, the power sector accounts for around 52 per cent of the total cost overrun in respect of delayed projects.

2.24 Sustainable growth hinges around the existence of a critical minimum in terms of the availability of the physical infrastructure. The acceleration of growth in the 1980s and 1990s exposed the gaps in the infrastructure, particularly in power, roads and highways, ports and telecommunications. Although the demand-supply gaps have narrowed since the second half of the 1990s, infrastructural bottlenecks remain the major impediment to accelerating growth. A critical issue in the development of the infrastructure is financing. Infrastructural projects are prone to a variety of risks beyond the traditional management and technical risks. The free rider problem and political considerations create appropriability risk. Financial and legal risks arise from non-recourse financing, complex payment mechanisms and imperfect credit enhancement. There are also instrument-specific risks arising from maturity mismatches, exposure to market risk, restrictions on assignability and charge creation. Evolving appropriate mechanisms to manage these risks holds the key to releasing resources for financing infrastructure (Box II.4).

Box II.4

Financing of Infrastructure

For resource-constrained developing countries like India, infrastructure financing, which is of irreversible nature, is always a key issue in designing the physical infrastructure necessary for achieving growth aspirations. In the literature, new strands regards finance is the wheels, if not the engine, of infrastructure growth. Recent models of financing infrastructure in the presence of a budget constraint for the regulator suggest that a reduction in available funds reduces the quantities produced by all types of firms and increases the interval in which there is bunching. In the absence of an equity market for infrastructure projects the need for competitive bidding has been highlighted.

Private investment worldwide in almost 2,500 infrastructure projects increased from about US $ 20 billion in 1990 to around US $ 130 billion in 1997 before falling to about US $ 60 billion in 2001. A large part of this investment was concentrated in Asia and Latin America. The share of private sector in infrastructure investment continues to be small in East Asia and much of this investment is backed by implicit or explicit government assurances. Furthermore, most East Asian economies adopted an incremental approach to private participation in infrastructure, *i.e.,* private investment for specific projects is ring-fenced to insulate them from the existing structure of delivery.

The India Infrastructure Report (IIR) (1996) had estimated the infrastructure requirements of the Indian economy at about US $ 215 billion for the period 2001-02 to 2005-06. About 85 per cent was expected to be met through domestic financing and 15 per cent by external saving, equiproportionally divided between debt and equity. The IIR envisioned the commercialisation of infrastructure projects as a solution to the unlocking of domestic resources.

In India, financing of infrastructure is still dominated by the public sector, except in telecommunications. Budget constraints and sub-optimal pricing are the principal impediments to public investment in infrastructure. Opportunities for private sector financing in areas previously in the exclusive domain of the Government have expanded not only through the sale of equity in State enterprises but also through inviting private parties for undertaking green-field projects. The power sector was the first among the infrastructure sectors to be opened up to the private sector. Foreign equity up to 100 per cent was allowed in green-field power projects in 1993-94. The recently approved Electricity Bill, 2003 may encourage private sector financing for electricity generation as it envisages delicensing of generation of power, free permission of captive power generation, and ensures transparent policies regarding subsidies. Foreign direct investment (FDI) up to 49 per cent has been permitted in telecommunication services. External Commercial Borrowing (ECB) limits have been made flexible with an increased share of ECBs in project cost. To further encourage private financing, the telecom policy of 1999 announced a package for migration from fixed license fee to revenue sharing for existing cellular and basic service providers. The road sector has been granted industry status to facilitate borrowing on easy terms and to permit floating of bonds. Foreign equity participation up to 100 per cent is allowed in construction and maintenance of roads and bridges. MRTP provisions have been relaxed to encourage private sector financing by large firms in the highway sector.

The Reserve Bank has also liberalised term loan financing by banks for infrastructure with recourse to finance through funds raised by way of subordinated debt, take out financing, direct financing, investment in infrastructure bonds and guarantees. Banks have been allowed to contribute to the equity capital in infrastructure projects and lend to special purpose vehicles (SPVs) in the private sector for directly undertaking infrastructure projects. The Securities and Exchange Board of India (SEBI) has extended relaxations

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for public issues by infrastructure companies regarding size, pricing, mode and minimum subscription of issues.

Despite all these efforts and the setting up of a specialised Infrastructure Development Finance Company (IDFC) in 1997, private sector participation in infrastructure financing has been grossly inadequate. There is a lack of commercialisation due to inadequate reforms in the area of user charges, cross subsidisation, lack of structured financing options to mitigate the risks involved, lack of clarity in policy guidelines and underdeveloped financial and capital markets. It is necessary to improve the access of urban local bodies to the capital market to raise resources at competitive rates. Private conglomerate businesses should be preferred for undertaking infrastructure projects. By having a diversified portfolio of activities, such companies can cross-subsidise the various risks.

The experience since the late 1990s suggests that a key prerequisite for the evolution of institutional arrangements for infrastructure financing is the development of the capital market. The central issue is not the adequacy of funds but the convergence of investment horizons of ultimate savers and borrowers in the economy. This, in turn, warrants intensifying reforms in insurance and pension funds which provide a natural hedge for the risks inherent in the financing of infrastructure.

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Mergers and Acquisitions (M&As)

2.25 The process of industrial restructuring continued during 2002-03 *via* mergers and acquisitions. The most important deals in 2002-03 were either due to privatisation of major public sector undertakings or deals struck by major domestic companies and multinational companies (MNCs).

2.26 As against 1,048 deals involving an amount of Rs.35,086 crore struck in the previous year, there were only 841 acquisition deals involving an amount of Rs.23,113 crore in 2002-03. There were 332 merger deals as against 319 during 2001-02.

2.27 The depressed stock market conditions in India encouraged open offers by promoters interested in increasing their stakes in industries with good growth prospects, but suffering from poor stock market valuations. There were 109 open offers/bids involving an amount of Rs.5,465 crore during 2002-03 as against 99 open offers/bids with an amount of Rs.4,791 crore during 2001-02. These developments provide an insight into the deep-seated changes underway in the structure of Indian industry (Box II.5).

Box II.5

Industrial Restructuring and Organisational Change

Industrial restructuring involves a suite of initiatives taken by firms to re-establish competitiveness, efficiency and profitability in the context of major changes in market trends - consumer preferences and competition technology, macroeconomic policies and the regulatory framework. Restructuring could entail changes, *inter-alia*, in the production structure, ownership (privatisation), labour, management and organisation, and could include divestiture, new investment, mergers and acquisitions (M&A) and alliances with ancillary industries. Restructuring differs from both rehabilitation - entailing modernisation and improvement - and expansion, which are all usually related to the same production structure. While restructuring can be welfare enhancing in the long run, it could involve a reduction in employment in the short run due to the rationalisation, consolidation or closure of inefficient units. Safety nets are, therefore, essential to take care of possible labour displacement.

In the recent period, there has been an upsurge of interest in industrial restructuring worldwide, with attention drawn to the increasing speed and scope of restructuring as well as the growing role of cross-border activities. A sizable acceleration in FDI flows both from and into OECD countries during the 1990s was accompanied by a progressive supercession of greenfield investments by cross-border M&As/international joint ventures, and the rising importance of small and medium sized enterprises (SMEs). Cross-border M&As accounted for a predominant share of FDI. The total value of M&As worldwide increased more than five times, with mega-mergers (of value more than US $1 billion) accounting for 60 per cent. Most of these mega-mergers took place among firms in the same sector, reflecting an increasing proclivity to concentrate on areas of core competence. An important issue in the context of global restructuring is that of 'hollowing out' of strategic activities (including research and development) to foreign locations.

Stylised evidence drawn from 46 developing countries, including India, indicates that the basis of industrial

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restructuring in these countries was the growing recognition of the need for a reduction in direct government ownership in industrial enterprises. Macroeconomic stability, market liberalisation and appropriate labour policies were factors found to have facilitated successful industrial restructuring. These country experiences underscore the significance of institutional reforms particularly the role of the government in respect of legislation and prudential regulation of the financial sector, bankruptcy legislation and its judicial enforcement, technology development and transfers, arbitration mechanisms to settle labour disputes, labour force training and dissemination of information regarding market opportunities, particularly in respect of exports.

At least a part of the pre-crisis Asian miracle is attributable to the manner in which industry in these countries adjusted to changes in the domestic and international environment. Practices, however, differed among the newly industrialised economies (NIEs). For instance, the Korean footwear industry was restructured by expanding the size of operations of firms rather than by entry of new firms. On the other hand, the Taiwanese footwear industry was restructured by shedding operations into small and medium enterprises. In general, there were three major types of responses: offshore investment, upgrading technology and new products and the flexible use of labour. The emphasis, however, varied across the countries. Singapore's industrial strategy is to upgrade its technology, given labour flexibility; while in Hong Kong the preference is not to upgrade its technology but to retain and modify labour intensive operations through the flexible use of labour.

The role of the public sector in industry has been scaled down significantly in India, as part of the structural reforms. At present, there are only six industries which require licensing and only three sectors are exclusively reserved for the public sector. FDI is allowed in all industries except for a short negative list. Initiatives have been taken to restructure and revive potentially viable PSUs and close down or sell the non-viable PSUs. The private sector has also been engaged in restructuring *via* refocusing on niche strategies and on areas of core competence. The Competition Act of 2002 is expected to address the adverse fall-out of M&As. Efforts to overhaul the legal and regulatory regime enabled the successful restructuring of the telecommunications sector.

A number of factors impinge upon the pace and nature of industrial restructuring in India:

- rigid and obsolete labour legislation - need to amend Industrial Disputes Act and Labour Contract Act;
- reorganisation and bankruptcy of sick units - scrapping of the Sick Industrial Companies Act and replacing of BIFR with a process in which defaulting companies are given time to work out an arrangement with creditors;
- restrictions on the acquisition and use of land for industrial purposes - evolving the appropriate legal framework for exits through sale of land.

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Small Scale Industries

2.28 Small scale industries (SSIs) continued to be an important segment of Indian industry in terms of output and employment. Despite relatively high interest rates faced by SSI units and increasing competition from domestic and foreign producers due to dereservation and import liberalisation of items, the SSI sector withstood the overall slowdown in the industrial sector, recording higher production and employment (Table 2.9).

2.29 There are several inhibiting factors impacting on the development of SSI. Vestiges of reservation in the small scale industry need to be phased out to enable producers to achieve appropriate economies of scale and technological upgradation. Furthermore, the SSI investment limits need to be reviewed to enable them to 'graduate' from traditional, labour-intensive, consumer-goods production to capital intensive sectors. Financial intermediaries need to review their credit assessment capabilities with

Table 2.9 : Performance of Small Scale Industries

	2002-03	2001-02	2000-01	1995-96	1990-91
1	2	3	4	5	6
1. No. of Units (millions)	3.57	3.44	3.31	2.66	1.95
2. Value of Output (Rupees crore)	5,14,292	4,78,456	4,51,033	2,96,400	2,07,200
3. Employment (millions)	20.0	19.2	18.6	15.3	12.5

Source : Ministry of Small Scale Industries, Government of India.

regard to small-scale enterprises. Cluster-based assessment of credit to the SSI can reduce the cost of credit.

Services Sector

2.30 Services regained their role as the principal driver of the Indian economy, accounting for 89.4 per cent of the real GDP growth in 2002-03. The resumption of near-trend growth in services was enabled by a pick up in activity in construction, 'financing, insurance, real estate and business services' and 'community, social and personal services'. This outweighed the deceleration in the growth of 'trade, hotels, transport and communication' services which constitute a little less than half of the services sector (Table 2.10).

2.31 Since the 1990s, high growth in ‘trade, hotels, transport and communication’ services has mainly reflected the robust growth of communication which benefited significantly from the reforms underway in the telecom sector. The growth of the communication sector accelerated from an average of 16.9 per cent during 1994-98 to 21.4 per cent during 1998-2002 with its share in GDP doubling by 2001-02. A resurgence of growth of revenue from freight traffic boosted the performance of railways, which played a critical role in the movement of foodgrains to tackle the drought. Similarly, cargo traffic at major ports accelerated due to enhanced traffic in respect of iron ore, POL and coal. Transport services expanded with the increased production of commercial vehicles. Improved financial performance of the banking system enabled a recovery of activity under banking and insurance which were held back by the sluggishness experienced since 1998-99 on account of the poor performance of non-banking financial institutions. The acceleration in 'community, social and personal services' during 2002-03 was mainly on account of personal, recreational, cultural, educational and other services.

2.32 The share of services in GDP moved up to 56.1 per cent in 2002-03 from 54.6 per cent in 2001-02. Services include construction which constitutes about 5 per cent of GDP. The impact of technological progress has led to the progressive splintering and disembodiment of services from goods and from services themselves. Currently, a host of services are produced and traded independent of the mode of delivery. Accordingly, the inclusion of construction under services has become an issue of considerable debate with questions relating to the 'service content' of construction in an environment where architectural design, project appraisal and execution, and a variety of managerial and technical services embodied in construction are priced and exchanged separately (Box II.6).

Information Technology Services

2.33 India maintained its internationally competitive edge in the production and exports of information technology (IT) services during 2002-03, despite a general contraction in this sector worldwide and intensifying competition. Revenues surged by 26 per cent, drawing from a major jump in IT enabled/ Business Process Outsourcing (BPO) services. IT enabled services grew at over 65 per cent during 2002-03 on account of increased outsourcing by US firms to cut costs and to improve bottom lines which improved India's export prospects. The BPO segment is estimated to have accounted for about a quarter of the total IT Enabled Services (ITES) and software exports from India. Indian companies increased their share of global IT spending and began to increase market penetration in new destinations in the Asia-Pacific region. Lower spending on IT was reflected in a fall in the share of India's software exports to Europe.

Table 2.10 : Sub-Sectoral Performance in the Services Sector

(Per cent)

Sub-sector	Share in services sector		Growth Rates		Relative Contribution to growth of services GDP	
	2002-03	2001-02	2002-03	2001-02	2002-03	2001-02
1	2	3	4	5	6	7
Trade, hotels, transport and communication	43.3	43.0	7.8	8.7	47.3	56.7
Financing, insurance, real estate and business services	22.6	22.8	6.1	4.5	19.5	16.2
Community, social and personal services	24.7	24.7	6.8	5.6	23.7	21.5
Construction	9.4	9.4	7.2	3.7	9.6	5.5
Services	**100.0**	**100.0**	**7.1**	**6.5**	**100.0**	**100.0**

Source : Central Statistical Organisation.

Box II.6

Construction: Industry or Services?

An important issue in the context of the structural transformation of the Indian economy is the classification of construction - whether as secondary or as tertiary activity. This has implications for the assessment of structural shifts and sectoral performance within the overall growth process. In the Economic Survey, the share of industry including construction was placed at 27.1 per cent of GDP in 2002-03, while services accounted for 50.8 per cent. On the other hand, in the Reserve Bank's Annual Reports, construction is included under services. Consequently, the share of the services works out to 56.1 per cent while that of industry to 21.8 per cent in 2002-03. The difference in classificatory practice with regard to construction produces variation in sectoral growth rates (Table).

Table : Share of Industry and Services in Real GDP (including and excluding construction)

(Per cent)

	2002-03	2001-02	2000-01	1999-2000	1998-99
1	2	3	4	5	6
Industry					
Without construction	21.8	21.5	22.0	21.6	22.0
	(5.7)	(3.2)	(6.5)	(4.1)	(3.2)
With construction	27.1	26.7	27.2	26.7	27.0
	(6.0)	(3.3)	(6.6)	(4.8)	(3.7)
Services					
Without construction	50.8	49.5	48.9	48.3	46.6
	(7.1)	(6.8)	(5.6)	(10.1)	(8.4)
With construction	56.1	54.6	54.1	53.4	51.6
	(7.1)	(6.5)	(5.7)	(9.9)	(8.1)

Note : Figures in brackets represent growth rates.
Source : Central Statistical Organisation.

In the Indian national accounts, construction comprises *kutcha* and *pucca* activities. The estimates of *pucca* construction, based on the use of construction materials such as cement, steel, bricks, timber and fixtures are prepared by the commodity flow approach, which is also adopted for computing the value added for the manufacturing sector. On the other hand, the estimates of *kutcha* construction undertaken with the help of freely available materials like leaves, reeds and mud are prepared by the expenditure approach which is adopted for estimation of GDP originating from the various kinds of services. If the mode of compilation is employed as a criterion, *pucca* construction needs to be classified under industry and *kutcha* construction under services. On the other hand, construction is also categorised as a part of fixed capital formation, partaking the features of industrial activity.

The debate on the classification of construction is not new. Conceptual difficulties were evident even in seminal works on the classification of the economy by type of activity with some preference expressed for including construction under services since a large part of its output consists of "repair and maintenance work". An intuitive bias for inclusion of construction under services is also discernible in India. Cross-country practices do not offer standards and are beset with a lack of uniformity. In some cases, construction is categorised separately without including it under any particular activity group (*viz.*, the Singapore Monetary Authority and the European Central Bank). Construction is treated as part of industry in the national accounts statistics of several countries including the US and the UK. The United Nations Statistical Office recommends that the general scope of the index of industrial production (IIP) should include construction apart from mining, manufacturing, electricity and gas. However, due to constraints of the data availability, the present general index of industrial production compiled in India has in its scope the mining, manufacturing and electricity sector only. In the IMF's data dissemination, the coverage of industrial production indices comprises mining and quarrying, manufacturing and electricity, gas and water supply.

The growing tertiarisation of the production process and the industrialisation of services as well as the growing externalities associated with services make an analytical classification by type of activity difficult. In particular, this poses a challenge to evaluating industrial production under a broader coverage inclusive of services.

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2.34 A factor contributing to the buoyancy in the services sector has been a shift in the consumption pattern away from goods over the years. The share of services in private final consumption expenditure in the domestic market moved up from 24.4 per cent in 1993-94 to 27.0 per cent in 2001-02. An examination of consumption patterns shows a clear preference in favour of expenditure on transport and communication. There has also been an increased allocation of investment in favour of services; its share

in aggregate capital formation moved up from 41 per cent in 1993-94 to 45 per cent in 2001-02.

2.35 The Indian economy continues to be predominantly services-intensive. Recent estimates show that 55 per cent of all the economic activities are directly services-intensive. Consequently, a major factor contributing to a resumption of the momentum of services sector growth was the pick up in industrial growth during 2002-03. The sustainability of services growth over the medium term would depend upon the emergence and growth of information, communication and entertainment and other 'new economy' of services, as well as the fuller exploitation of existing comparative advantages and synergies with commodity producing sectors.

AGGREGATE DEMAND

2.36 The halting recovery of aggregate demand seems to have restrained a stronger acceleration of sectoral activity in 2002-03. The evolution of real effective demand up to 2001-02 indicates that it is consumption which has held up aggregate demand in the period of slower growth since 1998-99. The upsurge in real consumption expenditures in the recent period was shared between private final consumption expenditure and government final consumption expenditure, the latter including the counter-cyclical component of fiscal policy in the context of the slowdown. On the other hand, the growth of real gross fixed capital formation slowed down in both private and public sectors, reflecting the moderation of planned investment in the presence of idle capacity. Since 1995-98, there has been a precipitous decline in private fixed investment in real terms and considerable volatility in stocks/inventories (Table 2.11).

Table 2.11: Growth in Select Sources of Real Effective Demand #

(Per cent)

Item	2001-02*	2000-01@	1999-2000	1998-99	1995-96 to 1997-98 (Average)
1	2	3	4	5	6
1. Total Final Consumption Expenditure	6.0	2.4	7.2	7.5	5.9
Of which :					
Private Final Consumption Expenditure	5.8	2.8	6.1	6.5	5.6
Government Final Consumption Expenditure	7.2	0.6	13.2	12.9	7.8
2. Total Investment +	3.0	-1.4	20.3	0.7	6.0
Private Investment ++	4.2	0.0	21.5	2.6	13.7
Public Investment ++	2.7	-5.0	13.3	7.3	-3.5
3. Total Fixed Investment	3.2	3.8	9.3	8.7	7.6
Of which :					
Private Fixed Investment	4.1	4.5	11.8	8.4	15.0
Public Fixed Investment	0.7	2.0	2.7	9.4	-5.1

\# Based on select disposition of real GDP at market prices.
* Quick Estimates.
@ Provisional.
\+ Adjusted for errors and omissions.
++ Unadjusted for errors and omissions.
Source: Central Statistical Organisation.

Saving and Capital Formation

2.37 The gross domestic saving (GDS) rate has been increasing in recent years, buoyed by the rise in both physical and financial saving of the household sector (Appendix Table II.10). A major factor contributing to this increase has been a steady improvement in personal disposable income. The improvement in the financial saving of the household sector has been mainly in the form of contractual instruments (Appendix Table II.11).

2.38 A major area of concern is an unprecedented deterioration in the rate of public sector saving from a high of 2 per cent of GDP in 1991-92 to a dissaving which began in 1998-99 and touched (-)2.5 per cent in 2001-02, posing a constraint on growth. The poor performance of public sector saving is attributable to a persistent fall in the gross tax/GDP ratio, coupled with the increase in expenditures on salaries under the Fifth Pay Commission award. The rate of saving of the private corporate sector has decelerated since 1996-97 as a result of declining profitability in the downswing of the business cycle (Chart II.5).

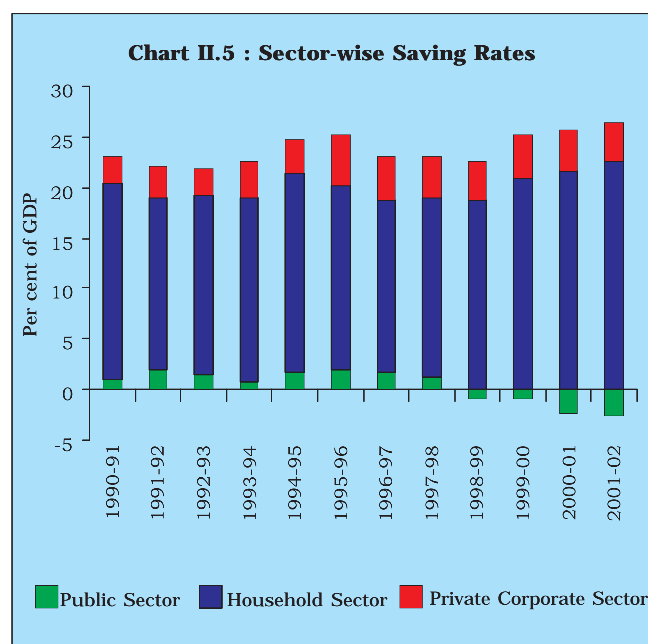

Table 2.12 : Household Saving In Financial Assets

(Amount in Rupees crore)

Item	2002-03#	2001-02P	2000-01P	1999-00	1998-99
1	2	3	4	5	6
A. Financial assets (Gross)	3,39,626	2,97,816	2,58,171	2,41,051	2,07,103
a) As per cent of GDP at current market prices	13.7	13.0	12.3	12.4	11.9
1. Currency	30,560	28,156	17,686	20,845	21,822
a) As per cent of GDP at current market prices	1.2	1.2	0.8	1.1	1.3
b) As per cent of financial assets (gross)	9.0	9.5	6.9	8.6	10.5
2. Deposits@	1,27,151	1,18,477	1,05,020	90,517	80,233
a) As per cent of GDP at current market prices	5.2	5.4	5.0	4.7	5.0
b) As per cent of financial assets (gross)	37.4	39.8	40.7	37.6	38.7
3. Claims on Government	57,983	51,929	39,007	28,985	28,220
a) As per cent of GDP at current market prices	2.3	2.3	1.9	1.5	1.6
b) As per cent of financial assets (gross)	17.1	17.4	15.1	12.0	13.6
4. Investment in shares and debentures+	13,299	8,251	10,932	18,119	6,992
a) As per cent of GDP at current market prices	0.5	0.4	0.5	0.9	0.4
b) As per cent of financial assets (gross)	3.9	2.8	4.2	7.5	3.4
5. Contractual saving**	1,10,634	91,002	85,526	82,585	69,836
a) As per cent of GDP at current market prices	4.5	4.0	4.1	4.3	4.0
b) As per cent of financial assets (gross)	32.6	30.6	33.1	34.3	33.7
B. Financial liabilities	65,563	46,679	31,756	35,275	26,773
a) As per cent of GDP at current market prices	2.7	2.0	1.5	1.8	1.5
C. Saving in financial assets (Net) (A-B)	2,74,063	2,51,136	2,26,415	2,05,776	1,80,330
a) As per cent of GDP at current market prices	11.1	10.9	10.8	10.6	10.4

Preliminary. P Provisional.
@ Comprise bank deposits, non-bank deposits and trade debt (net).
+ Including units of Unit Trust of India and other Mutual Funds.
** Comprise Life Insurance, Provident and Pension Funds.

Notes : 1. Based on the latest available information, these data are revised in July 2003 and hence may not tally with the data published in the Quick Estimates of the Central Statistical Organisation released in January 2003.

2. Data on GDP at current market prices for 2002-03 are not yet available from the CSO. In this Table, GDP at current market prices for 2002-03 has been estimated on the basis of the Revised Estimates of GDP at factor cost at current prices for 2002-03 released by the Central Statistical Organisation in June 2003.

2.39 On the basis of the latest available data, financial saving (net) of the household sector, as a percentage of gross domestic product at current market prices, is estimated at 11.1 per cent in 2002-03 as compared with the revised estimate of 10.9 per cent in the previous year (Table 2.12). The marginal increase in 2002-03 primarily reflected increases in the rates of contractual saving (life insurance, provident and pension funds) and shares and debentures. In contrast, the rate of household sector saving in the form of deposits is estimated to have shown a marginal deceleration in 2002-03 principally due to non-bank deposits and trade debt (net).

2.40 Despite the easing of the traditional constraints on the availability of domestic and external saving, rates of gross capital formation (GCF) at current prices and gross domestic capital formation (GDCF) (adjusted for errors and omissions) have decelerated (Table 2.13). The persistent slowdown in the private corporate investment rate underscores the imperatives for intensifying reforms in the core and infrastructure sectors of the economy. Available stylised and empirical evidence points to the crowding-in effects of public sector investment in the infrastructure sectors. Consequently, the declining trend in the rate of public sector investment is expected to have dampened private sector investment in an environment dominated by a synchronised global downturn in investment appetite.

Table 2.13 : Sector-wise Rates of Gross Capital Formation

Item	(As percentage of GDP at current market prices)		
	2001-02*	2000-01@	1999-2000
1	2	3	4
1. Household Sector	11.3	11.2	10.3
2. Public Sector	6.3	6.4	6.9
3. Private Corporate Sector	4.8	4.9	6.5
4. Gross Capital Formation (GCF)	22.4	22.5	23.7
5. Gross Domestic Capital Formation (GDCF)#	23.7	24.0	25.2

* Quick Estimates. @ Provisional.
# GDCF is adjusted for errors and omissions.
Source: Central Statistical Organisation.

2.41 Domestic saving has traditionally financed over 90 per cent of investment in India. The recourse to external saving has averaged less than one per cent of GDP since 1991-92. The deceleration of the investment rate has essentially reflected the failure of investment demand to absorb available resources. The overall saving-investment balance turned around into a surplus of 0.2 per cent of GDP in 2001-02 for the first time after the period 1975-78 (Box II.7).

Box II.7

Saving-Investment Surplus in a Developing Economy

For developing countries aspiring to accelerate growth, a saving-investment surplus appears to be a contradiction in terms. Typically, these countries plan investment rates in excess of their domestic saving rates, employing external saving to overcome the traditional resource constraints. A developing country with a saving-investment surplus is axiomatically an exporter of capital in the *ex post* sense and this seems to imply a disconnect with the received wisdom.

In the literature, the saving-investment balance is traditionally examined in the national accounting framework by which it is reflected in the external current account in an *ex post* sense. Operationalising this relationship as a target for macroeconomic policies has taken various forms: the elasticities, absorption and monetary approaches. Yet another variant is the so-called 'new' view which focuses on the optimality of saving and investment decisions in the private sector rather than the gap. Recent theoretical work, however, suggests that there is more to the national accounting relationship than the *ex post* identity. The inclusion of inter-temporal considerations in an open economy framework modifies the conclusions emerging from the traditional approaches, particularly the impact of terms-of-trade on saving and investment, the impact of fiscal policy and the exchange rate. A proper understanding of the inter-temporal decisions underlying saving and investment behaviour becomes crucial. The inter-temporal approach also has its limitations. For instance, a country may plan investment in excess of its saving but international credit ratings or even the concerted decision of lenders may impede its access to international financial markets. In the 1990s, developing countries, buffeted by financial crises, have made the adequacy of reserves an objective priority. Under these circumstances, external saving and even domestic saving may be employed to finance reserve adequacy, besides the planned investment.

A key issue in analysing the saving-investment relationship is that of capital mobility. If capital is freely mobile, an increase in investment need not cause any change in saving because it can be financed by net capital inflows - correlation between saving and investment is low and rates of return are equalised between countries. If saving and investment are closely correlated, capital mobility is low (Feldstein and Horioka, 1980). Subsequently, it was shown that saving and investment are jointly determined by the whole variety of influences on economic activity and so they tend to be highly correlated even if capital is freely mobile. A surprising finding in the empirical literature is that of relatively low saving-investment correlation in developing countries.

Empirical work undertaken on Indian data has yielded mixed results. High correlation between saving and investment has been found and interpreted as capital immobility. A study of the behaviour of the 'errors and omissions' in gross investment shows that the series is non-stationary and integrated of order 1, suggesting the presence of a systematic bias in the estimation of saving and investment.

The investment rate has historically stayed ahead of the domestic saving rate in India and this has been reflected in the current account deficit in the balance of payments. The stylised evidence, however, suggests at least one aberration from the national accounting relationship. In the period 1973-74, a current account surplus occurred in spite of a saving-investment gap reflecting massive inflows of workers' remittances related to the first oil shock.

Recent some empirical work conducted in the Reserve Bank on the behaviour of saving and investment finds high and significant correlation between the two, independent of the definition of investment chosen, *viz.,* gross domestic capital formation (GDCF), gross capital formation (GCF), or gross fixed capital formation (GFCF). The saving-investment surplus of 2001-02 is preceded by a surplus over fixed capital formation since 1997-98. The release of entrepreneurial efforts and building of capacities in the flush of liberalisation in the first half of the 1990s was dampened by the downswing of the business cycle that followed. Therefore, corrections in capacity utilisation, downsizing of scale and over investment in projects and the consequent saving-investment surplus need to be evaluated inter-temporally rather than episodically.

The appropriate approach is to explicitly analyse the dynamics of saving and investment decisions independently. Recent empirical estimates suggest that per capita income and financial deepening have a determining influence on saving behaviour. Important determinants of investment behaviour are real output, the real bank lending rate and public investment in services. It is the studies of this genre which will contribute to a better understanding of the underlying dynamics of the saving-investment balance in India.

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2.42 The growth prospects for the current financial year hinge around the sustainability of the industrial upturn and a recovery in agricultural performance. The performance of agriculture would continue to depend upon the progress of monsoon, particularly its spatial distribution. Initial expectations support a strong rebound from the absolute decline in output recorded last year. The climate for industrial revival is showing a distinct improvement in an environment of higher overall growth prospects, low and stable inflation, rising international competitiveness and conducive monetary and fiscal policies. The higher growth momentum in industry during 2003-04 so far was maintained principally on account of four out of the top five growth contributors in 2002-03. Basic chemical and chemical products, however, showed a decline, while rubber exhibited a turnaround in its performance. In terms of use-based classification, the consumer durables witnessed a turnaround over the corresponding quarter of the previous year. On the other hand, some deceleration was witnessed in the basic goods mainly on account of mining sector. The overall industrial growth at 5.3 per cent during April-June 2003 was higher than 4.3 per cent experienced a year ago. However, the infrastructure growth during the first quarter of 2003-04 at 4.1 per cent still trails behind the 6.2 per cent growth recorded in the first quarter of 2002-03. The financial performance of the private corporate sector has shown substantial improvement in terms of sales and profitability. Leading indices of industrial activity are indicating stable growth ahead. The industrial outlook is optimistic with expectations of fresh capital investments in existing projects, increase in capacity utilisation and a stabilising of inventory levels. Export demand is expected to increase over the next six months, supported by a realistically valued exchange rate. Easing the constraints in terms of availability of power, procedural bottlenecks, cost and availability of credit, and road and port facilities will entrench the industrial recovery. The buoyancy of the services sector would be contingent upon the strength of the symbiotic interface with the goods sector and the growth of 'new economy' activities.

2.43 The Tenth Five Year Plan (2002-07) has envisaged an average annual growth of 8 per cent. India's growth experience over the Eighth and Ninth Plan periods demonstrates that this growth target is feasible. The future growth strategy will have to rely on a combination of increased investment and improvement in efficiency. Rapid dismantling of policy constraints, procedural rigidities and price distortions will play a critical role in the drive to a higher growth path. It will also require that the appropriate changes in institutional architecture are put in place. In these efforts, achieving a growth rate of 6.0 per cent in 2003-04 becomes a critical minimum.

III MONEY, CREDIT AND PRICES

3.1 Monetary conditions closely tracked the evolution of real activity during 2002-03. The growth of non-food bank credit, inclusive of banks' investments in non-Statutory Liquidity Ratio (non-SLR) instruments, was in consonance with the recovery of industrial output. Credit expansion was facilitated by conditions of ample liquidity in financial markets, engendered by massive capital inflows. Interest rates declined across the spectrum in response to the easy liquidity conditions, and to monetary policy signals for softening that were transmitted through cuts in the Bank Rate, the repo rate and the cash reserve ratio (CRR). The lowering of interest rates was made possible by a benign inflation environment except for a spurt in the last quarter due to the hardening of international oil prices and of some drought related price hike for items such as oilseeds and edible oils. On the other hand, currency and deposit growth slowed down moderately reflecting the adverse impact of the drought on rural incomes and the lowering of deposit rates by banks. Broad money growth reflected these diverse impulses from real activity. Reserve money growth was moderated by the deployment of policy instruments to counter the expansionary effects of large external flows.

RESERVE MONEY

3.2 In recent years, reserve money has become the operating target of monetary policy in the endeavour to stabilise the demand for bank reserves and, thereby, to create conditions conducive for adequate credit growth in support of industrial activity. Consequently, the behaviour of reserve money increasingly reflects the impact of active liquidity management as the Reserve Bank alters its own balance sheet in response to market conditions. For most of 2002-03, excess liquidity in the market was absorbed through policy operations which impacted on the monetary base (Chart III.1).

3.3 The behaviour of reserve money in 2002-03 was predominantly influenced by the large inflows from abroad. Excess supply conditions in the foreign exchange market were reflected in continuous purchases of foreign exchange by the Reserve Bank and accretions to the Reserve Bank's foreign currency assets (Appendix Table III.1). The primary liquidity generated by this substantial accretion to the net foreign assets (NFA) was sterilised through active recourse to open market sales and repos under the liquidity adjustment facility (LAF). As a result, the net domestic assets (NDA) of the Reserve Bank declined to barely 2.9 per cent of reserve money at end-March 2003 (Chart III.2 and Table 3.1).

Chart III.1 : Reserve Money Growth

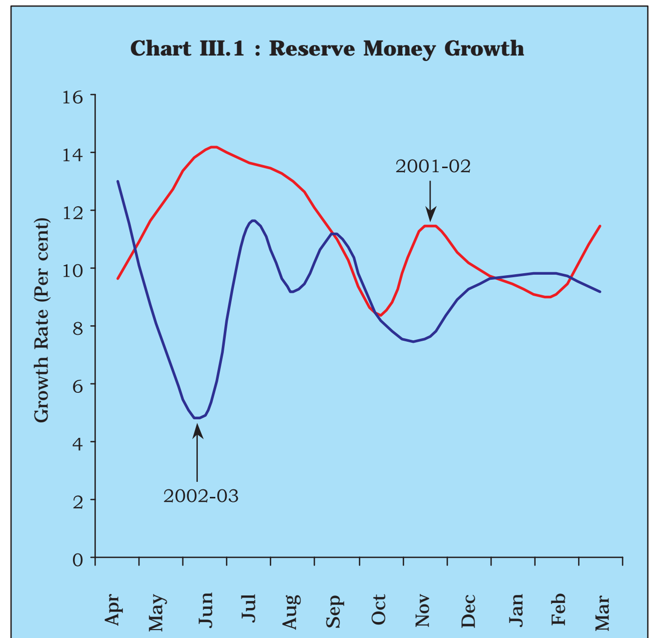

Chart III.2 : Sources of Reserve Money

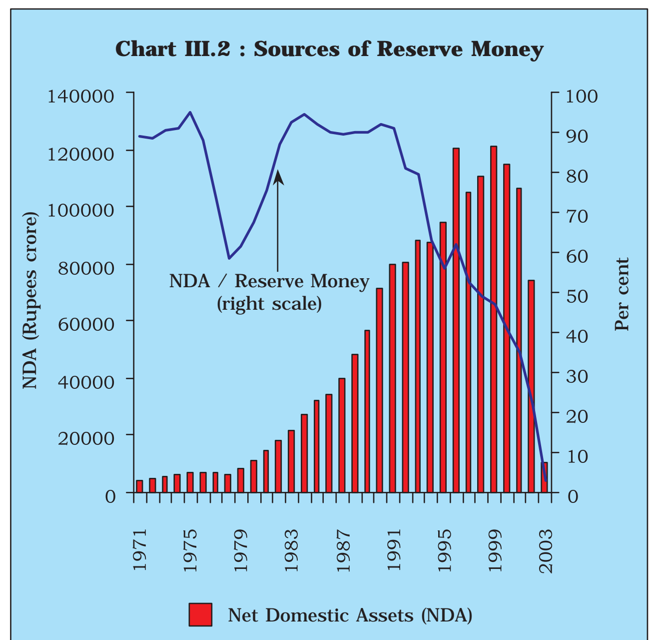

Table 3.1 : Variations in Major Components and Sources of Reserve Money

(Rupees crore)

	2002-03	2001-02	2002-03			
			Q1	Q2	Q3	Q4
1	2	3	4	5	6	7
Reserve Money	**31,091** (9.2)	**34,659** (11.4)	**-8,850**	**6,791**	**7,917**	**25,233**
Components						
1. Currency in Circulation	31,499 (12.6)	32,769 (15.0)	14,633	-5,901	11,206	11,561
2. Bankers' Deposits with RBI	-801	2,670	-23,873	12,451	-2,427	13,048
3. Other Deposits with RBI	393	-780	389	241	-861	624
Sources						
1. RBI's Net Credit to Government Sector	-31,499	-1,699	-4,212	-19,779	-17,427	9,919
of which : to Central Government	-28,399 (-20.1)	-5,150 (-3.5)	1,455	-19,555	-17,882	7,583
2. RBI's Credit to Banks and Commercial Sector	-6,468	-9,575	-6,537	-784	8	844
3. Net Foreign Exchange Assets (NFEA) of RBI	94,275 (35.7)	66,794 (33.9)	19,279	19,619	34,766	20,611
4. Government's Currency Liabilities to the Public	705	1,013	168	256	157	124
5. Net Non-Monetary Liabilities of RBI	25,922	21,875	17,548	-7,479	9,587	6,265
Memo:						
Net Domestic Assets	-63,184	-32,135	-28,130	-12,828	-26,849	4,623
Net Foreign Currency Assets, adjusted for revaluation	82,090	55,836	8,145	22,881	31,060	20,004
Net Purchases from Authorised Dealers	75,661	34,000	3,929	18,958	25,165	27,608
NFEA/Reserve Money (per cent) (end-period)	97.1	78.1	86.1	90.2	98.2	97.1

Note : 1. Data based on March 31 for Q_4 and last reporting Friday for all other quarters.
2. Figures in brackets are percentage variations during the year.

3.4 Given the stock of marketable instruments in the Reserve Bank's portfolio, the decline in the NDA to near-zero levels as a proportion to reserve money focuses attention on the limits being approached to full sterilisation and, therefore, on the future conduct of monetary policy in the context of large and sustained capital inflows (Box III.1).

3.5 The Reserve Bank's net credit to the Government – the major constituent of the NDA – contracted over the year with the divestment of government securities from its holdings through open market sales. With the growing market orientation of monetary policy, the Reserve Bank's net credit to the Centre no longer reflects its financial support to

Box III.1

Managing Capital Flows: Constraints on Discretionary Monetary Policy

In the aftermath of the institution of structural reforms and external liberalisation in the early 1990s, the Indian economy has experienced surges of capital flows on a hitherto unprecedented scale. Net capital flows increased from an average of US $ 5.8 billion (Rs.8,225 crore) per annum during the second half of the 1980s to US $ 9.1 billion (Rs.35,354 crore) per annum in the second half of the 1990s and to US $ 12.6 billion in 2002-03 alone. While the capital flows brought about an easing of the external financing constraint, they have also posed dilemmas for the conduct of monetary policy. With overall surpluses in the balance of payments emerging as the dominant factor driving money supply, this has necessitated rearguard monetary policy action to ensure that this exogenous monetary expansion does not endanger the pursuit of the final targets of growth with price stability.

A number of steps have been taken to manage the excess supplies in the foreign exchange market such as phased liberalisation of international transactions and pre-payment of multilateral debt. Furthermore, in 2002-03, the exchange rate of the rupee *vis-a-vis* the US dollar appreciated, an event unprecedented in the recent monetary history of India. The principal instrument for managing capital flows in India has been sterilisation, *i.e.*, heading off the expansionary impact of rising NFA by open market sales of government securities by the Reserve Bank from its portfolio. As a result, domestic money supply has been unaffected by the external inflows. These operations could have several implications like quasi-fiscal costs, bidding up of interest rates domestically and possibly depriving the economy of the benefits of capital inflows. Therefore, sterilisation is essentially a means of buying time until macroeconomic policies can be put in place to nurture a durable absorption of the capital flows

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into productive investments and augmentation of capacity in the economy.

The conduct of discretionary monetary policy in the face of surges in capital flows has engaged considerable attention in the literature. A key issue is whether or not monetary policy is held hostage to the capital flows. Does the monetary stance, say, a tightening effected through reduction of NDA get completely offset by the expansion of NFA on account of capital inflows? The alternate hypothesis is whether or not the monetary authority is able to sterilise the increase in NFA by a compensating reduction of NDA so that it retains control over money supply and is able to pursue its stated objectives. In other words, does the change in NFA cause NDA to change or does NFA respond to changes in NDA? For most countries, both lines of causality could be at play depending upon the degree of capital account liberalisation and sensitivity of foreign flows to interest rate differentials. An examination of the offset coefficient - the response of net foreign assets to net domestic assets - provides some clues. An offset coefficient close to unity would imply that the efforts to tighten monetary policy would induce equal offsetting foreign inflows leaving no scope of independent monetary policy. In contrast, an offset coefficient of zero would provide the monetary authority with complete control over money supply and, therefore, discretion in the conduct of monetary policy. For five out of six emerging market economies examined under pre-Asian crisis conditions, the offset coefficient lay in a range of (-)0.1 to (-)0.5 indicating scope for independent monetary policy; for Thailand, the offset coefficient was close to unity suggesting little scope of pursuing an independent monetary policy.

For India, the offset coefficient was estimated to be (-) 0.3 over the period April 1993 to March 1997, suggesting that sterilisation operations conducted during this period enabled sufficient independence for monetary policy to pursue domestic goals. In the subsequent period, net foreign assets have increased rapidly. Over the sample period April 1994 to March 2003, Granger causality tests indicate a uni-directional causality from changes in NFA to NDA. Thus, over the period 1994-2003, capital inflows were not induced by domestic monetary conditions. Moreover, the sterilisation coefficient – the response of change in NDA to that in NFA – was (-) 0.83, *i.e.*, an increase of Rs.100 in NFA attracted a policy response of sterilisation that drained away NDA worth Rs.83 from the system. As a result, the Reserve Bank was able to offset the expansionary effect of foreign capital flows on domestic money supply, consistent with its macroeconomic objectives.

A critical issue in the sustainability of sterilisation operations is the stock of the Government of India securities with the Reserve Bank – Rs.83,131 crore as on August 15, 2003. Of this stock around 47 per cent is marketable. The rest are special securities and funding operations have been carried out at discrete intervals to convert these into marketable instruments and these have quasi-fiscal implications. In the ultimate analysis, it is durable and consistent policies that expand the country's absorptive capacity which will ensure a natural habitat for capital inflows in India without threat to macro-economic stability. This, in fact, is the thrust of the growth strategy of the Tenth Five Year Plan.

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1. Pattanaik, S. (1997), “Target and Instruments for the External Sector with an Open Capital Account”, *Economic and Political Weekly*, Vol.32, No.40.

2. Schadler, Susan, Maria Carkovic, Adam Bennett and Robert Kahn (1993), “Recent Experiences with Surges in Capital Inflows.” *Occasional Paper*, 108, International Monetary Fund.

the Centre’s borrowing programme but rather the impact of secondary market operations which cause changes in the ownership of the underlying securities. The Reserve Bank’s primary subscriptions to the Centre’s fresh dated securities during the year were concentrated in the first and the fourth quarters. The fourth quarter primary subscriptions, however, were entirely the counterpart of the pre-payment of external loans owed to multilateral agencies. On the other hand, the Reserve Bank’s secondary operations in the form of open market sales (alongwith repo operations) were carried out throughout the year, intensifying from the second quarter onwards. The higher order of open market operations relative to primary placement is an indication of the pressures imposed by the need to sterilise capital inflows, since the Reserve Bank has been consistently pursuing the strategy of taking primary issuances of government securities on to its own books when market considerations are not favourable and subsequently off-loading them with a view to ensuring the successful completion of the borrowing programme at lower costs and higher maturities. Repo operations under the LAF balanced out over the year (Table 3.2).

3.6 The Centre’s comfortable liquidity position was reflected in lower recourse to loans and advances from the Reserve Bank during 2002-03 (Chart III.3). The loans and advances generally remained well within the stipulated limits (Rs.10,000 crore and Rs.6,000 crore for the first and the second halves of the year, respectively). The second half of the year, in fact, witnessed only a few incidents of

Table 3.2 : Variation in Net Reserve Bank Credit to the Centre

(Rupees crore)

Variable	2003-04	2002-03					
	Q1	Q4	Q3	Q2	Q1	2002-03	2001-02
1	2	3	4	5	6	7	8
Net Reserve Bank Credit to the Centre (1+2+3+4-5)	**435**	**7,582**	**-17,882**	**-19,555**	**1,455**	**-28,400**	**-5,150**
1. Loans and Advances to the Centre	8,145	0	0	-7,648	2,472	-5,176	-219
2. Treasury Bills held by the Reserve Bank	-3	3	0	0	-18	-15	-464
3. Reserve Bank's Holdings of Dated Securities	-11,300	11,116	-17,979	-11,761	-6,107	-24,731	-2,223
4. Reserve Bank's Holdings of Rupee Coins	163	-106	97	-146	64	-92	82
5. Central Government Deposits	-3,430	3,431	0	0	-5,044	-1,614	2,326
*Memo Items**							
1. Market Borrowings of Dated Securities by the Centre #	44,000	18,000	23,000	35,000	49,000	1,25,000	1,14,213
2. Reserve Bank's Primary Subscription to Dated Securities	5,000	13,000	0	1,157	22,018	36,175	28,892
3. Repos (-) / Reverse Repos (+) (LAF), net position £	-19,040	3,079	10,371	8,845	-20,355	1,940	-3000
4. Net Open Market Sales #	5,620	11,150	15,693	19,918	7,020	53,781	30,335
5. Primary Operations $	25,643	15,187	-12,527	-8,642	29,598	23,616	24,649

* At face value. # Excludes Treasury Bills. £ Includes fortnightly repos.
$ Adjusted for Centre's surplus investment.
Quarterly variations are based on March 31 for Q_4 and last reporting Fridays for other quarters.

recourse to loans and advances as the Centre often had sizeable surplus balances which were invested in its own securities. The comfortable market liquidity conditions also resulted in a reduction in the Reserve Bank's credit to banks and primary dealers (PDs) during the year (Appendix Table III.2).

Developments during 2003-04

3.7 Reserve money recorded a higher order of year-on-year expansion during 2003-04 so far (as on August 15, 2003) (Table 3.3). The growth in reserve money was entirely on account of sustained external flows driving up the NFA of the Reserve Bank. As a result, the NFA-currency ratio reached the level of 131.7 per cent as on August 15, 2003. The increase in NFA was partly offset by a further decline in the Reserve Bank's net credit to the Centre. Recourse of commercial banks and PDs to credit from the Reserve Bank also fell reflecting easy liquidity conditions.

Chart III.3 : Loans and Advances to the Centre

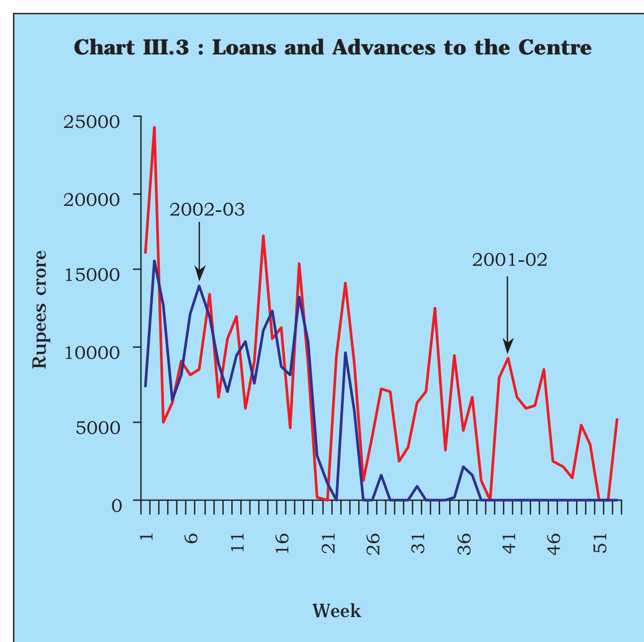

Table 3.3 : Reserve Money

(Rupees crore)

	Year-on-year Variations			
	As on August 15, 2003		As on August 16, 2002	
	Absolute	Percent	Absolute	Percent
1	2	3	4	5
Reserve Money	**47,017**	**14.0**	**31,231**	**10.2**
Major Components				
1. Currency in Circulation	35,024	13.3	32,049	13.9
2. Bankers' Deposits with RBI	11,106	15.8	-1,030	-1.4
Major Sources				
1. Net Reserve Bank Credit to Government	-49,880	-36.4	-19,842	-12.7
of which: to Centre	-50,820	-37.9	-18,436	-12.1
2. Net Foreign Exchange Assets (NFEA) of RBI	97,642 (1,04,484)	33.1	84,429 (69,291)	40.2

Note : Figures in brackets are foreign currency assets net of revaluation.

MONETARY SURVEY

3.8 Broad money (M_3) slowed down in consonance with real GDP growth during 2002-03, remaining within the indicative projection of the Monetary and Credit Policy announcement of April 2002. Slower growth of currency as well as aggregate deposits restrained monetary expansion, as deposits turned relatively unattractive at the margin in comparison with competing instruments of financial saving (Chart III.4 and Appendix Table III.3). This switch in preference away from bank deposits for alternative avenues of asset formation was also evident in a robust growth of postal deposits which drove up the principal liquidity measure *i.e.*, L_1 relative to M_3.

3.9 Currency demand was affected by the contraction of rural activity on account of the drought and remained below its trend growth. There was a generalised slackening of the appetite for deposits. Aggregate deposit growth dropped, driven down by the lagged response of time deposits to the moderation in deposit rates by banks, which also resulted in lower accruals of interest (included under time deposits). Non-resident foreign currency deposit growth fell sharply *vis-a-vis* domestic deposits, indicative of a shift in favour of relatively high interest bearing non-resident rupee deposits as well as positive exchange rate expectations. As a consequence, money supply excluding foreign currency liabilities *i.e.,* NM_3 recorded a higher order of expansion relative to M_3 (Appendix Table III.4). Deposits placed with non-bank financial companies were almost unchanged affecting the expansion of the widest measure of liquidity *i.e.*, L_3 (Table 3.4 and Appendix Table III.5).

3.10 In order to ensure consistency with conceptual and definitional principles adopted in India as in the majority of countries the world over, analysis of monetary aggregates during 2002-03 excludes the effects of mergers which resulted in the integration of non-monetary liabilities in the form of bonds and debentures with the balance sheet of the banking system. While the mergers resulted in 're-intermediation' and an expansion of the banking system's assets and liabilities, it is important to extract only the monetary liabilities therefrom for the purpose of compilation and analysis of money supply as conventionally understood (Box III.2).

Sources of Money Supply

3.11 Variations in monetary aggregates were driven in 2002-03 by shifts in the asset portfolios of banks in response to movements in relative rates of return as well as a generalised risk sensitivity in an environment characterised by depressed equity markets, an uncertain monsoon outlook and hesitant recovery of aggregate demand. The pick-up in domestic credit during 2002-03 was absorbed by the government and the commercial sectors. Net bank credit to the Government was maintained at around 41.0 per cent of domestic credit, reflecting the persistent appetite for government securities in the banking system. Scheduled commercial banks' holding of Government securities was around 39.0 per cent of their net demand and time liabilities (NDTL); at end-March 2003, they were higher by Rs.1,95,974 crore than the statutory minimum requirement of 25.0 per cent required for the maintenance of the SLR. In recent years, the progressive market orientation of the Centre's borrowing programme has minimised the recourse to automatic monetisation and captive financing. Since the 1990s, government securities have emerged as an attractive avenue for investments by banks, particularly in the context of prudential norms imposed under financial sector reforms.

Chart III.4 : Components of Money Supply

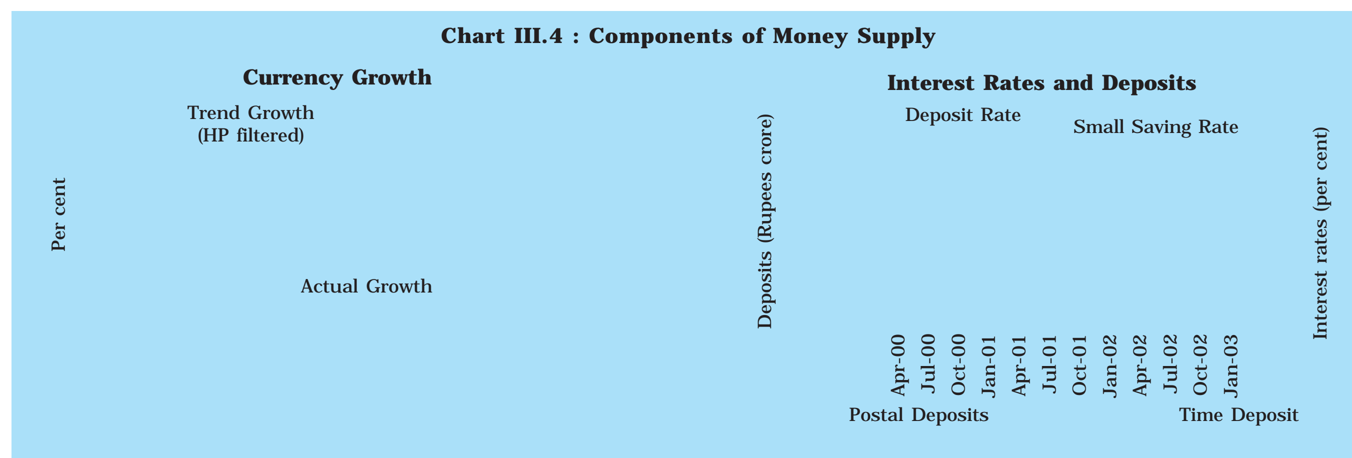

Table 3.4 : Monetary Indicators

Variable	Outstanding as on March 31, 2003 (Rupees crore)	(Variation in per cent)			
		Point to point Basis		Monthly Average Basis	
		2002-03	2001-02	2002-03	2001-02
1	2	3	4	5	6
I. Reserve Money	3,69,061	9.2	11.4	9.3	11.1
II. Broad Money (M_3)	16,95,551	13.2	14.1	14.0	16.1
a) Currency with the Public	2,70,983	12.5	14.9	13.8	12.7
b) Aggregate Deposits	14,21,326	13.3	14.1	14.1	16.9
i) Demand Deposits	1,98,602	10.8	7.8	9.9	10.3
ii) Time Deposits	12,22,725	13.7	15.2	14.8	18.0
of which: Non-Resident Foreign Currency Deposits	92,240	1.5	5.5	4.3	37.0@
III. NM_3	16,15,236	13.8	15.7	14.8	15.5
IV. a) L_1	16,70,283	14.1	16.0	15.1	15.8
of which: Postal Deposits	55,047	25.3	27.6	25.6	26.6
b) L_2	16,76,490	14.1	15.2	14.8	15.5
of which: FI Deposits	6,207	20.7	-60.2	-36.7	-15.0
c) L_3	16,96,063	14.0	15.2	14.5	15.2
of which: NBFC Deposits	19,573	0.8	10.8	6.0	0.8
V. Major Sources of Broad Money					
a) Net Bank Credit to Government (i+ii)	6,78,059	15.0	15.2	13.7	16.7
i) Net Reserve Bank Credit to Government	1,20,679	-20.7	-1.1	-17.4	1.5
of which: to the Centre	1,12,985	-20.1	-3.5	-17.9	0.6
ii) Other Banks' Credit to Government	5,57,379	27.4	22.1	25.5	23.9
b) Bank Credit to Commercial Sector	8,62,068	13.5	11.8	12.6	12.8
of which: Scheduled Commercial Banks' Non-food Credit	6,35,192	18.6	13.6	16.5	11.8
c) Net Foreign Exchange Assets of Banking Sector	3,93,715	26.6	24.5	31.4	24.5

Data provisional.

@ Reflects the Indian Millennium Deposits (IMDs) effect.

Note : 1. M_3, NM_3, L_1, L_2, L_3 and deposits are adjusted for the full impact of mergers while credit is adjusted for the initial impact of mergers since May 3, 2002.

2. Sharp variations in FI deposits reflect the impact of the mergers.

Contemporaneously, the Reserve Bank has had to adjust monetary policy to sterilise large inflows of capital. Consequently, the share of the Reserve Bank in outstanding net bank credit to the Government sector which was over 62 per cent in 1990-91 declined to around 20 per cent in 2002-03 (Chart III.5).

3.12 Food credit declined in 2002-03 due to a significant fall in procurement operations. This added to liquidity in the system. Non-food credit extended by scheduled commercial banks accelerated to accommodate the revival of industrial activity (Chart III.6 and Appendix Table III.6).

Box III.2

Mergers in the Banking System : Impact on Monetary Aggregates

In line with the rapidly expanding phenomenon of mergers and acquisitions the world over, Indian banking has experienced restructuring in the form of mergers of banks with other banks. Reverse mergers *i.e.,* mergers of non-banking institutions with banks are a relatively new phenomenon in India, the first one having occurred in March 2002. A merger of one bank with another bank leaves the aggregate assets and liabilities of the banking system unaffected. Accordingly, money supply, which involves a lateral aggregation of the balance sheets of all banking entities constituting the banking system, remains unaffected by the merger. In contrast, merger of a bank with a non-bank immediately results in an expansion in the balance sheet of the banking system since the assets and liabilities of a hitherto non-bank are taken over by the merged entity which is a bank. The key issue is the impact of the merger on money supply.

Money supply is conventionally defined to comprise currency and deposits *i.e.,* those liabilities of the banking system which perform the functions of money in terms of being a medium of exchange, a store of value, a unit of account and a standard for deferred payments. The key issue is moneyness: zero or near-zero transformation cost of an instrument to money, a criterion amply satisfied by bank deposits. A reverse merger results in the inclusion of the liabilities such as bonds and debentures of the erstwhile non-bank in the aggregate liabilities of the banking system. The crucial question that arises is: should these liabilities (bonds and debentures) be included in money *i.e.,* do they satisfy the criterion of moneyness?

In India, monetary statistics have undergone refinements from the time they were first disseminated in 1935 by the Reserve Bank. The rationale and analytical foundations underlying the definition of money to include currency and deposits only were first set out in 1961 by a Working Group appointed by the Reserve Bank. The Second Working Group,

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set up in 1977, endorsed this definition of money. The Third Working Group on Money Supply (1998) excluded bonds issued by financial institutions not only from the monetary aggregates but also from broader measures of liquidity. The Third Working Group surveyed as many as 38 countries in search of international best practices and did not find a single country practice of inclusion of bonds and debentures in the components of money supply.

The Monetary and Financial Statistics Manual (IMF, 2000) is ambivalent on the issue, preferring to defer to country specific circumstances. It notes that securities with maturities of up to two years may be included in broad money while securities with maturities of more than two years are usually excluded from money as the specific nature of contracts renders them illiquid. The European Central Bank considers bonds of maturity beyond three years as not 'adequately liquid' to be a part of money.

Liabilities of a non-bank are non-monetary in character prior to the merger and, in fact, represent some part of dis-intermediation from the banking system. The merger of the non-bank with a bank does not impart any monetary character (*i.e.,* of providing a base for credit creation or of being a medium of exchange) to them. Furthermore, when the public subscribes to the bonds of a non-bank, there is a simultaneous transfer of ownership of deposits held in the banking system from the public to the non-bank entity with no impact on money. Thus, the issue of bonds and debentures by a non-bank has already been recorded in the banking system. The inclusion would, therefore, lead to double counting.

Accordingly, liabilities in the form of bonds and debentures, which were of average maturity of nearly six years and entered the balance sheet of the banking system consequent upon the reverse merger, are excluded from analysis of monetary aggregates in India and are treated as net non-monetary liabilities of the banking system. This methodology has the advantage of recording the specific effects of re-intermediation when the merged entity converts the non-monetary bonds and debentures into deposits. From the point of view of the conduct of monetary policy, this helps to keep the monetary authority on guard against an exogenous source of monetary expansion. During 2002-03, available information indicates that bonds and debentures of about Rs.13,000 crore were liquidated and flowed back into the banking system, contributing nearly a percentage point of M_3 growth. Analogous treatment is accorded to bank credit; however, in view of the fact that the assets of the merged entities are well integrated into a single portfolio, only the initial impact of the merger is excluded.

References

1. *Monetary and Financial Statistics Manual (2000)*, International Monetary Fund, Washington D.C.
2. *Report of the Working Group on Money Supply: Analytics and Methodology of Compilation (1998)*, Reserve Bank of India.

3.13 The increase in non-food credit demand was well distributed across industries such as infrastructure, housing, cement, cotton textiles, gems and jewellery, iron and steel, electricity, computer software, automobiles, petroleum and fertilisers (Appendix Tables III.8 and III.9). Growth of credit to the housing industry continued to remain high, benefiting from tax incentives as well as the softening

Chart III.5 : Net Bank Credit to Government

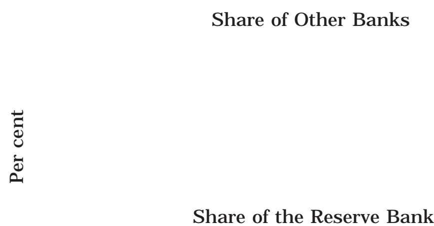
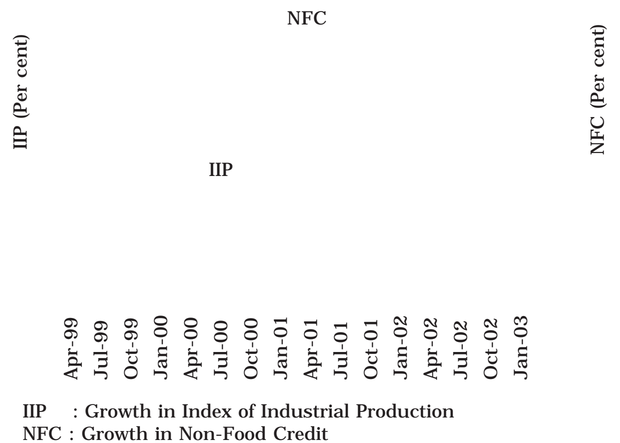


Chart III.6 : Non-food Credit and Industrial Production



IIP : Growth in Index of Industrial Production
NFC : Growth in Non-Food Credit

Table 3.5 : Sectoral Deployment of Gross Bank Credit
(Variation over the year)

(Rupees crore)

Sector	2002-03		2001-02	
	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5
1. Priority sector	28,540	16.3	20,845	13.5
2. Industry (Medium & Large)	28,011	16.3	9,487	5.8
3. Housing	12,308	55.1	6,203	38.4
4. Non-banking financial companies	4,399	45.6	1,843	23.6
5. Wholesale trade	1,939	9.5	2,614	14.6
6. Other sectors	9,481	11.5	12,595	18.0
7. Total (1 to 6)	**84,678**	**17.5**	**53,587**	**12.5**
of which:				
8. Export Credit	6,424	14.9	-343	-0.8

Note : Data are provisional and relate to select scheduled commercial banks which account for about 90 per cent of bank credit of all scheduled commercial banks.

Table 3.6 : Scheduled Commercial Banks' Non-SLR Investments

(Rupees crore)

Variable	As at end-March		
	2003	2002	1997
1	2	3	4
1. Commercial Paper	4,258	8,497	685
2. Shares issued by	9,017	5,914	1,252
2.1 PSUs	1,431	1,586	348
2.2 Private Corporate Sector	7,586	4,327	904
3. Bonds/Debentures issued by	79,760	66,589	16,631
3.1 PSUs	46,633	39,520	14,277
3.2 Private Corporate Sector	33,127	27,069	2,354
Total Non-SLR Investments (1+2+3)	93,036	81,000	18,568
Memo Items			
Conventional Bank Credit	7,29,216	5,89,723	2,78,401
Bank Credit including non-SLR Investments	8,22,252	6,70,723	2,96,969
	(64.2)	(60.8)	(59.4)

Note : Figures in parentheses indicate the ratio of bank credit (including non-SLR investments) to aggregate deposits.

of interest rates (Table 3.5). The recovery in export credit reflected high export growth (Appendix Table III.10). Engineering, coal and tobacco industries, however, recorded declines in credit off-take.

3.14 Bank credit flows to the commercial sector include their investments in commercial paper, shares, bonds and debentures, units of mutual funds and other instruments which fall outside the purview of eligible instruments for the purpose of maintaining the SLR. Since 1997-98, the share of such investments in commercial sector credit has doubled, indicative of a shift in portfolio choice for tradable assets as against traditional loans and advances (Table 3.6).

3.15 Bank portfolio shifts between credit and investments reflect the liberalisation of various segments of the financial market spectrum. They also indicate a diversification of core banking competencies with the objective of diffusing credit risk along with improved capabilities to manage market risk. Similar forces are at work driving banks to seek higher profits from treasury operations (Box III.3).

Box III.3

Determinants of Bank Credit and Investment

The portfolio allocation of banks between credit and investments assumes crucial importance on account of two reasons. First, in the tradition of the "credit view", the existence of market imperfections and information asymmetries make credit and investments in bonds imperfect substitutes. Accordingly, interest rates work through a menu of rates of returns on a host of financial assets and responses of bank portfolios to monetary policy impulses tend to be magnified through a financial accelerator framework. Second, the portfolio choice of banks is strongly influenced by cyclical effects. Typically during an economic slowdown, banks exhibit a pro-cyclical flight to safety preferring risk-free government securities to loans. This is further re-inforced by risk-based capital requirements. In the upturn, banks' portfolio preference shifts to high-returns credit. Underlying these overarching behaviourial characteristics are the fundamental determinants of bank credit and investments which play a decisive role in banks' portfolio selection.

Portfolio management approaches study the allocation of available funds to the banks (deposits and capital, adjusted for required reserves) across 'liquid assets', 'investment assets' and 'loans'. The desired size of liquid assets typically varies directly but less than proportionately with the size of deposits A bank's holdings in investment assets are determined by the expected rate of return and its variability. Loans are assets with highest risk and least liquidity, with expected return and risk determined in negotiations between borrower and lender. The combined effect of all the elements in the "loan terms" vector would determine the expected rate of return and risk on loans. An impulse in the form of deposit inflows would result in portfolio adjustment with immediate expansion of liquid assets like short-term investments and cash in hand, followed by movements towards long-term securities. The movement of funds towards loans is rather slow on account of both lender and borrower inertia.

The US experience suggests that shortly after the introduction of Basel I risk-based capital requirements, banks decreased the share of commercial and industrial

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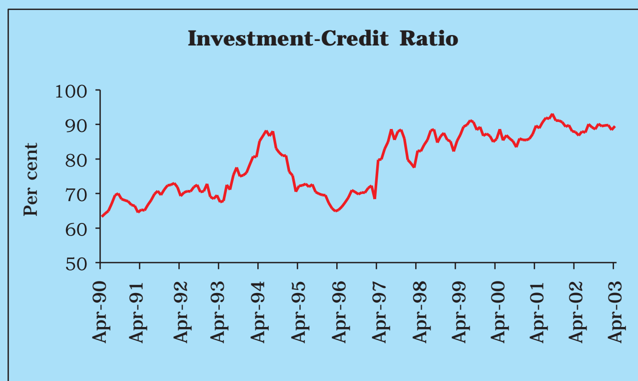
loans in total bank credit. The introduction of risk-based capital requirements and greater regulatory scrutiny of business loans encouraged banks to hold safer assets such as government securities and disfavoured commercial lending. The downturn in activity and secular shifts towards off-balance sheet items like letters of credit and loan commitments exacerbated the decline in commercial lending due to enforcement of regulatory standards.

The Indian experience shows that banks' investment-credit ratio has shown a steady upward movement over the 1990s (Chart). Empirical investigation suggests that both credit and investment are integrated of the same order *i.e.,* they exhibit strong co-movement in the long-run. Accordingly, if cyclical influences are cleaned out, expansion in bank credit tends to crowd in investment. It is only in phases of overall slowdown that risk aversion produces divergencies.



An empirical investigation of the credit dynamics of banks in India showed that the demand for non-food credit is predominantly influenced by the behaviour of industrial activity and is inversely related to the bank lending rate. Supply of bank credit is found to be positively influenced by the lending rate and its past behaviour, indicative of rigidities in the interest structure in India. Banks' investment in government securities is primarily influenced by the state of development of the gilt market and the application of prudential norms. A cross sectional analysis shows that public sector banks tend to be relatively more risk-averse with high share of deposits in their liabilities and higher share of gilt investments in assets. Contrasting behaviour is revealed by foreign banks and new private sector banks.

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3.16 As in the past, net foreign assets of the banking system continued to be dominated by large accretions to the Reserve Bank's foreign currency assets on account of purchases of foreign currency from banks. Scheduled commercial banks' foreign currency assets declined (Chart III.7). Expectations of a strengthening domestic currency combined with positive differentials between domestic and international interest rates seem to have produced a distinct home bias. This resulted in substantial net inflows of banking capital in the form of reduction in investments in foreign paper, substitution of foreign currency deposits by non-resident rupee deposits and higher overseas borrowings.

3.17 Banks have been steadily building up their capital accounts in the form of statutory capital, investment fluctuation and revaluation reserves, with a relatively small component of fresh equity issuances. During 2002-03, scheduled commercial banks' capital and reserves increased further, in consonance with their rising investments in government securities and greater freedom in respect of managing foreign assets. New issues of subordinated debt for Tier II capital during the year also augmented the banking system's capital account.

Chart III.7 : Commercial Banks' Foreign Currency Assets

Rupees crore

Mar-01 May-01 Jul-01 Sep-01 Nov-01 Jan-02 Mar-02 May-02 Jul-02 Sep-02 Nov-02 Jan-03 Mar-03

Table 3.7 : Variations in Money Supply

(Rupees crore)

	Year-on-year Variation			
	As on August 8, 2003		As on August 9, 2002	
	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5
Broad Money (M_3)	**1,86,673**	**11.4**	**1,99,334**	**14.3**
Major Components				
Currency with Public	31,717	12.5	30,910	13.8
Aggregate Deposits	1,54,071	11.2	1,68,320	14.4
Major Sources				
Net Bank Credit to Government	68,822	10.6	84,465	15.0
of which: by Reserve Bank	-68,421	-44.4	-11,921	-7.2
Bank Credit to Commercial Sector	87,306	10.6	86,723	12.5
of which: Scheduled Commercial Banks non-food Credit	90,717	15.3	73,230	15.4
Net Foreign Exchange Assets (NFEA) of the Banking Sector	83,426	24.3	88,514	34.7

Developments during 2003-04

3.18 Year-on-year broad money (M_3) expansion decelerated during 2003-04 (as on August 8, 2003) mainly on account of slowdown in aggregate deposits. Deceleration in time deposits growth continued in response to lower interest rates and the continuing impact of last year's drought. Among the sources, growth in net bank credit to the Government decelerated. Bank credit to commercial sector slowed down primarily on account of decline in food credit which, in turn, was due to lower procurement and higher off-take. Commercial banks' non-food credit remained more or less steady in consonance with industrial growth (Table 3.7). Non-SLR investments declined mainly on account of a decline in banks' investments in bonds/debentures.

Commercial Banking Survey

3.19 Commercial banks continue to be the dominant financial intermediaries in India, especially with the slackening of activity in other segments of the financial system in the downswing of the business cycle. Consequently, movements in the assets and liabilities of the commercial banks have a determining influence on the behaviour of monetary and credit aggregates. The commercial banking survey provides a bird's eye view of the flow of funds within the financial system between sources and uses during the year which needs to be superimposed upon the annual variations.

3.20 Liquidity in the banking system expanded on the back of the usual first quarter upturn in domestic deposits tapering off over the remaining quarters. The release of resources through the reduction in the CRR helped to augment the liquidity generated in the banking system. Call/ term borrowings from financial institutions decelerated sharply up to the third quarter due to ample liquidity conditions. In the fourth quarter, however, banks' call borrowings spurted due to relatively tight money market conditions.

3.21 As regards the uses of funds, the off-take of bank credit by the Government was heaviest in the first quarter, reflecting the launch of the market borrowing programme of the Centre. Growth in bank credit to the government dipped in the subsequent quarters. The pick-up in non-food credit occurred steadily from the second quarter of 2002-03. Banks' investments in non-SLR investments declined sharply in the fourth quarter following reduction in their investments in commercial papers and units of mutual funds. Net foreign assets of banks were drawn down from the second quarter onwards. Foreign currency repatriable deposits declined from the third quarter; overseas borrowings of banks rose, particularly during the second half of the year. With the prevailing easy liquidity conditions and phasing out of the collateralised lending facility (CLF), net bank reserves started increasingly reflecting the movements in the CRR requirements and LAF operations. A large build-up in the capital account occurred in the first quarter of the year reflecting mergers in the banking system and reserve accumulation by the banks (Table 3.8).

3.22 The flow of resources from non-banks by way of capital issues, GDRs/ADRs/FCCBs, CPs and credit from financial institutions (FIs) to the commercial sector continued to be subdued. Credit from FIs shrank for the second consecutive year due to slowdown in their new business while loans extended by them in the past were repaid. Capital issues dwindled under depressed conditions in the primary market and waning of corporates' interest due mainly to sluggish investment activity (Table 3.9).

Table 3.8 : Operations of Scheduled Commercial Banks : Variations

(Rupees crore)

	Outstanding as at end- March 2003	2002-03				2001-02			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Components									
Aggregate Deposits of Residents	**11,58,942**	**52,675**	**32,201**	**37,484**	**24,073**	**53,337**	**20,856**	**29,675**	**32,122**
Demand Deposits	1,70,289	4,717	-4,535	11,654	5,405	5,392	-9,382	10,074	4,412
Time Deposits of Residents	9,88,653	47,958	36,735	25,829	18,668	47,945	30,237	19,601	27,710
Call/Term Funding from Financial Institutions	**12,638**	**6,448**	**792**	**227**	**2,142**	**-341**	**1,865**	**409**	**-1,471**
Sources									
Credit to the Government	**5,23,417**	**47,047**	**18,716**	**22,680**	**23,798**	**24,213**	**21,088**	**13,791**	**12,049**
Credit to the Commercial Sector	**8,46,494**	**22,825**	**20,322**	**39,481**	**27,881**	**9,349**	**11,217**	**31,320**	**33,676**
Food Credit	49,479	7,030	-7,645	-1,415	-2,468	10,349	-2,079	4,015	1,702
Non-food Credit	6,35,192	7,522	19,945	32,541	39,439	-2,367	12,649	25,673	28,347
Net Credit to Primary Dealers	4,093	2,874	5,817	959	-5,886	221	-401	115	526
Investments in Other Approved Securities	24,129	-1,233	-459	-965	-306	-997	62	-1,452	-644
Other Investments (in non-SLR Securities)	1,33,601	6,633	2,664	8,361	-2,898	2,143	986	2,970	3,745
Net Foreign Currency Assets of Commercial Banks	**-68,366**	**2,748**	**-15,136**	**-9,027**	**-8,820**	**4,952**	**-941**	**-3,544**	**-2,670**
Foreign Currency Assets	31,082	4,718	-14,412	-7,955	-5,345	5,886	2,023	-1,996	-3,483
Non-resident Foreign Currency Repatriable Fixed Deposits	92,240	1,655	669	-230	-703	835	2,018	1,425	475
Overseas Foreign Currency Borrowings	7,208	315	55	1,302	4,178	99	946	123	-1,288
Net Bank Reserves	**65,823**	**-2,943**	**11,055**	**-1,619**	**-5,700**	**16,304**	**-7,373**	**-1,277**	**-3,929**
Capital Account	**86,541**	**15,152**	**-742**	**-1,815**	**1,625**	**4,403**	**2,297**	**958**	**1,150**
Memo Items									
Release of Resources through change in CRR	–	6,500	0	3,500	0	4,500	0	8,000	0
Net Open Market Sales to Commercial Banks	–	3,131	13,228	12,803	7,338	4,106	9,614	1,904	0

Note : Deposits have been adjusted for the full impact of the mergers while credit has been adjusted for the initial impact of the same since May 3, 2002.

Table 3.9 : Flow of Resources from Non-Banks to Commercial Sector

(Rupees crore)

Item	2002-03	2001-02
1	2	3
1. Capital Issues $ * (i+ii)	642	1,984
i) Non-Government Public Ltd. Companies (a+b)	642	1,634
a) Bonds/Debentures	218	774
b) Shares	424	860
ii) PSUs and Government Companies	0	350
2. Global Depository Receipts (GDRs)/American Depository Receipts (ADRs) and Foreign Currency Convertible Bonds (FCCBs) $	3,426	1,528
3. Issue of CPs #	1,812	676
4. Financial assistance extended by Financial Institutions (net) @ +	-4,848	-3,469
5. Total (1 to 4)	**1,032**	**719**

Data provisional.

$ Gross issuances excluding issues by banks and financial institutions.

Excluding issuances by financial institutions and banks' investments in CPs.

* Figures are not adjusted for banks' investments in capital issues, which are not expected to be significant.

@ Based on annual accounts, excluding ICICI Ltd. Comprises loans and advances, equity, other investments and bills of exchange and promisory notes discounted/rediscounted.

+ Includes IDBI, IFCI Ltd., IDFC Ltd., EXIM Bank, IIBI Ltd., SIDBI and TFCI Ltd.

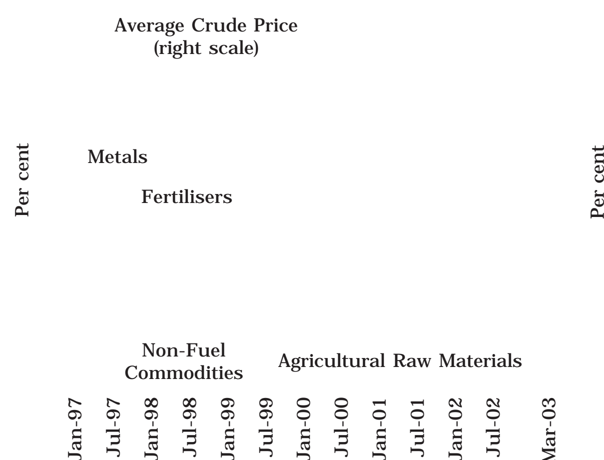
PRICE SITUATION

3.23 Inflation remained low in India over the first three quarters of 2002-03 in a benign international inflation environment. In the US and the Euro area, inflation was close to two per cent. Output gaps held down inflation in most of the industrial countries. Declining inflation raised the fears of deflation in several countries. The Japanese experience of prolonged decline in prices, bound in a spiral of weak activity and financial stress, is being examined afresh as several Asian countries (China, Hong Kong, Singapore, Taiwan and Thailand) joined Japan in deflation, either intermittently or persistently. Inflation continued to decline across the Commonwealth of Independent States (CIS) region and Africa, aided by progress in fiscal consolidation. Countries in Latin America and Russia faced significant inflation risk. Consumer prices are expected to increase by less than two per cent in 2003 in advanced economies and by just under six per cent in developing countries (World Economic Outlook, IMF, April 2003) (Chart III.8).

Chart III.8 : Global Inflation Environment (Consumer Price Inflation)

Note : Data for 2003 are IMF projections.
Source : World Economic Outlook, IMF, April 2003.

Chart III.9 : International Commodity Price Movement (Year-on-year)



3.24 International commodity prices recovered in 2002 after bottoming out in late 2001. Non-fuel commodity prices, however, remained bound by weak demand and inventory drawdown. In 2002, metal prices recovered weakly with stocks of key metals at comfortable levels. International prices of food items, agricultural materials and beverages firmed up in 2002, mostly due to adverse weather conditions in a number of regions. International crude prices rose markedly from early August 2002 up to early 2003 owing to the geo-political situation in Iraq (Chart III.9).

3.25 Headline inflation firmed up in June and July 2002 on the back of two rounds of increases in POL prices, and the impact of drought conditions which drove up prices of oilseeds and edible oils in the first half of the year. Inflation started easing in the second half of September 2002 as supply management strategies - step up in off-take, reduction in issue prices below economic cost, enhanced allocation for targeted employment programmes and imports - were put in place.

3.26 Reflecting the global situation, inflation in India firmed up in the last quarter of 2002-03, driven up by the hardening of international oil prices and supply side pressures on items like oil seeds, edible oils and oil cakes. Between December 14, 2002 and the end of March 2003 inflation rose by 3.3 percentage points, contributed mainly by prices of manufactures and POL prices. Statistical base effects arising out of a declining price level in 2001-02 were embedded in the inflation outturn during this period, tapering off towards the end of the year (Table 3.10).

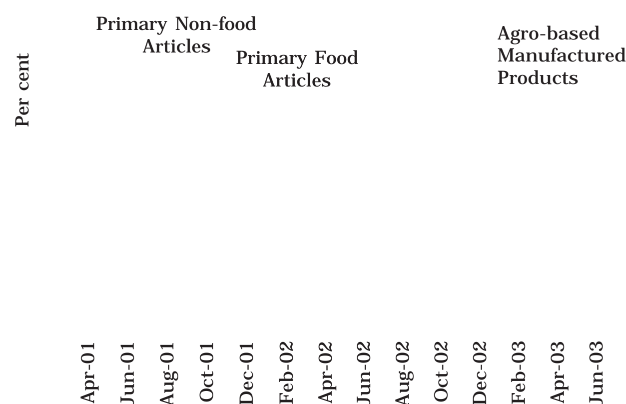
Table 3.10 : Disaggregated WPI Inflation

(Per cent)

Groups	Inflation Rate			Weighted Variation	
	Mar. 29, 2003	Feb. 22, 2003	Dec. 14, 2002	Feb. 22, 2003 over Dec. 14, 2002	Mar. 29, 2003 over Dec. 14, 2002
1	2	3	4	5	6
Fuel Group	10.8	7.5	4.4	0.5	1.6
Primary Articles	6.1	6.3	3.3	0.3	0.4
Manufactures	5.1	4.4	2.8	0.9	1.2
Base Effect	–	–	–	0.6	0.1
All Commodities	**6.5**	**5.5**	**3.2**	**2.3**	**3.3**

3.27 Within the overall variation in wholesale price inflation, disaggregated commodity price movements indicate that the inflation record of 2002-03 was dominated by the prices of non-food items; in contrast, it was primary food items which drove inflation in the preceding year. The drought conditions initially affected the prices of oil seeds and sugar cane. Eventually, the prices of primary non-food articles went up substantially in the post-*kharif* period, reflecting the visceral effects of moisture stress on the production of primary commodities. Prices of agro-based products in the manufacturing category rose contemporaneously (Chart III.10).

Chart III.10 : Agro-based Commodity Price Movements (year-on-year)



3.28 Prices of manufactures rose towards the close of 2002-03 on account of firming up of prices of items like iron and steel and cotton textiles reflecting improvement in the industrial climate. Domestic prices of metals and fertilisers weathered the volatility of international price movements (Table 3.11).

3.29 Edible oils and oil cakes recorded the highest order of price rises. Shortfalls in the domestic production of oilseeds necessitated imports of edible oils which account for about one-half of domestic demand. Consequently, the domestic prices of edible oils displayed close co-movement with international prices of edible oils, indicative of the import content of domestic inflation (Chart III.11).

3.30 Underlying inflation (measured by average WPI) during 2002-03 was dominated by the behaviour of the manufactured products group (Chart III.12). Within manufactures, edible oils, oil cakes and man-made fibres were the primary sources of inflation.

Table 3.11 : WPI Inflation by Component (Base: 1993-94=100)

(Per cent)

Group/Item	Weight	Weighted contribution to overall Inflation in 2002-03	Annual Point-to-Point Inflation		
			2002-03	2001-02	2000-01
1	2	3	4	5	6
All Commodities	**100.0**	**100.0**	**6.5**	**1.6**	**4.9**
I. Primary Articles	**22.0**	**21.6**	**6.1**	**3.9**	**-0.4**
a. Food Articles	15.4	2.2	0.8	5.2	-2.8
i) Cereals	4.4	2.9	4.0	0.8	-5.5
ii) Fruits and Vegetables	2.9	-0.6	-1.2	14.4	-2.9
b. Non-food Articles	6.1	19.3	22.1	0.6	6.0
i) Fibres	1.5	4.9	26.5	-17.9	7.4
ii) Oil Seeds	2.7	10.6	30.0	6.8	2.8
iii) Sugarcane	1.3	2.8	11.5	6.2	10.5
II. Manufactured Products	**63.7**	**44.3**	**5.1**	**0.0**	**3.8**
a. Food Products	11.5	14.0	8.7	0.3	-3.1
i) Sugar	3.6	-7.0	-15.0	-3.8	-0.9
ii) Edible Oils	2.7	8.5	27.4	12.5	-4.8
iii) Oil Cakes	1.4	8.8	40.3	15.0	0.4
b. Chemical and Chemical Products	11.9	8.2	4.2	2.5	4.0
of which: Fertilisers	3.7	1.2	2.1	3.6	3.4
c. Cement	1.7	0.3	1.1	-4.7	20.3
d. Basic Metals, Alloys and Metal Products	8.3	7.3	6.6	-0.9	3.2
of which: Iron and Steel	3.6	4.4	9.2	0.0	1.3
e. Machinery and Machine Tools	8.4	0.5	0.5	2.0	9.5
f. Transport Equipment and Parts	4.3	-0.6	-0.9	1.3	5.8
III. Fuel Group	**14.2**	**33.9**	**10.8**	**3.9**	**15.0**
a. Mineral Oils	7.0	29.7	18.4	1.2	17.0
b. Electricity	5.5	4.2	3.4	9.2	11.5
Food Items (composite)	**26.9**	**16.2**	**3.9**	**3.3**	**-2.9**
Agro-based Manufactured Products #	**28.3**	**27.4**	**7.4**	**-1.4**	**1.3**
Non-food Items (WPI excluding Food)	**73.1**	**83.8**	**7.5**	**1.0**	**8.0**
WPI excluding Food Items and Mineral Oils	**66.1**	**54.2**	**5.6**	**1.0**	**6.7**
Memo Items					
Average WPI Inflation			3.4	3.6	7.2
GDP Deflator			2.3	3.4	4.3
Services in CPI-IW @	16.4	21.5*	5.3	4.9	5.6
Housing in CPI-IW	8.7	13.2*	5.4	12.9	6.4

Includes manufactured food products, beverages, tobacco and tobacco products, textiles, wood and wood products, paper and paper products, leather and leather products and rubber and plastic products.
@ Miscellaneous Group in the Consumer Price Index for Industrial Workers (CPI-IW).
* Weighted contribution to CPI-IW Inflation in 2002-03.

Chart III.11 : Movement in Prices of Edible Oil

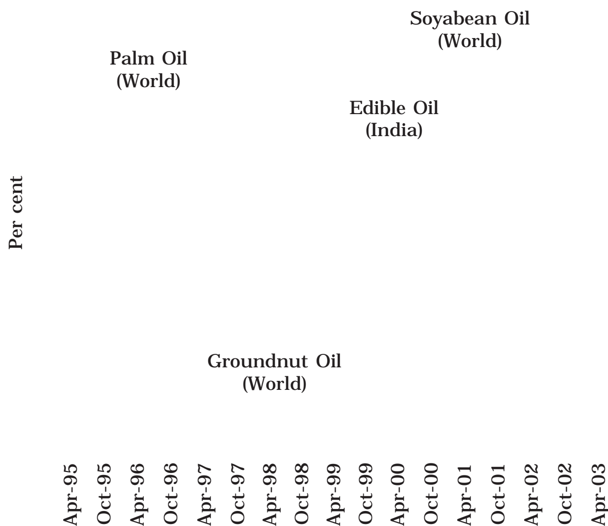
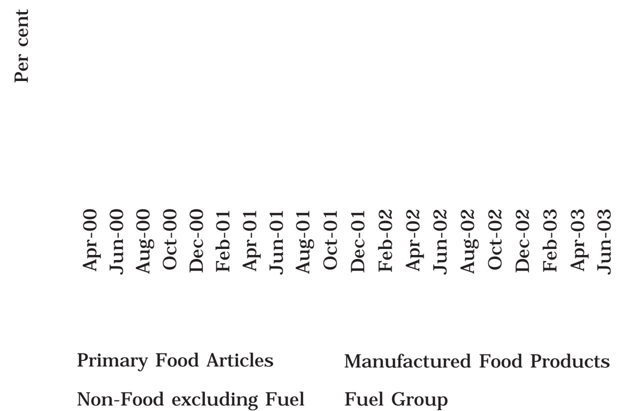


Chart III.12 : Weighted Contribution of Major Groups to WPI

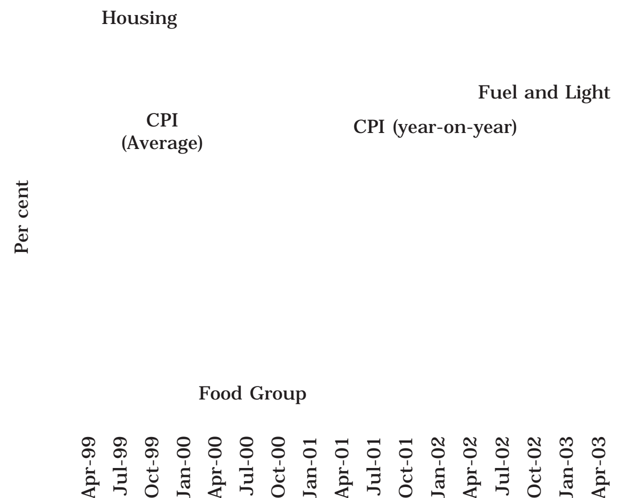


Consumer Price Inflation

3.31 Consumer price inflation, measured by the annual variation in the average consumer price index for industrial workers (CPI-IW) eased during the year, reflecting lagged adjustments to agricultural supply disturbances (Chart III.13 and Appendix Table III.13). Disaggregated commodity price movements within the CPI-IW basket broadly mirrored the wholesale price inflation. Food prices recorded moderate increase, primarily due to a sharp rise in the prices of oils and fats which edged up from 9.6 per cent at the beginning of the year to 34.9 per cent by March 2003. Housing inflation eased while services inflation (proxied by the broad miscellaneous group) was steady at around 5 per cent. The rise in international oil prices had a significant impact on retail inflation as the major part of domestic consumption is met through imports. During 2003-04 so far (upto June), consumer price inflation on a year-on-year basis was 4.4 per cent, marginally higher than that of 4.2 per cent a year ago.

3.32 The 1990s have been widely regarded as the era of price stability. Beginning in the early part of the decade, developed and developing countries alike experienced a distinct ebbing of inflation. The attainment of sustained price stability is attributed to structural changes in the global economy, productivity gains, favourable supply shocks as well as a credibility bonus to the institutional reform of monetary policy. More than independence, it is legitimacy and accountability that has underpinned the reputational eminence of monetary authorities. Increasingly, monetary authorities have set up internal policy analysis procedures within a precise framework in which inflation expectations are communicated to the public, including a thorough evaluation of the adjustment paths of policy action through which deviations of actual inflation from expectations would be corrected. Understanding the formation of inflation expectations has implications for the efficiency of forward-looking monetary policy. Country practices reveal a wide diversity in the efforts to obtain a reliable gauge on inflation conditions (Box III.4).

Chart III.13 : Consumer Price Inflation (year-on-year)



Box III.4

Monitoring Inflation: What are Central Banks Doing?

Central banks employ a variety of methods to assess inflation expectations including expectation surveys, yield spreads between nominal and indexed bonds, output gaps, unemployment and capacity utilisation information as well as econometric models relying on state-of-the-art techniques. Typically, these efforts are reflected in their communication to the public in the form of publications dedicated to the monitoring of inflation. The objective is to sensitise the public to the complexities associated with the formulation of the monetary policy strategy and the uncertainties upon which it is contingent, the confidence intervals within which the inflation expectations have to be assessed and also to enhance the reputation of the central bank's inflation forecasts.

Following the tradition begun by the Bank of England in 1993, 12 countries produce inflation reports (IRs) while others employ established dissemination vehicles like statements on monetary policy (Australia, Canada, South Korea, South Africa, New Zealand and Chile), Bulletins (Iceland and Switzerland) and Statements to Parliament (Colombia). These reports are usually of a quarterly frequency while some central banks adopt semi-annual reporting cycles. Typically, IRs present a discussion of the objectives of policy, the decision making process and how conflicting objectives are reconciled, the analytical framework and the information set on which policy is based, the inflation forecasts and evaluation of past policy performance. In most IRs, the inflation target and the tolerance margin are explicitly set out. The Bank of England adopts a point target. Others mostly specify a range with varying degrees of precision. The standard practice is to use one or more models to generate forecasts of inflation on the basis of available information. Assumptions are usually set out clearly. Off model corrections are another typical features of IRs, undertaken to incorporate the disconnect with the reality that formal models relegate to error terms. Inflation forecasts are typically undertaken by the staff of the monitoring authorities although in some countries private sector forecasts are also used (Brazil, Czech Republic, Mexico and the Philippines).

Eclectic evaluation of IRs suggests that central banks have acquired specialised competency in analysis of inflation. The analysis of macroeconomic conditions is rated as less than adequate as is the presentation of the risks involved in the policy choices and the discussions of monetary policy committees. Several central banks adopt the use of fan charts, among other devices, to present forecast uncertainty; however, the width of the fans is rarely adjusted to reflect time varying uncertainty (Sweden is the notable exception). Forecast horizons vary from one year to two years; New Zealand extends its forecasts to three years while Poland does not report forecasts. Almost all central banks also report forecasts of GDP growth, with only five reporting forecasts for unemployment (Iceland, Israel, New Zealand, Norway and Sweden). Central banks in Brazil and Israel forecast the current account in the balance of payments. Only Brazil and Thailand report a formal model for inflation forecasting; others present their procedures informally. Most central banks do not provide their views on interest rates and exchange rates in the future. Two countries - Chile and New Zealand - present the expected path of exchange rates while the Philippines and Thailand use explicit exchange rate equations in their forecasting models. Most IRs make a presentation of how policy is set (Australia, Norway and Sweden being exceptions). Policy decisions, however, are generally announced outside the IRs. The preferred vehicle is a press release, followed by press conferences. IRs typically fulfill an educational function.

Communication policies of monetary authorities have been transformed in recent years. IRs as a means to present relevant information are increasingly getting integrated into the authorities' 'overall communication strategy'. Their success in achieving low and stable inflation and the publication of high quality IRs seem to be linked in a virtuous circle. Considerable experience has been accumulated in the preparation of IRs and in anchoring public acceptance. The advantage of being a late entrant in the process is that, the 'best practices' are well known and that it is possible to catch up.

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Outlook

3.33 Upside risks from international oil prices for domestic inflation began to ebb with fortnightly downward revisions in domestic mineral oils (POL) prices beginning April 16, 2003. Point-to-point WPI inflation which had spurted to 6.9 per cent on May 3, 2003 caused by the one-time upward revision in electricity prices and the transporters' strike edged down below 4.0 per cent by August 2, 2003. Supply side effects on prices of primary articles due to transport disruptions in April 2003 turned out to be transient and impacted mainly on prices of fruits and vegetables. Driving inflation down was the softening of POL prices and manmade fibres. POL prices fell

by 7.5 per cent and manmade fibres by 5.2 per cent between end-March 2003 and August 2, 2003. Taken together, their weighted contribution to point-to-point inflation fell sharply from 35.5 per cent at the end of March to 15.6 per cent on August 2, 2003. More information on the progress and spread of rainfall needs to be juxtaposed with the July forecasts of a normal monsoon (98 per cent of the long period average) in the approaching season before a short-term prognosis of the effects on prices of primary articles can be made. Accordingly, prices of manufactures, which account for over two-third of inflation in terms of WPI, hold the key to the short-term inflation outcome.

3.34 International prices of vegetable oils and meals had firmed up in the first half of 2003 as global stocks of oil and fats declined for the third consecutive year on account of production shortfall caused by adverse weather. These have eased somewhat in recent weeks on expectations of higher production. Palm oil imports rose sharply following the reduction in customs duty on refined palm oil from 92 per cent to 70 per cent on April 30, 2003. These imports have restrained edible oil prices to some extent. While cotton prices have firmed up, the recent rationalisation of the duty structure and retention of excise exemptions in the Union Budget 2003-04 is expected to keep cotton textile prices range bound ahead of the dismantling of the quotas. Price competition from man-made textiles is a growing threat to low value addition cotton-based industry. Globally, the steel industry is grappling with over capacity. Nevertheless, with export demand picking up, steel prices in India are expected to remain firm in the short term. India is a price taker in petrochemicals including manmade fibres and the domestic market is closely linked to global developments. Accordingly, petrochemical price movements in India are expected to be capped by imports. Urea, di-ammonium phosphate and single super phosphate are widely used in India as fertiliser. There is an upsurge in the international prices of phosphatic fertilisers though the outlook remains vulnerable to wide price fluctuations. Urea prices continue to be controlled. Based on the evolving international environment, the movement of key international prices and the underlying monetary conditions in India, inflation in India is expected to be in the range of 5.0 to 5.5 per cent as projected in the Monetary and Credit Policy for 2003-04.

3.35 Monetary conditions in 2003-04 are expected to be dominated by external capital flows. During 2003-04 so far (up to August 8), the net foreign assets of the banking sector rose by Rs.32,997 crore. The demand for non-food bank credit is likely to be maintained on the rising trajectory which began in early 2002, given the positive investment climate and the anticipation of a recovery in agricultural activity. Notwithstanding the projected expansion of non-food credit (15.5 to 16.0 per cent) and the size of borrowings of the Government sector, capital inflows, the release of resources through the CRR cut in June 2003 and lower order of food credit growth, monetary and liquidity conditions would facilitate a soft and flexible interest rate regime, consistent with the monetary policy stance.

IV GOVERNMENT FINANCES

4.1 The slowing of economic activity due to the drought impacted on public finances in 2002-03. In the revised estimates, the combined gross fiscal deficit of the Centre and States overshot its budgeted level by more than one per cent of GDP on account of the shortfall in tax revenue and disinvestment from budget estimates. Furthermore, the imperatives for food supply management in the context of the drought necessitated fiscal support in the form of higher food subsidies, which surged back almost to 1991-92 level as a proportion to GDP. Despite these setbacks, there were distinct gains in expenditure management. The Centre reined in its expenditure by pruning non-plan spending. On the other hand, the States' expenditure exceeded budget estimates, but this was mainly in the form of a spurt in capital expenditure towards debt consolidation. Importantly, States were able to contain the revenue expenditure around the budgeted level. Notwithstanding these modest successes in expenditure containment, the slippages from the budgetary projections underscore the deterioration in the quality of fiscal adjustment.

4.2 The tax-GDP ratio has been losing buoyancy over the 1990s, falling by more than two per cent of GDP by the year 2001-02 from the level attained in the late 1980s. This imparts urgency to reforms in the tax regime in the form of simplification of rules, widening the tax base, reviewing exemptions and improving compliance. The surge in interest payments following reforms in budgetary financing has continued unabated, and it is only in 2002-03 that some moderation in pace has set in. The steady improvement in the primary deficit coupled with fall in capital outlay during the 1990s indicates that the burden of the unrelenting expansion in interest outgoes has devolved on productive elements of fiscal spending. The overarching priority attached to reduction of expenditure to meet deficit targets has accentuated the erosion of capital outlays with serious implications for expanding the productive capacity of the economy in the future. Expenditure on subsidies has remained impervious to fiscal adjustment, while spending on social infrastructure continues to remain low. Large gaps in disinvestment have intensified the fiscal stress. Reflecting these adverse developments, the debt-GDP ratio has been climbing since the second half of the 1990s and is expected to touch 77 per cent of GDP by the end of March 2004. Moreover, the monotonic rise in public debt has eroded the Government sector's ability to generate savings and to service its internal debt. The "quality" of the fiscal deficit has worsened, with the revenue deficit having increased substantially indicating that a larger share of borrowed fund is pre-empted by consumption expenditure. (Table 4.1).

Table 4.1: Indicators of Fiscal Policy

Items	2003-04 (BE)	2002-03 (RE)	2001-02	1995-96	1990-91
1	2	3	4	5	6
		(Per cent of GDP)			
Quantitative Indicators					
Gross Fiscal Deficit	9.2	10.1	9.9	6.5	9.4
Revenue Deficit	5.9	6.7	6.9	3.2	4.2
Primary Deficit	2.8	3.6	3.7	1.6	5.0
Qualitative Indicators					
Revenue Receipts	19.0	19.1	17.4	18.3	18.6
Tax Revenue	15.1	14.9	13.7	14.7	15.4
Direct Taxes	4.3	4.2	3.6	3.5	2.5
Indirect Taxes	10.8	10.7	10.1	11.2	12.9
Total Expenditure	29.6	30.4	28.5	25.6	28.8
Developmental Expenditure	14.6	15.4	14.3	13.9	17.4
Non-developmental Expenditure	15.0	15.1	14.1	11.6	11.4
Interest Payments	6.4	6.5	6.2	5.0	4.4
Debt	76.9	75.5	71.1	58.0	61.7
		(Per cent)			
Capital Outlay/ Total Expenditure	11.2	9.6	9.0	10.7	13.1
Interest Payments/ Revenue Receipts	33.7	34.0	35.6	27.2	23.6
Revenue Deficit/ GFD	64.0	66.7	70.4	48.8	44.6

Note : All indicators are based on combined data of the Centre and States. For States, data are provisional for the years 2001-02 onwards.

CENTRAL GOVERNMENT FINANCES, 2002-03

Expenditure Management

4.3 Expenditure management strategies put in place by the Centre since the second half of the 1990s have begun to yield room for fiscal manoeuvre, notwithstanding the slippages in terms of deficit indicators in the recent years. Despite additional expenditure on account of drought relief and Plan allocations, cuts in non-Plan expenditure enabled a reduction in overall spending (as per revised estimates *vis-à-vis* budget estimates) by the Centre in 2002-03. The reduction in non-Plan expenditure was on account of lower defence spending, reduced interest payments due to softening in the interest rate on Government securities, lower outgo on pension as well as grants and loans to States and UTs due to non-utilisation of funds under the 'Fiscal Incentive Fund'. The expenditure on subsidies, however, increased significantly during 2002-03 reflecting the impact of dismantling of the Administered Price Mechanism (APM) for petroleum products as also the increase in food subsidy on account of drought conditions. Till the dismantling of the APM, subsidies on various petroleum products were absorbed in the oil pool account. With the discontinuance of the latter since 2002-03, the subsidies for domestic Liquefied Petroleum Gas (LPG), Public Distribution System (PDS) kerosene and freight for far flung areas now fall on the budget (Table 4.2).

4.4 The gains in expenditure restraint, *albeit* limited, have strengthened the commitment to fiscal consolidation. They have prepared the ground for adequate forecasting and financial planning so as to ensure that the overall gains of fiscal prudence are also reflected in efficient intra-year cash management. Effective cash management helps in conserving scarce cash resources and ultimately, in controlling aggregate spending and the budgetary gap. In the context of Central Government finances, it is observed that the intra-year divergence between revenue flows and expenditure is high. There is also a tendency of bunching of expenditure during the latter part of the fiscal year (Chart IV.1).

4.5 The initiative to introduce cash management on a pilot basis in major spending Ministries in the 2003-04 budget needs to be seen

Table 4.2 : Aggregate Expenditure of the Centre

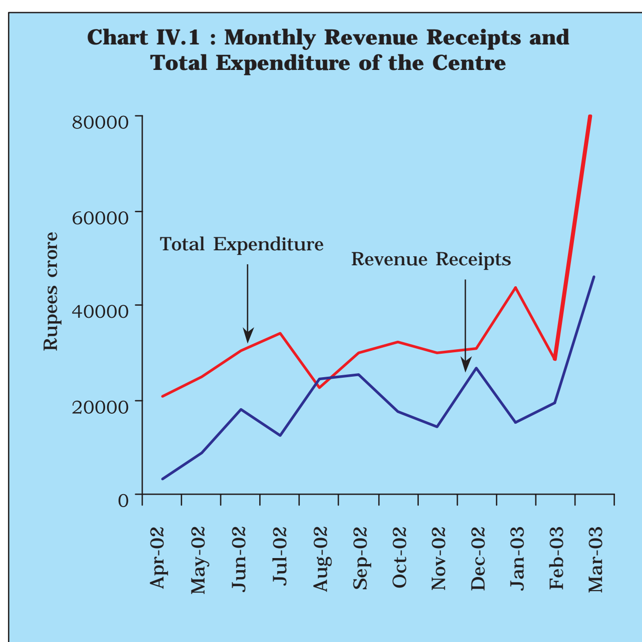
(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03)	
						Amount	Per cent
1	2	3	4	5	6	7	8
Total Expenditure (1+2=3+4)	4,04,013 (16.3)	4,10,309 (16.0)	3,62,453 (15.8)	1,78,275 (15.0)	1,05,298 (18.5)	-6,296	-1.5
1. Non-Plan Expenditure *of which:*	2,89,924 (11.7)	2,96,809 (11.6)	2,61,259 (11.4)	1,31,901 (11.1)	76,933 (13.5)	-6,885	-2.3
Interest Payments	1,15,663 (4.7)	1,17,390 (4.6)	1,07,460 (4.7)	50,045 (4.2)	21,498 (3.8)	-1,727	-1.5
Defence	56,000 (2.3)	65,000 (2.5)	54,266 (2.4)	26,856 (2.3)	15,426 (2.7)	-9,000	-13.8
Subsidies	44,618 (1.8)	39,801 (1.6)	31,207 (1.4)	12,666 (1.1)	12,158 (2.1)	4,817	12.1
2. Plan Expenditure	1,14,089 (4.6)	1,13,500 (4.4)	1,01,194 (4.4)	46,374 (3.9)	28,365 (5.0)	589	0.5
3. Revenue Expenditure	3,41,648 (13.8)	3,40,482 (13.3)	3,01,611 (13.1)	1,39,861 (11.8)	73,516 (12.9)	1,166	0.3
4. Capital Expenditure@	62,365 (2.5)	69,827 (2.7)	60,842 (2.6)	38,414 (3.2)	31,782 (5.6)	-7,462	-10.7

RE : Revised Estimates. BE : Budget Estimates.

@ Includes capital outlays and loans and advances.

Note : Figures in brackets are per cent of GDP.



as an important step forward towards effective expenditure management. The cross-country experience indicates that the time-sliced release of funds for spending and incentive-based cash management practices contribute to overall fiscal discipline (Box IV.1).

4.6 Subsidies have almost doubled in the last five years with a sharp increase in 2002-03. Food and fertiliser subsidies account for 87.4 per cent of the expansion in subsidy spending since 1990-91. Food subsidy, mainly financing the buffer carrying cost and producers' subsidy, has been rising *pari passu* with the accumulation of foodstocks. The fiscal impact of the increase in foodgrain stocks is visible in the unprecedented expansion in food subsidies since 2000-01. On the other hand, the rationalisation of the Retention Price Scheme and enhancement of the maximum retail price of fertilisers has had positive effects on fertiliser subsidies. The budget for 2001-02 announced a phased programme of

Box IV.1
Public Expenditure : Cash Management

Public expenditure management involves determination of the size of the budget, size of the outlays on different functions and the magnitude of outlays on various programmes within the resource constraints at various stages of government decision making. A core element of public expenditure management is cash management which involves conservation and optimisation of cash flow and a sensitivity to cash costs. Effective cash management involves (a) forecast of receipts, disbursements and the resulting cash balances within the governmental financial system on a high frequency basis; (b) strict control over cash inflows to minimise time lags between expected and actual receipts; (c) cash outflow control to prevent both late and premature payments; and (d) minimising operating cash balances.

Cross-country experience indicates that three types of practices for releasing funds are in existence. In countries where budgeted amounts are available soon after the budget is approved (few British Commonwealth countries and some economies in transition), a system of time-sliced releases is in existence. An alternative arrangement is one under which formal warrants are issued by the Ministry of Finance in response to requests from the spending agencies. Such requests have no defined periodicity and primarily reflect the changing seasonal requirements for outlays other than those on personnel. Under the third type of arrangement, fixed amounts are released for commitment and payment on either a monthly or a quarterly cycle.

All these arrangements regulate the release of cash rather than amounts of cash to be credited to spending agencies. Institutional arrangements for aggregate fiscal discipline can range from constitutional restraints on aggregate expenditure (*e.g.*, Indonesia) through formal laws (*e.g.*, Maastricht, New Zealand, Australia) to public commitments by the executives with or without the commitment of the legislature (*e.g.*, U.S.). Incentive-based practices are followed in some countries like Sweden where the annual budget appropriations are deposited into each agency's interest-bearing account. Slow spending agencies get some interest earnings and the fast spenders have to pay interest. Also, to avoid the end-of-year spending surges, the agencies are allowed to carry forward their unused appropriations.

In the Indian context, public expenditure management has received focused attention as part of fiscal consolidation. An important institutional arrangement in this direction was the creation of the Expenditure Reform Commission to suggest measures to strengthen expenditure management. Following the recommendations of the Commission, the Government has taken several measures to contain expenditure growth and ensure efficiency in the expenditure management. The weak link in expenditure management, however, is cash management.

The pattern of expenditure reveals that for the last three years on an average, about 19 per cent of the total expenditure is incurred during the last month of the fiscal

(Contd....)

(Concld....)

year. The pilot cash management system introduced in the Union Budget, 2003-04 adopts time-slicing of funds release to permit convergence of expenditure with the availability of resources within the year. Based on the actual requirement, monthly or quarterly cash limits for various ministries will be prescribed. The improved cash management is expected to avoid both mis-matches between receipts and expenditure and the rush of expenditure in the last quarter of the fiscal year.

References

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complete decontrol of the urea prices by April 1, 2006. The impact of these measures is reflected in the decline in fertiliser subsidies in recent years. Moreover, the emergence of petroleum subsidy since 2002-03 is the result of the dismantling of APM for petroleum products. The total subsidies are, however, high at 1.6 per cent of GDP in 2002-03, even after excluding the subsidy on the petroleum products (Table 4.3).

4.7 As mentioned before, earlier efforts at fiscal correction have resulted in a persistent decline in capital expenditure. In general, it is capital outlays which have provided the soft option for deficit-based fiscal correction. In the revised estimates for 2002-03, capital outlays fell short of the budgetary target by more than 25 per cent, implying the diversion of resources from productive investments to current expenditures. In the Indian context, there is

Table 4.3 : Expenditure on Subsidies by Major Heads

(Rupees crore)

Year	Food	Fertiliser	Interest	Petroleum	Other	Total Subsidies
1	2	3	4	5	6	7
1990-91	2,450	4,389	379	0	4,940	12,158
	(0.4)	(0.8)	(0.1)	–	(0.9)	(2.1)
1991-92	2,850	5,185	316	0	3,902	12,253
	(0.4)	(0.8)	(0.1)	–	(0.6)	(1.9)
1992-93	2,800	6,136	113	0	1,775	10,824
	(0.4)	(0.8)	–	–	(0.2)	(1.4)
1993-94	5,537	5,079	113	0	876	11,605
	(0.6)	(0.6)	–	–	(0.1)	(1.4)
1994-95	5,100	5,769	76	0	909	11,854
	(0.5)	(0.6)	–	–	(0.1)	(1.2)
1995-96	5,377	6,735	34	0	520	12,666
	(0.5)	(0.6)	–	–	–	(1.1)
1996-97	6,066	7,578	1,222	0	633	15,499
	(0.4)	(0.6)	(0.1)	–	–	(1.1)
1997-98	7,900	9,918	78	0	644	18,540
	(0.5)	(0.7)	–	–	–	(1.2)
1998-99	9,100	11,596	1,434	0	1,463	23,593
	(0.5)	(0.7)	(0.1)	–	(0.1)	(1.4)
1999-2000	9,434	13,244	1,371	0	438	24,487
	(0.5)	(0.7)	(0.1)	–	–	(1.3)
2000-01	12,060	13,800	111	0	867	26,838
	(0.6)	(0.7)	–	–	–	(1.3)
2001-02	17,499	12,595	210	0	903	31,207
	(0.8)	(0.5)	–	–	–	(1.4)
2002-03(RE)	24,200	11,009	765	6,265	2,379	44,618
	(1.0)	(0.4)	–	(0.3)	(0.1)	(1.8)
2003-04(BE)	27,800	12,720	179	8,116	1,092	49,907
	(1.0)	(0.5)	–	(0.3)	–	(1.8)

RE : Revised Estimates. BE : Budget Estimates.
Note: Figures in brackets are per cent of GDP.

Table 4.4 : Capital Expenditure of the Centre

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03)	
						Amount	Per cent
1	2	3	4	5	6	7	8
Total Capital Expenditure (1+2)=(3+4)	62,365 (2.5)	69,827 (2.7)	60,842 (2.6)	38,414 (3.2)	31,782 (5.6)	-7,462	-10.7
1. Capital Outlay	30,345 (1.2)	40,691 (1.6)	26,558 (1.2)	14,099 ((1.2)	12,130 (2.1)	-10,346	-25.4
2. Loans and Advances	32,020 (1.3)	29,136 (1.1)	34,284 (1.5)	24,316 (2.0)	19,652 (3.5)	2,884	9.9
3. Non-Plan Capital Expenditure *of which*	20,945 (0.8)	26,640 (1.0)	21,305 (0.9)	21,062 (1.8)	15,348 (2.7)	-5,695	-21.4
Defence Capital	14,912 (0.6)	21,411 (0.8)	16,207 (0.7)	8,015 (0.7)	4,552 (0.8)	-6,499	-30.4
4. Plan Capital Expenditure (i+ii)	41,420 (1.7)	43,187 (1.7)	39,537 (1.7)	17,353 (1.5)	15,745 (2.8)	-1,767	-4.1
i) Central Plan Outlay	18,735 (0.8)	18,205 (0.7)	18,193 (0.8)	8,255 (0.7)	9,134 (1.6)	530	2.9
ii) Central Assistance for State and UT Plans	22,685 (0.9)	24,982 (1.0)	21,344 (0.9)	9,098 (0.8)	6,611 (1.2)	-2,297	-9.2

RE : Revised Estimates. BE : Budget Estimates.

Note: Figures in brackets are per cent of GDP.

considerable evidence that public investment has played a preponderant role in entrenching the conditions for higher growth. Moreover, expanding capital outlay in infrastructure has distinct salutary effects in terms of crowding in private investment. Under these circumstances, compression of capital outlay would inevitably affect asset creation and development of the physical infrastructure which holds the key to accelerated growth (Table 4.4).

Revenue Position

4.8 Various components of revenue receipts were impacted differentially by underlying macroeconomic conditions. The gap in revenue receipts *vis-a-vis* initial expectations was due to the fall in collections of direct taxes - individual income tax and corporation tax - as well as the Union excise duties. Both Union excise duties and corporation tax collections were, however, significantly higher than that in the preceding year, benefiting from the revival of industrial activity and the significant improvement in the financial performance of manufacturing companies. Customs duties benefited from the surge in import demand and posted a modest increase relative to budget estimates (Table 4.5).

4.9 The tax-GDP ratio of the Centre has suffered a steady deterioration from more than 10 per cent in the late 1980s to just about 9 per cent in 2002-03, reflecting a decline in tax buoyancy[1]. Over the Eighth and Ninth Plan periods, the buoyancy of Central taxes deteriorated from 0.9 to 0.8 mainly on account of indirect taxes; although the buoyancy in direct tax collection was maintained at 1.3, it has stagnated in recent years and has not compensated adequately for the fall in buoyancy of indirect taxes. The restructuring of both direct and indirect taxes effected since 1991-92, coupled with the structural shift in the composition of GDP towards the less-taxed services sector, appears to have affected the growth in tax revenue (Table 4.6).

4.10 Non-tax revenue remained broadly unchanged at 3 per cent of GDP in 2002-03, unresponsive to the impulses of fiscal reforms. However, the need for restructuring of public sector undertakings is critical, encompassing a thorough rationalisation of user charges and cost recoveries on the services rendered by the Government or its entities in areas such as transport, power and irrigation. The Prime Minister's Economic Advisory Council (2002) had identified establishment of rational user charges and credible regulatory

[1] Tax buoyancy is defined as proportionate change in tax collection as a ratio to proportionate change in tax base/GDP.

Table 4.5 : Total Receipts of the Centre

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03)	
						Amount	Per cent
1	2	3	4	5	6	7	8
Total Receipts	4,04,013 (16.3)	4,10,309 (16.0)	3,62,453 (15.8)	1,68,468 (14.2)	93,951 (16.5)	-6,296	-1.5
Revenue Receipts	2,36,936 (9.6)	2,45,105 (9.6)	2,01,449 (8.8)	1,10,130 (9.3)	54,954 (9.7)	-8,169	-3.3
Tax Revenue (Net)	1,64,177 (6.6)	1,72,965 (6.8)	1,33,662 (5.8)	81,939 (6.9)	42,978 (7.6)	-8,788	-5.1
Non-Tax Revenue	72,759 (2 .9)	72,140 (2.8)	67,787 (3.0)	28,191 (2.4)	11,976 (2.1)	619	0.9
Capital Receipts	1,67,077 (6.8)	1,65,204 (6.5)	1,61,004 (7.0)	58,338 (4.9)	38,997 (6.9)	1,873	1.1
Memo Items@							
Corporation Tax	44,700 (1.8)	48,616 (1.9)	36,609 (1.6)	16,487 (1.4)	5,335 (0.9)	-3,916	-8.1
Income Tax	37,300 (1.5)	42,524 (1.7)	32,004 (1.4)	15,592 (1.3)	5,371 (0.9)	-5,224	-12.3
Customs Duty	45,500 (1.8)	45,193 (1.8)	40,268 (1.8)	35,757 (3.0)	20,644 (3.6)	307	0.7
Union Excise Duty	87,383 (3.5)	91,433 (3.6)	72,555 (3.2)	40,187 (3.4)	24,514 (4.3)	-4,050	-4.4

RE : Revised Estimates. BE : Budget Estimates.
@ Memo items are on gross basis which include States' share.
Note : Figures in brackets are per cent of GDP.

Table 4.6 : Gross Tax Revenue of the Centre

(Per cent of GDP)

Years	Major Taxes				Gross Tax Revenue
	Income Tax	Corporation Tax	Excise Duties	Customs Duties	
1	2	3	4	5	6
1990-91	0.9	0.9	4.3	3.6	10.1
1991-92	1.0	1.2	4.3	3.4	10.3
1992-93	1.1	1.2	4.1	3.2	10.0
1993-94	1.1	1.2	3.7	2.6	8.8
1994-95	1.2	1.4	3.7	2.6	9.1
1995-96	1.3	1.4	3.4	3.0	9.4
1996-97	1.3	1.4	3.3	3.1	9.4
1997-98	1.1	1.3	3.2	2.6	9.1
1998-99	1.2	1.4	3.1	2.3	8.3
1999-00	1.3	1.6	3.2	2.5	8.9
2000-01	1.5	1.7	3.3	2.3	9.0
2001-02	1.4	1.6	3.2	1.8	8.1
2002-03(RE)	1.5	1.8	3.5	1.8	9.0
2003-04(BE)	1.6	1.9	3.5	1.8	9.2

RE : Revised Estimates. BE : Budget Estimates.

authorities as the two critical features on which the success of infrastructure development will depend. The rationalisation of user charges covers utilities such as power, water and transport. User charges could be index-linked to input cost and a process of periodic revision should be automatic (Box IV.2).

4.11 The disinvestment programme made some progress during 2001-02 with the strategic sale process of some public sector undertakings gaining momentum; nevertheless the actual proceeds were lower than the targeted amount. In 2002-03, the disinvestment process remained below expectations. A major challenge facing the programme of public sector restructuring has been the closing down of persistently loss making and non-viable public sector undertakings (PSUs) so that the profitability of the other public enterprises could be a major source of resource generation to provide budgetary support. The stage is set for reforms in the PSUs by restructuring of potentially viable PSUs and improving the profitability and efficiency of the viable units. Priorities in reforms include raising return on investments in PSUs and infusing professionalisation in management (Box IV.3).

Box IV.2

Pricing Policy for Public Services : The Dilemma of User Charges

The success of ensuring the critical physical infrastructure in the country depends on levying affordable and adequate user charges. In sectors like roads, telecommunications and ports where it has been possible to identify and levy proper user charges, overall growth has been noteworthy. Despite the well-known benefits of rationalising user charges to reflect true economic costs, progress in this direction has been impeded mainly by political economy considerations and the acute lack of the enabling legal architecture.

Taxation to cover the deficit is generally not favoured as an alternative to the raising of user charges. It is regarded as inequitable since everybody - not just the users of the public service - would be charged. Furthermore, while lump sum taxation to cover the deficit would not involve efficiency loss but it would be regressive. The Ramsey rule suggests that a mark-up (over the marginal cost) set in inverse proportion to the (compensated) price elasticity of demand for the product would minimise dead weight or efficiency loss.

Another solution to the policy dilemma is to charge a two-part tariff (a flat user fee which would be equivalent to a lump sum tax and hence would not involve any resource misallocation *plus* charge per unit of service) to those availing of the public service. Such techniques are used in the case of pricing of public utilities such as telephones, electricity and water supply.

Yet another technique is to apply price discrimination, wherein the consumer is charged a price equivalent to marginal cost at the last unit but higher prices for earlier units. Given the differences in the demand schedules of consumers, this would entail differential pricing as is evident in the case of electricity charges for residential and commercial groups.

In the case of public utility regulations, pricing is typically based on the principle of covering costs plus a fair return on capital, commensurate with that in respect of other industries. This is usually the case when public services are supplied in competition with private firms (which usually price the service above marginal cost). In accordance with the Theorem of the Second Best, setting price equivalent to marginal cost would be inefficient in other (public) sectors. In such cases, prices could be set equivalent to long-run average costs plus a normal return on capital. This would ensure fair competition and prevent high cost public producers from displacing more efficient low cost private producers.

Peak-load pricing involves charging higher user charges during periods of 'excess' demand and charging the marginal operating cost during off-peak periods (as was the case in respect of telephones in India). The same principle could be applied to address congestion on (toll) roads/bridges during peak hours. The pricing of negative externalities such as pollution is rendered much more difficult by the absence of adequate relevant information. Even so, efficient pricing involves adding the 'costs' of such externalities and setting the user charge equivalent to the marginal social cost.

In India, the need to raise user charges is underscored in the pricing of telecom services where it is seen as an essential ingredient of transition from a protected market to competition. As far as water pricing is concerned, a model based on capital, operation and maintenance costs has been attempted in some areas, although studies have shown that costs of water provision exceeded recovery in nearly 76 per cent of cities and towns in India. Cross-subsidisation of electricity charges in India has acted as a regressive tax on the commercial sector. Thus, electricity companies could recover only 68.6 per cent of their cost from the consumers. Proper pricing of power alone can reduce the financial burden of the state electricity boards and render them viable. As regards the railways, the fare freight ratio (earning per passenger Km. *vis-a-vis* earning per tonne Km.) continues to be one of the lowest in the world at 0.31 in 2001-02. Revenue losses of state road transport corporations were placed at around Rs.1,950 crore in 1999-2000.

Pricing and cost recovery policies have often not taken account of the fiscal effects and the cost of public funds. Setting user charges to economically efficient levels should, therefore, be the first priority for financing the economic infrastructure. Moreover, the user charges need to cover maintenance expenditures and control the level of services usage. Pricing policy should also address social concerns relating to public utilities and their long-term commercial viability.

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Box IV.3

Disinvestment Strategies and PSU Reform

The terms, 'disinvestment' and 'privatisation', are usually used interchangeably all over the world. In actuality, while 'disinvestment' represents sale of government share holding in PSUs, 'privatisation' is a more comprehensive concept and implies denationalisation including transfer of management and control to private entities. Widespread privatisation of PSUs has been a common phenomenon in both developing and developed countries in recent years, particularly as a response to their inefficient functioning and their adverse impact on State budgets. More than 100 countries across the globe have privatised some of their state-owned enterprises.

In India, initiatives have been taken over the years to enhance the efficiency and profitability of PSUs. Early PSU reforms focused on the creation of a buffer in the form of a holding company in line with the recommendations of the Committee to Review Policy for Public Enterprises (Chairman: Arjun Sengupta, 1984). Subsequently, a system of Memorandam of Understanding (MoU), imparting clarity to PSU objectives, was put in place.

The disinvestment process in India has evolved over more than a decade. The Government of India's Interim Budget for 1991-92 contained the first explicit statement on divestiture - the proposal to divest up to 20 per cent of the Government equity in select PSUs in favour of public sector institutional investors. A Disinvestment Commission was set up in 1996 and it recommended a shift from public offerings to strategic/trade sales with transfer of management in respect of a number of PSUs. The Union Budget of 1999-2000 provided clear guidelines for the classification of PSUs as strategic (defence-related, atomic energy related, railway transport) or non-strategic. A Department of Disinvestment was constituted in 1999 as a nodal department to streamline and speed up the process of disinvestment. Since 2000-01, major policy statements on disinvestment included closing down of PSUs which could not be revived, disinvestment in all non-strategic PSUs up to 74 per cent or higher and protection of workers' interest through safety nets. The Union Budget 2002-03 announced the completion of strategic sales in seven PSUs and some government-owned hotels and indicated that the shift in approach to strategic sales of blocks of shares to strategic investors (instead of disinvestments of small lots of shares) had enhanced the price/earnings (P/E) ratios. The policy on disinvestment announced in December 2002 specifically focused, *inter-alia*, on the modernisation and upgradation of PSUs, creation of new assets, generation of employment, retiring of public debt, setting up a Disinvestment Proceeds Fund and avoiding the emergence of private monopolies consequent upon disinvestment. The Union Budget 2003-04 has viewed the disinvestment process as a means for unlocking the productive potential of the PSUs and for reorienting the Government away from business and towards the business of governance.

Reforms in PSUs have varied across industries in India. The reform process in the power sector has envisaged privatisation of distribution, segregation of concentrated zones of high load density, competitive market structure and multi-tier regulation. The process, however, remains far from complete. Liberalisation of the telecommunication sector is substantially complete with the enactment of the National Telecom Policy 1994, setting up of the Telecom Regulatory Authority of India (TRAI) in 1997 and the New Telecom Policy 1999 which has enabled the opening up of almost all telecom services to the private sector. The oil sector has also completed the first round of disinvestment but the major stake is still with the Government.

Out of 62 PSUs considered for disinvestment by the Disinvestment Commission, the Central Government has so far taken decisions to divest 49 PSUs. Out of 919 State PSUs, the process of disinvestments/winding up/ restructuring has been initiated for 221 units and the process of privatisation has been completed for 33 units. Realisation through disinvestment during 1991-2003 stood at Rs.29,488 crore for the Centre as against a target of Rs.78,300 crore, *i.e.,* an achievement of about 38 per cent of the target.

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Overall deficit

4.12 The revised estimates for 2002-03 posted moderate slippages in the key indicators of the budgetary gap as initial expectations of higher growth in revenue collections and enhanced realisation from disinvestments were belied (Table 4.7).

4.13 The persistence of fiscal stress limits the manoeuverability in revenue and expenditure policy and thereby restricts the scope of fiscal policy as a counter-cyclical tool. The committed nature of the expenditure and rigidities in the revenue side impede fiscal discretion in the context of the downturn phase of the business cycle (Box IV.4).

Table 4.7 : Deficit Indicators of the Centre

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03)	
						Amount	Per cent
1	2	3	4	5	6	7	8
Gross Fiscal Deficit	1,45,466	1,35,524	1,40,955	60,243	44,632	9,942	7.3
	(5.9)	(5.3)	(6.1)	(5.1)	(7.8)		
Revenue Deficit	1,04,712	95,377	1,00,162	29,731	18,562	9,335	9.8
	(4.2)	(3.8)	(4.3)	(2.5)	(3.3)		
Gross Primary Deficit	29,803	18,134	33,495	10,198	23,134	11,669	64.3
	(1.2)	(0.7)	(1.5)	(0.9)	(4.1)		

RE : Revised Estimates. BE : Budget Estimates.

Note: Figures in brackets are per cent of GDP.

Box IV.4

Fiscal Stress and the Counter-Cyclical Policy

Fiscal policy influences economic activity through the operation of built-in or automatic stabilisers or through discretionary fiscal policy measures. In the short-run, automatic stabilisers, both on the revenue (progressive taxation) and expenditure side (unemployment insurance programme), would come into operation, ensuring efficiency in the system. Thus, in times of economic slowdown, the ideal policy stance is to accommodate a higher fiscal deficit since any effort to achieve a balanced budget target would turn out to be pro-cyclical. The problem with automatic stabilisers is, however, the persistence of 'deficit bias' as observed in several European countries. These countries adopted an expansionary fiscal stance in the times of slowdown but failed to restrict the expenditure in phase of recovery. It is also a fact that automatic stabilisers are more relevant only in industrialised economies with respect to the response of revenues to cyclical fluctuation in output. In developing countries, discretionary fiscal policy embodied in expenditure policies ensures effective counter cyclical response in times of slowdown. The basic theoretical underpinnings of the role of discretionary fiscal policy in stabilising the economy lie in the Keynesian framework where the government expenditure help the recovery of economic activity through revival of aggregate demand and multiplier effects.

The emergence of the European Monetary Union (EMU) represents a milestone in the historical evolution of fiscal policy. Its 'Stability and Growth Pact' seeks to strengthen the way for automatic stabilisers and balanced or surplus budgets as they would avoid structural deficits and consequent accumulation of the public debt. Countries like US, Japan and France reinforced the automatic stabilisers through an easy stance of fiscal policy in the 1990s recession. The tight stance of discretionary fiscal policy in some of the countries in the European Union, in fact, delayed the recovery from the 1993 recession. Countries like UK, Sweden and France have eased fiscal policy during the recession and tightened later. They achieved success in stabilising the economy but at the cost of fiscal positions that were weak in 1999 with substantially high debt-to-GDP ratios. In the US, on the other hand, fiscal policy acted as a powerful complement to automatic fiscal stabilisation and the desired result of stabilisation was achieved with a better debt position.

The fiscal position in India is marked by the persistence of the deficit. The structure of Government expenditure is skewed towards non-productive sectors. Committed expenditure like interest payments and wages and salaries has risen, leaving little scope for the Government to direct resources towards developmental and productive channels. The sluggish trend in revenues as also the committed nature of expenditure has constrained the use of fiscal policy to counter the slowdown in the economy. Empirical studies have shown that the fiscal deficit in India is mainly of a structural type and the cyclical component is negligible. The presence of a large structural deficit implies less scope for relying on automatic stabilisers.

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STATE GOVERNMENT FINANCES, 2002-03[2]

4.14 In recent years, the focus of fiscal reform has turned sub-national. It is increasingly recognised that it is the State finances where the government sector's interface with the people is most significant. Issues in the reform of fiscal policy in the States have a direct bearing on the quality of life.

4.15 The growth of revenue receipts of States during 2002-03 over the previous year was facilitated mainly by a rise in States' own taxes and grants from the Centre. Tax revenues were, however, affected by the slowing of activity in the wake of the drought. There were shortfalls in the States' own revenue receipts (tax and non tax revenue) as well as in States' share in Central taxes in the revised estimates *vis-a-vis* budget estimates. In the States' own taxes, the decline was mainly on account of sales tax collection; both States' property taxes and income taxes exceeded the budget estimates. Under States' non-tax revenue, receipts from State lotteries and interest receipts were lower in the revised estimates, while dividend and profits exceeded the budget estimates. Capital receipts of the States were higher on account of a rise in market borrowings and special securities issued to the National Small Saving Fund (Table 4.8).

4.16 Total expenditure in the revised estimates exceeded budget projections in 2002-03 on account of higher capital expenditure which rose to constitute one fifth of total expenditure of States. The increase in capital expenditure was mainly due to increases in the repayment of loans to the Centre and financial institutions reflecting the retirement of high cost debt owed to the Centre under the debt-swap scheme. Capital outlay in the revised estimates for 2002-03, however, fell short of budget estimates (Table 4.9).

4.17 The revised estimates for 2002-03 indicate deviations in all major deficit indicators of State finances, with significant slippages in the revenue deficit as well as the primary deficit. Gross fiscal deficit was also higher in the revised estimate as compared with the budget estimates (Table 4.10).

Table 4.8 : Total Receipts of States

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03)	
						Amount	Per cent
1	2	3	4	5	6	7	8
Total Receipts (1+2)	4,37,292 (17.7)	4,25,655 (16.6)	3,80,106 (16.6)	1,80,433 (15.2)	91,160 (16.0)	11,637	2.7
1. Revenue Receipts (a+b)	2,93,873 (11.9)	3,06,844 (12.0)	2,55,599 (11.1)	1,36,803 (11.5)	66,467 (11.7)	-12,971	-4.2
a) Tax Revenue	2,02,518 (8.2)	2,15,049 (8.4)	1,80,275 (7.9)	92,913 (7.8)	44,586 (7.8)	-12,531	-5.8
States Taxes	1,49,358 (6.0)	1,52,590 (6.0)	1,31,710 (5.7)	63,865 (5.4)	30,344 (5.3)	-3,232	-2.1
Sharable Taxes	53,160 (2.2)	62,459 (2.4)	48,565 (2.1)	29,048 (2.4)	14,242 (2.5)	-9,299	-14.9
b) Non-Tax Revenue	91,355 (3.7)	91,795 (3.7)	75,324 (3.3)	43,891 (3.7)	21,881 (3.8)	-440	-0.5
Grants	55,401 (2.2)	54,008 (2.2)	43,048 (1.9)	20,996 (1.8)	12,643 (2.2)	1,393	2.6
States Own Non-Taxes	35,954 (1.5)	37,787 (1.5)	32,276 (1.4)	22,895 (1.9)	9,238 (1.6)	-1,833	-4.9
2. Capital Receipts	1,43,419 (5.8)	1,18,811 (4.6)	1,24,507 (5.4)	43,630 (3.7)	24,693 (4.3)	24,608	20.7

RE : Revised Estimates. BE : Budget Estimates.
Note : Figures in brackets are per cent of GDP.
Source : Budget Documents of State Governments.

[2] Provisional data based on the Budget Documents of 28 State Governments and the NCT Delhi, of which three are Vote-on-Account.

Table 4.9 : Total Expenditure of the States

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03) Amount	Per cent
1	2	3	4	5	6	7	8
Total Expenditure (1+2)	4,42,609 (17.9)	4,30,842 (16.8)	3,77,555 (16.4)	1,77,584 (14.9)	91,088 (16.0)	11,767	2.7
1. Revenue Expenditure *of which*	3,55,175 (14.4)	3,55,159 (13.9)	3,14,833 (13.7)	1,45,004 (12.2)	71,776 (12.6)	16	0.0
Social Services	1,19,039 (4.8)	1,20,698 (4.7)	1,07,655 (4.7)	53,607 (4.5)	27,962 (4.9)	-1,659	-1.4
Economic Services	72,803 (2.9)	70,409 (2.8)	65,889 (2.9)	35,669 (3.0)	20,892 (3.7)	2,394	3.4
2. Capital Expenditure *of Which*	87,434 (3.5)	75,683 (3.0)	62,722 (2.7)	32,580 (2.7)	19,312 (3.4)	11,751	15.5
Capital Outlay	41,600 (1.7)	43,619 (1.7)	32,206 (1.4)	18,495 (1.6)	9,223 (1.6)	-2,019	-4.6

RE : Revised Estimates. BE : Budget Estimates.

Note : Figures in brackets are per cent of GDP.

Source : Budget Documents of State Governments.

4.18 A key issue in redrawing of boundaries between the public and the private sectors from the societal point of view is the physical and social infrastructure which provides the wherewithal for a durable improvement in standards of livelihood and significantly impacts the health of the State finances. In this regard, power sector reforms have assumed critical importance in recent years. The States of Andhra Pradesh, Delhi, Haryana, Karnataka, Madhya Pradesh, Orissa, Rajasthan, Uttar Pradesh and Uttaranchal have enacted State Electricity Reform Acts providing, *inter alia*, for unbundling/ corporatisation of State Electricity Boards (SEBs). Twenty one States have either constituted or notified the constitution of State Electricity Regulatory Commission (SERC). Twenty five States have signed tripartite agreements envisaged under the scheme for one-time settlement of outstanding dues payable by the SEBs to the Central Public Sector Undertakings (Box IV.5)

Table 4.10 : Major Deficit Indicators of State Governments

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03) Amount	Per cent
1	2	3	4	5	6	7	8
Gross Fiscal Deficit	1,16,730 (4.7)	1,02,882 (4.0)	95,986 (4.2)	31,426 (2.6)	18,787 (3.3)	13,848	13.5
Revenue Deficit	61,302 (2.5)	48,314 (1.9)	59,233 (2.6)	8,201 (0.7)	5,309 (0.9)	12,988	26.9
Primary Deficit	42,584 (1.7)	30,629 (1.2)	33,497 (1.5)	9,494 (0.8)	10,132 (1.8)	11,955	39.0

RE : Revised Estimates. BE : Budget Estimates.

Note : Figures in brackets are per cent of GDP.

Source: Budget Documents of State Governments.

Box IV.5

Issues in Sub-National Fiscal Reforms

Fiscal reform at the State level has assumed critical importance in recent years and there is a heightened sensitivity all around, displayed in conscious policy decisions. In this context, it is important to take note of certain constraints faced by the States in achieving their fiscal goals. A large proportion of expenditure is of a committed nature. Declining buoyancies in tax and non-tax receipts, competitive sales taxes and related concessions have affected their financial position. Internal resource mobilisation by the States has been further constrained by losses incurred by the State Public Sector Undertakings, especially electricity boards and transport undertakings.

Many States have initiated measures such as setting up of consolidated sinking fund, guarantee redemption fund, statutory and administrative limits on guarantees. Other important initiatives relate to the preparatory work for introduction of Value Added Tax (VAT) and rationalisation of user charges mainly relating to power, water and transport. On the expenditure front, a number of States have proposed containment of revenue expenditure through restrictions on fresh recruitment/creation of new posts and curbs on the increase in administrative expenditure. Some States have proposed introduction of a contributory pension scheme for newly recruited staff. Some States have initiated measures to provide statutory backing to fiscal reforms through enabling legislation.

In recent years, States have initiated measures pertaining to PSU reforms. Maharashtra has constituted a Board for restructuring State PSUs, while States such as Punjab and Tamil Nadu have initiated measures for constituting disinvestment commissions. In regard to power sector reforms, measures taken by the States relate to the constitution of State Electricity Regulatory Commissions (SERCs) for determining the tariff structure, unbundling of electricity boards into separate entities for power generation, transmission and distribution, increasing power tariffs, measures for reducing transmission and distribution losses.

The Centre has also initiated measures to encourage fiscal reforms at the State level. Guided by the recommendations of the Eleventh Finance Commission, the Central Government has set up an Incentive Fund for encouraging fiscal reforms in the States on the basis of a monitorable fiscal reform programme. Under this scheme, the States draw up a Medium-Term Fiscal Reforms Programme (MTFRP) aimed at bringing down the fiscal deficit to sustainable levels. The Union Budget, 2002-03 made provision for reform-linked assistance of Rs.12,300 crore for States under various schemes such as Accelerated Power Development and Reform Programme (APDRP), Accelerated Irrigation Benefit Programme (AIBP), Urban Reforms Incentive Fund (URIF), and Rural Infrastructure Development Fund (RIDF). In addition, a lump sum amount of Rs.2,500 crore was proposed for implementing policy reforms in sectors which are constraining growth and development.

COMBINED BUDGETARY POSITION OF THE CENTRE AND STATES

4.19 The combined revenue receipts of the Centre and States recorded a shortfall from the budgeted level. The rise in non-tax revenue, *albeit* marginal, was inadequate to compensate the shortfall in tax collections. The combined capital receipts increased in the revised estimates partly due to additional market borrowings by the States under the debt swap scheme to prepay the high cost debt to the Centre. The combined aggregate expenditure exceeded the budget estimates on account of higher than anticipated revenue expenditure and loans and advances, while capital outlay (capital expenditure net of loans and advances) registered a decline. Developmental expenditure rose mainly on account of increased spending in the social sector. On the other hand, non-development expenditure (excluding others) was lower than the budgeted level due to reduction in interest payments and non-developmental capital outlay. The revised estimates for 2002-03 place all the major deficit indicators of the combined Government sector (Centre and States) higher than their budgeted levels (Table 4.11).

FINANCING OF FISCAL DEFICITS

Financing of Deficit of Centre

4.20 Market borrowings have emerged as the major financing item of the gross fiscal deficit (GFD) of the Centre since the mid-1990s, with a corresponding decline in the share of other liabilities and external financing. There was net outgo under external assistance due to large repayments during 2002-03, including pre-payment of a part of external debt of the order of about Rs.13,000 crore. Another important development affecting the size of market borrowings was the transfer of the entire net proceeds collected under small saving schemes to State Governments with effect from 2002-03. The average utilisation of WMA at Rs.4,182 crore during 2002-03 was lower than that in the previous year (Table 4.12).

Table 4.11 : Indicators of Combined Finances of Centre and States*

(Rupees crore)

Items		2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03) Amount	Per cent
Gross Fiscal Deficit	Centre	1,45,466	1,35,524	1,40,955	60,243	44,632	9,942	7.3
		(5.9)	(5.3)	(6.1)	(5.1)	(7.8)		
	States	1,16,730	1,02,882	95,986	31,426	18,787	13,848	13.5
		(4.7)	(4.0)	(4.2)	(2.6)	(3.3)		
	Combined	2,48,979	2,26,864	2,26,418	77,671	53,580	22,115	9.7
		(10.1)	(8.9)	(9.9)	(6.5)	(9.4)		
Revenue Deficit	Centre	1,04,712	95,377	1,00,162	29,731	18,562	9,335	9.8
		(4.2)	(3.7)	(4.4)	(2.5)	(3.3)		
	States	61,302	48,314	59,233	8,201	5309	12,988	26.9
		(2.5)	(1.9)	(2.6)	(0.7)	(0.9)		
	Combined	1,66,014	1,43,691	1,59,395	37,932	23,871	22,323	15.5
		(6.7)	(5.6)	(6.9)	(3.2)	(4.2)		
Primary Deficit	Centre	29,803	18,134	33,495	10,198	23,134	11,669	64.3
		(1.2)	(0.7)	(1.5)	(0.9)	(4.1)		
	States	42,584	30,629	33,497	9,494	10,132	11,955	39.0
		(1.7)	(1.2)	(1.5)	(0.8)	(1.8)		
	Combined	88,492	64,442	84,048	18,598	28,585	24,050	37.3
		(3.6)	(2.5)	(3.7)	(1.6)	(5.0)		
Total Receipts (A+B)		7,46,601	7,36,538	6,55,907	2,96,629	1,52,398	10,063	1.4
A. Revenue Receipts (1+2)		4,71,600	4,90,665	4,00,229	2,17,527	1,05,757	-19,065	-3.9
1. Tax Receipts (a+b)		3,66,696	3,88,015	3,13,937	1,74,852	87,564	-21,319	-5.5
a) Direct Taxes		1,03,858	1,15,211	83,466	41,603	14,267	-11,353	-9.9
b) Indirect Taxes		2,62,838	2,72,804	2,30,471	1,33,248	73,297	-9,966	-3.7
2. Non-Tax Receipts		1,04,904	1,02,650	86,292	42,675	18,193	2,254	2.2
B. Capital Receipts (a+b)		2,75,001	2,45,873	2,55,678	79,102	46,641	29,128	11.8
a. Non-Debt Capital Receipts		14,657	19,726	18,158	6,968	3,233	-5,069	-25.7
b. Debt Capital Receipts		2,60,344	2,26,147	2,37,520	72,134	43,408	34,197	15.1
Aggregate Expenditure (4+5)		7,51,917	7,41,724	6,53,354	3,03,586	1,63,673	10,193	1.4
1. Revenue Expenditure		6,37,614	6,34,357	5,59,624	2,55,457	1,29,628	3,257	0.5
2. Capital Outlay		71,945	84,310	58,763	32,594	21,370	-12,365	-14.7
3. Loans and Advances		25,678	18,589	26,417	14,115	11,589	7,089	38.1
4. Development Expenditure		3,79,589	3,72,374	3,29,007	1,65,361	98,686	7,215	1.9
5. Non-Development Expenditure (Including others)		3,72,329	3,69,350	3,24,348	1,38,225	64,987	2,979	0.8

RE : Revised Estimates. BE : Budget Estimates.

* For States, data are provisional for the year 2001-02 onwards.

Notes : 1. Figures in brackets are per cent of GDP.

2. Combined GFD is the GFD of the Central Government plus GFD of the State Governments *minus* net lending from the Central Government to States.
3. Revenue deficit is the difference between revenue receipts and revenue expenditure adjusted for inter- Governmental transactions in the revenue account.
4. Gross primary deficit is defined as combined GFD *minus* combined interest payments.

Table 4.12 : Financing of Gross Fiscal Deficit of the Centre

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03)	
						Amount	Per cent
1	2	3	4	5	6	7	8
Market Borrowings (Net)	1,12,865	95,859	87,724	33,087	8,001	17,006	17.7
	(77.6)	(70.7)	(62.2)	(54.9)	(17.9)		
Other Liabilities	40,799	38,895	49,126	17,031	22,103	1,904	4.9
	(28.0)	(28.7)	(34.9)	(28.3)	(49.5)		
of which							
Small Savings#	0	8,000	8,755	12,761	9,104	-8000	–
	(0.0)	(5.9)	(6.2)	(21.2)	(20.4)		
State Provident Funds	8,500	10,000	4,173	2,261	1,221	-1,500	-15.0
	(5.8)	(7.4)	(3.0)	(3.8)	(2.7)		
Special Deposits	10,280	9,898	8,070	5,295	7,716	382	3.9
	(7.1)	(7.3)	(5.7)	(8.8)	(17.3)		
External Finance @	-13,496	770	5,601	318	3,181	-14,266	–
	(-9.3)	(0.6)	(4.0)	(0.5)	(7.1)		
Draw Down of Cash Balances	5,298	–	-1,496	9,807	11,347	5,298	–
	(3.6)		(-1.1)	(16.3)	(25.4)		

RE : Revised Estimates. BE : Budget Estimates.

\# Since 2002-03 all the net amount collected through small savings is transferred to States/UTs.

@ As against net external assistance of Rs.770 crore budgeted in 2002-03, the revised estimates show that net external assistance would be negative at Rs.13,496 crore due to higher repayments/prepayment of Rs.25,210 crore than the budgeted amount of Rs.10,563 crore.

Note : Figures in brackets are per cent of GFD.

Source : Budget documents, Government of India.

4.21 Among domestic sources, amounts mobilised through small savings and provident funds have generally been at a higher cost than market borrowings through dated securities. Though interest rates have converged since the late 1990s, the cost of small savings continues to be higher than that of market borrowings considering the tax concession available on these funds. The average interest rate on overall public debt of the Centre shows a declining trend since 2000-01, reflecting the fall in the cost of raising funds in the gilt market (Table 4.13)

Financing of States' Deficit

4.22 The share of market borrowings in financing the GFD of the States has steadily increased. The share of small saving receipts (special securities issued to the NSSF) remained the major source of financing. The share of loans from the Centre was lower in the revised estimates reflecting repayments by States under the debt-swap scheme (Table 4.14).

DOMESTIC PUBLIC DEBT

Debt Position of the Central Government

4.23 The widening fiscal gap has led to a steep rise in the outstanding liabilities of the Government. Of the outstanding domestic debt of the Central Government, internal debt (including special securities issued *in lieu of* small savings outstanding as at end March 1999) alone accounted for 66.4 per cent and 'other liabilities', which comprise small savings and provident funds accounted for 29.9 per cent at the end of March, 2003. The sharp increase in the debt-GDP ratio since the mid-1990s is reflected in burgeoning interest payments, despite a decline in interest rates. This essentially represents the overhang of outstanding liabilities contracted at high interest cost in the past. This has created a vicious circle of high debt leading to higher interest payments, which in turns leads to higher deficit, higher borrowings and higher debt.

Table 4.13 : Average Interest Rate on various Components of Outstanding Liabilities of the Centre#

(Per cent)

Year	Internal Debt@	*of which* Market Loans	Small Savings, and PFs	Other Obligations	Reserve Funds	Domestic Liabilities	External Debt*	Public Debt
1	2	3	4	5	6	7	8	9
1991-92	7.35	10.43	10.94	0.78	0.63	8.44	8.58	8.46
1992-93	7.84	10.44	10.56	0.79	0.68	8.67	9.55	8.76
1993-94	7.83	11.33	12.96	0.54	0.72	9.18	8.81	9.14
1994-95	7.80	11.94	13.67	0.46	0.90	9.30	8.50	9.22
1995-96	8.32	11.76	12.12	0.78	0.87	9.36	8.67	9.29
1996-97	8.85	11.66	13.46	0.59	1.12	9.96	8.24	9.81
1997-98	9.08	12.04	12.78	0.58	1.34	9.90	7.58	9.71
1998-99	10.24	13.09	11.27	2.14 $	1.05	10.17	7.89	10.01
1999-00	10.72	13.35	12.60	0.68	0.80	10.79	7.87	10.61
2000-01	10.89	12.99	12.04	0.64	0.34	10.27	7.55	10.11
2001-02	10.82	11.32	11.25	0.44	0.19	9.97	6.55	9.18
2002-03 RE	9.93	10.69	11.08	0.73	0.25	8.61	6.31	8.49

\# Rates for each component are computed by dividing the interest payments in a year by the respective outstanding liabilities of the preceding year.

* External debt is at historical exchange rates.

@ Internal debt mainly comprises market loans, treasury bills, special securities issued to the Reserve Bank, compensation and other bonds, special securities converted to marketable securities, securities issued to international financial institutions and securities against small savings.

$ The jump is partly due to interest paid on special bonds issued to oil companies in 1998-99 in *lieu* of part of their outstanding claims under the APM for petroleum products.

4.24 Another disquieting feature has been the high debt discharge obligations of the Government. The servicing of debt of the Central Government rose significantly during 2002-03. Though the elongation of the average maturity of the dated securities in the recent years has helped in curtailing the rise in

Table 4.14 : Financing Pattern of Gross Fiscal Deficit of State Governments

(Rupees crore)

	2002-03 (RE)	2002-03 (BE)	2001-02	1995-96	1990-91	Variation between RE and BE (2002-03)	
						Amount	Per cent
1	2	3	4	5	6	7	8
Loans from the Centre	8,138 (7.0)	18,731 (18.2)	9,098 (9.5)	14,801 (47.1)	9,978 (53.1)	-10,593	-56.6
Market Borrowings	23,264 (19.9)	11,823 (11.5)	17,017 (17.7)	5,888 (18.7)	2,556 (13.6)	11,441	96.8
Special Securities issued to NSSF	49,865 (42.7)	40,179 (39.1)	37,900 (39.5)	Nil	Nil	9,686	24.1
State Provident Fund	9,656 (8.3)	10,086 (9.8)	9,923 (10.3)	4,201 (13.4)	2,489 (13.2)	-430	-4.3
Others*	25,807 (22.1)	22,064 (21.4)	22,048 (23.0)	6,536 (20.8)	3,764 (20.0)	3,743	17.0

RE : Revised Estimates. BE : Budget Estimates.

NSSF : National Small Saving Fund of the Central Government.

* Includes loans from banks and financial institutions, reserve fund, deposits and advances, *etc.*

Notes : 1. Figures in brackets are per cent of gross fiscal deficit.

2. Under the revised accounting procedure effective from 1999-2000, the States' share in small savings, which was included under 'Loan from the Centre', are treated as receipts against special securities issued to NSSF which are included under internal debt of State Governments.

Source : Budget Documents of State Governments.

Table 4.15 : Combined Liabilities and Debt-GDP Ratio

Year (end-March)	Outstanding Liabilities (Rupees crore)			Debt - GDP Ratio (in per cent)		
	Centre	States	Combined	Centre	States	Combined
1	2	3	4	5	6	7
1990-91	3,14,558	1,10,289	3,50,957	55.3	19.4	61.7
1995-96	6,06,232	2,12,225	6,89,545	51.0	17.9	58.0
2001-02	13,66,408	5,89,797	16,32,084	59.5	25.7	71.1
2002-03 (RE)	15,61,875	6,94,289	18,66,626	63.2	28.1	75.5

RE : Revised Estimates.
Note : Data regarding States are provisional.

repayments, debt servicing, on an average, accounted for more than 70 per cent of the gross market borrowings of the Central Government during the period 1990-91 to 2002-03 (Chart IV.2).

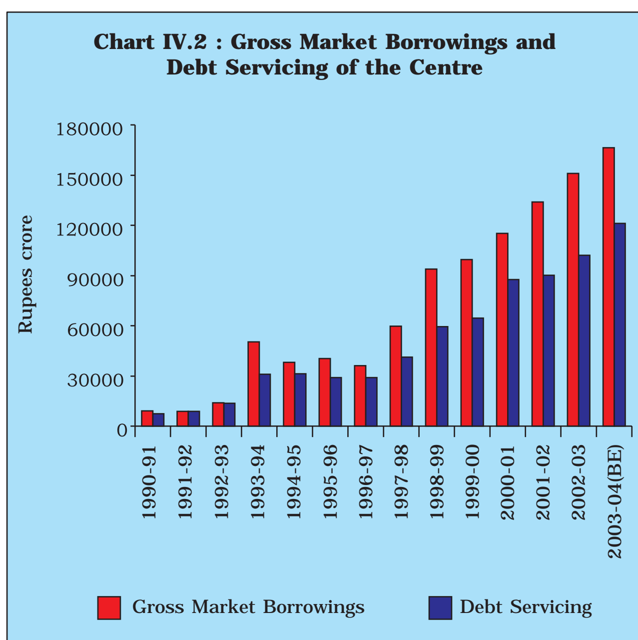
States' Debt

4.25 The high level of gross fiscal deficit have aggravated the debt position of States in recent years. The total outstanding debt of States rose by 17.7 per cent in 2002-03. The debt-GDP ratio of States rose to 28.1 per cent by end-March 2003.

Combined Debt

4.26 The combined outstanding liabilities of the Centre and the State Governments rose during 2002-03. Over the period between 1990-91 to 2002-03, outstanding liabilities of the Central and State Governments shot up by almost 15 per cent per annum (Table 4.15).

Chart IV.2 : Gross Market Borrowings and Debt Servicing of the Centre



Contingent Liabilities/Guarantees of the Government

4.27 The growing size of contingent liabilities has implications for the sustainability of Government finances. The volume of guarantees in the case of States has shown some signs of improvement in the year 2001-02. The contingent liabilities of State Governments also reflects the practice of setting up of special purpose vehicles (SPVs) to borrow from the market. Given the low user charges and inefficient operations of PSUs, these contingent liabilities are a potential threat to the stability and sustainability of the fiscal system (Table 4.16).

4.28 Many States have initiated measures to contain the growth of guarantees such as setting up of guarantee redemption funds and statutory and administrative limits on guarantees following the recommendation of the Technical Committee on State Government Guarantees (1999). Besides, some States have planned to charge guarantee commissions on outstanding guaranteed amounts. The recent Report of the 'Group to Assess the Fiscal Risk of State Government Guarantees' (2002) has made a number of recommendations to limit guarantees by the State Governments so as to contain the fiscal risk (Box IV.6)

Table 4.16 : Outstanding Government Guarantees

(Rupees crore)

Year (end March)	Centre		States		Total	
	Amount	Per cent of GDP	Amount	Per cent of GDP	Amount	Per cent of GDP
1	2	3	4	5	6	7
1992-93	58,088	7.8	42,515	5.7	1,00,603	13.4
1993-94	62,834	7.3	48,866	5.7	1,11,700	13.0
1994-95	62,468	6.2	48,479	4.8	1,10,947	11.0
1995-96	65,573	5.5	52,631	4.4	1,18,204	9.6
1996-97	69,748	5.1	63,409	4.6	1,33,157	9.7
1997-98	73,877	4.9	73,751	4.8	1,47,628	9.7
1998-99	74,606	4.3	97,454	5.6	1,72,060	9.9
1999-2000	83,954	4.3	1,32,029	6.8	2,15,983	11.2
2000-01	86,862	4.1	1,68,712	8.0	2,55,574	12.1
2001-02 (P)	95,859	4.2	1,66,116	7.2	2,62,975	11.5

Note : Ratios may not add up to the total due to rounding off. P : Provisional.

Source : 1. Data on Centre's guarantees are sourced from Budget Documents of the Central Government.

2. Data on States' guarantees are based on the information received from State Governments and pertain to 17 major States.

Box IV.6

Fiscal Risk of State Government Guarantees

The contingent liabilities of governments have not been accorded due importance in conventional fiscal analysis. Central to fiscal stability and sustainability is the need for the fiscal risk of contingent liabilities to be recognised, identified, classified and provided for. In India, the hard budget constraint faced by State Governments has forced recourse to off-budget financing through State level undertakings or special purpose vehicles supported by guarantees, leading to their sharp rise in the second half of the 1990s. The Technical Committee on State Government Guarantees (February 1999) recommended that States fix a ceiling on guarantees; that there should be some selectivity in issuance of guarantees; and that information on guarantees should be comprehensive and disclosed in budget documents.

The Group to Assess the Fiscal Risk of State Government Guarantees was constituted to suggest, *inter alia,* a method for evaluation of the fiscal risk of State Government guarantees. The major recommendations of the Group are:

- Guarantees to be met out of budgetary resources should be identified and treated as equivalent to debt;
- For other guarantees, projects/activities need to be classified and assigned appropriate risk weights.
- Mapping of guarantees and future devolvement.
- Central financial institutions should amend their Acts/ policies and do away with the practice of insisting on guarantees.
- Regular publication of data regarding guarantees in budget documents;
- State Level Tracking Unit for guarantees;
- At least one per cent of outstanding guarantees to be transferred to the Guarantee Redemption Fund (GRF) each year specifically to meet the additional fiscal risk.

THE FISCAL OUTLOOK

Union Budget, 2003-04

4.29 The Union Budget 2003-04 has accorded high priority to fiscal consolidation, with a commitment to eliminate budgetary drags and to strive for revenue enhancement under a modern tax regime. All major deficit indicators are expected to be lower than during 2002-03 (Table 4.17).

4.30 The budget envisages improvement in the buoyancy of tax receipts. The increase in tax revenue is expected to emanate from Union excise duties, corporation tax, income tax, customs duties and service tax. Of the gross tax collection, the share of States works out to 25.3 per cent. The measures envisaged to increase the tax collections are anchored on broadening the tax base and improving the compliance. This is sought to be achieved by integrating services into the tax net in a comprehensive manner through a constitutional amendment, improvements in tax administration by way of greater application of information technology, and further rationalisation of excise duties. Non-tax revenue in the form of interest receipts and dividends

Table 4.17 : Centre's Fiscal Position

(Rupees crore)

	2003-04 (BE)	2002-03 (RE)	Variation (BE over RE)	
			Amount	Per cent
1	2	3	4	5
Total Receipts/ Expenditure	4,38,795 (16.0)	4,04,013 (16.3)	34,782	8.6
Revenue Receipts	2,53,935 (9.3)	2,36,936 (9.6)	16,999	7.2
Capital Receipts	1,84,860 (6.7)	1,67,077 (6.8)	17,783	10.6
Revenue Expenditure	3,66,227 (13.3)	3,41,648 (13.8)	24,579	7.2
Capital Expenditure	72,568 (2.6)	62,365 (2.5)	10,203	16.4
Gross Fiscal Deficit	1,53,637 (5.6)	1,45,466 (5.9)	8,171	5.6
Revenue Deficit	1,12,292 (4.1)	1,04,712 (4.2)	7,580	7.2
Gross Primary Deficit	30,414 (1.1)	29,803 (1.2)	611	2.1

RE : Revised Estimates.
BE : Budget Estimates.
Note : Figures in brackets are per cent of GDP.

Table 4.18 : Receipts of the Centre

	2003-04 (BE)	2002-03 (RE)	Variation (BE over RE)	
			Amount	Per cent
1	2	3	4	5
Total Receipts	4,38,795 (16.0)	4,04,013 (16.3)	34,782	8.6
Revenue Receipts	2,53,935 (9.3)	2,36,936 (9.6)	16,999	7.2
Tax Revenue (Net)	1,84,169 (6.7)	1,64,177 (6.6)	19,992	12.2
Gross Tax Revenue	2,51,527 (9.2)	2,21,918 (9.0)	29,609	13.3
Of which:				
Corporation Tax	51,499 (1.9)	44,700 (1.8)	6,799	15.2
Income Tax	44,070 (1.6)	37,300 (1.5)	6,770	18.2
Customs Duty	49,350 (1.8)	45,500 (1.8)	3,850	8.5
Union Excise Duty	96,791 (3.5)	87,383 (3.5)	9,408	10.8
Capital Receipts	1,84,860 (6.7)	1,67,077 (6.8)	17,783	10.6
Of which				
Recoveries	18,023	18,251	-228	-1.2
Disinvestment	13,200	3,360	9,840	292.9
Market Borrowings	1,07,194	1,12,865	-5,671	-5.0
State Provident Funds	7,500	8,500	-1,000	-11.8
Special Deposits	9,970	10,280	-310	-3.0
External Finance	3,582	-13,496	17,078	–
Others	25,391	27,317	-1,926	-7.1

RE : Revised Estimates. BE : Budget Estimates.
Note: Figures in brackets are per cent of GDP.

and profits is expected to decline. Capital receipts are budgeted to show a rise mainly due to sharp increase in projected proceeds from disinvestment (Table 4.18).

4.31 The Union Budget has initiated fresh measures to contain the size of expenditure, improve cash management and accelerate the debt restructuring process. A major constraint in this endeavour is the downward inflexibility of revenue expenditure which accounts for over 70 per cent of the growth in overall expenditure anticipated in 2003-04. Non-Plan revenue expenditure comprising outflows such as interest payments, defence expenditure, and subsidies would form nearly 80 per cent of revenue expenditure. Interest payments alone would pre-empt 48.5 per cent of the revenue receipts during 2003-04. A noteworthy feature of the expenditure pattern for 2003-04 is that capital outlays are budgeted to increase, while loans and advances are expected to decline (Table 4.19).

State Budgets, 2003-04

4.32 The State Budgets for 2003-04 envisage continued efforts towards fiscal consolidation through revenue augmentation and containment of expenditure. The revenue deficit is budgeted to narrow from 2.5 per cent of GDP in 2002-03 to 1.8 per cent in 2003-04 and is expected to enable a decline in the gross fiscal deficit of the States from 4.7 per cent in 2002-03 to 4.0 per cent in 2003-04.

4.33 Revenue receipts of the States are budgeted to rise by 13.3 per cent over the previous year. A significantly high proportion of this rise (65 per cent) would be contributed by States' own revenue receipts comprising States' own tax and non-tax receipts. Thus, States' own revenue (SOR) resources are expected to finance the major portion of aggregate expenditure in 2003-04 (Table 4.20). The capital receipts of the States are budgeted to decline mainly on account of recovery of loans and advances, market borrowings and reserve funds.

Table 4.19 : Aggregate Expenditure of the Centre

(Rupees crore)

	2003-04 (BE)	2002-03 (RE)	Variation (2 over 3)	
			Amount	Per cent
1	2	3	4	5
Total Expenditure (1+2=3+4)	4,38,795 (16.0)	4,04,013 (16.3)	34,782	8.6
1. Non-Plan Expenditure	3,17,821 (11.6)	2,89,924 (11.7)	27,897	9.6
of which:				
Interest Payments	1,23,223 (4.5)	1,15,663 (4.7)	7,560	6.5
Defence	65,300 (2.4)	56,000 (2.3)	9,300	16.6
Subsidies	49,907 (1.8)	44,618 (1.8)	5,289	11.9
2. Plan Expenditure	1,20,974 (4.4)	1,14,089 (4.6)	6,885	6.0
3. Revenue Expenditure	3,66,227 (13.3)	3,41,648 (13.8)	24,579	7.2
4. Capital Expenditure	72,568 (2.6)	62,365 (2.5)	10,203	16.4

RE : Revised Estimates BE : Budget Estimates.
Note: Figures in brackets are per cent of GDP.

4.34 The growth rate of total expenditure of States is budgeted to decelerate to 7.6 per cent from 17.2 per cent (in the revised estimates for 2002-03), reflecting the expenditure compression measures undertaken by the States. The share of developmental expenditure in total expenditure is budgeted to decline in 2003-04 mainly due to deceleration in expenditure on economic services (Table 4.21).

Table 4.20 : Revenue Receipts as a Percentage of Expenditure of States

Year	SOR as a per cent of		CTR as a percentage of	
	Revenue Expenditure	Total Expenditure	Revenue Expenditure	Total Expenditure
1	2	3	4	5
1990-91	55.1	43.4	37.5	29.5
1995-96	59.8	48.9	34.5	28.2
2000-01	51.3	43.0	30.4	25.5
2001-02	52.1	43.4	29.1	24.3
2002-03 (RE)	52.2	41.9	30.6	24.5
2003-04 (BE)	55.1	44.2	32.0	25.7

RE : Revised Estimates. BE : Budget Estimates.
SOR : States' Own Revenue Receipts.
CTR : Current Transfers from Centre, *i.e.,* sharable taxes and grants.
Source : Budget Documents of State Governments.

Table 4.21 : Expenditure Pattern of State Governments

(Per cent of Total Expenditure)

	2003-04 (BE)	2002-03 (RE)	2001-02	1995-96	1990-91
1	2	3	4	5	6
I. Development Expenditure (a+b)	54.8	56.0	57.4	64.7	69.5
a) Revenue	42.3	43.3	46.0	50.3	53.5
b) Capital	12.5	12.7	11.4	14.4	15.9
II. Non-Development Expenditure (c+d)	37.2	36.3	36.6	31.2	24.8
c) Revenue	36.4	35.5	36.2	30.5	24.3
d) Capital	0.8	0.8	0.4	0.7	0.5
III. Others (e+f)	8.0	7.7	6.1	4.2	5.8
e) Revenue @	1.5	1.4	1.2	0.9	1.0
f) Capital *	6.5	6.3	4.8	3.3	4.7

RE : Revised Estimates. BE : Budget Estimates.
@ Comprise compensation and assignments to local bodies, grants-in-aid contributions and reserves with finance departments.
* Comprise discharge of Internal debt and repayment of loans to the Centre.
Source: Budget Documents of State Governments.

4.35 Non-developmental expenditure of States mainly comprise three items, *viz.*, interest payments, administrative expenditure and pensions. The expenditure on these three items taken together as a percentage of revenue receipts is budgeted to show a marginal decline over the previous year (Table 4.22).

Table 4.22 : Selected Items under Non-Development Expenditure of States

(Rupees crore)

Year	Interest	Pensions	Administrative Services	Total (2+3+4)
1	2	3	4	5
1990-91	8,655	3,593	7,018	19,266
1995-96	21,932	7,813	13,391	43,136
2001-02	62,489	28,197	27,069	117,755
2002-03 (RE)	74,147	31,989	28,740	134,876
2003-04 (BE)	82,287	35,723	30,490	148,501
As a per cent of Revenue Receipts				
1990-91	13.0	5.4	10.6	29.0
1995-96	16.0	9.4	9.8	35.2
2001-02	24.4	11.0	10.6	46.1
2002-03 (RE)	25.2	10.9	9.8	45.9
2003-04 (BE)	24.7	10.7	9.2	44.6

RE : Revised Estimates. BE : Budget Estimates.
Source: Budget Document of State Governments.

Table 4.23 : Measures of Deficit of the Central and State Governments

Year	Rupees crore			Per cent of GDP		
	Gross Fiscal Deficit	Revenue Deficit	Primary Deficit	Gross Fiscal Deficit	Revenue Deficit	Primary Deficit
1	2	3	4	5	6	7
1990-91	53,580	23,871	28,585	9.4	4.2	5.0
1995-96	77,671	37,932	18,598	6.5	3.2	1.6
1996-97	87,244	48,768	17,156	6.4	3.6	1.3
1997-98	1,10,743	62,782	32,466	7.3	4.1	2.1
1998-99	1,57,053	1,10,618	63,956	9.0	6.4	3.7
1999-2000	1,84,826	1,21,393	74,375	9.5	6.3	3.8
2000-01	1,99,852	1,38,803	77,885	9.5	6.6	3.7
2001-02	2,26,418	1,59,395	84,048	9.9	6.9	3.7
2002-03 (BE)	2,26,864	1,43,691	64,442	8.9	5.6	2.5
2002-03 (RE)	2,48,976	1,66,014	88,492	10.1	6.7	3.6
2003-04 (BE) @	2,51,951	1,61,300	76,463	9.2	5.9	2.8

RE : Revised Estimates. BE : Budget Estimates.

@ Per cent of GDP are worked out on the basis of the implicit nominal GDP underlying the budget estimates of the Central Government for the year 2003-04.

Combined Budgets for 2003-04

4.36 By the mid-1990s, the combined gross fiscal deficit was brought down significantly; by the end of the 1990s, however, it slipped back to pre-reform levels. The budgets for 2003-04 project all the major deficit indicators of the Government sector lower in terms of GDP. The reduction in deficit indicators in terms of GDP is envisaged through compressing the rise in expenditure and improvement in tax buoyancy (Table 4.23).

4.37 The combined revenue receipts of the Centre and States are budgeted to rise and lead to an improvement in the combined tax-GDP ratio. Developmental expenditure is estimated to register a lower expansion on account of reduction in the share of the social sector to 8.2 per cent of GDP (Table 4.24).

Financing

4.38 During 2003-04, the overall borrowing requirement (GFD) of the Centre is budgeted to rise by Rs.8,171 crore. Market borrowings would finance the major part of the GFD, 'other domestic liabilities' being the second important item of financing. On the utilisation of borrowed funds, the bulk of the GFD would continue to be used for financing the revenue deficit. (Table 4.25).

Table 4.24 : Combined Receipts and Disbursements of Central and State Governments

(Rupees Crore)

	2003-04 (BE)	2002-03 (RE)	Variations between BE and RE	
			Amount	Per cent
1	2	3	4	5
I. Total Receipts (A+B)	8,04,728	7,46,601	58,127	7.8
A. Revenue Receipts (1+2)	5,20,320	4,71,600	48,720	10.3
1. Tax Receipts	4,11,263	3,66,696	44,567	12.2
a) Direct Taxes	1,17,503	1,03,858	13,645	13.1
b) Indirect Taxes	2,93,760	2,62,838	30,922	11.8
2. Non-Tax Receipts	1,09,057	1,04,904	4,153	4.0
B. Capital Receipts	2,84,408	2,75,001	9,407	3.4
II. Total Disbursements (A+B)	8,11,321	7,51,917	59,404	7.9
A. Developmental Expenditure	3,99,926	3,79,589	20,337	5.4
B. Non-Developmental Expenditure (Including others)	4,11,395	3,72,329	39,066	10.5

RE : Revised Estimates. BE : Budget Estimates.

Table 4.25 : Financing and Decomposition of Centre's GFD

(Per cent)

Years	Financing of GFD				Decomposition of GFD		
	Market Borrowings	Other Liabilities	External Financing	91 day TB	Revenue Deficit	Capital Outlay @	Loans & Advances*
1	2	3	4	5	6	7	8
1990-91	17.9	49.5	7.1	25.4	41.6	27.2	31.2
1991-92	20.7	45.5	14.9	18.9	44.8	23.0	32.2
1992-93	9.2	47.0	13.2	30.6	46.2	29.0	24.7
1993-94	48.0	25.4	8.4	18.2	54.3	22.0	23.7
1994-95	35.2	56.9	6.2	1.7	53.8	16.1	30.1
1995-96	54.9	28.3	0.5	16.3	49.4	21.1	29.6
1996-97	30.0	45.8	4.5	19.8	48.9	20.6	30.5
1997-98	36.5	63.3	1.2	-1.0	52.2	18.7	29.1
1998-99	60.9	37.6	1.7	-0.2	59.1	11.4	29.5
1999-00	67.1	30.9	1.1	0.8	64.6	21.3	14.1
2000-01	61.4	33.3	6.3	-1.0	71.7	19.0	9.2
2001-02	62.2	34.9	4.0	-1.1	71.1	16.3	12.7
2002-03 (RE)	77.6	28.0	-9.3	3.6	72.0	18.6	9.5
2003-04 (BE)	69.8	27.9	2.3	0.0	73.1	18.9	8.0

@ Net of Disinvestment Receipts.
* Net of Recoveries of Loans.

4.39 Small savings receipts would continue to be a major source of financing the States' fiscal deficit, accounting for 58.0 per cent of GFD in 2003-04. Loans from the Centre and State provident fund are anticipated to finance 10.7 per cent and 7.0 per cent of GFD, respectively; however, the share of market borrowings is budgeted to decline to 12.4 per cent from 19.9 per cent in 2002-03. The balance is budgeted to be financed by loans from financial institutions, reserve funds, deposits and advances, *etc.*

4.40 The combined borrowings requirement (GFD) of the Centre and States has increased, on an average, by 15.3 per cent between 1990-91 and 2002-03. For 2003-04, however, the borrowings requirement is budgeted to increase moderately by 1.2 per cent (Table 4.26).

4.41 Major initiatives in fiscal consolidation are envisaged in the context of the State budgets for 2003-04. A few States have proposed to introduce a new contributory pension scheme for newly recruited employees. With regard to the value added tax, preparatory work towards its introduction is in progress. In view of the apprehensions expressed by a large number of States, the Union Budget 2003-04 envisages that the Central Government would compensate 100 per cent of the loss in the first year, 75 per cent of the loss in the second year and 50 per cent in the third year of the introduction of VAT.

4.42 The Twelfth Finance Commission which was constituted on November 1, 2002 is expected to make recommendations regarding improvement in distribution of net tax proceeds between the Union

Table 4.26 : Financing of Gross Fiscal Deficit of the Centre and States

(Rupees crore)

Year	Market Borrowings	State Provident Fund	Small Savings	External Borrowings	Others	Gross Fiscal Deficit
1	2	3	4	5	6	7
2001-02	1,04,741	14,096	43,773	5,601	58,206	2,26,417
	(46.3)	(6.2)	(19.3)	(2.5)	(25.7)	(100.0)
2002-03(BE)	1,07,682	20,086	40,000	770	58,327	2,26,865
	(47.5)	(8.9)	(17.6)	(0.3)	(25.7)	(100.0)
2002-03 (RE)	1,36,129	18,156	52,200	-13,496	55,990	2,48,979
	(54.7)	(7.3)	(21.0)	-(5.4)	(22.5)	(100.0)
2003-04 (BE)	1,20,683	16,063	60,000	3,582	51,622	2,51,950
	(47.9)	(6.4)	(23.8)	(1.4)	(20.5)	(100.0)

RE : Revised Estimates. BE : Budget Estimates.
Note : Figures in brackets are per cent of GFD.

and the States, and to review evolving principles governing grants-in-aid to the States. The Union Budget 2003-04 has proposed constitutional amendment which would enable levy of tax on services and empowerment to Central and State Governments to collect the proceeds.

4.43 Based on the recommendations of the Eleventh Finance Commission, an Incentive Fund has been instituted for the purpose of encouraging fiscal reforms in the States on the basis of a monitorable fiscal reform programme under the 'States Fiscal Reforms Facility' (2000-01 to 2004-05). Several States have drawn up Medium-Term Fiscal Reforms Programme (MTFRP) by setting targets for broad fiscal indicators in the medium term and by covering various aspects such as fiscal consolidation, public sector enterprises reform, power sector reforms and fiscal transparency. The Planning Commission is also extending support to the MTFRP by ensuring that the Annual Plan framework is consistent with it. The Twelfth Finance Commission would also review the fiscal reform facility introduced by the Central Government and suggest measures for effective achievement of its objectives.

4.44 With the passage of the revised Fiscal Responsibility and Budget Management (FRBM) Bill by the Parliament, institutional arrangements are being envisaged to achieve sound fiscal management through reduction in fiscal and revenue deficits and a phased decline in the Centre's borrowings. Recognising that there could be extraordinary circumstances caused by domestic and global factors, the revised Bill proposes fiscal targets as part of policy rules rather than enacted by legislation, in order to strike a balance between legislative intervention and the need for flexibility to deal with fiscal imperatives. At the State level, Karnataka, Punjab and Tamil Nadu have already enacted the Fiscal Responsibility legislation, while a fiscal responsibility bill has been passed by the State assembly in Kerala. A similar initiative has also been taken by Maharashtra.

Outlook

4.45 A downward inflexibility in the fiscal deficit and the corrosion of public sector outlays on the social and physical infrastructure are the dominant concerns weighing upon the fiscal stance for 2003-04. There is a gathering urgency to halt the dissaving of the public sector, embodied in the rising preemption of resources through the revenue deficit. Elimination of the revenue deficit of the Centre is now envisaged as a medium-term constitutional objective. Fiscal authorities in States which have already moved in the direction of enacting legislation for fiscal responsibility are required to take a hard option *i.e.,* attacking the earmarking of funds for current consumption expenditures. In the current phase of the business cycle, the priority attached to augmenting revenues in the context of the steady deterioration of the tax-GDP ratio has to be tempered with the need to stimulate investment demand and maintain consumption expenditures. Consequently, the thrust of efforts towards revenue mobilisation would have to be on improvements in tax administration, rationalisation of tax structures, rapidly putting in place the IT-enabled environment critical to the implementation of the VAT and widening the tax base by including services in a comprehensive manner in the tax net. Initial shortfalls observed in the cross-country experience in a VAT environment are likely to be more than counterbalanced by the lasting buoyancy gained from uniformity and stopping leakages, particularly in the context of the States.

4.46 While expenditure management would be carried forward with renewed vigour, improvements envisaged on the revenue side are expected to halt the retrenchment of capital outlays forced by the process of fiscal consolidation. The composition of public expenditure is expected to change in favour of public investment at the cost of subsidies and transfers. Public investment is envisaged in a twin role of raising the level of aggregate demand, and expanding the productive capacity of the economy, as there is compelling evidence that it is public investment which has made the predominant contribution to building human and capital stock in India and that it has been the major facilitator of private investment. 'Crowding in' properties of public investment are particularly strong in the social and physical infrastructure. Accordingly, health, housing, education, employment, agriculture and export promotion are the guiding themes of the Centre's budget for 2003-04, indicative of a shift in focus to the quality of fiscal policy. This is extended to all aspects of the ongoing consolidation, and in particular, towards ensuring the sustainability of public debt, including through pension reforms and limits on contingent liabilities - the two major risks to the progress of fiscal reforms. Pension reforms would assume priority in the coming years with the availability of a menu of schemes, diversification of risk and independent regulatory oversight. Steps are being taken to identify and provide for the fiscal risk embodied in State Government guarantees with limits imposed to restrain their growth. These structural changes are expected to impart sustainability to public debt over the medium-term.

V FINANCIAL MARKETS

5.1 Financial markets were flush with liquidity over the greater part of 2002-03, bolstered by sustained capital inflows and a liquidity overhang. There was a general easing of market conditions in terms of turnover and rates, the latter enabled by the accommodative monetary policy stance. In the money markets, key rates ruled close to the repo rate, except for a transient firming in mid-May 2002 and episodic spurts after October 2002. Market sentiment recovered quickly from border tensions in May 2002 and over the rest of the year, there was a modest appreciation of the spot exchange rate against the US dollar and a softening of forward premia. Repeated price rallies in the government securities market pushed down yields and flattened the yield curve, abating temporarily in February 2003 as fears of war in Iraq mounted. Yields on corporate bonds fell more sharply than those on gilts as risk perceptions improved. While bank deposit rates decreased in response to monetary policy impulses, this was not fully reflected in the lending rate reductions in the credit market. Activity in the credit market, however, picked up on the back of an upturn in demand from a range of industries. Equity markets remained subdued during the year, tracking developments in international markets. Uncertainty surrounding the disinvestment strategy and the lack of appetite among foreign institutional investors dampened market sentiment (Table 5.1).

5.2 Global financial markets witnessed major declines in the first half of 2002-03 with investor confidence severely undermined by financial distress among major corporate entities and geo-political tensions. Equity markets went through their steepest declines since September 11, 2001. The negative sentiment spilled over into the corporate bond markets where issuances slowed down and credit spreads widened. Sovereign spreads on emerging market paper rose markedly during June-July 2002. Activity

Table 5.1: Money, Gilt, Foreign Exchange and Equity Markets

Month	Call Money		Gilt	Foreign Exchange				Liquidity Management			Equity			
	Average Daily Turnover (Rs. crore)	Average Call Rates (Per cent)	Turnover in Govt. Securities (Rs. crore)+	Average Daily Inter-bank Turnover (US $ million)	Average Exchange Rate (Rs. per US $)	RBI's net Foreign Currency Sales (-)/ Purchases(+) (US $ million)	Forward premia 3-month (Per cent)	Net OMO Sales(-) Purchases (+) (Rs. crore)	Average Daily Repos (LAF) Outstanding (Rs. crore)	Average Daily Reverse Repo (LAF) Outstanding (Rs. crore)	Average Daily BSE Turnover (Rs. crore)	Average Daily NSE Turnover (Rs. crore)	Average BSE Sensex	Average S & P CNX Nifty
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
2002-03														
April	41,616	6.58	1,93,091	6,541	48.92	477	6.12	-5,307	8,119	1,322	1,312	2,424	3435	1121
May	39,326	6.90	1,20,173	4,966	49.00	86	6.23	-1,525	1,924	17	1,279	2,499	3303	1080
June	28,905	6.04	1,16,846	4,836	48.97	241	5.37	-189	10,420	0	1,166	2,212	3257	1066
July	32,386	5.75	2,35,586	4,922	48.76	1,829	4.40	-6,538	17,092	0	1,162	2,235	3215	1035
August	32,269	5.72	2,44,717	4,564	48.59	1,179	4.09	-7,025	19,046	0	1,132	2,196	3053	978
September	28,883	5.75	1,70,345	4,429	48.44	965	3.94	-6,355	19,483	0	1,221	2,325	3086	987
October	30,469	5.73	2,48,038	4,156	48.37	1,171	3.81	-71	20,653	0	1,316	2,472	2950	955
November	25,821	5.45	3,34,605	5,093	48.25	2,115	3.66	-11,073	13,859	2	1,367	2,703	3058	992
December	24,305	5.58	2,95,943	5,054	48.14	1,679	3.32	-4,548	10,911	0	1,456	2,951	3316	1074
January	24,034	5.66	3,55,821	4,941	47.93	1,785	3.42	-10,996	6,325	13	1,343	2,816	3328	1073
February	20,682	5.71	1,39,689	5,206	47.73	2,335	3.55	-88	4,259	45	1,235	2,542	3279	1056
March	24,357	5.86	1,31,947	5,542	47.64	1,849	3.60	-66	2,265	1,570	1,013	2,158	3156	1016
2003-04														
April	17,338	4.87	2,26,803	5,585	47.38	1,432	2.08	-7	27,372	109	1,041	2,449	3037	965
May	18,725	4.87	2,99,933	5,960	47.08	2,342	1.10	-5,569	25,223	10	1,072	2,604	3033	963
June	20,544	4.91	3,00,504	5,805	46.71	896	2.76	-44	24,805	–	1,187	2,933	3387	1069
July	18,698	4.90	3,04,587	5,986	46.23	3,146	2.65	-57	42,690	39	1,434	3,429	3665	1150

OMO: Open Market Operations. + Outright turnover in Central Government dated securities. LAF: Liquidity Adjustment Facility.
BSE: Bombay Stock Exchange. NSE: National Stock Exchange.

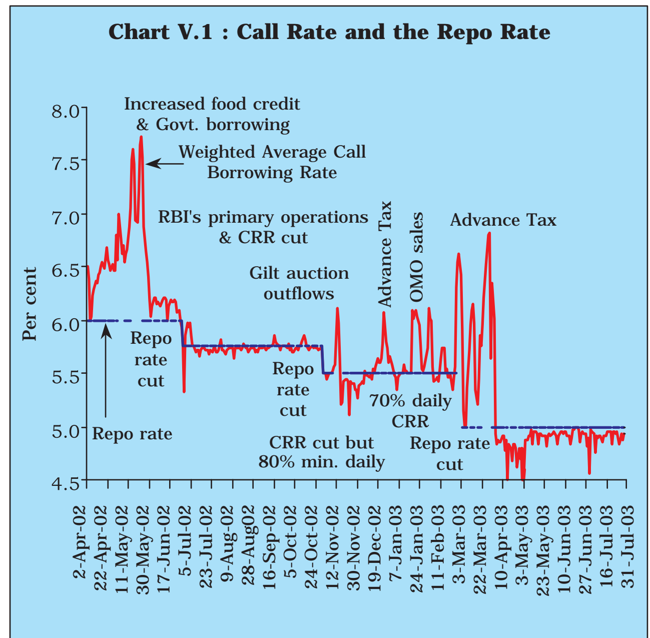
in all segments of the international banking market experienced a pronounced slowdown, mainly due to a decline in inter-bank lending and subdued credit demand. A revival of investor confidence set in during October and equity markets began to recover. Corporate bond markets shared in this optimism as credit spreads narrowed. Emerging markets were dominated by local developments. International banking activity stabilised with some improvement in credit to non-banks. Nevertheless, sentiment in international financial markets remained uncertain with the weakening of the global recovery in the fourth quarter and the downward adjustment in expectation of stronger corporate earnings in the near term. Emerging markets were bound down by sluggish capital inflows, although the cessation of outflows of private capital shored up sentiment considerably towards the close of the year. In the foreign exchange markets, the US dollar depreciated against the Euro and Yen reflecting diminished attractiveness of US assets, a slowdown in the Euro area's diversification away from euro-denominated assets, growing apprehensions about the US's large trade deficit and geo-political concerns.

MONEY MARKET

Call/ Notice Money Market

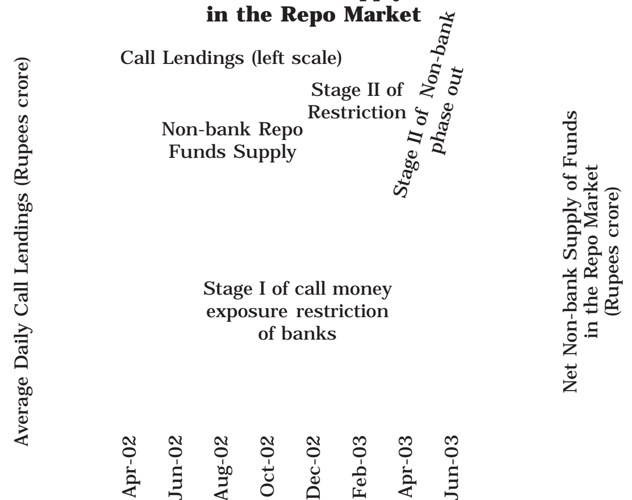
5.3 Call/notice money market activity during 2002-03 was dominated by shifts in liquidity conditions. The usual beginning-of-the-year liquidity evinced considerable appetite for LAF repos. The commencement of the Centre's market borrowing and open market sales for improving price discovery evened out the excess liquidity, and the weighted average call borrowing rate edged above the Bank Rate of 6.5 per cent at the end of April (Chart V.1). As the borrowing programme intensified, drawals of food credit began and border tensions surfaced in May, market liquidity tightened, driving up the average call rate to a high of 7.7 per cent on May 22, 2002. The demand for LAF repos waned until a reverse repo auction and a series of private placements of government securities with the Reserve Bank brought the call rate down by end-May 2002 (Appendix Table V.1).

5.4 Easing of monetary conditions - reduction of CRR - and redemption inflows drove the call rates below the repo rate by the fourth week of June. The reduction in the repo rate on June 27 started a long phase of stability in the call money market with the call rates trailing just below the repo rate up to October 2002. Amidst ample liquidity and phasing out of non-



banks from the call/notice money market, as the first stage of call money exposure limits for banks became effective in October, the turnover in call/notice money market segment declined while the participation and exposure in the repo market segment increased (Chart V.2).

5.5 Call/notice money market conditions remained relatively volatile in the remaining part of the year, with rates edging up around mid-November due to gilt auction outflows and higher minimum average daily CRR maintenance requirements. Another round of monetary policy easing calmed the market and the



* Includes Non-banking Financial Institutions and Mutual Funds.

Table 5.2 : Summary Statistics on Call/Notice Money Borrowing Rates

	Low				High				Weighted Average			
	Min. (%)	Max. (%)	Avg. (%)	CV	Min. (%)	Max. (%)	Avg. (%)	CV	Min. (%)	Max. (%)	Avg. (%)	CV
1	2	3	4	5	6	7	8	9	10	11	12	13
2001-02	**3.61**	**8.00**	**5.70**	**0.12**	**6.66**	**22.00**	**8.09**	**0.25**	**6.34**	**13.13**	**7.17**	**0.11**
2002-03	**0.50**	**6.50**	**4.59**	**0.17**	**5.20**	**20.00**	**6.36**	**0.15**	**5.01**	**10.35**	**5.89**	**0.09**
2002-03												
April	3.54	5.75	5.19	0.12	6.45	20.00	7.43	0.32	5.99	10.35	6.58	0.11
May	3.54	6.50	5.62	0.10	6.55	9.25	7.55	0.08	6.04	7.73	6.90	0.06
June	3.00	5.30	4.82	0.13	6.25	7.00	6.51	0.03	5.32	6.22	6.04	0.04
July	2.71	4.95	4.46	0.15	5.80	6.70	5.99	0.04	5.66	5.97	5.75	0.01
August	3.00	4.76	4.43	0.08	5.80	6.25	5.92	0.02	5.64	5.77	5.72	0.00
September	4.00	4.77	4.68	0.04	5.80	6.55	6.21	0.05	5.69	5.85	5.75	0.01
October	4.00	4.83	4.47	0.06	5.75	6.55	6.11	0.05	5.51	5.85	5.73	0.01
November	0.50	5.00	3.60	0.38	5.50	7.20	5.83	0.07	5.10	6.11	5.45	0.04
December	3.50	4.70	4.32	0.07	5.50	6.80	6.08	0.06	5.27	6.07	5.58	0.03
January	3.50	5.00	4.45	0.07	5.60	7.50	6.19	0.08	5.35	6.11	5.66	0.04
February	2.00	5.40	4.45	0.14	5.60	7.10	6.12	0.07	5.34	6.62	5.71	0.07
March	3.00	5.37	4.47	0.13	5.20	12.00	6.91	0.16	5.01	6.83	5.86	0.09
2003-04												
April	1.00	5.25	2.94	0.38	5.05	12.00	5.73	0.30	4.50	6.03	4.87	0.07
May	1.80	4.00	3.32	0.25	5.00	5.25	5.10	0.01	4.46	4.97	4.87	0.02
June	2.00	4.00	3.60	0.15	4.88	5.50	5.11	0.02	4.56	4.99	4.91	0.02
July	2.25	4.00	3.70	0.14	5.00	5.50	5.07	0.02	4.75	4.97	4.90	0.01

Min. : Minimum Max. : Maximum Avg. : Average CV : Co-efficient of variation

call rates softened below the repo rate by the end of the month. An increase in the notified amount of 91-day Treasury Bill auctions, application of second stage call money exposure restrictions and advance tax outflows moved the call rates above the repo rate in December 2002. Liquidity conditions eased as the minimum average daily CRR maintenance requirement was lowered.

5.6 The call money rates firmed up intermittently in the last quarter of the year - in mid-January, 2003 on account of sizeable open market sales and in the later part of February 2003 due to geopolitical uncertainties and on-tap sale of State loans. The repo rate reduction on March 3, 2003 brought the call rates down for a brief period before they rose again towards the end of the month in a typical end-of-the-year upturn (Table 5.2).

5.7 The year 2003-04 began with softer call rates during April 2003 following inflows on account of large deferred expenditure undertaken by the government, purchase of foreign currency by the Reserve Bank and unwinding of the year-end tightness of liquidity. Capital inflows continued and monetary conditions were eased with a reduction in CRR in June 2003. The call rates settled at sub-repo levels during May-August 2003 (up to August 13) reflecting ample liquidity conditions. The turnover in call/notice money market fell in July 2003 subsequent to the application of call lending restrictions on the non-banks in June 2003.

Other Money Market Segments

Term Money Market

5.8 The main factor that has inhibited the development of term money and other money market segments in India is the absence of a smooth rupee yield curve providing an anchor for expectations for longer tenor. The skewness in liquidity among participants is also proving to be a deterrent for proper development of this market. Furthermore, corporates' preference for "cash" credit rather than for "loan" credit generally forces banks to deploy a large amount in the call money market instead of the term money market to meet sudden demand from corporates. For all these reasons, market activity tends to be concentrated predominantly in the call segment. Activity in the term money market during 2002-03 was dormant up to October but for an aberrational spurt in August due to temporary funds invested in the term money segment towards the later part of the month. With the imposition of prudential limits on exposure to the call/notice money market on banks and primary dealers, term money transactions rose from November 2002 onwards with

Table 5.3 : Activity in Other Money Market Segments

(Rupees crore)

Month	Average Daily Turnover in Term Money Market	Transactions in Repo Market (Outside Reserve Bank)	Commercial Paper (Outstanding Amount)	Certificates of Deposit (Outstanding Amount)	Commercial Bills Rediscounted by commercial banks	Forward Rate Agreements/ Interest Rates Swaps (Notional Amount)
1	2	3	4	5	6	7
2002-03						
April	225	47,020	8,046	1,393	371	88,813
May	123	44,431	8,111	1,360	463	1,03,993
June	135	37,848	8,447	1,359	701	1,17,644
July	108	34,170	8,520	1,303	400	1,24,453
August	1,179	33,281	9,125	1,007	341	1,32,354
September	247	41,768	9,549	1,236	572	1,31,898
October	117	46,595	8,426	1,394	502	1,31,340
November	392	34,503	8,599	1,219	332	1,53,260
December	454	37,651	9,025	1,163	462	1,61,566
January	288	66,599	8,554	1,226	455	1,92,170
February	281	65,413	7,070	1,125	295	2,18,816
March	546	74,236	5,749	908	105	2,44,161
2003-04						
April	604	41,815	5,994	1,485	164	2,49,449
May	455	43,328	6,820	1,996	334	2,84,048
June	610	48,605	7,108	2,183	393	2,93,127
July	573	74,936	7,557	–	364	3,01,062

– Not Available.

the average daily turnover turning out to be significantly higher in 2002-03. The momentum has been maintained during 2003-04 so far with a further phase-out of non-banks from call/notice money market in June 2003 (Table 5.3).

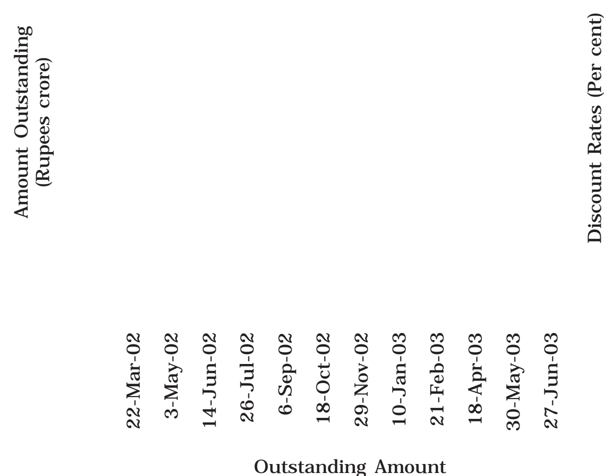
Certificates of Deposit issued by Banks

5.9 The market for certificates of deposit (CDs), which are essentially securitised high cost short-term time deposits, tends to be active when liquidity conditions tighten and banks try to meet the liquidity gap by issuing CDs, often at a premium. Comfortable liquidity kept the outstanding amount of CDs low during 2002-03 (Appendix Table V.2). The typical discount rate for 3-month CDs softened, especially during the second half of the year (Chart V.3). During 2003-04 (up to June 27), the issuances of CDs rose and the typical discount rate showed some hardening.

Commercial Paper

5.10 Commercial Paper (CPs) and CDs exhibit contrasting behaviour. Activity in the CP market picks up amidst ample liquidity conditions when eligible entities can raise funds through CPs at an effective rate of discount lower than the lending rate of banks. The outstanding amount of CPs rose during the first three quarters of 2002-03 before shifts in

Chart V.3 : Certificates of Deposit



market sentiment drove down issuances (Chart V.4 and Appendix Table V.3). A marginal decline in the cumulative flow of primary issuances of CPs during 2002-03 as against 2001-02 reflected primarily a fall in primary issuances by the manufacturing companies which had access to sub-PLR lending.

Chart V.4 : Commercial Paper

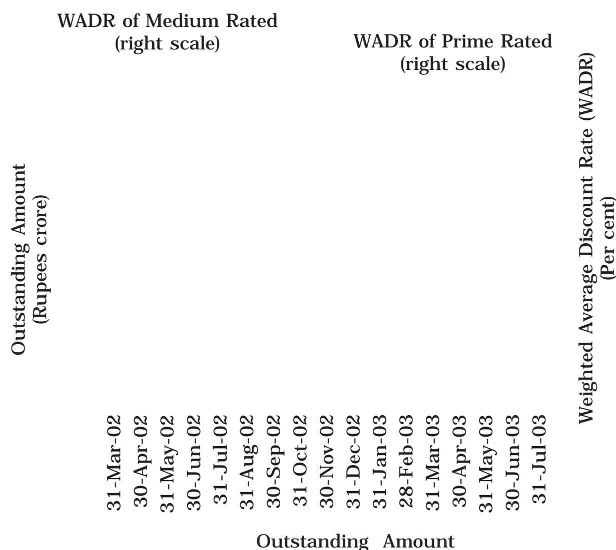
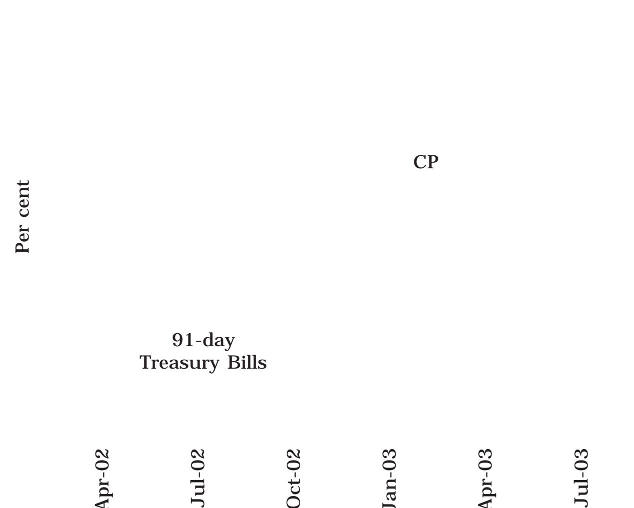


Chart V.5 : Cut-Off Yields on 91-day T-Bill and Discount Rate on CP (61-90 days)



On the other hand, the primary issuances of leasing and finance companies and those of financial institutions moved up. The weighted average discount rate (WADR) of the CP softened, with the spread between the prime rated and medium rated companies narrowing during 2002-03.

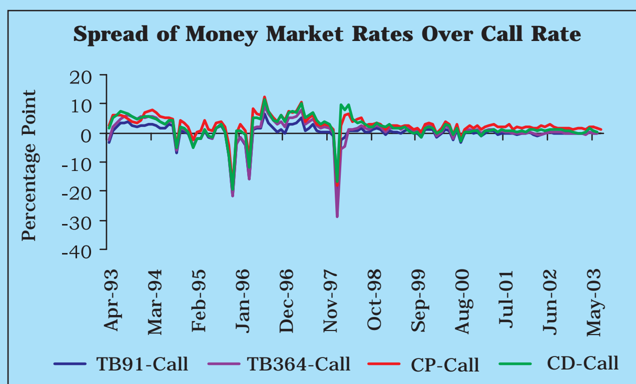
5.11 The outstanding amount of CPs has risen so far during 2003-04 (up to July). Ample liquidity conditions in the beginning of 2003-04 generated activity in the CP market. The WADR declined steadily. The spread between the yields of CP (61-90 days) and 91-day Treasury Bills widened around mid-May 2003 reflecting the substantial drop in the cut-off yields of 91-day Treasury Bills. A recovery in the 91-day Treasury Bill yields narrowed the spread subsequently (Chart V.5).

5.12 Money market rates have exhibited a significant degree of synchronicity indicating that they are increasingly getting jointly determined by a common set of factors embodied in macroeconomic and financial conditions. In contrast to earlier instances of joint behaviour in episodes of uncertainty, the recent convergence has occurred under ample liquidity conditions as well as orderliness and selectivity in bid/ offer activity (Box V.1)

Box V.1

Synchronicity in Money Market Segments

A significant feature of financial market behaviour during 2002-03 was a close co-movement of market segments at the short-end, *i.e.*, call money, Treasury Bills, CP and CDs. Rates in these markets frequently joined the call rates in dipping below the repo rate, the informal floor for the financial market spectrum in India, on many occasions during the course of the year. Similar co-movement was evident in turnovers. The consequent narrowing of spreads at the short end of the market spectrum and the strength of this synchronicity has implications for the operational efficiency of markets as well as for the effectiveness of the transmission of monetary policy which typically operates at the short end of the market structure (Chart). Recognition of this interesting development was reflected in the Statement on Monetary and Credit Policy for 2003-04:



(Contd....)

(Concld....)

"interest rates in money market instruments converged to a narrow band....".

In the literature, convergence of risk-adjusted returns is regarded as a necessary condition for market integration, though not a sufficient one. In particular, co-movement in rates is suspect since financial market rates show 'random walk' in that they exhibit no tendency to return to trend value once disturbed. Moreover, association in rate movements may indicate contagion rather than integration. Empirical investigation conducted in the Reserve Bank in a vector error correction model (VECM) framework indicated contemporaneous episodes of excess returns in the call, Treasury Bill, CP and forward segment of the foreign exchange market during periods of turbulence in financial markets. Simultaneous presence of excess returns disappeared with the return of stability in market activity. This asymmetric integration constrains the conduct of monetary policy since simultaneous interventions are required in the disturbed segments and monetary policy could be imprisoned in a self-fulfilling vicious circle.

It is important, therefore, to carefully sift through the empirical evidence on market integration for calibrating the reaction of monetary policy to market movements. Correlation may well obscure the differences in maturity, liquidity and risk characteristics. In particular, it is important to closely scrutinise the stylised evidence of market synchronicity in periods of calm as opposed to the earlier exercise which was conducted on episodes of perturbation. Similar efforts have been conducted in the context of mature financial markets. With the introduction of the gilt repo in the UK money market, tighter spreads were observed between the two-week market rate and the official repo rate, resulting in lower money market volatility at the very short end of the money market curve with no sign of volatility transmission up the curve. Stability in the long-run relationship between the policy rate and T-bill rate under shifting monetary policy regimes was observed in an error correction framework capturing both asymmetries and non-linearities in interest rate dynamics in the US. Co-movement in various money market rates is often explained by the market's expectations about the operating rate over the term of the instrument *plus* a risk premium. A broad conclusion emerging from these country specific studies is that integration in money market segments tends to reduce volatility. This would work towards improving the transmission of monetary policy.

Empirical investigation of the relationship between the money market rates in a co-integration framework in India indicates the presence of a unique and stable long-run co-movement, despite their being unstable (non-stationary) individually. A vector error correction process suggests that the call rate adjusts rapidly to exogenous disturbances and 'herds' other money market rates back to equilibrium. These findings indicate that money market segments are getting integrated even in periods of normalcy, and the call rate could well emerge as the reference rate for the money market.

Broadbasing of the Negotiated Dealing System and the establishment of CCIL as a central counter party risk manager would foster market integration by reducing uncertainty relating to funds position. The implementation of RTGS would reduce the settlement risks and strengthen the co-movement of money market rates. This would also help in developing a continuous short-term rupee yield curve through efficient price discovery.

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Commercial Bill Market

5.13 The market for bills rediscounting recorded a general decline in activity during 2002-03. The outstanding amount of commercial bills rediscounted by commercial banks with various financial institutions (FIs) was nearly half of the volume in April 2002 than a year ago. As the year progressed, commercial bill rediscounting activity by the FIs trailed off substantially since May. Small Industrial Development Bank of India (SIDBI), however, continued to rediscount a major part of the commercial bills as it accounted for 78.2 per cent of the total transactions in this market segment during 2002-03. During 2003-04 (up to July 2003), the market for bills rediscounting recorded a rise with SIDBI continuing to remain the major participant.

Repurchase Agreements (Other than LAF)

5.14 During 2002-03, the weekly transaction volumes (first leg only) in the market repo segment ranged between Rs.5,248 crore and Rs.18,749 crore. The imposition of call money exposure restriction on banks and primary dealers coupled with the process of phasing out of non-banks from the call/notice money market prompted market participants to take increased recourse to the repo market, thereby driving up the average weekly transactions in the repo market to Rs.14,898 crore during mid-December 2002 to

March 2003 from Rs.9,087 crore during April to mid-December 2002. Repo rates generally ranged between 4.00 per cent and 8.50 per cent during the year except for occasional spikes.

5.15 During the year 2003-04 (up to July 25, 2003), the weekly volume (first leg only) in the repo market ranged between Rs.6,030 crore and Rs.20,725 crore and rates generally ranged between 2.50 per cent and 6.50 per cent. The volume of transactions in the repo market rose more sharply in July 2003, reflecting increased participation of non-banks as their lendings in the call/notice money market were further scaled down in June 2003.

Forward Rate Agreements (FRAs)/ Interest Rate Swaps (IRS)

5.16 There was a sharp increase in the volume in the Forward Rate Agreements (FRAs)/Interest Rate Swaps (IRS) market (See Table 5.3). Despite a significant increase in the number and amount of contracts, participation in the market continues to remain restricted to select foreign and private sector banks and a primary dealer. In a majority of these contracts, National Stock Exchange-Mumbai Inter-bank Offered Rate (NSE-MIBOR) and Mumbai Inter-bank Forward Offered Rate (MIFOR) were used as the benchmark rate. The other benchmark rates used include yield on government paper with one-year residual maturity and primary cut-off yield on 364-day Treasury Bills.

Collateralised Borrowing and Lending Obligation

5.17 Collateralised Borrowing and Lending Obligation (CBLO) was operationalised as a money market instrument through the Clearing Corporation of India Ltd. (CCIL) on January 20, 2003 with original maturity between one day and up to one year. There were 52 members in CCIL's CBLO segment as on July 31, 2003. The total turnover in CBLO stood at Rs.7,925 crore, with a daily average turnover of Rs.74 crore.

FOREIGN EXCHANGE MARKET

5.18 Tightness prevailed in the foreign exchange market during the first three months of 2002-03. Concerns regarding rising crude oil prices, tensions in Gujarat and short covering by importers exerted pressure on the spot exchange rate of the Rupee *vis-a-vis* the US dollar which depreciated by 0.4 per cent during April 2002. Heightened border tensions led to a burst of hectic short covering which dragged down the spot rate even further in May. A renewal of demand for US dollars amidst receding supplies of foreign investment kept the spot rate weak in June. The excess demand conditions were reflected in the gap in the merchant segment of the spot market turnover. In the inter-bank segment, banks took positions with respect to merchant activity.

5.19 The spot exchange rate firmed up from the third week of June as rising repatriation of export proceeds eased supply conditions and demand from corporates and importers moderated. The weakening of the US dollar against major currencies also shored up the Rupee. Heavy inflows in the last week of June on account of FDI strengthened the recovery.

5.20 Supplies continued to rise in the second quarter from export proceeds, unwinding of long dollar positions by banks and remittance inflows. The US dollar continued to weaken against the Euro and the Japanese Yen reflecting weak US economic data and financial irregularities in the US corporate sector which lowered investor confidence. The gains in the spot rate, however, were capped by demand from public sector banks. In terms of monthly averages, the spot exchange rate appreciated by 1.0 per cent between April-September 2002 despite net purchases from the market by the Reserve Bank.

5.21 The spot rate continued to gain strength as remittances from exporters, non-resident Indians and foreign direct investment continued while demand remained slack during October-November. Falling global crude oil prices and rising levels of foreign exchange reserves improved market sentiment and the spot exchange rate appreciated by 0.7 per cent in the third quarter with purchases by the Reserve Bank arresting further gains (Table 5.4). Lingering weakness in the US dollar against major currencies owing to dismal US economic fundamentals contributed to the Rupee's gains. Purchases by the Reserve Bank checked the spot appreciation at 1.1 per cent at end-November 2002 over end-March 2002.

5.22 An increase in foreign investment flows from end-December 2002, despite mounting tensions in the Middle East, kept sentiments in the market upbeat and poised for further gains. Nevertheless, the real effective exchange rate (Reserve Bank’s five - country trade weighted indices - Base: 1993-94=100) of the Rupee was undervalued by around three per cent by March 2003 over March 2002, given the steep decline in US dollar against other currencies (Chart V.6).

5.23 Soaring global crude oil prices resulting from war fears weighed heavily on market sentiment in the last quarter of the year, despite the significant liberalisation of banks' overseas investment and

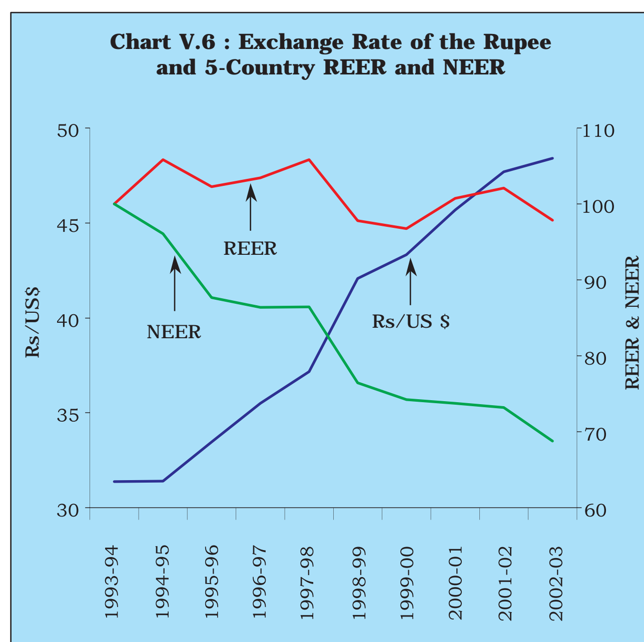
Table 5.4 : Purchases and Sales of US dollars by Reserve Bank

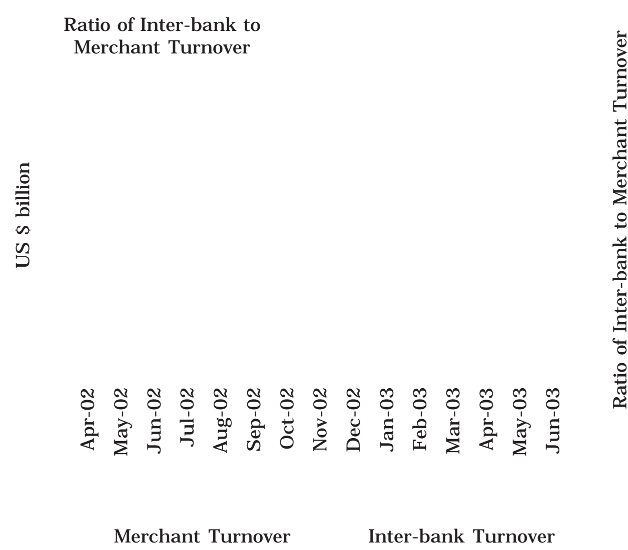
(US $ million)

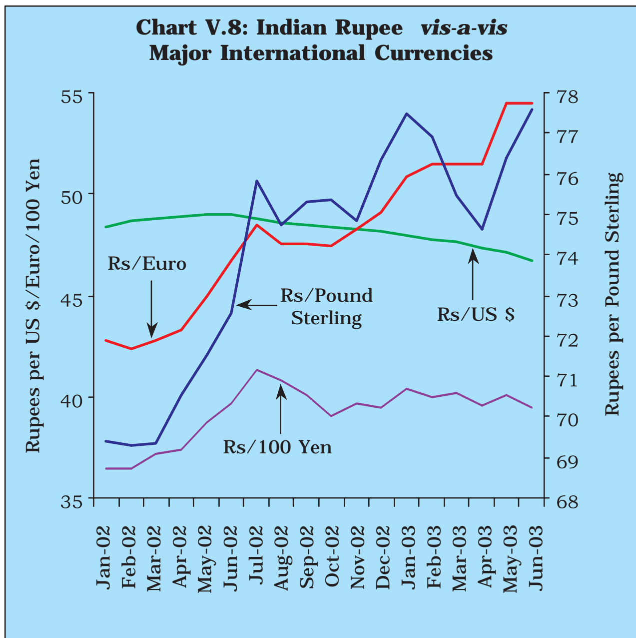
Month	Purchases (+)	Sales (-)	Net (+/-)	Cumulative (over end-March)	Outstanding Net Forward Sales (-)/ Purchases (+) at the end of month
1	2	3	4	5	6
2002-03					
April	2,082	1,606	477	477	(–)400
May	1,233	1,147	86	563	(–)400
June	812	571	241	803	(–)400
July	2,514	685	1,829	2,632	(–)400
August	2,638	1,459	1,179	3,811	(–)200
September	2,922	1,956	965	4,776	(+)475
October	2,594	1,423	1,171	5,947	(+)638
November	3,087	972	2,115	8,062	(+)812
December	3,231	1,552	1,679	9,741	(+)2,260
January	2,831	1,046	1,785	11,525	(+)2,872
February	3,506	1,171	2,335	13,860	(+)2,577
March	3,189	1,339	1,849	15,709	(+)2,420
2003-04 (so far)					
April	2,943	1,511	1,432	1,432	(+) 3,281
May	3,978	1,636	2,342	3,774	(+) 4,186
June	1,879	982	896	4,670	(+) 3,866
July	6,096	2,950	3,146	7,815	(+) 4,549

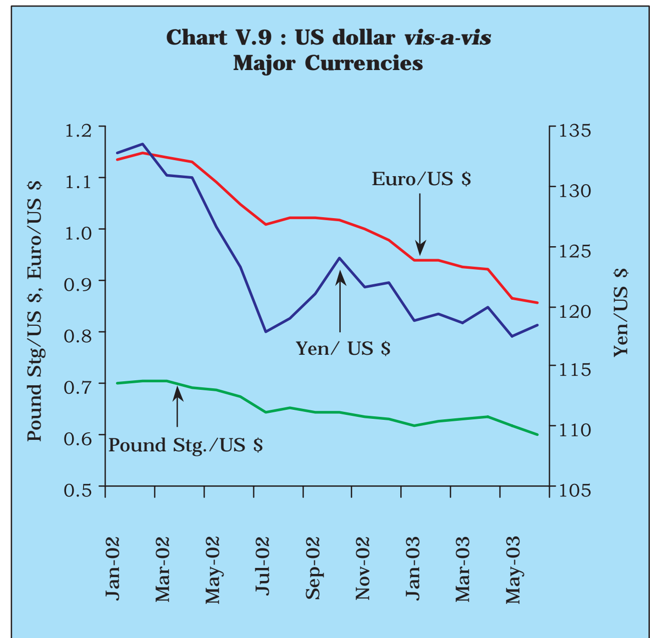
relaxation of restrictions in the forward market. Robust inflows of exports proceeds and inward remittances, however, continued to provide support to the spot exchange rate. On the basis of monthly averages, the Rupee appreciated against the US dollar by 2.3 per cent in 2002-03.

5.24 Activity in both the merchant and inter-bank segments of the foreign exchange market rose strongly (Chart V.7 and Appendix Table V.4). The inter-bank to merchant turnover ratio, however, declined, indicating the stability of market conditions and the narrowing of interest differentials.









5.25 In cross currency trade, the Rupee weakened against the Euro, the Pound Sterling and the Japanese Yen during the first four months of 2002-03. The Rupee regained strength against the three currencies over the period August-October 2002 in alignment with the US dollar. With the US dollar's weakening from November 2002 onwards, the Rupee steadily depreciated against other major currencies over the rest of the year (Chart V.8).

5.26 In terms of monthly averages, the US dollar depreciated against the Euro, the Pound Sterling and the Japanese Yen (Chart V.9). The US dollar's depreciation against the major currencies at the beginning of 2002 became more pronounced during the course of the year with the shift in foreign capital from US financial products to the European market. The US dollar was also weighed down by factors such as the impending war with Iraq and tensions concerning North Korea. The softness of the dollar has been ascribed to several fundamental factors which include the large and persistent current account deficit of the US, subdued growth with uncertain prospects for a faster recovery and the worsening of geo-political environment. For non-dollar area investors with investments in dollars, there was an erosion in the value of portfolios by more than 30 per cent in just one year and any further fall in the US dollar could trigger a major change in the pattern of global capital flows. Developing countries such as South-East Asian economies, whose exchange rates are linked to the US dollar, benefited from the soft dollar environment as their exports to non-dollar areas became competitive. If the fall in the US dollar continues there is, however, a risk that the interest rate cycle in the US may reverse much earlier than expected.

5.27 The Rupee continued to gain strength against the US dollar during the first four months of 2003-04. In terms of monthly average exchange rates, the Rupee appreciated by 3.0 per cent against the US dollar during the period. Sustained foreign exchange inflows from export proceeds, remittances and investments by FIIs continued to provide strength to the Rupee in the face of subdued demand for the US dollar. Absorption of flows by the Reserve Bank/ state-run banks, however, kept the Rupee in the range of Rs.46.09- Rs.47.46 per US dollar during April-July 2003. The outlook for the Rupee remains buoyant with a lingering weak dollar against the other major currencies, large inflows of dollar through entities such as exporters and foreign funds and rising foreign exchange reserves. The exchange rate of the Rupee was Rs. 45.91 per US dollar on August 13, 2003.

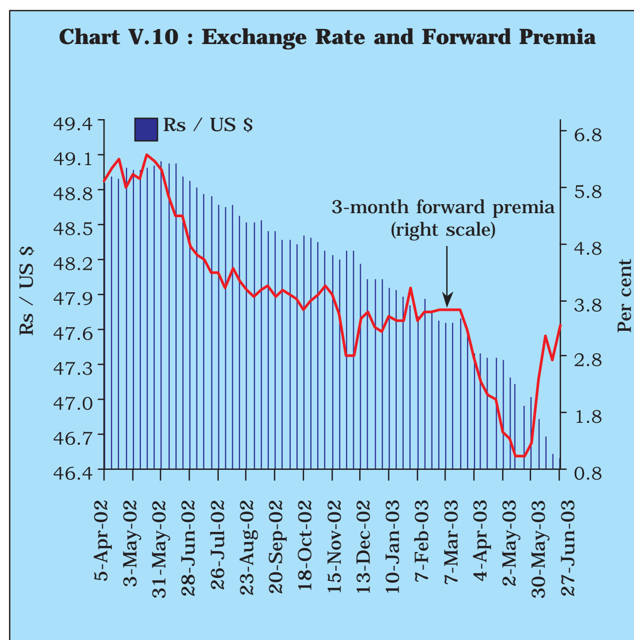
5.28 In cross-currency trade, the Rupee continued to weaken against the Euro after US dollar lost grounds against this unit in overseas markets. In terms of monthly average exchange rates, the Rupee depreciated against the Euro by 2.0 per cent during the first four months of 2003-04. The Rupee, however, appreciated by 0.4 per cent against the Pound Sterling and 3.0 per cent against the Japanese Yen during the same period.

Forward Market

5.29 Excess demand conditions prevailed in both merchant and inter-bank segments of the forward exchange market during the first quarter of 2002-03. One-month and the six-month forward premia hardened in May. As the spot market recovered in June, excess supply conditions characterised the forward market and continued to prevail during the rest of the year. The excess supply conditions in the forward segment necessitated a reversal in the strategy of intervention by the Reserve Bank. Outstanding net forward sales of the Reserve Bank remained negative up to August 2002. Forward premia in all maturities declined steadily reflecting heavy forward sales by exporters and easy liquidity conditions in the domestic money market (Chart V.10).

5.30 The covered interest parity (CIP) condition would suggest that forward rates reflect the differential between domestic and foreign interest rates. In the recent period, however, downward movements in the forward premia have been driven by the anticipation of further appreciation of the spot exchange rate against the US dollar. This is broadly consistent with the theory of efficient markets which postulates that the forward rate is a predictor of the future spot rate. This phenomenon is strengthened by a rush to borrow foreign exchange overseas at relatively low interest rates and convert it into rupee assets which attract a relatively higher rate of return. If the spot exchange rate does appreciate, the borrowers of foreign exchange expect to make a financial gain (as fewer rupees would be required to repay the "borrowed" dollars). This situation is also reflected in banks going "short" on dollars during intra-day and inter-day foreign currency trade. At the same time, however, corporates and other market participants accumulate large "unhedged" exposures on their future dollar obligations such as imports and debt service payments. These conflicting considerations warrant a re-appraisal of the intrinsic relationship between spot and forward exchange rates (Box V.2).

Chart V.10 : Exchange Rate and Forward Premia



Box V.2

Spot and Forward Exchange Rates: Revisiting the Fundamentals

Foreign exchange market efficiency is usually examined through evaluation of the co-movement of domestic and foreign interest rates and the exchange rate. Two key parity conditions - 'covered parity' and 'uncovered parity' - provide a measurement of the extent of market integration and efficiency. According to the covered interest parity (CIP) condition, the forward premium/ discount should equal the interest rate differential between domestic and foreign currency assets. On the other hand, the uncovered interest parity (UIP) condition postulates that the expected change in the exchange rate should equal the interest rate differential. Taken together, the CIP and UIP suggest that forward premia/discounts are an unbiased predictor of the future spot exchange rate. The interest parity hypotheses are important from a policy perspective, since deviations from UIP provide scope for central banks to undertake sterilised foreign exchange market intervention as well as interest rate defence of the exchange rate.

Available empirical evidence in regard to advanced economies suggests that CIP generally holds for assets of similar maturity and similar risk profile; profitable arbitrage opportunities appear for longer maturities. As regards empirical evidence for UIP, it is overwhelmingly rejected. Its failure has been attributed, *inter alia*, to sudden shifts in risk perceptions and expectations that characterise foreign exchange markets while pricing 'news' as well as interventions.

An empirical examination of these parity conditions for India covering monthly data was undertaken over the period April 1993 to March 2003. The interest differential, measured as the difference between 3-month Treasury Bill yields for India and the US, is found to be positively related to forward premia but the operation of CIP is not validated on account of imprecision in the estimated coefficients and the presence of correlated errors.

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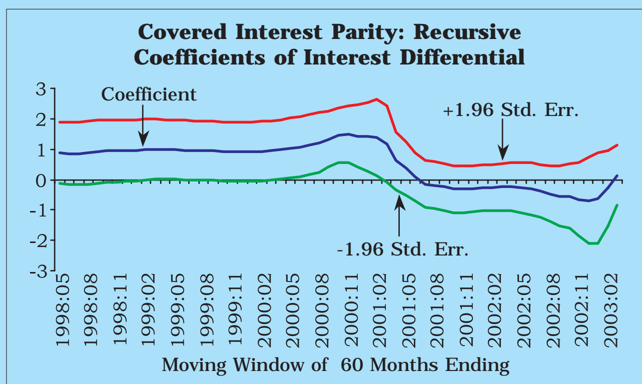
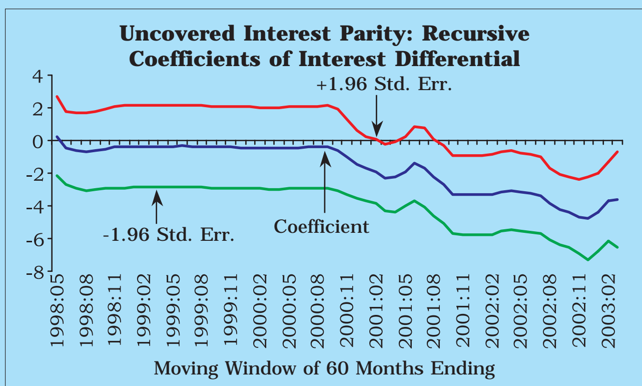


As regards UIP, the results negate its existence, a finding corroborating the overwhelming international evidence. The residuals in all the estimated equations



turn out to be serially correlated, indicative of market inefficiency.

An alternative test of UIP is based on the notion that there should not be any systematic excess returns in an efficient foreign exchange market, *i.e.*, interest rate differential *less* capital gains/losses from exchange rate movements should be a 'white noise' process. Over the sample period, the excess return measure is not statistically significant and is also found to be 'stationary'. This indicates no systematic and predictable excess returns in the Indian foreign exchange market. Transient excess returns generated by lack of full market integration dissipate rapidly, *i.e.,* within two months.

Despite the mixed evidence on market efficiency, forward premia and interest differentials tend to move together in the long-run. Deviations from the parity conditions can be attributed to prudential restrictions on banks' borrowing/ investments abroad. Central bank interventions in the market can also affect market behaviour. Finally, short-run deviations from UIP suggest that sterilised foreign exchange market intervention can be effective in ensuring orderly conditions.

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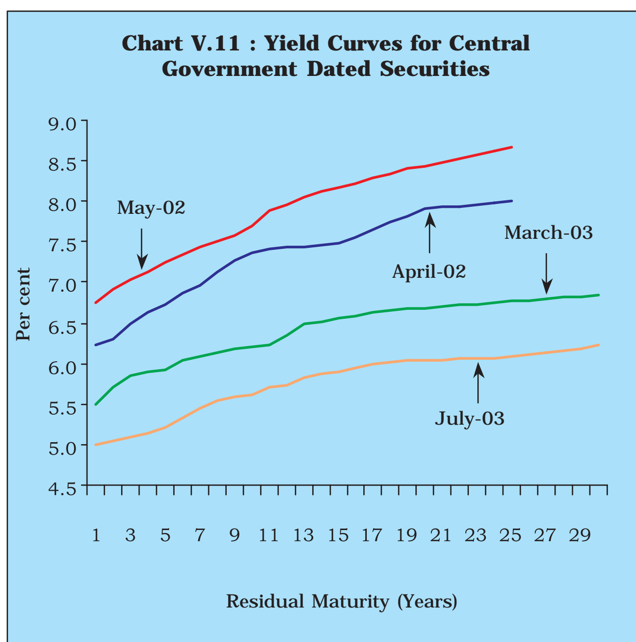
5.31 Reflecting the excess supply condition in the spot exchange market, the average one-month and three-month forward premia declined by 102 basis points and 95 basis points to 2.79 per cent and 2.65 per cent, respectively, during April-July 2003.

GOVERNMENT SECURITIES MARKET

5.32 Yields declined in the secondary segment of government securities market during 2002-03 for the third year in succession reflecting ample liquidity and persistent expectations of interest rate cuts. Yields across residual maturity exceeding 14 years fell sharply relative to the benchmark 10-year security, flattening the yield curve (Chart V.11). The aggregate volume of transactions in Central and State Government dated securities and Treasury Bills (outright as well as repos) rose during the year, although the share of outright transactions decreased (Appendix Table V.6).



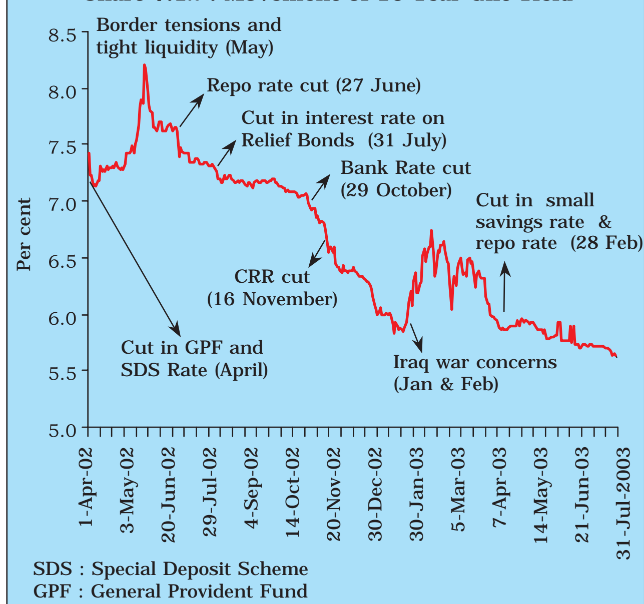
5.33 The easing of liquidity conditions at the beginning of 2002-03 and reductions in administered interest rates set a bullish tone to the government securities market during the first week of April 2002. OMO sales stabilised the market and sentiment turned cautious. Tensions at the border and tighter liquidity conditions hardened the yields on the government paper, pushing the 10-year yield to a high on May 21, 2002 (Chart V.12). The Reserve Bank's private placement assuaged market sentiment and drove down yields by end-May 2002.

5.34 The repo rate cut on June 27, 2002 spurred a rally in the gilt market. Moreover, reduction in administered interest rates and anticipations of further reductions in U.S. interest rates resulted in easing the liquidity situation which exerted a downward pressure on yields. The lowering of CRR and the Bank Rate in the Mid-Term Review of Monetary and Credit Policy of 2002-03 and a cut in the Fed Funds target rate helped sustain the rally in November 2002. After the benchmark 10-year yield breached the Bank Rate on December 27, 2002, the gilt market experienced a sharp rally which culminated in 10-year yield reaching the year's low on January 22, 2003. OMO sales and apprehensions of military action in the Middle East reversed trends in yields in the last week of January 2003. Reduction in the small saving rates announced in the Union Budget 2003-04, followed by a repo rate cut regenerated a rally in government paper. The rally was, however, short-lived and turnovers fell in March 2003 due to inflation concerns and ongoing military action in Iraq. Gilt prices recovered towards the end of March as the Iraq war abated.

5.35 The decline in yields in the 2 to 5 year segment averaged around 60 basis points while in the 6 to 10 year and 11 to 20 year tenors the fall in yields was of the order of 102 and 115 basis points, respectively, on account of active trading interest at the long end in a period of low interest rates. On the other hand, the relative stability of the overnight call rates checked similar reductions in the yields of government securities of the shorter tenors. This resulted in a flattening of the yield curve during the year. The spread between AAA-rated corporate bonds and government securities narrowed during 2002-03 (Chart V.13).

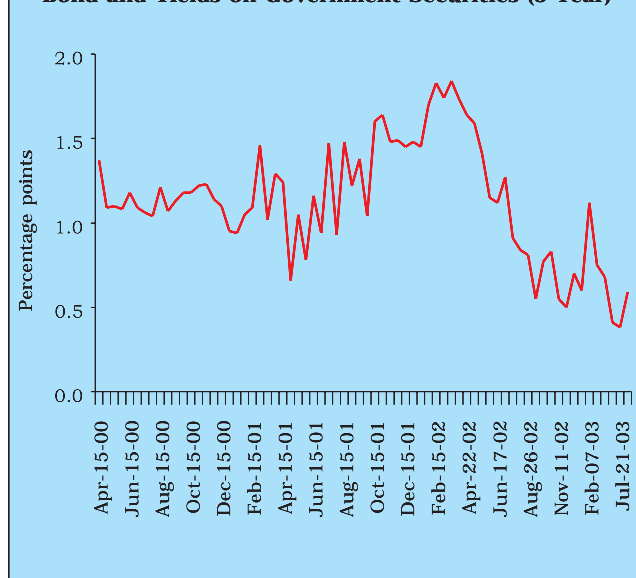
5.36 Ample liquidity conditions and declining inflation generated a rally in gilt prices, especially in the short (below five years) maturity segment, in April 2003. The yield curve steepened immediately after the announcement of the Monetary and Credit Policy with surplus liquidity drawing down short-term yields. The yield curve, however, flattened during the last three weeks of May 2003 reflecting lowering of inflation expectations. The yields continued to fall in June 2003 on the back of persistent surplus liquidity, monetary easing in US and other developed countries and fall in inflation rate. The 10-year government yield fell by around 67 basis points during 2003-04 (up to August 16) to 5.54 per cent.

Chart V.12 : Movement of 10-Year Gilt Yield



SDS : Special Deposit Scheme
GPF : General Provident Fund

Chart V.13 : Spread Between AAA-rated Corporate Bond and Yields on Government Securities (5-Year)



CREDIT MARKETS

5.37 Easy liquidity conditions and monetary policy impulses for softening induced a reduction in deposit rates across all maturities (Table 5.5). Comparable reductions were, however, not fully reflected in the prime lending rates (PLRs). Sub-PLR lending of the banking system (excluding exports, the bulk of which is at sub-PLR rates) constituted over one-third of total lending by December 2002. As many as 40 banks comprising 18 public sector banks (PSBs), 6 foreign banks and 16 private banks reduced their PLRs after the announcement of the mid-term Review of Monetary and Credit Policy in October 2002. The effective lending rates of commercial banks remained high due to wide spreads over the PLR which remained unchanged over 2002-03. The interest rate on home loans came down substantially over the year due to policy initiatives to boost the housing finance market.

5.38 Four factors are generally attributed to the rigidity of bank lending rates in India. First, deposit holders expect nominal rates which are reasonably in excess of inflation. Secondly, offering fixed deposit rates is the traditional practice. Thirdly, non-interest operating expenses as well as the carrying costs of non-performing assets (NPAs) push up the lending rates. Fourthly, the persistent and large volume of market borrowing requirements of the Government gives an upward bias to the interest rate structure. In the recent years, there has, however, been considerable progress in relaxing these constraints. Inflation rates have moderated, interest cost of government borrowings have come down and banks are being encouraged to offer floating interest rates on deposits. Furthermore, recent reductions in deposit rates and administered interest rates on small savings have created the environment for commensurate lowering of lending rates. A key issue in this context is locating the appropriate level of the real lending rate. There is some criticism, particularly in industry circles, that bank lending rates remain high. On the other hand, there is the apprehension that too low real lending rates may push the economy into a deflationary gap (Box V.3).

Table 5.5 : Movements in Deposit and Lending Rates

(Per cent)

Interest Rates	July 2003	March 2003	December 2002	June 2002	September 2002	March 2002
1	2	3	4	5	6	7
1. Domestic Deposit Rates						
Public Sector Banks						
a) Up to 1 year	3.75-5.75	4.00-6.00	4.25-6.25	4.25-6.75	4.25-6.75	4.25 – 7.50
b) 1 year up to 3 years	5.00-6.25	5.25-6.75	6.00-7.00	7.00-8.00	6.50-7.75	7.25 – 8.50
c) Over 3 years	5.25-6.50	5.50-7.00	6.50-7.25	7.50-8.25	7.00-8.25	8.00 – 8.75
Private Sector Banks						
a) Up to 1 year	3.00-7.00	3.50-7.50	3.50-8.00	4.00-8.75	4.00-8.75	5.00 – 9.00
b) 1 year up to 3 years	5.50-7.50	6.00-8.00	6.50-8.25	7.25-9.50	7.25-9.50	8.00 – 9.50
c) Over 3 years	5.75-8.00	6.00-8.00	6.50-8.50	8.00-10.0	7.50-9.50	8.25 – 10.0
Foreign Banks						
a) Up to 1 year	3.00-7.75	3.00-7.75	3.25-7.75	4.25-9.75	4.00-9.75	4.25 – 9.75
b) 1 year up to 3 years	3.50-8.00	4.15-8.00	4.50-8.00	6.25-10.0	5.50-10.0	6.25 – 10.0
c) Over 3 years	4.50-8.50	5.00-9.00	4.75-8.50	6.25-10.0	5.50-10.0	6.25 – 10.0
2. Prime Lending Rates						
Public Sector Banks	9.00-12.25	9.00-12.25	9.00-12.50	10.00-12.50	10.00-12.50	10.00–12.50
Private Sector Banks	8.00-15.50	7.00-15.50	9.00-15.50	10.00-15.50	9.50-15.50	10.00–15.50
Foreign Banks	5.45-17.50	6.75-17.50	6.50-17.50	7.90-17.50	7.40-17.50	9.00 –17.50

Box V.3

Where are the Real Lending Rates?

The real interest rate reflects forces of thrift as well as productivity. It is unobservable but can be measured by the nominal interest rate on saving adjusted for the expected rate of inflation. In a frictionless, perfect-information world no difference exists between the real borrowing and lending rates. In reality, however, bank intermediation drives a wedge between them. Since the real lending rate embodies the true cost of funds for investors in an economy, two questions arise. First, is the real lending rate consistent with the growth rate of the economy? Second, given the structural rigidities, is the wedge between the bank deposit rate and bank lending rate reasonable? These issues become crucial for

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assessing the investment climate and for gauging the efficacy of the monetary policy transmission mechanism.

In the literature, the determinants of the long run real interest rate vary across growth models. In neoclassical growth models with exogenous saving, the marginal productivity of capital determines the real interest rate. On the other hand, in a Ramsay-type model with endogenous saving, the effective rate of time preference determines allocation of saving and investment and therefore, the real interest rate. In the overlapping generation models, lifetime saving could facilitate build up of assets to allow for consumption smoothing, which could explain the inter-temporal path of the real interest rate. The debate, however, is far from settled. In real life, the short-term nominal interest rate is under the direct control of monetary policy authorities. Additional factors such as maturity period, arbitrage opportunities, taxation, special features of the contract such as call options and risk characteristics, and uncertainties on account of information asymmetry determine the long-term interest rates.

Globally, the 1980s was a period of high nominal interest rates which spilled over into the 1990s. Since the second half of the 1990s there has been a generalised decline in interest rates in an environment of low inflation and weakening real sector activity. Developments in India have mirrored international trends. This has generated intense interest into where is the real lending rate and where it is headed. Industry circles typically complain about high real interest rates. Their view of the real interest rate is the bank prime lending rate adjusted for *ex post* or past inflation. On the other hand savers argue that the real interest rate is too low by adjusting the deposit rate for inflation on the same basis.

Three stylised facts stand out in respect of the movement of interest rates in India in recent years. First, the generalised decline in inflation since the second half of the 1990s has been reflected in a downward trend in nominal interest rates. Secondly, the fall in nominal interest rates of banks has been lower than the decline in the rate of inflation so that real interest rates may not have fallen in tandem with nominal rates. Thus, despite the fall in deposit rates, depositors have received positive real interest rates of close to 2 per cent in the second half of the 1990s, which is much higher than the real return on deposits during the first half of the 1990s. Finally, it is estimated that the average lending rate of scheduled commercial banks has declined from a peak of about 17 per cent in 1995-96 to around 14 per cent by March 2002.

An analysis of the costs of bank lending shows that structural rigidities of the system impose several costs on banks over and above the cost of funds and inflation. Non-performing assets impose a cost on the banking sector in that the greater are the non-performing assets of a bank, the higher must be the margins which its performing assets have to earn for the bank to break even. Cash reserve requirements involve an implicit cost as a portion of these assets are not remunerated at all and the rest earn interest at the Bank Rate which is typically lower than the prime lending rate. A preliminary analysis to assess the level of real lending rate was conducted on data for March 2002. For the purpose of this exercise, the inflation expectations was taken to be the projected inflation in the Monetary and Credit Policy Statement for 2002-03 in April 2002, *i.e.*, four per cent. Accordingly, the real lending rate works out to 10 per cent - average lending rate of 14 per cent, adjusted for inflation expectations. The derived real lending rate needs to be adjusted for the wedges in the form of the CRR pre-emption as well as carrying costs of NPAs, estimated at about one per cent each. Furthermore, implicit in the real lending rate is a risk premium, which can be proxied by the spread of the discount rate on commercial paper over the yields of 91-day Treasury Bills estimated at around two per cent. Thus, the real lending rate adjusted for these “mark ups” over fund costs is closely aligned with the trend real growth rate of the economy. With lower fund costs, reductions in the CRR, lower NPAs and improvements in risk perceptions during 2002-03, banks have room for undertaking more aggressive reductions in average lending rate so that the real lending rate remains in alignment with the trend GDP growth rate. With the CRR set on a declining trajectory, the key pre-requisites for a durable reduction in the bank lending rates in India are better management of NPAs and reduction in any unreasonable wedge between the costs and returns.

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Mobilisation of Resources by Non-Bank Financial Sector

Financial Institutions

5.39 Select all-India financial institutions (FIs) have been permitted by the Reserve Bank to raise resources by way of term money borrowings, issue of CDs, CPs, acceptance of term deposits and inter-corporate deposits (ICDs). The aggregate limits of FIs for raising of resources declined essentially on account of mergers and a sharp reduction in net owned funds of the IFCI during the course of 2002-03. As a result, the outstanding aggregate amount of resources raised by the FIs (IDBI, IFCI Ltd., EXIM Bank, SIDBI, IIBI Ltd., TFCI Ltd., NABARD, IDFC Ltd. and NHB Ltd.) by way of short-term money market instruments declined during the year. On an average, ICDs continued to remain the preferred instruments, followed by term deposits, CPs, CDs and term money borrowings.

Table 5.6 : Resources Raised by way of Bonds/Debentures* by Select all-India Financial Institutions (Provisional)

(Amount in Rupees crore)

	Resources Raised during		Total Borrowings Outstanding at end		Weighted average Cost of Funds (%)		Weighted average Maturity (years)	
	2002-03	2001-02	March 2003	March 2002	2002-03	2001-02	2002-03	2001-02
1	2	3	4	5	6	7	8	9
IDBI	5,009	4,213	45,280	45,464	8.4	10.3	2.8	4.3
IFCI	267	651	20,046	19,789	6.8	11.1	5.1	8.7
IIBI	150	551	1,468	1,807	12.8	12.9	7.0	6.4
Exim Bank	2,505	625	5,424	3,067	8.9	10.8	6.1	6.4
NABARD	2,988	2,549	8,703	6,078	6.1	8.0	3.2	2.6
NHB	1,876	238	4,675	3,003	6.4	8.7	4.0	7.4
SIDBI	961	1,224	2,498	3,020	6.6	7.5	2.3	1.0
TFCI	93	48	632	689	10.1	10.5	8.5	7.0
IDFC	400	250	1,400	1,000	7.6	9.0	5.6	5.0
Total	**14,249**	**10,349**	**90,126**	**83,917**				

* Includes only rupee resources and does not include foreign currency borrowings.
Source : As furnished by the respective financial institution.

5.40 The interest rate offered on term money borrowings by FIs reflected the easy liquidity conditions and declined sharply towards the end of the year. Interest rates on CDs issued by the FIs and ICDs followed a similar pattern. Term deposit rates remained range bound over the year, 2002-03.

5.41 Total resource mobilised by way of issue of rupee bonds/ debentures (including private placement and public issue) by select all-India FIs rose significantly during 2002-03 as they took advantage of falling interest rates to retire their old high cost debt. The weighted average maturity of instruments across these FIs varied between 2.3 years and 8.5 years. The average interest rates on resources mobilised by way of rupee bonds/debentures by these FIs was in the range of 6.1 per cent per annum and 12.8 per cent per annum (Table 5.6).

Non-Banking Financial Companies

5.42 The slowdown in the activities of the non-banking financial companies (NBFCs) continued. Public deposits held by NBFCs as a proportion to aggregate deposits of commercial banks declined sharply from 2.2 per cent in December 2000 to 1.5 per cent in March 2003 reflecting investors' aversion towards riskier saving options. The interest rate ranged between 10 per cent to 12 per cent for 35.11 per cent of the deposits, and 12 to 14 per cent for 38.71 per cent of the deposits mobilised by NBFCs (excluding residuary non-banking companies) as at end-March 2002. According to the information pertaining to large NBFCs (including RNBCs) with a deposit base of Rs.20 crore and above, the aggregate public deposits amounted to Rs.17,615 crore for 25 companies as at March 2003 as compared with Rs.17,842 crore for 42 companies as at end-March 2002.

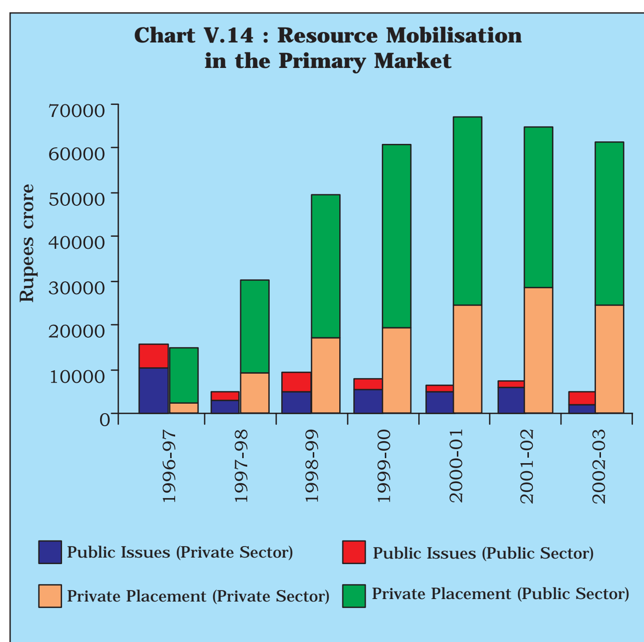
EQUITY AND DEBT MARKETS

5.43 The capital market remained depressed during 2002-03. The primary market was subdued mainly due to lack of demand for funds by the corporates. Positive investor response to quality issues in the primary market, however, points to selectivity breaking through a generalised risk aversion. The secondary market was weighed down by a host of adverse domestic developments as well as the sell-offs in international equity markets in the first half of the year. Notwithstanding fall in prices of blue chip scrips, mid-cap scrips, PSU scrips and bank scrips experienced increased buying interest.

Primary Market

5.44 The primary capital market, which comprises the public issues and the private placement market, is a source of funds (both equity and debt) for the corporates and an avenue for investment of surplus funds by the investors. During the last few years, resource mobilisation from the public issue market has been declining. Paucity of new issues entering the market and fading investor interest continued to characterise the market during 2002-03 (Chart V.14 and Table 5.7).

5.45 The bulk of resource mobilisation from the public issues market in 2002-03 was by banks and FIs. Prompted by the positive secondary market



response to banking sector stocks, three public sector banks floated equity issues. In addition, there were five bond issues by the IDBI and three bond issues by the ICICI Bank. Resources mobilised by non-Government non-financial public limited companies declined sharply (Appendix Table V.10 and Chart V.15).

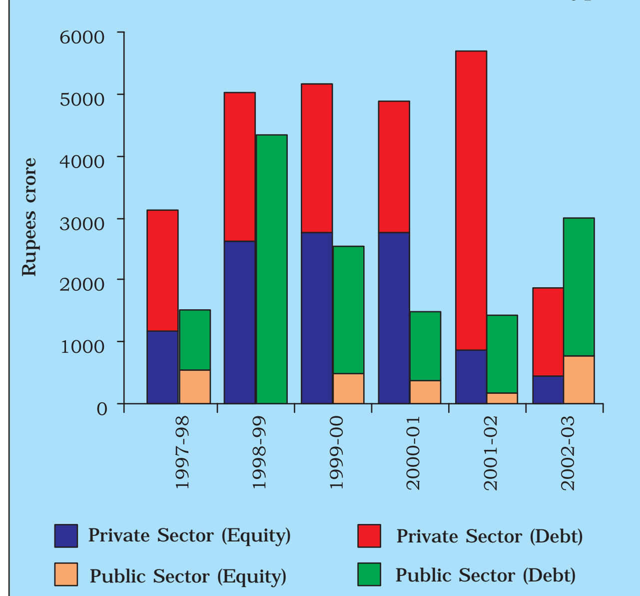
5.46 In sharp contrast to the public issues market, the private placement market has emerged as an alternative and more convenient source of funds for the corporate sector, even though the growth of this market has slowed down during the last few years. The decline in resource mobilisation during 2002-03, however, is partly attributable to the ICICI-ICICI Bank merger, since the erstwhile ICICI was a large mobiliser of funds from the private placement market. The non-financial sector mobilised a larger part of resources from the private placement market. While state level undertakings and banks continued to raise substantial resources from the private placement market, the share of AIFIs declined.

Table 5.7 : Mobilisation of Resources from the Primary Market*

(Amount in Rupees crore)

Item	2002-03 P		2001-02	
	No. of Issues	Amount	No. of Issues	Amount
1	2	3	4	5
A. Prospectus and Rights Issues				
1. Private Sector (a+b)	**9**	**1,878** (-67.0)	**19**	**5,692** (16.4)
a) Financial	4	1,236	10	4,091
b) Non-financial	5	642	9	1,601
2. Public Sector (a+b+c)	**8**	**2,989** (110.5)	**5**	**1,420** (-3.6)
a) Public Sector Undertakings	–	–	–	–
b) Government Companies	–	–	1	350
c) Banks/Financial Institutions	8	2,989	4	1,070
3. Sub Total (1+2)	**17**	**4,867** (-31.6)	**24**	**7,112** (11.8)
B. Private Placement+				
1. Private Sector (a+b)	**904**	**24,598** (-14.1)	**672**	**28,620** (27.1)
a) Financial	364	10,102	363	16,019
b) Non-financial	540	14,496	309	12,601
2. Public Sector (a+b)	**243**	**37,148** (2.5)	**286**	**36,256** (-20.5)
a) Financial	149	18,616	167	17,358
b) Non-financial	94	18,532	119	18,898
3. Sub Total (1+2)	**1,147**	**61,746** (-4.8)	**958**	**64,876** (-4.8)
C. Total (A+B)	**1,164**	**66,613** (-7.5)	**982**	**71,988** (-3.4)
Memo Item :				
Euro Issues	**11**	**3,426** (43.7)	**5**	**2,384** (-43.2)

* Including both debt and equity. P : Provisional. – Nil/Negligible.
+ Estimates based on information gathered from arrangers, FIs and newspaper reports.
Note : Parenthetic figures represent percentage variations over the previous year.



5.47 The Euro issues market, which comprises the Foreign Currency Convertible Bonds, Global Depository Receipts and American Depository Receipts, witnessed increased activity during 2002-03.

5.48 The deceleration in activity in the primary capital market, especially in the public issues market could be attributed to factors operating both on demand and supply. The tightening of disclosure standards and entry point norms by the SEBI has meant that only companies with established track record are able to access the market. This has helped improve the quality of paper and checked fly-by-night operators. Nevertheless, some issues have been highly oversubscribed even in the depressed market conditions, suggesting that investor interest is marked by selectivity rather than general market aversion. During 2002-03, most of the issues were oversubscribed and there was not even a single issue which was not fully subscribed. The slackening of investment by the private corporate sector since the second half of 1990s has affected the demand for funds. The demand for funds by corporates is contingent on several factors impinging on the overall macroeconomic environment as well as sector-specific/firm-specific factors that shape the investment climate (Box V.4). During April-June 2003, the primary market witnessed further slowdown as there was no issue in the public issues market as compared with three issues aggregating Rs.613 crore during the corresponding period of the previous year. There was one issue of Rs.224 crore during April-June 2003 in the Euro issues market.

Box V.4

Determinants of Investment Climate

The investment climate influences both the demand and supply of funds in the financial markets. A favourable climate for private investment is determined by general economic activity, the soundness of the financial system, asset prices, credit worthiness, business expectations and risk appetite. In the context of globalisation and the emergence of foreign direct investment (FDI) as a dominant element in international capital flows, improving conditions for investment has become the central concern of policy makers among countries competing for capital. Here, the investment climate includes a host of institutional factors and policies which affect the returns that investors expect and the uncertainties associated with these returns. Fiscal, monetary and exchange rate policies, political stability, the country's regulatory framework, *i.e.,* issues of entry and exit, labour laws, taxation rules, and the quality and quantity of the physical and financial infrastructure are crucial elements in determining the investment climate of a country.

The most crucial aspect of private investment, *i.e.,* investment in fixed assets and equipments for capacity enhancement, has been the subject of considerable theoretical and empirical attention. The determinants of business fixed investment are typically identified as output, sales or profits and the cost of capital. In the Indian context, some empirical estimates indicate that the cost of capital unambiguously affects investment. Availability of bank credit affects smaller unincorporated firms more than bigger and established firms. Assessment of investment climate at an international level has gathered interest from the point of view of comparative assessment of countries and competitive performance. Several agencies compile country rankings and benchmarks on the basis of indicators that determine investment climate. Some of the available indicators are country credit ratings, country risk rankings, business environment survey, governance indicators and indices of competitiveness, globalisation, FDI confidence, human development, market access and economic freedom.

In India, the pace of private investment has lost momentum since the second half of the 1990s on account of several factors including lack of adequate reforms and public investment in infrastructure as well as uncertainties in the domestic investment climate. The dampening of the investment climate is also reflected in a drastic fall in the number of companies accessing the primary capital market, and a continuous decline in sanctions and

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disbursements by financial institutions (Appendix Table V.9). The investment climate in India is also being increasingly influenced by global developments such as the global downturn in investment demand and the large declines in equity markets. Efforts to brighten the investment climate will involve a strategic approach to investment and competitiveness.

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3. World Bank (2002), *Improving the Investment Climate in India*.

Mutual Funds

5.49 Under the overall depressed conditions in the capital market, resource mobilisation by mutual funds during 2002-03 declined mainly due to net outflow of funds from the UTI, which was restructured during the year (Table 5.8).

Table 5.8 : Net Resource Mobilisation by Mutual Funds

(Amount in Rupees crore)

Item	2002-03		2001-02	
	No. of Schemes	Amount	No. of Schemes	Amount
1	2	3	4	5
1. Unit Trust of India	59	-9,434	72	-7,284
2. Public Sector Mutual Funds	74	1,988	69	1,474
3. Private Sector Mutual Funds	337	12,026	266	12,947
Total (1 to 3)	**470**	**4,580**	**407**	**7,137**

Notes: 1. Data are provisional.
2. For UTI, the figures are net sales (with premium), including re-investment sales, and for other mutual funds, figures represent net sales under all schemes.
3. Data exclude amounts mobilised by off-shore funds and through roll-over schemes.

5.50 The subdued conditions in the secondary equity market and buoyancy in the debt market enabled debt schemes to attract funds in 2002-03 (Table 5.9). Of the total asset under management of Rs.1,09,299 crore at end-March 2003 (as against Rs.1,00,954 crore at end-March 2002), net assets under debt schemes accounted for 74.0 per cent, followed by nearly equiproportional shares of equity and balanced schemes at 13.0 per cent. The resource mobilisation by mutual funds rose sharply during April-June 2003 to Rs.19,432 crore as compared with an outflow of Rs.832 crore during the corresponding period of the previous year.

Table 5.9 : Scheme-wise Resource Mobilisation by Mutual Funds

(Rupees crore)

Year	Equity-Oriented	Debt-Oriented	Balanced	Total
1	2	3	4	5
2001-02	-534	13,064	-5,354	7,175
2002-03	43	5,781	-1,628	4,196

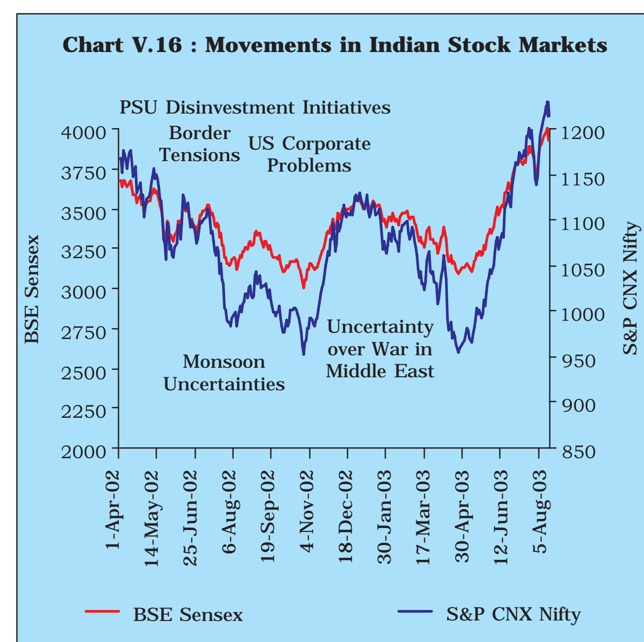
Source : SEBI

Secondary Market

5.51 The downtrend in the domestic stock markets, which set in during March 2001, persisted throughout 2002-03 due to a combination of adverse domestic and international developments such as border tensions, unsatisfactory monsoons, lower than expected quarterly results of some major corporates, continuing uncertainties regarding the PSU disinvestment programme, tensions in the Middle East and the rise in international oil prices (Chart V.16 and Appendix Table V.11).

5.52 Market sentiment was also affected by the sharp decline in the major international markets in the first half of the year. The BSE Sensex declined by 12.1 per cent on a point-to-point basis over the year which was, however, much lower in comparison with the fall in major international market indices like the Nasdaq Composite Index (by 27.3 per cent) and the Dow Jones Industrial Average (by 23.2 per cent) (Chart V.17).

Chart V.16 : Movements in Indian Stock Markets



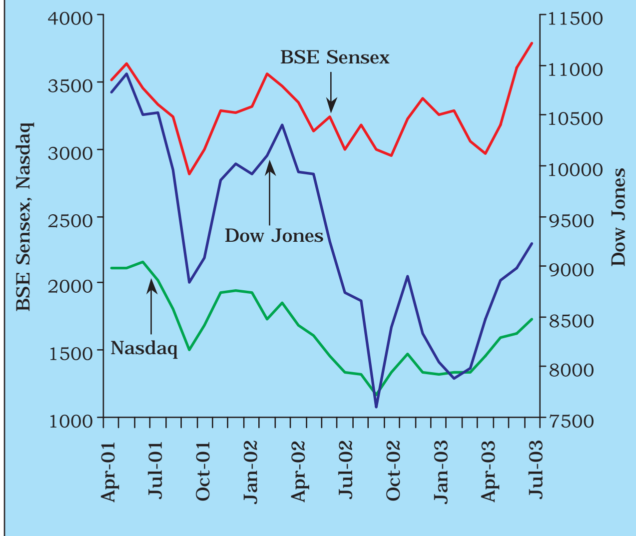


Chart V.17 : Movements in BSE Sensex, Nasdaq and Dow Jones

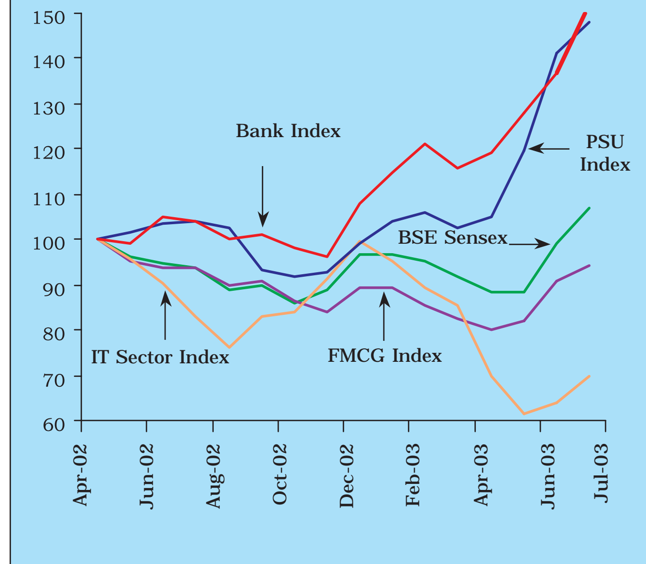


Chart V.18 : Sectoral Indices *vis-a-vis* BSE Sensex

5.53 The stock market was affected significantly by some sector specific factors at different points of time during the year (Chart V.18). In the first half of the year, the BSE Sensex was pulled down by the Fast Moving Consumer Goods (FMCG) sector, which remained subdued on account of drought fears and the depressed Information Technology (IT) sector, which posted lower than expected quarterly results. The BSE Sensex recovered to some extent during November and December 2002 as a result of the rally in PSU stocks on expectations of disinvestment initiatives. Bank scrips, in particular, witnessed a sharp increase almost throughout 2002-03, with improvement in profitability and relaxations on foreign direct investment (FDI) in private sector banks (Box V.5). The BSE Sensex was pulled down by the subdued FMCG and IT sector again in the last quarter of 2002-03.

Box V.5

Banking Reforms and the Behavior of Bank Stocks

In contrast to the generally sluggish conditions characterising the stock markets in India, bank scrips have shown a sharp upward movement in prices. On a point-to-point basis, the S&P CNX Bank Index registered an increase of 18.1 per cent during 2002-03, while the BSE Sensex and S&P CNX Nifty declined by 12.1 per cent and 13.4 per cent, respectively. In the current financial year up to August 12, 2003, the S&P CNX Bank Index increased by 46.5 per cent, while S&P CNX Nifty and BSE Sensex registered gains of 26.2 per cent and 27.6 per cent, respectively.

At a disaggregated level, the price gains in respect of many bank scrips some of which are not included in the S&P CNX Bank Index have been way ahead of the market average and have outperformed several blue chips. The major price gainers during 2002-03 were Bank of Baroda (80.1 per cent), Indian Overseas Bank (78.0 per cent), Vijaya Bank (76.9 per cent), Dena Bank (76.1 per cent) and Oriental Bank of Commerce (62.5 per cent). The market preference for banking sector scrips is also reflected in the sharp rise in trading volumes. In terms of average daily turnover, the most active scrips during 2002-03 were State Bank of India, Syndicate Bank, ICICI Bank, Bank of Baroda and Bank of India.

The progress of banking sector reforms has been a major factor in enhancing the attractiveness of banking sector stocks. A significant factor leading to heightened activity in bank scrips was the relaxation in the foreign direct investment (FDI) norms for private sector banks in May 2001. This made the old private sector banks particularly attractive because of their undervalued price levels. Improved financial performance drawing from huge trading profits was another contributing factor. Some banks attracted buying interest in anticipation of a takeover or merger in future. The market expectations regarding disinvestments of public sector banks also fuelled some speculative activity.

The prices of the banking sector stocks could be influenced by bank-specific factors and/or general factors. The 'beta' (which measures the riskiness of a

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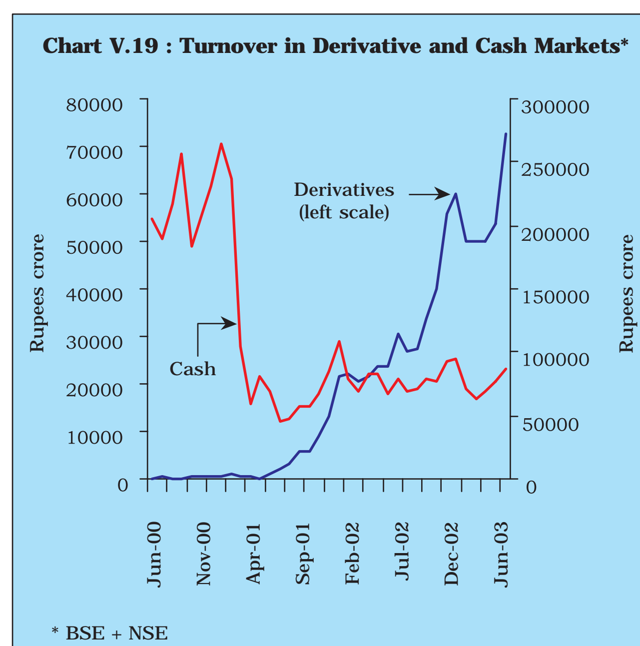
stock relative to the market) and synchronicity tests (which indicate the fraction of stocks that move in the same direction) suggest that risk-return perception for banks are determined to a large extent by the industry-wide factors rather than by bank-specific factors. The beta values were found to be varying widely among the individual bank scrips and close to unity only in case of a few bank scrips. On an average, the beta of bank scrips was around 0.7 as reflected in the beta of S&P CNX Bank Index. The synchronicity tests based on daily returns data for the 25 bank stocks showed that, on an average, about 70 per cent of bank scrips move in the same direction.

5.54 Investments in various instruments of the stock market are guided by risk-return perceptions. In the recent period, the rate of interest available on various fixed income instruments has declined sharply following the overall softening of interest rates. Although the stock markets experienced a sharp reduction in volatility during the last three years, returns from the stock markets declined. As a result of the decline in prices, the P/E ratio and overall market capitalisation also declined. There was, however, improvement in the turnover ratio reflecting increased liquidity (Table 5.10).

5.55 Increased liquidity has also been noticed in the derivatives market. The growth of derivatives market, especially single stock futures, suggests growing popularity of the segment (Chart V.19 and Appendix Table V.12).

5.56 In the absence of a significant presence of retail investors, the stock markets in India are increasingly influenced by institutional investors. Investments by mutual funds declined as they continued to shift from equities to debt in search of better returns. Investments by FIIs also slowed down sharply during 2002-03 (Table 5.11). Net investment by FIIs turned negative during April-June 2002, driving down the stock market. As net investment by FIIs turned positive subsequently, the market recovered and moved in a narrow range. Significantly, FIIs made investments in the debt instruments of Rs.4,151 crore

Chart V.19 : Turnover in Derivative and Cash Markets*



* BSE + NSE

Table 5.10 : The Indian Equity Markets – Key Indicators

Indicator	BSE		NSE	
	2002-03	2001-02	2002-03	2001-02
1	2	3	4	5
1. BSE Sensex/S&P CNX Nifty				
(i) Average	3206	3332	1037	1077
(ii) End of the year	3049	3469	978	1130
2. Co-efficient of Variation (%)	4.9	7.2	5.2	6.8
3. Price -Earning Ratio@	14.5	16.6	15.2	15.7
4. Price-Book Value Ratio@	2.2	2.4	2.6	2.6
5. Yield @ (per cent per annum)	2.2	2.0	2.1	1.2
6. Listed Companies #	5,650	5,782	673	793
7. Turnover (Rupees crore)	3,14,073	3,07,292	6,17,989	5,13,167
8. Market Capitalisation # (Rupees crore)	5,72,197	6,12,224	5,37,133	6,36,861
9. Turnover Ratio	0.5	0.5	1.2	0.8

@ Based on scrips included in the BSE Sensex and the S&P CNX Nifty and are averages for the year.
\# As at end-March.
Source : The Stock Exchange, Mumbai and the National Stock Exchange of India Limited.

Table 5.11 : Net Investments by Institutional Investors

(Rupees crore)

Year	FIIs		Mutual Funds	
	Equity	Debt	Equity	Debt
1	2	3	4	5
2000-01	10,124	-46	-2,767	5,023
2001-02	8,067	685	-3,796	10,959
2002-03	2,528	162	-2,067	12,604
Total	**20,719**	**801**	**-8,630**	**28,586**

Source : SEBI

during November 2002-July 2003. It was, however, not at the cost of investment in the equity market (Rs.9,288 crore). Investments by FIIs are influenced both by global factors such as interest rate changes, inflationary expectations, *etc.,* as also, growth prospects and performance of the corporate sector (Box V.6).

5.57 Several steps have been taken in the equity markets in recent years to enhance investor protection, and the safety and integrity of the market (Box V.7).

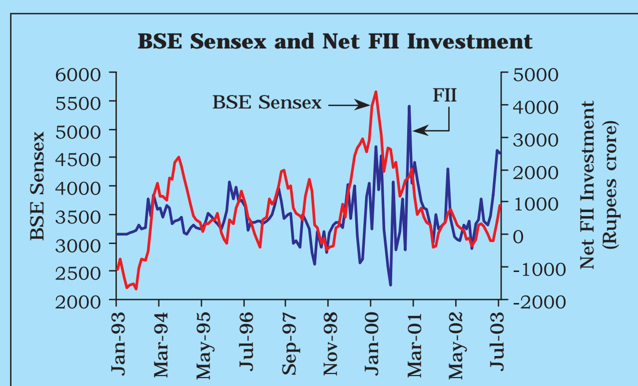
Box V.6

Determinants of Portfolio Flows

The globalisation of the world economy during the 1990s resulted in a substantial increase in portfolio flows from industrialised countries to emerging market economies. Private portfolio flows to emerging markets rose steadily from US $ 56.1 billion during 1992 to US $ 94.6 billion during 1996 but thereafter fell to US $ 1.7 billion during 1998, driven by outflows from the five crisis-affected Asian countries of Indonesia, Korea, Malaysia, Philippines and Thailand. Portfolio flows recovered to around US $ 41.4 billion in 1999. While there is little disagreement about the benefits of portfolio flows as a source of funds, their "hot money" character has often escalated the possibilities of contagion. This has sparked off a considerable interest in the determinants of capital flows.

Portfolio flows are, by and large, determined by the performance of stock markets of the host economy relative to that of the home economy. There is empirical evidence to suggest that equity flows would be "pulled" towards an economy with relatively higher returns. When the recipient economy is small, equity inflows could also be "pushed" in once stock returns in the rest of the world rise sufficiently to allow investors to take such risks. Official policies, especially in terms of capital controls, influence the scale of portfolio flows. The degree of cross-country portfolio diversification which the investors in the developed economy are willing to accept often depends on the "home bias" which is, however, gradually eroding with the increase in global financial integration and the degree of risk spreading enabled by such investments. For example, emerging equity markets were reported to be offering higher returns at more or less unchanged or reduced portfolio risks during 1988-94. During 1995-98, they yielded lower returns, without reducing portfolio risk. Other factors explaining portfolio flows include interest rate differentials, volatility in the stock markets, exchange rate fluctuations and measures of country risk. There are also feedback-trading effects in that gains (losses) in an economy tend to reinforce the next round of investment (disinvestment). Portfolio inflows are often persistent and besides, such flows to different countries in a particular region often tend to be highly correlated. Stylised evidence suggests that the advantages of informed trading explains about three-fourth of the total persistence. Finally, portfolio flows to emerging market economies in the late 1990s were also driven by sector-specific factors such as the availability of technology scrips during the technology boom of the late 1990s. The evidence on determinants of portfolio flows continues to be mixed depending on model specifications. One set of results suggests that FII flows are, by and large, driven by stock market returns while other variables such as US and world returns and country risk returns are not very significant in explaining capital flows. Other findings indicate that portfolio flows are affected by a combination of domestic, regional and global variables including global interest rates, lagged returns in emerging markets, nominal depreciation expectations of the exchange rate and credit rating downgrades.

India opened its stock market to FIIs in September 1992. As at end-March 2002, about four-fifth of FII investment emanated from the USA, UK and Western Europe. FII flows were consistently positive for the first few years reflective of buoyant stock market conditions but turned negative in September 1997 for the first time at the time of the Asian crisis (Chart). Although there have been a



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few periods of net outflows during brief episodes of foreign exchange market volatility, they were quickly reversed once stability returned to the financial markets.

An analysis of the data reveals that FII flows and stock market performance in India are strongly correlated. Daily data for the period October 1999-January 2002 show that there is a bi-directional causality between FIIs' equity investments and changes in the BSE Sensex. This implies that portfolio decisions made by FIIs influence and, in turn, are influenced by the market performance.

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5.58 The process of demutualisation and corporatisation of stock exchanges, which has already been initiated, is expected to improve investor confidence in the stock market (Box V.8).

5.59 Liquidity conditions in money, gilt and foreign exchange segments are expected to remain comfortable over 2003-04, with developments in the year so far providing early indications of market activity in the near term. In the money market segments, rates are expected to remain soft and clustered around the repo rate. The outlook for the Government securities market continues to be positive. The early signs suggest that the liquidity conditions are expected to remain adequate for supporting the government market borrowing programme as well as the off-take of credit for sustaining industrial recovery. The foreign exchange

Box V.7

Risk Management in Stock Exchanges

A proper risk management system for the stock exchanges is a necessary precondition for the integrity and safety of the market. The main elements of risk management in stock exchanges in India comprise capital adequacy, exposure limits, margin requirements, counter-party guarantee in the form of trade guarantee funds, price bands and a surveillance system. Capital adequacy refers to the requirement on the part of the trading members of stock exchanges to provide base capital in specified assets in a prescribed proportion. Exposure norms, either in the form of scrip-specific trading limits or a ceiling on the cumulative outstanding position, are linked to capital. Furthermore, scrip-specific and broker-specific margins are collected from the members in order to reduce the risk associated with market fluctuations. While the margin system has limited the members' ability to take highly leveraged positions, the system of circuit filters (price bands) in which the trading in a scrip is halted once it crosses a band, acts as a direct measure to curb volatility. Circuit filters were first introduced in the US in the wake of a sharp fall in share prices. Counter-party guarantees in the form of a trade/settlement guarantee fund to honour the pay-in liabilities by a member act as a risk insurance system in the case of default. Besides, a surveillance system has been instituted in major stock exchanges to ensure efficient functioning of the market.

Minimum capital requirements have been stipulated at broker and sub-broker level. At present, gross exposure limits, stipulated at 15 times the base minimum capital and additional capital, and intra-day trading limits at 33$^1/_3$ times the base minimum capital and additional capital, are applicable. There are mainly three types of margins in operation, *viz.,* a daily margin, mark-to-market margin and volatility margin in order to curb excess volatility and deter the build up of excessive outstanding positions. Members are required to pay the excess of the mark-to-market margin over the daily margin only if the former exceeds the latter. Price bands were revised from time to time to provide exit and flexibility in trading. There is a price band of 20 per cent (either side) for scrips which are neither included in the BSE Sensex or S&P CNX Nifty, nor included in the list on which derivative products are allowed. To bring about a co-ordinated trading halt in all equity and equity derivative markets nationwide, the SEBI prescribed with effect from July 2, 2001, an index-based market-wide circuit breaker system, at three stages of the index movement either way at 10 per cent, 15 per cent and 20 per cent. All the scrips attract a 99 per cent Value-at-Risk (VaR)-based margin. Stock exchanges have Settlement Guarantee Funds/ Trade Guarantee Funds to face any exigencies that may arise. Major stock exchanges monitor the exposure and intra-day trading limits on a real time basis. A system of pre-set alerts has been introduced as part of the surveillance system. These risk containment measures have been able to enhance the safety of the market in times of extreme volatility, manage credit risk and ensure that settlements take place smoothly.

For safe and quick transfer of shares, all actively traded shares have been shifted to the dematerialised form, substantially reducing transaction costs and risks of bad delivery. Two depositories, *viz.,* the National Securities Depositories Ltd. and the Central Depository Services Ltd. have established inter-connectivity between themselves and 10 stock exchanges accounting for 99 per cent of the turnover have established connectivity with either of the two depositories.

Box V.8

Demutualisation of Stock Exchanges

Stock exchanges were set up the world over as non-profit organisations owned by their member brokers. In the recent years, however, there has been an increasing trend towards alternative structures from the traditional co-operative or mutual models to corporate service provider models. Demutualisation involves separation of trading rights from ownership and management control. In most cases, this involves the conversion of an existing not-for profit organisation into a for-profit organisation.

The basic rationale for demutualised stock exchanges is that exchanges owned by members often tend to work towards the interest of members alone, which could at times be detrimental to the rights of other stakeholders. The division of ownership between members and outsiders can lead to a balanced approach, remove conflicts of interest and create greater management accountability, transparency and market discipline. The exchanges increasingly need to invest in technology upgradation to face the competition from newly created technology-oriented market entities. Demutualised exchanges could be better equipped to face this challenge by raising the capital from the market. Furthermore, the forces of competition and globalisation have also created the need for strategic alliances and cross-holdings. The experience the world over shows that the broker-managed stock exchanges are relatively slow and reluctant to respond to changes.

In recent years, many stock exchanges such as Frankfurt, Stockholm, Amsterdam and Australia have demutualised. The Amsterdam and the Australia stock exchanges have additionally become publicly listed companies and the Deutsche Bourse in Frankfurt is considering this step. In Asia, the Stock Exchange of Singapore and Singapore Monetary Exchange (Simex) have been merged.

Demutualisation, however, raises some concerns. One of the major concerns is about the compatibility of the demutualised structure with the role of stock markets as self-regulators. In particular, it is argued that the conversion into for-profit organisation could adversely affect the support of funding for regulation. It is also argued that even demutualised exchanges may be reluctant to bring enforcement actions against holders of trading rights if they are also major stakeholders. It is often argued, therefore, that after demutualisation, the stock exchange should merely be a transaction clearing entity and not a self-regulatory organisation. The stock exchange as a company should not have special powers over other companies whose shares are also listed and traded. Hence, in some countries, regulators are considering the possibility of taking away listing powers from such exchanges as a matter of fair play.

In India, stock exchanges have historically been set up as not-for-profit organisations, though the need for a demutualised structure of stock exchanges has also been recognised. The National Stock Exchange (NSE) and the Over-the-Counter Exchange of India (OTCEI) followed demutualised models from the beginning. The Union Finance Minister, in his Budget Speech for 2002-03, emphasised the need to separate trading, ownership and management in stock exchanges. A Group constituted by the SEBI under the chairmanship of Justice M.H. Kania examined the legal, financial and fiscal issues involved to corporatise and demutualise the stock exchanges. It recommended that the three stakeholders, *viz.*, shareholders, brokers and the investing public through the regulatory body should be equally represented on the governing board of the demutualised stock exchange, with a ceiling of 5 per cent of the voting rights which can be exercised by a single entity or groups of related entities, irrespective of the size of ownership of the shares held. The Chairman of the board should not be a practicing broker. The Group suggested that the trading card system be replaced by the deposit system wherein the money deposited by a member to obtain trading rights only be considered as deposit with the stock exchange for trading purposes. Since the transfer of stock exchange assets and membership cards from the present legal structure into the new company (exchange) would attract one-time capital gains and other taxes, the Group suggested a one-time exemption from taxes for the newly demutualised stock exchanges. The Union Budget, 2003-04 announced exemption from payment of capital gains tax for exchanges on corporatisation. The Government has proposed necessary amendments to the Securities Contract (Regulation) Act, 1956 which are necessary to separate the ownership of these stock exchanges from their management in order to enhance investor confidence.

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market is reflecting conditions of excess supply which have dominated the first few months of the year. The behaviour of the exchange rate is likely to depend considerably on the movements of the US dollar *vis-a-vis* other major currencies. The capital market has been experiencing heightened activity recently. Current valuations are attractive and FIIs' appetite for Indian paper is getting rekindled. The market is expected to further consolidate these gains in the near future. A sustained recovery in financial market activity is contingent upon the abiding strength of the macroeconomic fundamentals and a stronger and more durable recovery in international markets.

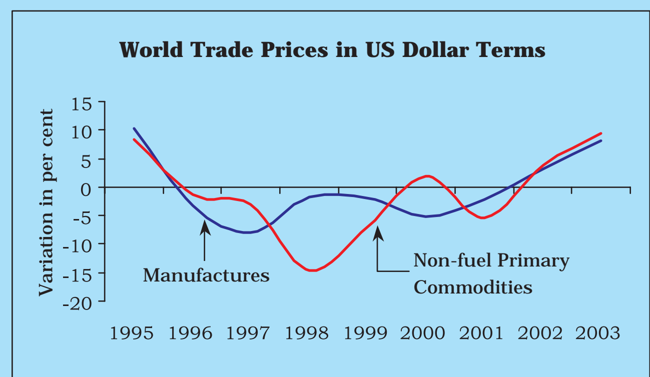
VI EXTERNAL SECTOR

6.1 A vibrant and diversified export performance underpinned the growing vigour and resilience of India's external sector in 2002-03 notwithstanding an environment dominated by the weakness of the global recovery, declines in equity markets and geo-political uncertainties. Import demand was driven up by the pace of revival of industrial activity domestically relative to the rest of the world; however, with India emerging as the world's fastest growing exporter after China amongst leading exporting nations, the current account of the balance of payments was in surplus for the second successive year. A rising confidence in the macro-fundamentals created a distinct home bias. Readjustments of net financial claims of banks, corporates and exporters in favour of domestic assets resulted in net capital inflows becoming stronger, in spite of lower debt flows and foreign investment. The positive developments in current and capital account transactions were reflected in a modest appreciation of the exchange rate *vis-a-vis* the US dollar. There was an unprecedented order of accumulation of foreign exchange reserves, the third largest increase among emerging market economies in the year. At the end of March 2003, the reserves were equivalent of around 14 months of imports or about five years of debt servicing, amply satisfying the so-called 'Guidotti rule' (usable foreign exchange reserves should exceed scheduled amortisation of foreign currency debts, assuming no rollovers, during the following year). The burgeoning reserves enabled a further consolidation of external debt during the year through prepayment of multilateral and commercial debt as well as shifts in the composition and maturity of non-resident deposit liabilities.

INTERNATIONAL DEVELOPMENTS

6.2 Global recovery was hesitant in 2002, losing momentum from the fourth quarter amidst rising uncertainties related to the war in Iraq and the fallout from the bursting of the equity market bubble. Stock markets across the globe experienced declines for the third consecutive year as investor confidence continued to remain weak. The expansion of world trade volume (goods and services) was modest. It occurred mainly on account of the Asian and transition economies where trade growth, according to the World Trade Organisation (WTO), was at least twice as fast as output growth, supported by vigorous expansion of intra-regional demand. The appreciation of the US dollar had the effect of 'deflating' world trade prices measured in US dollar terms in the last few years. This trend was reversed during 2002 with the depreciation of the US dollar. Internationally traded prices of manufactures in US dollar terms increased for the first time since 1995. Traded prices for cereals, in particular, wheat, rose markedly, reflecting the effect of a decline in production for the second year in a row due to drought in four of the five traditional exporting regions (Chart VI.1).

Chart VI.1 : Global Output and Trade



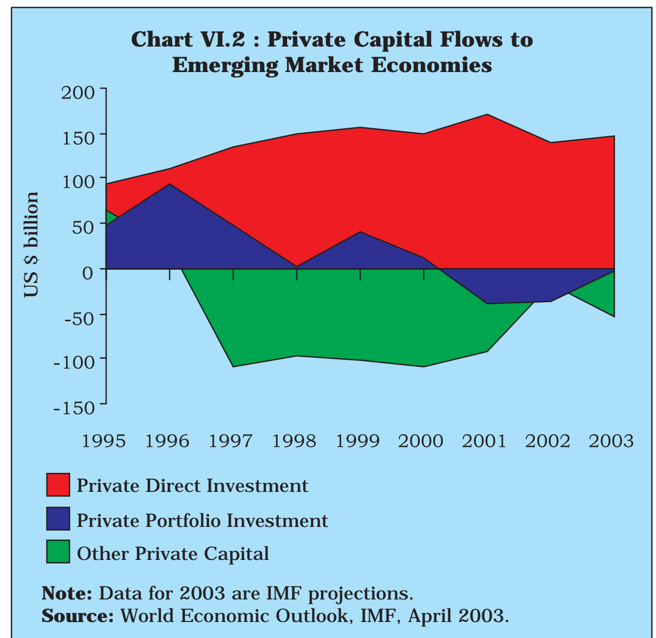
Note : Data for 2003 are IMF projections.
Source : World Economic Outlook, IMF, April 2003.

6.3 Overall GDP growth in emerging market economies (EMEs), particularly in the Asia Pacific region, remained strong despite adverse external developments. According to the Economic and Social Commission for Asia and the Pacific (ESCAP), the region emerged as the fastest growing in the world in 2002. Financing conditions in EMEs also improved with the decline in emerging market spreads since October 2002. Although private direct investment flows were lower, a moderation in outflows of other private capital flows helped to maintain the volume of net private capital flows to EMEs (Chart VI.2). These flows are expected to be marginally higher during 2003 on account of some improvement in FDI inflows.

6.4 Global inflation generally remained benign, ruling below two per cent in industrial countries in the face of widening output gaps in the USA and the Euro area. With several Asian economies experiencing declines in inflation and the ongoing slowdown in Japan, there has been concern about the possibility of a widespread global deflation. Since deflation has large potential costs, it underscores the importance for central banks to act aggressively and pre-emptively, if needed, to forestall the onset of deflationary forces (Box VI.1).

6.5 According to the International Monetary Fund (IMF) projections, global GDP and trade volume growth may show some acceleration in 2003 to 3.2 per cent and 4.3 per cent, respectively. Reduction in geo-political

Chart VI.2 : Private Capital Flows to Emerging Market Economies



Note: Data for 2003 are IMF projections.
Source: World Economic Outlook, IMF, April 2003.

uncertainties, stabilising equity market conditions and a turn in the inventory cycle are expected to lead to the improvement in growth prospects. Despite the accommodative stance of monetary and fiscal policies, marked differences persist in the macroeconomic stimuli available in the pipeline in the key currency areas. The large and growing global macroeconomic imbalances present the biggest risk to a sustained global recovery (Box VI.2).

Box VI.1
Deflation - Is it a Global Concern?

The world economy has been experiencing a prolonged downturn since the second half of the year 2000 which has been accompanied by a decline in prices in some industrial and emerging market economies. Commodity prices, in particular, have witnessed a substantial decline in the 1990s, affecting world trade prices of both manufactures and non-fuel primary commodities. This has raised fears of a generalised and persistent deflation for the second time after the Asian crisis.

The threat of global deflation emerges from a combination of large output gaps (*i.e.,* excess capacity in many economies), the loss of wealth due to persistent decline in equity markets and increasing banking sector problems in some economies. Excess capacity and weak demand after the bursting of the IT boom is another significant risk. A persistent deflation leads to erosion of growth in an atmosphere of uncertainty and distortions in resource allocation and income distribution. Even a mild deflation could develop in to a more sustained and self-reinforcing deflationary spiral of falling prices, employment, profits and incomes. A persistent deflation imposes severe constraints on the effectiveness of monetary policy in the form of the so-called 'zero bound' on nominal interest rates.

The risk of deflation is rising in some Asian economies, in particular, Japan, Hong Kong SAR and Taiwan Province of China. Hong Kong SAR's deflation is partly attributed to the peg to the US dollar and partly to the decline in housing values. China's deflation is linked mostly to factors triggered by high productivity combined with a *de-facto* pegged exchange rate. WTO-related tariff cuts and regulatory regime of administered prices have also contributed to falling prices. Within the Euro area, Germany faces the maximum risk of deflation in view of limited policy options. As regards the US, deflation risks are relatively low. Overall, the world economy faces small risks of deflation but policy authorities need to be vigilant and prepared with pre-emptive policy options.

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Box VI.2
Global Macroeconomic Imbalances

The global economy has been beset with the emergence of large macroeconomic imbalances in the last two decades on account of a general decline in saving rates in advanced economies which, in turn, fuelled fears of a global capital squeeze in the early 1990s. The global saving gap is widely regarded as the key factor underlying the rising real interest rates in the 1980s and the 1990s. By the end of the 1990s, however, developing countries as a group turned into net exporters of capital and helped to finance large and growing current account deficits of some of the advanced economies (Table). Nevertheless, concerns about a disorderly correction of the global imbalances have been amplified by large currency realignments, and exacerbated by the recent depreciation of the US dollar. Although the growing imbalances may seem to be an integral feature of globalisation, there are nonetheless limits to the accumulation of net claims against an economy that are implied by persistent current account deficits. The cost of servicing such claims adds to the current account deficit and, under certain circumstances, can be destabilising.

There are apprehensions that the moderation in real interest rates in the recent period may be reversed with stronger global recovery if the saving imbalance is not corrected through real sector adjustments (*i.e.,* lower growth in deficit countries like the US and higher growth in surplus countries). This can, however, weaken the growth prospects of the rest of the world, given the large dependence of the global economy on the performance of the US economy. In the Asian region, current account surpluses and high official foreign exchange reserves are a manifestation of the global imbalance. As stronger recovery takes root across the globe, these countries would have to confront again the challenge of the early 1990s, *i.e.,* whether global savings are adequate to meet the investment demand of emerging markets and what order of imbalance could be considered as appropriate from the stand point of ensuring global monetary and financial stability. Sustained improvement in fiscal positions of all countries could be the most desirable option. Demographic factors, however, could continue to depress saving rates and even operate as a constraint to fiscal consolidation. Since the imbalance has to unwind at some stage, it could be less disorderly if the process is driven by stronger growth in other regions with only a modest drop in the value of the US dollar.

Table : Global Current Account Imbalances

(US $ billion)

Country/Region	2003	2002	2001	2000	1996	1995
1	2	3	4	5	6	7
Advanced Economies	-270.4	-217.2	-187.3	-224.5	39.6	56.3
US	-576.7	-503.4	-393.4	-410.3	-117.8	-105.8
Euro Area	91.0	72.1	19.4	-15.1	83.9	57.2
Japan	115.5	112.8	87.8	119.6	65.7	111.4
Developing Countries	73.6	54.9	31.1	67.1	-74.7	-95.9

Source : IMF (2003).

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6.6 Sustaining growth in 2003 would depend largely upon stimulating domestic demand as the stimulus from external demand is unlikely to be strong. Signs of the recent slow down in the global information technology sector, the delay in a significant decline in international oil prices after the end of the war in Iraq, large depreciation of the US dollar and very weak economic activity in the first quarter of 2003 suggest that the pace of further recovery in growth may not be fast. The outbreak of Severe Acute Respiratory Syndrome (SARS) in several Asian developing countries and the global alert issued by the World Health Organisation (WHO) in March 2003 affected the short-term growth prospects of East Asia. Various projections by international organisations suggest that growth in the East Asian countries could be affected in the range of 0.1 to 0.4 percentage points.

6.7 With the increasing integration of developing countries into global production processes, trade and financial flows, external developments have a major bearing on their domestic growth prospects. While the known opportunities associated with globalisation in terms of access to wider markets, greater capital, higher competitive efficiency and better technology justify the need for sustaining the process, the costs of globalisation, particularly in terms of growing income inequality and greater vulnerability to financial crisis, have emerged as major challenges (Box VI.3).

6.8 As mentioned earlier, occurrence of financial crisis and large external effects are associated with the process of globalisation. While the responsibility for preventing crisis from occurring is essentially regarded as national, the objective of mitigating the

Box VI. 3

Globalisation - Challenges and Opportunities

The process of globalisation has been quite uneven in terms of the distribution of benefits and costs across countries. Divergent country experiences and public opinion on the effects of globalisation have come to the fore in the quest for making it work for the benefit of all. Countries pursuing sound macroeconomic policies and with strong and resilient financial systems can reap the benefits of globalisation. Bad policies in a globalised world, on the other hand, may be punished severely. The need for creating the right policy environment to contain the adverse effects of globalisation has influenced the speed, sequencing and content of reforms implemented by developing economies.

Dealing with the adverse effects of globalisation dominated international discussions in 2002. An examination of indicators of poverty and inequality during the process of globalisation since 1980 suggests the presence of five notable trends: (a) acceleration in growth of poor countries, (b) significant decline in the number of poor people in the world, (c) modest decline in global inequality, (d) no general trend toward higher inequality within countries, and (e) rising worldwide wage inequality. These findings have been questioned on the ground that current statistics are too deficient to yield a confident answer on the global poverty trend. Alternative methodologies could very well indicate that global inequality might be increasing and that absolute income gaps between the West and the rest are widening. According to Bhalla (2002), however, there is no welfare indicator in terms of which the world economy has not done better in the past 20 years.

Like income inequality, the risks associated with financial openness have also been a major policy concern, and contrasting empirical findings on the effects of financial openness make the issue increasingly ambiguous. Financial globalisation may give rise to higher capital inflows which need not translate into higher growth. This assessment could be justified on the ground that differences in per capita income across countries need not stem from differences in capital-labour ratios (which can be influenced by financial globalisation) but from differences in total factor productivity (which may depend on domestic factors like governance, rule of law, respect for property rights, rather than financial globalisation). There could also be a "threshold effect" so that only countries having a certain level of absorptive capacity can benefit from financial globalisation. A comparison of 14 empirical studies on the impact of financial globalisation on growth shows that only in three studies, positive effect of financial globalisation on growth was reported.

Since the East Asian crisis, the international perception on financial openness has changed considerably. There is a publicly expressed hostility, often finding vent outside the semi-annual meetings of the Bretton Woods institutions. Yet the process itself has not received any major setback. There is a greater emphasis on harnessing the benefits of globalisation while containing the risks. Globalisation could work better for all if the advanced economies open their markets to developing countries and liberalise their immigration policies to facilitate greater cross-border labour mobility. Globalisation involves free flow of labour as much as free flow of goods and services. It is also recognised that a country needs to raise its absorptive capacity to participate effectively in globalisation. This depends on the nature of human capital, depth of domestic financial markets, macroeconomic policies, and the quality of governance.

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fall out of these crises, if and when they occur, needs to be assigned globally in an integrated and interdependent world. This has provoked the search for the appropriate international financial architecture. With a view to strengthening the crisis prevention and resolution architectures, both at the national and international levels, considerable emphasis is being laid on the Sovereign Debt Restructuring Mechanism (SDRM) to contain the vulnerability to financial crisis (Box VI.4).

BALANCE OF PAYMENTS

6.9 India's balance of payments (BoP) improved significantly during 2002-03, with an overall surplus in each quarter. A surge in exports of merchandise and invisibles posted the current account into a surplus, in contrast to the previous year when a small current account surplus appeared due to lack of import demand. Growing openness in terms of the share of tradables in the economy is increasingly being driven

Box VI. 4

Progress on the Sovereign Debt Restructuring Mechanism

In the aftermath of the repeated financial crises of the 1990s, the international financial community has made considerable progress in reforming certain elements of the international financial architecture, particularly in areas related to crisis prevention. Progress in the area of crisis resolution, however, has not been significant. The recent debate on the establishing an appropriate Sovereign Debt Restructuring Mechanism (SDRM) initiated by the IMF's First Deputy Managing Director, Anne Krueger raised considerable hopes of a significant move forward. The key features of the latest position of the IMF on the SDRM include:

- Major restructuring that would allow the sovereign debtor and the majority of its creditors to reach an agreement on the terms of restructuring that would be binding on all the creditors.
- Provision for deterrence of disruptive litigation under the so-called 'Hotch pot' rule whereby any amount that is recovered by a creditor through litigation would be deducted from its residual claim under an approved restructuring agreement.
- Protection of creditor interests.
- Priority financing to induce fresh financing.

The IMF's SDRM has been mired by the absence of consensus among member countries on the design, coverage, implementation and methodological issues as well as the stance taken by the various creditors' groupings. Several unresolved issues exist: allowing unilateral activation of the SDRM by debtors; criteria for enforcing a stay on creditor litigation; coverage of debt; and, ensuring equity between domestic and external creditors.

The private sector has been apprehensive of the SDRM, citing in particular, the conflict of interest between the senior creditor status enjoyed by the IMF and its alleged bias towards debtors (who are the members of the Fund) in dispute resolution. The private sector is also concerned about debtor moral hazard and, therefore, places greater faith in the market mechanism to resolve sovereign debt crisis. For the market mechanism to operate successfully, the collective action problem has to be dealt with by the incorporation of collective action clauses (CACs) in bond contracts. Collective action problem arises since individual creditors could hold out, *i.e.,* decline to participate in a voluntary restructuring in the hope of recovering payment on the original contractual terms, even though creditors as a group would be better served by agreeing to such a restructuring that would help limit reduction in the asset value.

In February 2002, the US Treasury mooted the proposal for incorporation of various CACs. In September 2002, the G-10 Working Group Report on CACs set out the key features of CACs for sovereign bonds. In April 2002, the International Monetary and Financial Committee (IMFC) encouraged the IMF to investigate a "twin-track" approach consisting of SDRM and CACs. The market-based approach provides for greater flexibility than SDRM since it is appropriate for a case-by-case resolution of debt crisis, taking into account the peculiarities of each case. Its drawback is that it does not address the problem related to the existing issues that do not include CACs. Another problem is that CACs do not provide for aggregation clauses, *i.e.,* clauses that aggregate bonds across all issues of a sovereign debtor to provide for inter-creditor equity and simultaneously prevent litigation and disruption by hold-out creditors who may enjoy a majority in any single bond issue.

A positive aspect of the recent debate on SDRM and CACs has been the growing interest in CACs by market participants and sovereign debtors. The European Union has allayed the debtor's 'first mover' problem by agreeing to take the lead in incorporating CACs in the EU countries' sovereign bond issues. Recently, Mexico and Brazil have also incorporated CACs in their international bond issues, belying the first mover problem of incurring additional risk premium. The IMFC concluded in its April 2003 meeting that it is not feasible to move forward to establish the SDRM but work should continue on issues that are of general relevance to the orderly resolution of financial crisis.

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by exports. The healthy rise in current receipts has had salutary effects on debt servicing capabilities and on import purchasing power. Banking capital movements supported by stable non-resident deposits brought in higher net capital flows, notwithstanding substantial pre-payments of multilateral debt (Table 6.1).

Table 6.1 : Balance of Payments : Key Indicators

(US $ million)

Item/Indicator	2002-03	2001-02	2000-01	1999-2000	1990-91
1	2	3	4	5	6
i) Trade Balance	-12,474	-12,703	-14,370	-17,841	-9,437
ii) Invisibles, net	16,182	13,485	10,780	13,143	-243
iii) Current Account Balance	3,708	782	-3,590	-4,698	-9,680
iv) Capital Account	12,638	10,573	10,018	10,444	7,056
v) Overall Balance #	16,980	11,757	5,856	6,402	-2,492
vi) Foreign Exchange Reserves (Increase-, Decrease +) (excluding valuation changes)	-16,980	-11,757	-5,830	-6,142	1,278
Indicators (in per cent)					
1. Trade					
i) Exports/GDP	10.4	9.3	9.8	8.4	5.8
ii) Imports/GDP	12.8	12.0	12.9	12.4	8.8
iii) Income Terms of Trade Growth	..	1.6	18.2	3.4	0.1
iv) Export Volume Growth	..	3.9	23.9	15.5	11.0
2. Invisibles					
i) Invisibles Receipts/GDP	8.4	7.7	7.6	6.8	2.4
ii) Invisibles Payments/GDP	5.3	4.9	5.2	3.8	2.4
iii) Invisibles (Net)/GDP	3.1	2.8	2.4	3.0	-0.1
3. Current Account					
i) Current Receipts@/GDP	18.7	16.9	17.3	15.1	8.0
ii) Current Receipts Growth@	17.7	2.4	17.6	12.9	6.6
iii) Current Receipts@/Current Payments	103.6	100.5	95.3	93.0	71.5
iv) Current Account Balance/GDP	0.7	0.2	-0.8	-1.1	-3.1
4. Capital Account					
i) Foreign Investment/GDP	1.1	1.7	1.5	1.2	0.0
ii) Foreign Investment/Exports	10.6	18.1	15.1	13.8	0.6
5. Others					
i) Debt-GDP Ratio	20.0	21.0	22.4	22.2	28.7
ii) Debt Service Ratio	14.7	13.9	17.2	16.2	35.3
iii) Liability Service Ratio	15.7	14.9	18.4	17.0	35.6
iv) Import Cover of Reserves (in months)	13.8	11.3	8.6	8.2	2.5

Includes Errors and Omissions. .. Not available. @ Excluding official transfers.

Merchandise Trade

6.10 Notwithstanding the subdued recovery in world trade, India ranked second only to China as the fastest growing exporting economy in the world in 2002 amongst leading exporting nations. Export growth at 19.2 per cent surpassed the target of 12 per cent set for 2002-03. This reflected recovery in trade volume as well as in the terms of trade. Various policy initiatives taken by the Government in the recent years for export product and market diversification have helped in improving export competitiveness (Box VI.5).

6.11 Export growth during 2002-03 was broad-based, across commodity groups as well as destinations. Both primary products and manufactured goods posted strong growth (Table 6.2 and Appendix Table VI.4). The major sources of increase in primary product exports were ores and minerals, rice and marine products. The increase in the exports of ores and minerals benefited from the recovery in international metals prices. Among the major agricultural commodities, the exports of cereals (rice and wheat) recorded sharp expansion mainly due to world-wide supply shocks caused by severe drought in the USA, Canada and Australia. While the exports of tobacco and marine products made a smart recovery, those of tea and coffee continued to decline. The performance of these export items is being impacted by the process of structural transformation in Indian exports. Over the years, tea and coffee have lost importance in terms of share in India's total exports and India's world market shares. Structural constraints, especially in the case of tea, have also affected exports. In the recent years, the Indian tea

Box VI.5

Changing Patterns of Export Competitiveness

Significant changes are taking place in the global patterns of trade. A number of developing countries and economies in transition have gained perceptibly in terms of global trade competitiveness. Technology has played a key role in the process of change. Stylised facts suggest that countries have recorded improvement in products in which there are dynamic and discernible buyers at home. The presence of suppliers and firms in supportive industries in the vicinity of exporting firms has also been a major source of competitive advantage. Understanding the theoretical foundations and the underpinnings of sustainable competitive advantage is crucial, especially in the context of the need for rapid expansion of exports as a means for accelerating economic growth.

Export competitiveness, which implies the ability of a country to expand its share in world markets, depends upon both price and non-price factors. Traditionally, productivity growth in a country in comparison to that in trading partners is considered to be a crucial factor. In recent literature, it is being increasingly recognised that dynamic factors, rather than static production abilities, play a vital role. Structural changes in production caused, *inter alia*, by new technologies, novel ways of organising production, trade policies including in partner or competing countries and multilateral trading rules also impact on competitiveness. The exchange rate is regarded as a crucial determinant of price competitiveness. Non-price factors such as product quality, brand name, packaging, delivery and after sales services are seen as equally important factors.

It is not easy to decipher the role of policy changes on export performance. Nevertheless, it can reasonably be argued that the opportunities provided by global developments were exploited through enabling shifts in the policy regime in the form of industrial and trade liberalisation; strategic export promotion through removal of restrictions or regulations; widening the reach of export incentives; announcement of product or market specific schemes; and, procedural simplifications. Studies in India show that increased competition has led to decline in price-marginal cost mark-ups and firms are increasingly resorting to mergers and acquisitions, adoption of modern technology, and greater R&D efforts. There is a broad consensus about a turnaround in total factor productivity growth (TFPG) in Indian manufacturing since the mid-1980s, which is attributable, *inter alia*, to the reorientation in trade policies and improved infrastructure performance. There is also some evidence on improvement in efficiency in the use of material inputs, notably during the second half of the 1990s. Transaction costs of exporters on account of procedural or administrative hassles have declined, though in absolute terms they continue to be high.

India's share in world exports rose to 0.8 per cent in 2002 after having fallen to below 0.5 per cent in the mid-1980s from two percent at the time of Independence. Past studies had pointed out that, in stark contrast to the dramatic compositional changes in the exports of East Asian countries, the commodity structure of India's exports had remained almost stationary until the mid-1990s. Data for the recent years, however, indicate that the commodity structure of India's exports has begun to shift towards technology-intensive high-value manufactures and away from the traditional labour intensive goods and raw materials. It is, however, too early to conclude that dramatic changes would take place. The destination profile of exports is changing in favour of the developing countries and the countries in the OPEC group. India's competitive position in a global perspective has improved marginally. According to the Global Competitiveness Reports of the World Economic Forum, India ranked 48 in "Growth Competitiveness Rank" in 2002 as compared with 52 in 1999. India enjoys distinct superiority in a number of key areas. In 2002, India ranked first in 'prevalence of foreign technology licensing', second in 'availability of scientists and engineers', fifth in 'access to credit', seventh in 'intensity of local competition', and eleventh in 'interest rate spread'. The UNCTAD assessment of the pattern of global trade competitiveness reveals that in a group of 20 top gainers of export market share in the period 1985-2000, India ranks fourteenth in terms of overall exports, fifth in resource-based manufactures, ninth in low-technology manufacturers, and seventeenth in medium-technology manufacturers.

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industry has been facing depressed prices due to sluggish domestic demand and lower off-takes of orthodox tea by traditional importers. On the other hand, processed items such as vegetables, fruits and juices, floricultural products, meat and meat preparations and marine products have gained importance, drawing from the impetus for diversification in agricultural and trade policies.

Table 6.2 : India's Exports of Selected Commodities

Percentage Variation

Commodity Group	2002-03 P	2001-02
1	2	3
I. Primary Products	**16.0**	**0.5**
A. Agricultural & Allied Products	8.7	-1.2
of which :		
1. Tea	-7.0	-7.9
2. Coffee	-12.3	-11.5
3. Rice	66.5	3.7
4. Tobacco	22.5	-10.8
5. Marine Products	11.7	-11.3
B. Ores & Minerals	50.5	9.5
II. Manufactured Goods	**14.9**	**-2.8**
of which :		
A. Leather and Manufactures	-6.4	-1.8
B. Chemicals and Related Products	16.2	2.8
C. Engineering Goods	20.6	2.0
D. Textiles	9.3	-9.3
E. Gems and Jewellery	21.2	-1.1
F. Handicrafts	31.3	-17.0
G. Carpets	-2.6	-12.3
III. Petroleum Products	**14.3**	**12.0**
IV. Others	**168.1**	**-2.7**
Total Exports	**19.2**	**-1.6**

P Provisional.
Source : DGCI&S.

6.12 The export expansion in value-added manufactured goods was led by gems and jewellery, engineering goods, chemicals and related products and textiles (Table 6.2). The sharp increase in the exports of gems and jewellery is, *inter alia,* attributable to pick-up in demand in major markets like the USA, Belgium, Israel and Singapore. These exports also benefited from supportive policy measures such as reduction in value addition norms for exports of plain and mechanised unstudded jewellery, abolition of the licensing regime for rough diamonds and zero customs duty on imports of rough diamonds. Higher exports of engineering goods, emanating mainly from the 'transport equipments' and 'iron and steel' segments, reflected improvements in global demand as also the internationalisation in production processes. In fact, absorption by industrialised countries, notably the USA, Germany and Italy led the expansion in transport equipment exports. In case of iron and steel, export growth was mainly observed in emerging market economies such as Chinese Taipei, Korea, Malaysia, the UAE and Nepal and was associated with improvement in domestic production. Exports of leather and manufactures and carpets, however, declined.

6.13 Apart from product diversification, India's export strategy during the past few years has also focused on market diversification with initiatives such as 'Focus Latin American Countries' (launched in November 1997 and extended up to March 2003) and 'Focus Africa' (launched on March 31, 2002). During 2002-03, sizeable growth was recorded in exports to major markets like the USA, the euro area, other developing countries and OPEC. Within the developing country group, the most notable sources of expansion were China (almost doubling of exports) and Singapore (Box VI.6). Exports to the Latin American countries also increased. Within the OPEC group, the main source of expansion was the UAE.

Box VI.6
India's Trade with China

Bilateral trade between India and China resumed officially in 1978. In recent years, trade between the two countries has increased significantly, especially since the signing of the Bilateral Agreement in February 2000 under which China agreed to offer duty concessions on 24 items, mainly relating to agriculture, agro-products and marine commodities. Besides relaxation of banking and insurance norms, the Agreement also covered rationalisation of tariff rate quotas for agricultural products, opening up of the pharmaceutical industry and easing of phyto-sanitary norms to facilitate export of Indian commodities to China. Other major policy initiatives include the signing up of memoranda of understandings (MoUs) in 2000 for setting up a Joint Working Group on Steel and cooperation in the fields of information technology and labour. During the period 1999-2000 to 2002-03, India's exports to China increased at an average rate of 50.2 per cent per annum in US dollar terms while imports from China recorded an annual average growth of 26.6 per cent, far higher than the growth of India's overall exports and imports during the same period. During 2002-03 alone, India's exports to China more than doubled, narrowing the trade deficit with China (Table).

Table : India's Trade With China

(US $ million)

	Exports	Imports	Trade Balance
1	2	3	4
1990-91	18	35	-17
1998-99	427	1,097	-670
1999-00	539	1,288	-749
2000-01	831	1,502	-671
2001-02	952	2,036	-1,084
2002-03	1,961	2,783	-821

Source : DGCI&S.

(Contd....)

(Concld....)

The surge in India's exports to China has been marked by a distinct concentration in products involving medium-to-high technology. The major items of exports from India to China have been engineering goods, iron ore, and chemicals and related products. In 2002-03, these three product groups accounted for more than 70 per cent of India's exports to China. As regards imports, electronic goods are emerging as the principal item. This has led to a reduction in the share of the other major imports like chemicals, coal, coke and briquettes (Table).

Table : India's Principal Exports to and Imports from China

(Per cent to total exports/imports)

Item/Group	2002-03	2001-02	2000-01	1997-98
1	2	3	4	5
Exports				
Engineering Goods	31.3	7.0	12.4	4.4
Iron Ore	20.4	21.7	15.6	13.6
Chemicals and Related Products	19.8	32.1	29.7	10.4
Other Ores and Minerals	6.3	11.9	8.8	6.2
Marine Products	5.4	8.9	13.9	16.0
Imports				
Electronic Goods	27.8	18.9	16.3	9.7
Chemicals	13.3	14.8	15.2	22.1
Textile Yarn, Fabrics, Made-up Articles	7.6	6.2	5.2	4.9
Coal, Coke and Briquittes	6.0	12.9	17.4	16.6
Medicinal and Pharmaceutical Products	5.2	5.2	4.7	5.9

Source : DGCI&S.

The recent buoyancy notwithstanding, India still accounts for less than one per cent of China's global trade (0.8 per cent in 2001). Some of the major commodities imported by China such as machinery, minerals and mineral products, iron and steel, organic chemicals, medical and surgical equipment and agricultural products constitute important items of India's export basket. The Chinese market, therefore, offers huge potential to Indian exporters. With China becoming a member of the WTO in December 2001, the opening up of its domestic markets to greater foreign competition and commercial presence offers rich opportunities for Indian exports. There is likely to be an increasing commonality of interests of the two countries within the WTO and other multilateral institutions. However, with the largest export markets of China (namely, the US, Hong Kong, Japan, the European Union and Korea) also being amongst India's key markets for exports, India is likely to face stiff competition from China in overseas export markets for textiles, garments, leather and leather products and light machinery.

A further boost to trade could emanate from the services sector if India and China could share their experiences and core competencies in the field of information technology (software and hardware, respectively) to develop strategies to bridge the digital divide between the two countries and optimising the e-governance systems.

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6.14 Imports rose sharply during 2002-03 with both oil and non-oil components showing substantial increases (Appendix Table VI.3). While the non-oil import growth reflected the pick-up in domestic industrial activity, the sharp increase in oil imports was due to the hardening of international crude prices from US $ 23 per barrel during 2001-02 to US $ 27 per barrel during 2002-03, increase in refinery throughput and stagnant domestic production of crude oil.

6.15 There was a marked decline in imports of gold and silver, mainly attributable to the sharp increase in the international prices and decline in rural demand. Non-oil imports net of gold and silver recorded a sharp growth. Capital goods and export-related items such as pearls and precious stones, raw cashew nuts, textile yarn and fabric were the major sources of the increase. With the pick-up in industrial demand, the imports of capital goods, notably transport equipment, 'electronic goods including computer software' and 'machinery except electrical and electronics' as also of several industrial raw materials such as pulp and waste paper, iron and steel, artificial resins and plastic materials, and medicinal and pharmaceutical products recorded significant expansion. Imports of edible oils rose sharply, reflecting the widening domestic supply-demand gap in the wake of the drought (Table 6.3 and Appendix Table VI. 4).

6.16 Imports increased from all major regions and country groups with developing countries recording the highest growth. Within the OECD group, imports from the USA, Belgium, France and Germany recorded sharp increases. Amongst developing countries, the Peoples Republic of China, Malaysia and Kenya were the principal sources of imports.

6.17 During the first quarter of 2003-04 (April-June), exports recorded a growth of 11.1 per cent as compared with that of 14.4 per cent during the corresponding period of the previous year. Imports

Table 6.3 : India's Imports of Selected Commodities

Percentage Variation

Commodity Group	2002-03 P	2001-02
1	2	3
Petroleum, Petroleum Products and Related Material	26.0	-10.5
Edible Oil	33.3	3.6
Fertilisers	-13.5	-9.7
Non-Ferrous Metals	-0.4	21.2
Paper, Paperboard and Manufacturing including Newsprint	-1.5	-0.9
Crude Rubber, including Synthetic and Reclaimed	3.8	14.8
Pulp and Waste Paper	15.5	4.6
Metalliferrous Ores and Metal Scrap	-12.3	47.7
Iron and Steel	12.8	7.2
Capital Goods	29.0	10.5
Pearls, Precious and Semi-Precious Stones	31.0	-3.8
Textile Yarn, Fabric, *etc.*	27.9	25.3
Cashew Nuts, raw	181.3	-57.0
Gold and Silver	-7.6	-1.2
Total Imports	**19.2**	**1.7**
Memo Items		
Non-Oil Imports	**16.7**	**7.2**
Non-Oil Imports excluding Gold & Silver	**20.0**	**8.5**

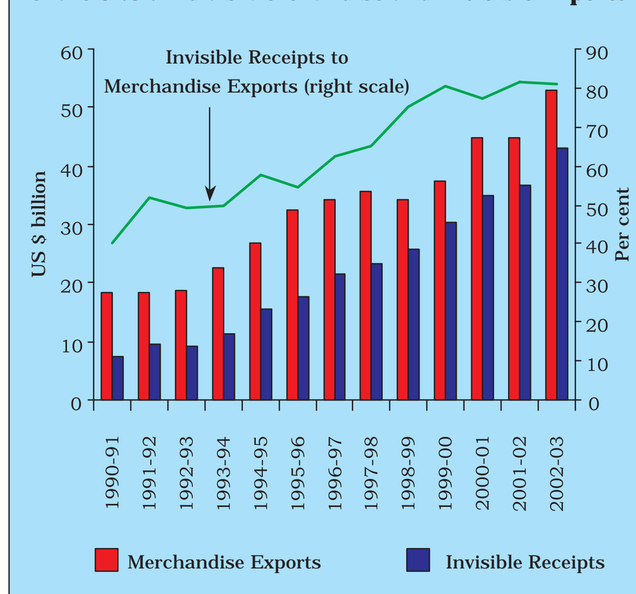
P Provisional.
Source : DGCI&S.

during April-June 2003 increased sharply by 27.0 per cent as compared with 6.7 per cent during April-June 2002. This was mainly on account of non-oil imports which increased by 30.9 per cent as compared with 7.5 per cent in the previous year. As a result, trade deficit during April-June 2003 widened to US $ 4.2 billion from US $ 1.8 billion during the corresponding period of the previous year.

Invisibles

6.18 Since the 1970s, India's invisible exports have provided crucial support to the balance of payments, including through the difficult years of the major oil shocks. In fact, it was the abrupt loss of invisible export markets that, *inter alia*, exacerbated the external payments crisis of 1990-91. Since then, compositional changes have characterised the rising profile of Indian foreign exchange earnings, indicative of shifts in dynamic comparative advantage towards services. In 2002-03, invisibles shared in the vigorous export expansion, rising to constitute 81 per cent of merchandise exports, *i.e.,* 45 per cent of gross current receipts. The distinct improvement in competitiveness

Chart VI.3 : India's Merchandise and Invisible Exports



can be gauged from a comparison with 1990-91 when invisibles were only 40 per cent of merchandise exports and less than a third of current receipts (Chart VI.3). Globally, the share of invisibles in current receipts has been broadly stable at around 35 per cent, bringing into sharp focus the competitive edge of India's invisible exports.

6.19 India's invisible earnings are dominated by private transfers (comprising mainly workers' remittances), followed by software and other business services (Table 6.4). Remittances from Indians employed abroad have traditionally been the principal source of invisible earnings. India is the largest recipient of private transfers in the developing world and these amounted to US $ 14.8 billion in 2002-03. India's share in global flows of private transfers is

Table 6.4 : Composition of Gross Invisible Receipts

(Per cent)

	2002-03	2001-02
1	2	3
Transfers	35.4	34.3
Software Services	22.3	20.6
Non-software Miscellaneous	21.2	20.4
Travel	7.0	7.9
Transportation	5.9	5.4
Income	6.6	9.4
Insurance and GNIE	1.6	2.0
Memo:		
Total Receipts (US $ billion)	**43.0**	**36.7**

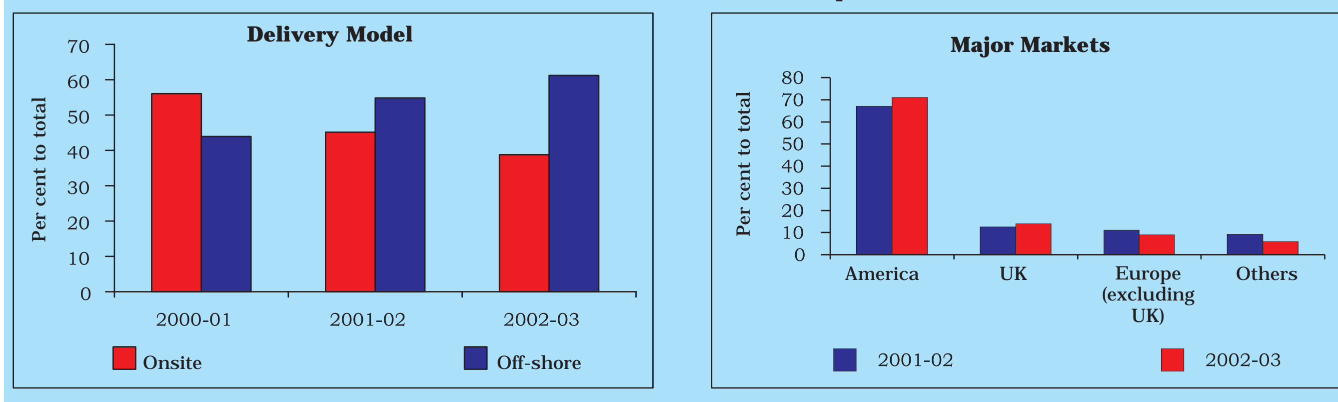
Note: GNIE: Government not included elsewhere.

placed at around 3 per cent. The profile of workers' remittances has undergone secular shifts in consonance with the evolution of the world economy. Receipts from indentured labour in Africa and the West Indies gave way to massive labour export earnings from the Middle East in the Gulf boom of the 1970s and 1980s. By the late 1980s, several major labour exporting countries including India had to contend with the fallout of return migration as the Gulf-centred labour export upswing ebbed and moved outwards to Bangladesh and the Philippines. Since the 1990s, the pattern of India's labour exports has shifted away from the Middle East; Western Europe and the USA became the major destinations for Indian workers. Market diversification has been greatly enabled by changes in composition of labour outflows. Lower skill categories are being vacated for white collar and technically specialised employment. About 30 per cent of remittances take the form of local withdrawals from non-resident rupee deposits which are included under private transfers.

6.20 Software exports increased by around 27 per cent to US $ 9.6 billion during 2002-03 which is noteworthy in the context of the continuing 'technology slowdown' in the global economy and shedding of new economy stocks in world equity markets. The software industry is undergoing fundamental restructuring through mergers and acquisitions and major software companies are innovating their recruitment strategies for building global delivery capabilities. The resilience acquired by Indian software is attributable to diversification towards new service lines such as package software implementation, systems integration and network management. While banking, financial services and insurance (BFSI), manufacturing and telecommunication remained the main areas of focus, the software industry also expanded into retail business, utilities, telecom service providers and health care during 2002-03. Small and medium enterprises (SMEs) emerged as high performers relative to industry standards. Business process outsourcing (BPO) was the fastest growing segment in software exports, expanding at twice the industry average and contributing a quarter of total software exports. India turned out to be a preferred destination for BPO, notwithstanding barriers in the form of anti-outsourcing laws and visa restrictions. These developments have further strengthened the shift to offshore delivery as part of the business strategy of the software industry in India. The US remained the principal destination of India's software exports (Chart VI.4).

6.21 The category of commercial services comprising travel, transportation, insurance and business services has been experiencing depressed conditions world wide in the aftermath of the terrorist incidents of September 11, 2001. Airlines insurance and tourism industries were particularly affected. According to the WTO, global commercial services expanded by five per cent in 2002. India ranked twenty-first in exports of commercial services with a share of 1.3 per cent in world trade. India's exports of travel services were affected by the generalised adverse conditions following recent events. Tourist arrivals in India remained subdued reflecting fears of terrorism and geo-political insecurity. Transportation receipts benefited from the vigorous growth of merchandise exports. The category of other business services expanded robustly, emerging as the third largest source of invisible earnings. Payments for commercial services increased in consonance with the rising trend evident in recent years in response to the progressive liberalisation of the exchange and payments regime. The growth in travel payments during 2002-03 was on account of both leisure and business travel.

Chart VI.4 : India's Software Exports



6.22 Under investment income which records the servicing of foreign assets and liabilities, receipts were lower in 2002-03 on account of the declining international interest rates which affected earnings from the deployment of foreign exchange reserves. On the other hand, investment income payments were higher due to profit and dividends (including retained earnings) relative to interest payments which moderated.

Current Account

6.23 The interplay of developments in merchandise and invisible transactions brought compositional shifts into the behaviour of the current account balance in 2002-03. In India, as in many other developing countries, it is the merchandise trade deficit which sets the external financing requirement. A qualitative difference in the Indian experience is the financing support provided by net surpluses in the invisible account, economising on the recourse to external liabilities. Invisibles financed around two-third of the merchandise trade gap during the second half of the 1990s. In 2002-03, as in the preceding year, it is the invisible account which emerged as the principal component, completely covering the trade deficit and driving the current account into surplus (Chart VI.5).

6.24 The movement of the current account into surplus for the second consecutive year in 2002-03 is part of a broader trend emerging out of the crisis of 1990-91 – a conscious policy choice of a moderate current account deficit as an intermediate target for external sector policies. Benefits accruing from the

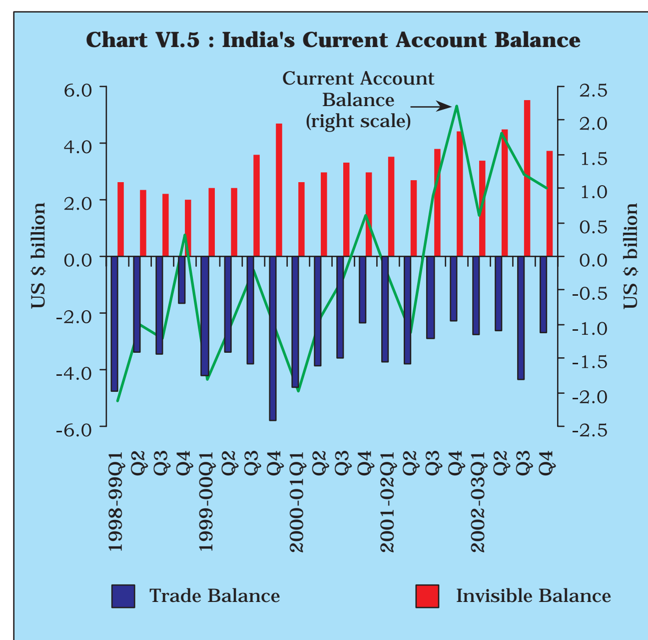


Table 6.5 : Current Account Balances : Major Economies

(US $ billion)

Country/Region	2001-02	1999-2000	1995-96
1	2	3	4
Japan	100.6	117.4	87.7
East Asia (excluding Japan)	111.4	108.8	-24.1
Euro Area	21.3	-52.4	50.5
China	26.4	20.8	4.4
Taiwan, China	21.8	8.6	8.3
Singapore	18.3	16.2	13.7
Hong Kong SAR	12.1	8.2	-4.1
Korea	7.2	18.4	-15.8
Malaysia	7.3	10.5	-6.6
Indonesia	7.1	6.9	-7.0
Thailand	6.9	10.9	-14.1
Philippines	4.4	8.2	-3.0
India	2.5	-3.7	-5.8
USA	-448.4	-351.6	-111.8

Note: (-) indicates deficit.

Source: BIS Quarterly Review, June 2003.

policy change are visible in viability and distinct strength in the balance of payments and international reserves. Superimposed upon the trend is the synchronised downturn across Asia in the wake of financial crisis of 1997-98 to which India was not immune. Adjustment to that shock was reflected in persistent current account surpluses in several Asian countries as import demand was compressed by the downturn (Table 6.5). In India, the current account surplus was associated with a 17.7 per cent growth in current receipts during 2002-03. As a result, the debt service ratio remained one of the lowest after China and Malaysia and the current receipt/current payments ratio showed rising import purchasing power.

6.25 It is useful to examine the emergence of surplus in the current account of the balance of payments against the co-movement of the internal macro-balances. The deterioration of the dis-saving of the public sector is more than offset by the improvement in the private sector's saving-investment surplus. This stylised fact suggests that it is the private sector surplus which is spilling over into a current account surplus. It is vital, therefore, to closely monitor the underlying constituents of the current account balance to gauge the strength of the upturn in the business cycle.

Capital Account

6.26 Capital account developments dominated the balance of payments in 2002-03, a phenomenon that was interrupted only once in 1995-96 since the surges of capital inflows began in 1993-94. This is indicative

of the sustained international confidence in the strength of the economy, impervious to the downgradings by external credit rating agencies that began during the crisis of 1990-91. Net capital flows were higher in 2002-03 than in any single year so far (Appendix Table VI.2).

6.27 Over this period, there have been significant changes within the capital account, partly in response to policy changes, but also reflecting the patterns of financial flows to emerging market economies. Official assistance, the mainstay of the capital account up to the end of the 1980s, has generally been recording net outflows (net of principal repayment and interest payments) since 1995-96. Outflows increased in 2002-03 consequent upon the prepayment of multilateral debt - US $ 1.34 billion to Asian Development Bank and US $ 1.68 billion to the World Bank. Prepayments of high cost commercial debt were also put into effect by corporates. Net outflows rose in 2002-03 as corporates turned to domestic financial markets for their financing requirements. The appetite for external commercial borrowing has remained weak since 1998-99 in the context of the slowdown in industrial activity. Thus, the long and medium term debt component of the capital account contracted in 2002-03, extending a phase of consolidation of external debt that has dominated external sector management since the adjustment to the crisis of 1990-91. Short-term debt flows increased to finance the higher order of POL imports (Table 6.6).

6.28 Net inflows under non-resident deposits, another important element in debt flows, underwent compositional changes in 2002-03. There was a sharp increase in balances under the repatriable rupee-denominated external rupee accounts [NR(E)RA] as maturing balances of the discontinued non-repatriable rupee deposits [NR(NR)RD] poured into the repatriable scheme. Taken together, the net inflows into these rupee deposits were broadly stable during the year (Table 6.7). Lower net inflows under the foreign-currency denominated FCNR(B) scheme could be attributed to better exchange rate adjusted return on the competing rupee deposits.

Table 6.6 : Capital Flows

(US $ million)

	2002-03	2001-02
1	2	3
Foreign Direct Investment	3,611	4,741
In India	4,660	6,131
Abroad	-1,049	-1,390
Portfolio Investment	944	1,951
In India	979	2,020
Abroad	-35	-69
External Assistance	-2,460	1,117
External Commercial Borrowing	-1,698	-1,576
Short-term Trade Credits	979	-891
Non-resident (NRI) Deposits	2,808 *	2,754
Banking Capital (excluding NRI deposits)	5,435	2,838
Other Capital Flows	3,019	-361
Total Capital Flows	**12,638**	**10,573**

* Provisional

Table 6.7 : Balances under NRI Deposit Schemes

(US $ million)

Schemes	Outstanding (end March)		Net Inflows@	
	2003 P	2002	2002-03 P	2001-02
1	2	3	4	5
1. FCNR(B)	10,193	9,673	520	594
2. NR(E)RA	14,716	8,449	5,987	1,626
3. NR(NR)RD	3,449	7,052	-3,704	508
Total	**28,358**	**25,174**	**2,803**	**2,728**

@ All figures are inclusive of accrued interest and valuation changes arising on account of fluctuations in non-dollar currencies against US dollar.

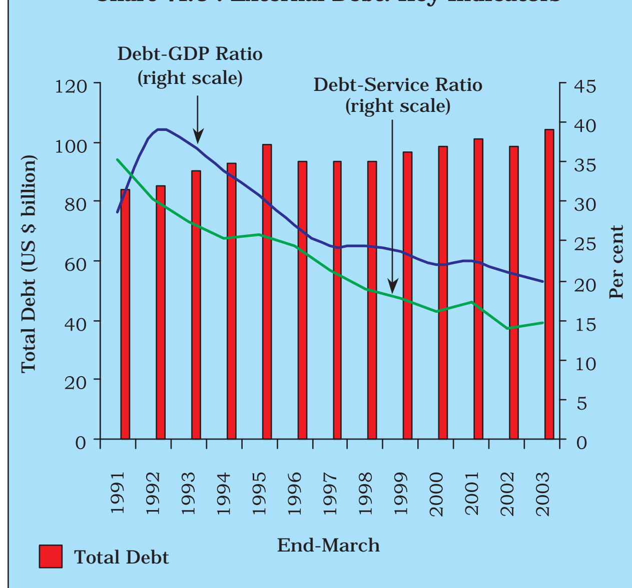
P Provisional

Note : Variations do not match with the differences between the outstanding stocks for rupee deposits on account of exchange rate fluctuations during the year.

External Debt

6.29 India's total external debt increased by US $ 5.5 billion over the year, from US $ 98.8 billion at the end of March 2002 to US $ 104.2 billion at the end of March 2003 (Chart VI.6 and Appendix Table VI.10). This increase has taken place despite the prepayment

Chart VI.6 : External Debt: Key Indicators



by the Government of high-cost foreign currency loans amounting to US $ 3,030 million to the Asian Development Bank and the World Bank during the last quarter of 2002-03. The increase in external debt was mainly due to an increase in non-resident Indian (NRI) deposits of US $ 6.8 billion and in bilateral debt, mainly concessional, of US $ 1.5 billion. Total concessional debt has increased by US $ 3.1 billion. The recorded increase in NRI deposits is partly of a technical nature because of the shifting of hitherto non-repatriable rupee accounts [NR(NR)RD accounts] to repatriable accounts. Non-repatriable rupee deposits are excluded from the external debt statistics. The Union budget of 2002-03 announced the discontinuation of NRI non-repatriable rupee deposit schemes and allowed the shifting of balances on maturity from such accounts to the account holders' NRE accounts (repatriable). The actual net increase of NRI deposits during 2002-03 was US $ 2.8 billion, which was of similar order as witnessed during the previous year.

6.30 Bilateral and multilateral debt constituted about 45 per cent of the debt stock (Appendix Table VI.10). The Government of India has decided to discontinue receiving aid from bilateral partners other than Japan, the UK, Germany, the USA, EC and the Russian Federation and it will prepay bilateral debt amounting to Rs.7,491 crore (US $ 1.6 billion) to partners other than Japan, Germany, the USA and France. Concessionality and long maturity associated with this component impacts favourably on the overall stock of debt in terms of the cost of servicing. External commercial borrowings (21.3 per cent) and long-term non-resident deposits (22.5 per cent) are the other principal components of external debt.

6.31 Key indicators of debt sustainability suggest continuing consolidation and improvement in solvency. The external debt-GDP ratio declined during the year to 20.0 per cent and proportion of short-term debt to total debt increased to 3.9 per cent at end-March 2003 from 2.8 per cent at end-March 2002. At 14.7 per cent, the debt service ratio continued to remain low in 2002-03. The marginal increase in debt service and liability service ratios during 2002-03 was due to pre-payments of official debt in the last quarter (Table 6.8).

Table 6.8 : External Debt Service Payments

(US $ million)

	2002-03	2001-02	2000-01
1	2	3	4
1. External Assistance @	6,308	3,240	3,706
2. External Commercial Borrowing *	5,988	5,997	7,665
3. IMF #	0	0	26
4. NRI Deposits (Interest Payments)	1,268	1,555	1,659
5. Rupee Debt Service	474	519	617
6. Total Debt Servicing	14,038	11,311	13,673
7. Total Current Receipts **	95,627	81,220	79,342
8. Debt Service Ratio (6/7) (per cent)	14.7	13.9	17.2
9. Interest Payments to Current Receipts Ratio (per cent)	4.1	5.4	6.6
10. Debt to Current Receipts Ratio (per cent)	109.0	121.6	127.5
11. Liability Service Ratio (per cent)	15.7	14.9	18.4

@ Inclusive of non-Government account.
* Inclusive of interest on medium, long-term and short-term credits.
# Excluding charges on net cumulative allocation.
** Excluding Official Transfers.

Note : 1. Debt service payments in this table follow accrual method of accounting consistent with balance of payments and may, therefore, vary from those recorded on cash basis.
2. Liability service ratio represents debt service payments and remittances of profits and dividends taken together as a ratio of total current receipts.

Foreign Investment

6.32 A striking feature of the movements in the capital account since the 1990s has been the rising prominence of foreign investment, reflecting a policy-preferred hierarchy in capital inflows as part of the consolidation of debt. Foreign investment flows rose to a peak in 1996-97 with the debt/equity ratio falling to as low as 0.2 in 2001-02. Weak stock markets pulled down foreign investment flows, both direct and portfolio, during 2002-03. Amounts raised through GDRs/ADRs were maintained. In view of bringing the foreign direct investment (FDI) compilation of India in line with international best practices, coverage of data on FDI has been expanded from 2000-01 by including certain new items, *viz.*, equity capital of unincorporated bodies, reinvested earnings and inter-corporate debt transactions between the related entities. Accordingly, FDI in India stood at US $ 6.1 billion in 2001-02 and US $ 4.7 billion in 2002-03 (Table 6.9). The decline in FDI in 2002-03 was on account of fall in inflows through SIA/FIPB route, mainly in electronics, electrical and service sectors.

6.33 Companies registered in Mauritius and the USA were the principal source of FDI in India during 2002-03 in line with the trend during the 1990s. The bulk of FDI was channelled into 'services', 'computers (hardware and software)' and 'engineering industries' (Table 6.10).

Table 6.9 : Foreign Investment Flows to India by Category

(US $ million)

	2002-03(P)	2001-02 (R)	2000-01 (R)
1	2	3	4
A. Direct Investment (I+II+III)	**4,660**	**6,131**	**4,029**
I. Equity (a+b+c+d+e)	**2,700**	**4,095**	**2,400**
a) Government (SIA/ FIPB)	919	2,221	1,456
b) RBI	739	767	454
c) NRI	–	35	67
d) Acquisition of shares *	916	881	362
e) Equity capital of unincorporated bodies	126	191	61
II. Re-invested earnings	**1,498**	**1,646**	**1,350**
III. Other capital $	**462**	**390**	**279**
B. Portfolio Investment (a+b+c)	**979**	**2,021**	**2,760**
a) GDRs / ADRs #	600	477	831
b) FIIs @	377	1,505	1,847
c) Off-shore funds and others	2	39	82
C. Total (A+B)	**5,639**	**8,152**	**6,789**

P Provisional. R Revised.

* Relates to acquisition of shares of Indian companies by non-residents under Section 5 of FEMA, 1999.

\# Represents the amount raised by Indian corporates through Global Depository Receipts (GDRs) and American Depository Receipts (ADRs).

@ Represents net inflow of funds by Foreign Institutional Investors (FIIs).

$ Data pertain to inter company debt transactions of FDI entities.

Note : 1. The coverage of foreign direct investment inflows has been widened since 2000-01 to approach the international best practices. FDI data since 2000-01 include, besides equity capital, 'reinvested earnings' (retained earnings of FDI companies) and 'other direct capital' (inter-corporate debt transactions between related entities). Data on reinvested earnings for 2002-03 are estimated as average of the previous two years. Data on FDI since 2000-01, therefore, are not comparable with FDI data for previous years.

2. Data on foreign investment presented here represent inflows into the country and may not tally with the data presented in other tables, which include direct imports against foreign investment, Indian investment abroad as well as disinvestments. They also differ from data relating to net investment in stock exchanges by FIIs in Section V of this Report.

6.34 Capital flows in 2002-03 were driven by large movements in banking capital, reflecting repatriation of assets held abroad in response to exchange rate expectations and interest differentials (Appendix Table VI.2 and Chart VI.4). With the progressive liberalisation of the capital account, cross-border assets and liabilities of banks have assumed importance from the point of view of systemic stability. These comprise (i) assets and liabilities *vis-a-vis* non-residents and (ii) assets and liabilities of resident banks (both domestic and foreign) operating in India *vis-a-vis* residents in foreign currencies. The major components of banks' international assets and liabilities are loans and deposits, debt securities, equity shares, participation and working capital. Thus, banking flows include several elements which do not form a part of the country's external debt. On a remaining maturity basis, international assets of banks located in India were broadly unchanged in 2002 as the increase in foreign currency loans to residents was almost offset by a decline in *nostro* balances from June 2002 onwards reflecting banks preference for domestic assets. There was an increase of the international liabilities of banks, mainly on account of non-resident deposits. The sharp rise in NRE balances reflected the switch from the maturing balances of the discontinued NR(NR)RD scheme (Table 6.11). International assets and liabilities were predominantly US dollar denominated. The USA was the dominant destination for the banks' international assets as well as the major source of liabilities. Almost two-thirds of liabilities were of maturities up to six months. International banks were the major creditors, followed by the non-bank private sector.

Table 6.10 : Foreign Direct Investment: Country-wise and Industry-wise Inflows*

(US $ million)

Source	2002-03(P)	2001-02	2000-01
1	2	3	4
Total	**1,658**	**2,988**	**1,910**
Country-wise Inflows			
Mauritius	534	1,863	843
USA	268	364	320
UK	224	45	61
Germany	103	74	113
Netherlands	94	68	76
Japan	66	143	156
France	53	88	93
Singapore	39	54	22
Switzerland	35	6	8
South Korea	15	3	24
Others	227	280	194
Industry-wise Inflows			
Chemical and allied product	53	67	137
Computers	297	368	306
Engineering	262	231	273
Electronics and electrical equipment	95	659	213
Finance	54	22	40
Food and dairy product	35	49	75
Pharmaceuticals	44	69	62
Services	509	1,128	226
Others	309	395	578

P Provisional.

* Data in this table exclude FDI inflows under the NRI direct investment route through the Reserve Bank and inflows due to acquisition of shares under Section 5 of FEMA, 1999.

International Investment Position

6.35 The International Investment Position (IIP) is a summary record of stocks of external financial assets and liabilities of the country and has a more comprehensive coverage than the external debt

Table 6.11: International Liabilities and Assets of the Banks in India

(US $ million)

	Outstanding at the end of			
	December 2002	September 2002	June 2002	March 2002
1	2	3	4	5
Total International Liabilities	**39,914**	**38,295**	**37,456**	**35,110**
Of which :				
FCNR(B) Deposits	8,952	8,488	8,319	8,122
NRE Rupee Deposits	10,035	8,635	7,336	6,810
Foreign Currency Borrowings	2,654	2,142	2,198	1,130
Bonds (including RIBs and IMDs)	9,306	9,253	9,158	8,931
NRNR Deposits	3,820	4,533	5,478	5,570
ADRs and GDRs	801	779	755	382
Exchange Earners' Foreign Currency (EEFC) A/Cs	1,115	1,078	1,062	997
Total International Assets	**21,630**	**21,800**	**21,440**	**19,630**
Of which:				
Foreign Currency Loans to Residents	7,170	4,720	4,190	4,008
Outstanding Export Bills	3,440	3,300	3,200	3,113
Nostro balances	8,510	11,170	11,740	11,402

Note : All figures are inclusive of accrued interest. In view of the incompleteness of data coverage from all the branches, the data reported here are not strictly comparable with those capturing data from all the branches.

statistics which are restricted to only those external liabilities which have a contractual obligation to service (Box VI.7). Elements like foreign investment and banking capital excluding non-repatriable rupee deposits, which are external liabilities in the ultimate sense are incorporated under the IIP. Segregation under the Reserve Bank, the banking sector, Government sector and the other sector including corporates enables an assessment of sectoral movements in foreign assets and liabilities.

6.36 Information available up to March, 2002 indicate a distinct improvement in India's net international investment position over the period 1997-2002 on account of a decline of about US $ 13 billion in net foreign liabilities due to the build up of foreign exchange assets by the Reserve Bank. Of the gross foreign liabilities, loans were the dominant component, closely followed by portfolio investment and direct investment in India, and currency and deposits. Other liabilities like trade credits (excluding suppliers credit up to 180 days), debit balances of *nostro* accounts and credit balances of *vostro* accounts were relatively small. Foreign exchange reserves were the predominant component of gross international assets (Table 6.12).

Box VI.7

International Investment Position - Framework and Methodology

India has a long history of measuring the country's international investment position (IIP) dating back to 1948. Initially undertaken as benchmark surveys on 'India's Foreign Liabilities and Assets', they have been complemented since 1956 by annual assessments of 'Foreign Investments in India' based on information from Indian branches of foreign companies and foreign controlled Indian joint stock companies engaged in commercial and industrial activity in India. Beginning from 1963-64, the IIP was prepared based on quarterly survey reports in respect of private sector to dovetail into the periodicity of the compilation of balance of payments. Since 1987, foreign investment surveys, which do not cover the corporate and banking sectors, are benchmarked against a quinquennial Census of Foreign Assets and Liabilities, the latest relating to the end of March, 1997 (the first Census was actually conducted in June, 1948). In the aftermath of the financial crisis of 1997-98, the IIP has become the focus of attention on account of its comprehensive coverage and the feasibility of assessing the impact of policies on the composition of capital flows. The IMF prescribed dissemination of these data, at the minimum, on annual basis but preferred at quarterly intervals under its Special Data Dissemination Standard (SDDS). India was committed to compile the IIP of the country for the period ending March 2002 by September 2002 as per the SDDS of the IMF. Accordingly, annual IIP of India for the period March 1997 to March 2002 were placed on the Reserve Bank's website.

The IIP presents the stocks of external financial assets and liabilities under the classification recommended by the IMF under the broad heads of direct investments, portfolio investments, other investments and reserve assets. As recommended by the National Statistical Commission (August 2001), the methodology of compilation of data on IIP was re-oriented so as to make increasing use of flow data wherever stock data are not readily available with a view to adhering to the dissemination calendar.

Some important categories incorporated in the current presentation are:

- Loans by Direct Investors (DIs) to Direct Investment Enterprises (DIEs) - classified under 'other capital' of Direct Investment Liabilities.
- Buyers' Credits - classified under 'Loans - Other sector'
- Investments of non-resident governments and international institutions entities - classified under 'Portfolio Investments' and 'Currency & Deposits - Monetary Authority'.

Table 6.12 : International Investment Position of India

(US $ million)

Item	March 2002P	March 2001P	March 1997
1	2	3	4
A. Assets			
1. Direct investment abroad	3,763	2,616	617
2. Portfolio investment	493	498	282
2.1 Equity securities	185	270	172
2.2 Debt securities	308	228	110
3. Other investments	15,279	17,316	11,156
3.1 Trade credits	728	922	973
3.2 Loans	1,989	1,768	548
3.3 Currency and deposits	9,049	10,873	5,287
3.4 Other assets	3,512	3,752	4,348
4. Reserve assets	54,715	42,897	26,714
Total Foreign Assets	**74,250**	**63,327**	**38,769**
B. Liabilities			
1. Direct investment in India	23,690	20,053	10,630
2. Portfolio investment	31,650	31,376	18,743
2.1 Equity securities	18,723	17,493	13,631
2.2 Debt securities	12,927	13,883	5,113
3. Other investments	85,476	86,986	89,388
3.1 Trade credits	3,819	4,877	5,698
3.2 Loans	62,846	63,993	67,743
3.3 Currency and deposits	18,508	17,807	15,300
3.4 Other liabilities	303	309	646
Total Foreign Liabilities	**1,40,816**	**1,38,415**	**1,18,762**
Net Foreign liabilities (B-A)	**66,566**	**75,088**	**79,992**
Net Foreign liabilities (as per cent to GDP)	**14.1**	**16.7**	**21.0**

P Provisional.

Note : Data are partially revised based on extended coverage of FDI data and revised external debt information for 2001 and 2002 only. Data may undergo changes depending on the availability of information on extended coverage of FDI data for previous years and also to availability of latest information from other sources.

FOREIGN EXCHANGE RESERVES

6.37 Overall surpluses have appeared in the balance of payments since 1993-94 (except in 1995-96). This has been reflected in growing accretions to the foreign exchange reserves. The accretion during 2002-03, the highest in any single year, was almost entirely in the form of foreign currency assets with small valuation gains booked under gold holdings (Table 6.13). The major sources of accretion to foreign currency assets were the current account surplus and inflows in the form of foreign investment, banking capital and non-resident deposits. Valuation gains due to cross currency movement in exchange rates amounted to US $ 3.8 billion.

6.38 The Reserve Bank's operations in the forward market during 2002-03 extinguished existing outstanding forward liabilities and resulted in creation of forward assets (Chart VI.7).

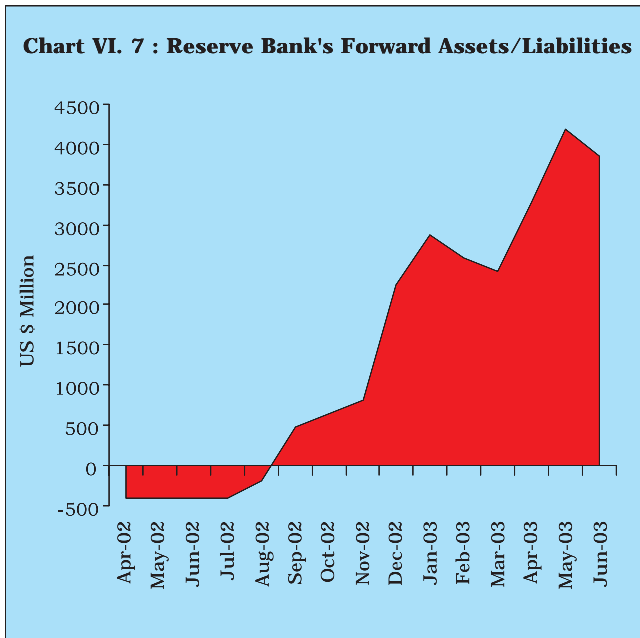
6.39 On August 15, 2003 India held the sixth largest stock of international reserve assets among emerging market economies at US $ 85.4 billion. In terms of foreign currency assets alone, the dominant component of the reserves (other standard constituents are gold and Special Drawing Rights (SDRs)), India ranked seventh in the world with an accretion of US $ 10.0 billion over the end-March 2003 level. Recognition of the growing strength of the reserves has been reflected in the International Monetary Fund (IMF) designating India as a creditor country under its Financial Transaction Plan (FTP). India participated in the IMF's financial support to Burundi in March-May, 2003 and to Brazil in June 2003. Since 2001, India has been among a select group of countries which subscribed to the IMF's data template under its Special Data Dissemination Standard (SDDS) to provide information on key parameters which determine the content and quality of the management of foreign exchange reserves.

Table 6.13 : Foreign Exchange Reserves

(US $ million)

Year	Gold	SDRs	Foreign Currency Assets	Total	Reserve Position in the Fund	Outstanding Use of the IMF Credit
1	2	3	4	5	6	7
March 1993	3,380	18	6,434	9,832	296	4,799
March 1994	4,078	108	15,068	19,254	299	5,040
March 1995	4,370	7	20,809	25,186	331	4,300
March 1996	4,561	82	17,044	21,687	310	2,374
March 1997	4,054	2	22,367	26,423	291	1,313
March 1998	3,391	1	25,975	29,367	283	664
March 1999	2,960	8	29,522	32,490	663	287
March 2000	2,974	4	35,058	38,036	658	26
March 2001	2,725	2	39,554	42,281	616	0
March 2002	3,047	10	51,049	54,106	610	0
March 2003	3,534	4	71,890	75,428	672	0
June 2003	3,698	1	78,546	82,245	976	0

Chart VI. 7 : Reserve Bank's Forward Assets/Liabilities



Reserve Management Operations

6.40 The Reserve Bank draws its empowerment as the custodian of the country's foreign exchange reserves from the Reserve Bank of India Act 1934. Section 17 of the Act authorises the Reserve Bank to buy and sell foreign exchange, bullion and securities issued by foreign governments, and to hold deposits/investments in foreign central banks, banks incorporated abroad, or multilateral banking entities. These provisions also define the scope of investment of external assets. Stringent restrictions are placed on the credit quality of counter-parties/securities. Broadly, the eligible investment categories include deposits with other central banks and the Bank for International Settlements (BIS), deposits with foreign commercial banks, debt instruments representing sovereign/sovereign-guaranteed liability and other instruments/institutions as approved by the Central Board of the Reserve Bank.

6.41 The broad strategy for reserve management, including currency composition and investment policy, is decided in consultation with the Ministry of Finance, Government of India from time to time. Reserve management encompasses preservation of the long-term value of reserves and the need to minimise risk and volatility in returns consistent with the primary objectives of safety and liquidity. Reserve management strategies are continuously reviewed in terms of currency composition, duration and instruments. A periodical Management Information System (MIS) report ensures that the Reserve Bank's management is kept informed about shifts in the composition of reserves.

6.42 Movements in the foreign currency reserves occur mainly out of purchases and sales of foreign exchange by the Reserve Bank in the market, including a small volume of transactions in the forward segment. In addition, there is income from deployment of foreign exchange assets held in the portfolio of the Reserve Bank. In line with international trends, the Reserve Bank follows the practice of expressing the foreign exchange reserves in US dollar terms which implies that the movement of the US dollar would influence its share in the composition of reserves. It may be mentioned that the precise currency composition of reserves is generally not released by most countries including India, as per prevailing international practice. This is because short-term variations in reserves held in different currencies by central banks are regarded as being market sensitive.

6.43 Decisions involving the pattern of investments are driven by the broad parameters of portfolio management with a strong bias for capital preservation and liquidity. All of the foreign currency assets are invested in assets of the highest quality with a significant proportion convertible into cash at short notice. There are explicit constraints on the portfolio such as limits on various securities, currencies, counter-parties and sovereigns. The counter-parties with whom deals are conducted are subject to a rigorous selection process, taking into account their international reputation and track record, apart from factors such as size, capital, rating, financial position and efficiency of operations. Counter parties could be banks, subsidiaries of banks or security houses. Investments in securities are restricted to sovereign and sovereign guaranteed instruments with residual maturity not exceeding 10 years. The reserves are also invested in money market instruments, including deposits with the best international commercial banks.

6.44 Internationally, reserve management is conducted by dividing the reserves portfolio into "tranches", *viz.,* liquidity tranche and investment tranche, according to the objectives of policy requirements. The Reserve Bank has two broad portfolios with independent risk parameters, *viz.,* the money market portfolio and the bonds portfolio. The money market portfolio comprises instruments with maturity of less than one year and it is predominantly guided by transaction and intervention needs. The money market portfolio has a lower duration and runs a lower market risk in relation to interest rate movements. In contrast, the bonds portfolio consists

of long-term holdings of triple-A rated instruments issued by sovereigns and supra-nationals.

Management of Gold Reserves

6.45 The Reserve Bank of India has a modest gold holding of 357 tonnes, of which 65 tonnes (18.2 per cent of total gold holdings) are held abroad. Holdings of gold have remained virtually unchanged and gold reserves are managed passively. As part of the response to the balance of payments crisis of 1990-91, loans were raised against the collateral of gold from the Bank of Japan and Bank of England. On repayment of the loans in November 1991, the gold was placed as deposits with Bank of England and the BIS, the latter on a specific request as it does not normally accept gold deposits. The gold deposits earn a modest return.

6.46 The status of gold as a reserve asset is under increasing scrutiny in recent years. Gold continues to be a low yielding asset in comparison with a majority of other financial assets. Nevertheless, it is potentially an avenue for diversification of the portfolio. The 1990-91 crisis demonstrated the importance of gold as an asset of the "last resort" and this warrants an active stance for management of gold reserves.

Risk Management

6.47 The overall approach to reserve deployment is one of high risk aversion with a preference for stable returns. Sound internal control systems are in place to identify, measure, monitor and control various types of risks encountered in the conduct of reserve management.

- Credit risk arising out of potential default or delay in payment of obligations is addressed by investing only in financial instruments issued by sovereigns as well as banks and supra-nationals conforming to a minimum rating of AAA. Placement of deposits with the BIS is also considered credit risk-free. Deposits with commercial banks as also transactions in foreign exchange and bonds/treasury bills with commercial banks/security firms are subjected to stringent credit criteria for selection of approved counter-parties; limits are also fixed for each category. Ratings given by international rating agencies as also various other financial parameters are considered before grading and fixing limits for each counter-party. The day-to-day developments in respect of the counter-parties are closely monitored with a view to identifying credit quality under potential threat. Accordingly, credit limits are pruned down or these counter-parties are delisted altogether, if considered necessary.
- The foreign currency reserves are invested in multi-currency multi-market portfolios. Decisions are taken regarding the exposure to different currencies, depending on the likely currency movements and other medium-term considerations such as the need for maintaining a major portion of the reserves in the intervention currency, maintaining the approximate currency profile of the reserves in alignment with the external trade invoicing profile, and the benefits from diversification of currency risk.
- The interest rate sensitivity of the reserves portfolio is identified in terms of benchmark duration and the permitted deviation around the benchmark. The emphasis is to keep the duration short in order to remain risk averse. The benchmark duration and the leeway for deviation are suitably altered, keeping in view the market dynamics. A benchmark is specified for each portfolio to evaluate performance. It is derived on the basis of risk tolerance levels accepted and set by the Management of the Reserve Bank.
- The choice of instruments determines the liquidity of the portfolio. While bonds and treasury bills of AAA rated sovereigns are highly liquid, BIS Fixbis/Discount fixbis can be liquidated at any time to meet liquidity needs. Exercises are undertaken to test the liquidity at risk (LaR) of the various constituents of the reserves.
- Internally, there is a total separation of the front office and back office functions and the internal control systems ensure several checks at the stages of deal capture, deal processing and settlement. The middle office is responsible for risk measurement and monitoring, performance monitoring and concurrent audit. The deal processing and settlement system is also subject to internal control guidelines based on the principle of one point data entry and powers are delegated for generation of payment instructions. Codes of conduct are prescribed for dealers to ensure a high degree of integrity.
- A major portion of the securities are custodised with the central banks, mainly the US Federal Reserve, the Bank of England and the Bank of Japan. All primary cash accounts are with foreign central banks. The BIS provides both custodial and investment services for investments placed with it. A small portion of other securities and assets

managed by external asset managers are custodised with carefully selected global custodians. The custodial arrangements are reviewed from time to time and the developments relating to the custodians are tracked regularly to ensure that the risk is kept to the minimum.

Audit and Monitoring

6.48 There is a system of concurrent audit for monitoring compliance in respect of all the internal control guidelines, independent of the process flows. Furthermore, reconciliation of *nostro* accounts is undertaken on a daily basis in respect of major currencies. In addition to annual inspection by the Inspection Department of the Reserve Bank and statutory audit by external auditors, a special external auditor is appointed to audit dealing room transactions. The main objective of the special audit is to ensure the adherence to risk management systems and internal control guidelines.

External Asset Managers

6.49 A small portion of the reserves is assigned to external asset managers with the objectives of gaining access to and deriving benefit from their market research. This also helps to take advantage of the technology available with asset managers and to provide training/exposure to the Reserve Bank's own dealers. The asset managers are carefully selected from among internationally reputed asset management companies. They are given clear investment guidelines and benchmarks and their performance is evaluated at periodic intervals by a separate unit within the middle office. External asset managers' views and outlook on international bond and currency markets are examined and taken as inputs for operational functioning.

Reserve Management and the Reserve Bank's Balance Sheet

6.50 Foreign currency assets are held as assets in the Issue Department (foreign securities) as well as in the Banking Department (balances held abroad and investment). Gold is also held in the Issue Department (under Gold coin and bullion) and in the Banking Department as well. Although SDRs form part of India's official reserves, these are held by the Government of India and are not reflected in the Reserve Bank's balance sheet.

6.51 Key accounting practices in the management of reserves are: (i) all realised as well as accrued but unrealised interest/discount incomes are taken to the revenue account with the exception of penal interest and dividend which are accounted for on receipt basis; (ii) all realised gain/loss on foreign exchange and securities transactions are also taken to the revenue account; (iii) unrealised gains/losses on currency and gold revaluation are taken to the Currency and Gold Revaluation Account (CGRA); (iv) unrealised losses on bonds revaluation are taken to the revenue account as direct deduction from interest income; and (v) outstanding forward positions are revalued and net losses, if any, are charged to profit and loss account.

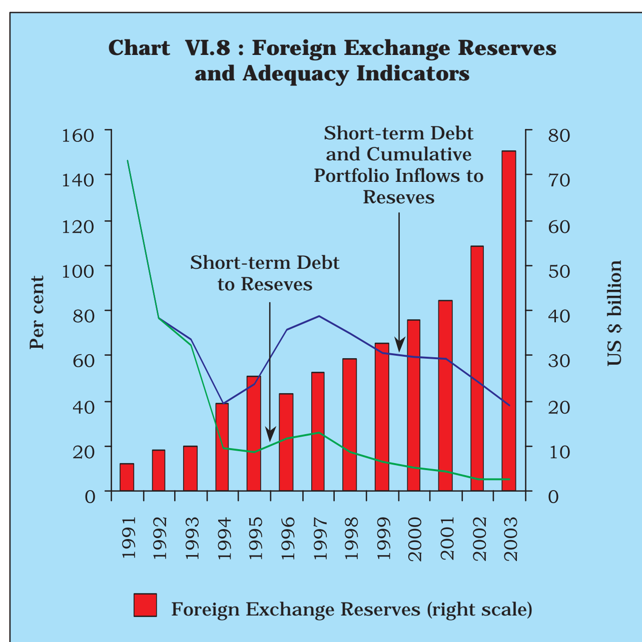
6.52 In the case of bonds/securities held as part of the foreign currency assets, revaluation is undertaken every month on the basis of the month-end market prices. The principle of "lower of market or book value" is followed *i.e.,* if the market value is lower than the book value, the holdings are written down to the market value and valuation is not altered subsequently even if the market value increases. The income from the foreign exchange reserves is combined with other incomes of the Reserve Bank.

Transparency Issues

6.53 International reserve holdings are subjected to the best standards of public disclosure. The policy on reserve management is articulated through a semi-annual Monetary and Credit Policy Statement. The Annual Report of the Reserve Bank provides a perspective on developments during the year. Movements in foreign exchange reserves are reported weekly in the Weekly Statistical Supplement (WSS) to the Reserve Bank's monthly Bulletin. The Reserve Bank's purchases and sales in the foreign exchange market along with outstanding forward positions are published on a monthly frequency in the Bulletin. Information on a number of parameters including deployment of foreign exchange reserves and the forward position is provided under the IMF's SDDS at the websites of the IMF and the Reserve Bank.

Costs of Holding Reserves

6.54 The accumulation of foreign exchange reserves represents the Reserve Bank's policy of maintaining an adequate level of foreign exchange reserves to meet import requirements, unforeseen contingencies, and "liquidity risks" associated with different types of capital flows. The reserves at this level serve the basic objectives of maintaining confidence in monetary and exchange rate policies, enhancing the capacity to intervene and limit volatility and providing confidence to the markets (Chart VI.8).



6.55 The substantial growth in reserves in the recent period has generated a debate regarding the costs and benefits of holding reserves. For developing countries, sharp exchange rate movements can be highly disequilibrating and costly for the economy during periods of uncertainty. The costs of financial crisis are deleterious in terms of loss of GDP and welfare. These economic costs are likely to be substantially higher than the net financial cost of holding reserves which are typically measured in terms of the difference between the opportunity cost of deploying reserves in domestic assets and the rate of return earned on the actual deployment of foreign currency assets. The increase in reserves in the recent period is through net purchases by the Reserve Bank in the domestic foreign exchange market. An equivalent amount of domestic currency has been sold to counter-parties who have the freedom to invest them in domestic assets and reap the rupee-denominated return. The accretion to reserves in the recent period has occurred without increasing the overall level of external debt and instead through higher workers' remittances, quicker repatriation of export proceeds and non-debt inflows. Even after taking into account foreign currency denominated non-resident deposit flows (where the interest rates are linked to LIBOR), the financial cost of additional reserve accretion in India in the recent period is quite low, and is likely to be more than offset by the return on additional reserves.

6.56 In any cost-benefit analysis of holding reserves, it is essential to keep in view the objectives of holding reserves, which, *inter alia,* cover: (a) maintaining confidence in monetary and exchange rate policies; (b) enhancing the capacity to intervene in foreign exchange markets; (c) limiting external vulnerability so as to absorb shocks during times of crisis; (d) providing confidence to the markets that external obligations can always be met; (e) adding to the comfort of the market participants, by demonstrating the backing of domestic currency by external assets; and (e) reducing volatility in foreign exchange markets.

6.57 In the recent period, the overall approach to the management of India's foreign exchange reserves is judiciously built upon a host of identifiable factors and other contingencies. Such factors, *inter alia,* include: the size of the current account deficit; the size of short-term liabilities (including current repayment obligations on long-term loans); the possible variability in portfolio investments and other types of capital flows; the unanticipated pressures on the balance of payments arising out of external shocks and movements in the repatriable foreign currency deposits of non-resident Indians. A sufficiently high level of reserves is necessary to ensure that even if there is prolonged uncertainty, reserves can cover the "liquidity at risk" on all accounts over a fairly long period. Furthermore, the quantum of reserves in the long-run should be in line with the growth in the economy and the size of risk-adjusted capital flows, which provides greater security against unfavourable or unanticipated developments, which can occur quite suddenly.

6.58 India was one of the 20 countries selected for a case study in a recent document published by the International Monetary Fund as a supplement to the IMF's "Guidelines for Foreign Exchange Reserve Management". The IMF has observed that India's management of foreign exchange reserves has generally been in accordance with IMF guidelines and is comparable to the global best practices in this area. In line with global developments, in the recent period, India's reserve management operations have become more transparent. The emphasis is on efficient management of reserves. In areas like greater and more efficient use of information technology, use of sophisticated risk management techniques like Value at Risk (VaR), determination of optimal currency composition, sound management of credit and market risks and the internal governance structure, India's policies are comparable with international best practices.

VII ASSESSMENT AND PROSPECTS

Assessment of 2002-03

7.1 The Indian economy performed reasonably well in 2002-03, in spite of the simultaneous impact of several adverse developments. Border tensions in the early months of the year were followed by the worst drought in fifteen years. The estimated fall of 29 million tonnes in foodgrains production was the largest since Independence. Furthermore, the global economy was characterised by an environment of generalised uncertainty and low growth in the period leading up to the war in Iraq. During this period, there was also considerable hardening of international crude prices.

7.2 It is important to note that in the past, the occurrence of any one of the shocks experienced in 2002-03 in isolation had produced a sharp loss of growth, higher inflation, balance of payments difficulties, and even financial instability in the economy. Seen in this context, the performance of the economy during 2002-03 demonstrates the developing resilience of the Indian economy. This suggests that perseverance with structural reforms, despite the drag of slower growth in the second half of the 1990s, has helped to relatively shock-proof the economy and sustain a stable macro-economic environment.

7.3 The growth of the Indian economy in 2002-03, although significantly lower than expected, was still among the highest in the world. Timely and coordinated supply management strategies were effective in containing potential inflationary pressures, with headline inflation remaining benign over the greater part of the year. The strategy of accumulating food stocks and international reserves served the economy well by cushioning the impact of the shocks and by providing domestic and international confidence in the presence of considerable adversity. A heartening feature of the performance of the economy in 2002-03 was the revival of industrial activity, driven mainly by the strength of export demand that indicates the growing international competitiveness of Indian industry.

7.4 The comfortable state of India's balance of payments reflected the high growth of merchandise exports at 19.2 per cent and buoyant invisibles. Consequently, the current account was in surplus for the second year in succession. International confidence in the fundamentals of the economy was further reflected in sustained capital inflows which in combination with the surplus in the current account led to an unprecedented accumulation of foreign exchange reserves in 2002-03. Recognition of the growing strength of the reserves has also led to the designation of India as a creditor country by the International Monetary Fund (IMF) under its Financial Transaction Plan (FTP). In recognition of the increasingly comfortable balance of payments situation, further progress was made during 2002-03 in liberalising external current and capital transactions covering overseas investments and remittances abroad by banks, corporates and resident individuals.

7.5 Monetary policy was effective in ensuring stability and orderliness in the domestic money, debt and foreign exchange markets. The expansionary impact of large capital flows was managed through timely action in the form of open market sales and LAF operations, supported by a sequenced liberalisation of outward international transactions. Interest rates declined in all segments of the market spectrum in response to the monetary policy stance of facilitating a softer interest rate regime that would support the revival of investment demand. The active management of liquidity conditions enabled the successful completion of the market borrowing programme of the Centre and States. Public debt management was strengthened through prepayment of external debt, debt swaps between the Centre and the States and a comprehensive restructuring of the scheme of ways and means advances and overdrafts for the States.

7.6 Ensuring financial stability continued to be a dominant objective underlying the intensification of financial sector reforms during 2002-03. Prudential norms were strengthened, consistent with the strategy to bring about greater convergence with international best practices. Significant initiatives were put in place to clean up and strengthen the balance sheets of banks. Management of non performing assets (NPA)

was fortified by the operationalisation of the Corporate Debt Restructuring (CDR) mechanism and the enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFAESI) Act, 2002 which provides statutory support for the enforcement of creditors' rights and, *inter alia,* paves the way for the establishment of Asset Reconstruction Companies (ARCs). The supervisory function was improved considerably through the institution of Prompt Corrective Action as an early warning tool. The development of financial markets was carried forward by putting in place the infrastructure for the retailing of government securities by order-driven, screen based trading in stock exchanges and the introduction of exchange traded interest rate derivatives. These developments will enable market participants to manage market risk better. The impact of financial sector reforms was reflected in an improvement in profitability of banks and in the overall efficiency of the financial sector.

7.7 The industrial recovery was well-diversified, particularly in manufacturing. The resurgence of industrial exports had a salutary effect across a wide spectrum of industry groups. In particular, exports of automobiles and components, chemicals, basic metals, food products, beverages and tobacco were robust. In terms of the demand composition, the revival of industrial activity in 2002-03 was led by consumer non-durables. The pick up in demand from the retail segment was also evident in the upturn in construction activity which was mirrored in the substantial increase in demand for bank credit from housing and cement industries. There was overall improvement in production conditions in the infrastructure industries, despite some shortfalls from targets. A significant development was the strong revival in the production of capital goods, heralding an improvement in the investment outlook. The financial performance of the corporate sector improved steadily in every quarter. A healthy expansion in sales and reduction in interest costs enabled a surge in post-tax profits, especially in the second half of the year.

7.8 There has been an active and continuous attempt at bringing about reforms in the infrastructure sector. The government is slowly moving away from its traditional role as a 'provider' of services to one of 'facilitator' by ensuring that infrastructure services are delivered in a desirable manner. The government has made rapid progress in the implementation of the National Highway Development Project (NHDP). There have been some efficiency gains in ports through the privatisation of ports services and berths. The telecom sector has perhaps seen the most significant development. Tariffs in the telecom sector have declined sharply in response to deregulation, competition and technology. Consequently, there has been a sharp increase in the growth of telephone lines, particularly in mobile services.

7.9 Although there have been some slippages in fiscal consolidation on account of the counter-drought stance of fiscal policy and the slack in economic activity, there was a renewal of the commitment to improve the quality of fiscal adjustment through monitorable reform programmes, debt consolidation and measures designed to bring back buoyancy to the tax-GDP ratio. With the passage of the revised Fiscal Responsibility and Budget Management (FRBM) Bill in the Parliament, the institutional architecture is being put in place for a much greater transparency in respect of the fiscal position and a phased decline in the Centre's borrowings to meet its capital and revenue expenditure. Some States have also enacted fiscal responsibility legislations.

7.10 The outlook for the global economy turned even more uncertain than a year ago. Despite positive developments such as the cessation of hostilities in Iraq, retreat of the Severe Acute Respiratory Syndrome (SARS) epidemic and reversal of persistent sell-offs in major equity markets, signs of recovery in major industrial economies are still not clear. Interest rate cuts by the Federal Reserve and the European Central Bank (ECB) in June 2003 have taken key international rates to all-time lows, reflecting a growing concern about possibility of deflationary trends emerging. The hesitant recovery of growth in the emerging market economies of Asia has been accompanied by the return of capital flows with falling bond spreads and a modest regaining of access to international capital markets. There are some concerns that higher capital flows reflect prospects of low returns in developed countries rather than strong fundamentals of emerging market economies. In spite of large cross-currency movements, misalignments continue to persist in the face of the continued global imbalances, particularly the high current account deficit in the US, which entail a downside risk for the prospects of recovery.

Outlook for 2003-04

7.11 The year 2003-04 has begun on a strong, positive note. Excess rainfall *vis-a-vis* the long period average in July 2003 - the sowing month for the *kharif* season - and revised projections of a normal monsoon have brightened the prospects for agriculture considerably. The satisfactory spread of the South-West monsoon so far is expected to compensate for the delay in sowing on account of the late arrival of the rains. A precise assessment of the anticipated levels of output under various crops would await more information on the intensity and distribution of the monsoon. Nevertheless, comfortable food stocks and the progressive improvement in reservoir levels provide sufficient protection against any unexpected developments.

7.12 The momentum of industrial growth has been sustained, with manufacturing output rising strongly in the first quarter. A heartening feature of the emerging industrial sector profile is the turnaround in the consumer durables sector after twelve successive months of decline. The outlook for the industrial sector is expected to be reinforced by the renewal of agricultural activity, the abiding strength of export demand and the improved environment for new investments indicated by a surge in the production of capital goods and non-oil imports, low interest rates and improved all round corporate profitability. Business confidence remains positive with expectations of increase in capacity utilisation, no major changes in employment and inventory levels and higher export orders.

7.13 Notwithstanding the unfavourable international environment, India's external sector continues to post gain, with merchandise export growth in April-June, 2003 adhering to the target growth path set for the year. Capital flows continue to be buoyant with significant increase in non-resident rupee deposits and portfolio investment by foreign institutional investors in the first quarter of the fiscal year. Reflecting these developments, accretions to foreign exchange reserves have continued, taking their level to US $ 85.4 billion on August 15, 2003 – up by US $ 10.0 billion over the end-March level on top of an increase of US $ 21.3 billion in 2002-03.

7.14 The substantial expansion in net foreign assets of the Reserve Bank has engendered easy liquidity conditions so far. Net Reserve Bank credit to the Centre, on the other hand, declined sharply on account of Liquidity Adjustment Facility (LAF) repos and open market sales. Broad money expansion was also lower on account of slowing deposit growth, and a slack in currency demand. Lower procurement operations resulted in a weak off-take of food credit. Non-food credit expansion has been broadly maintained.

7.15 Financial markets exhibited stability and ample liquidity. Call rates softened to sub-repo levels since May 2003. Despite the launch of the Centre's borrowing programme for 2003-04, the gilt market has been range-bound by expectations of a further decline in yields. In the foreign exchange market, the Indian rupee appreciated against the US dollar on the back of strong supplies. Forward premia hovered between 1-3 per cent in April, 2003 before increasing mildly thereafter. The capital market experienced increased activity in the current year with significant buying interest in Public Sector Unit (PSU) and bank scrips.

7.16 Monetary policy for 2003-04 retains its stance of maintaining adequate liquidity in the system to meet credit growth and support investment demand in the economy while continuing a vigil on movements in the price level. Accordingly, the preference for a soft and flexible interest rate environment within the framework of macroeconomic stability is being continued. The endeavour of monetary policy would continue to be the development and smooth functioning of the financial markets, enhancing the allocative efficiency of the financial sector, preserving financial stability and improving the transmission mechanism of monetary policy.

7.17 By early-July, 2003, inflation retreated from a temporary spike during the last fortnight of June on account of spurts in prices of vegetables, processed tea and iron and steel. In the beginning of July, vegetable and fruits prices declined. Oilseeds prices have been ebbing since the beginning of June on the prospects of a good monsoon. The decline in the prices of mineral oil and man-made fibres continues to restrain overall inflation. By early August 2003, wholesale price inflation fell below 4 per cent. Internationally, inflation remains weak in the US, the UK and the Euro Area. The Fed and the Bank of England reduced their key policy rates by another 25 basis points each as the possibility of deflation continues to be a cause for concern. Although the international inflation scenario remains benign, a close watch will have to be kept on commodity prices of key items, such as, iron and steel, POL, edible oils and cotton, which exhibit some possibilities of firming up.

7.18 The fiscal deficit of the Centre was somewhat lower in April-June, 2003 than in the previous year. The revenue deficit and primary deficit were, however, higher during the first quarter of 2003-04 as a result of a substantial decline in proceeds from corporation tax, income tax and union excise duties. Custom duties, on the other hand, benefited from the surge in import growth and registered an increase. Aggregate expenditure during April-June 2003 registered a moderate growth. As the Tenth Plan document has noted, the key to sustaining growth of 8 per cent per annum is prudent fiscal management based on increased public investment financed by higher government saving and internal resource mobilisation by the public sector. States would have to play a predominant role in making investment decisions, particularly in infrastructure development. Priority needs to be accorded to arresting the declining trend in government saving. The revenue deficit must be contained and has to be reduced to 2.4 per cent of GDP by the end of the Tenth Plan period. This would also help in ensuring sustainability of public debt, inclusive of contingent liabilities. The large size of contingent liabilities has implications for the sustainability of Government finances. The contingent liabilities in case of State Governments essentially reflect the practice of setting up special purpose vehicles (SPVs) to borrow from the market. Given the low user charges and inefficient operations of PSUs, these contingent liabilities are a potential threat to the stability and sustainability of the financial system. In view of these systemic risks associated with any possible default of State Government guaranteed paper, there have been ongoing discussions between the Reserve Bank and the State Governments. States have now become sensitised to the risk inherent in committing support to unsustainable contingent liabilities and various mechanisms are being considered to limit them.

7.19 A number of initiatives have been taken to ensure adequate credit to the agricultural sector. There are broadly three categories of institutions which deliver credit to rural areas, *i.e.*, commercial banks, Regional Rural Banks (RRBs) and co-operative banks. Although public sector banks as a group have achieved the targets for lending to the priority sector, the flow of credit to rural areas by other segments of the banking system has not been buoyant. The non-performing assets of RRBs have been declining in recent years largely due to an increase in the share of assets in the standard category. This augurs well for the credit delivery mechanisms of the RRBs in the context of their specialised function. The rural co-operative sector remains dependant on flow of finance from the National Bank for Agriculture and Rural Development (NABARD). The Government of India has introduced an amendment to the NABARD Act, 1981 to enable it to provide refinance facilities directly to District Central Co-operative Banks (DCCBs), in addition to State Co-operative Banks (StCBs) and Regional Rural Banks (RRBs) to which NABARD is already providing refinance. This would enable the system to reduce the rate of interest charged to the ultimate borrower. There is a continuing need to improve the delivery of rural credit so that farmers receive timely and adequate credit at a reasonable cost in an institutional manner.

7.20 The scheme of micro-finance has made rapid strides in India, both in terms of Self-Help Groups (SHGs) linked with banks and the number of beneficiaries covered. The progress of micro-finance across the States has, however, been uneven. Micro-finance forms an integral part of priority sector lending with banks allowed to classify their credit under the SHG-bank linkage programme as advances to weaker sections. Banks are being encouraged to mainstream micro-credit and enhance the outreach of micro-credit providers. The Reserve Bank has been placing emphasis on the flow of bank credit to micro-enterprises in rural and semi-urban areas. This programme is also of benefit to the banks by externalising the credit delivery process and ensuring more than 95 per cent recoveries, besides being cost effective.

7.21 Real GDP growth in 2003-04 was projected at about 6.0 per cent in the Statement on Monetary and Credit Policy for the year 2003-04, issued in April, 2003, based on the assumption of somewhat below normal rainfall forecast by the Meteorological Department at that time. As per the latest assessment of rainfall conditions, a strong recovery in agricultural output is likely during the year. Along with the continuance of the upturn in the industrial and the services sectors, the expected growth for 2003-04 may significantly exceed the earlier projection, if output growth in agriculture shows a sizeable increase over the low base of 2002-03. Based on current assessment, the inflation rate in 2003-04 on a point-to-point basis, is placed in the range of 5.0 to 5.5 per cent. Consistent with the expected GDP growth and inflation, the projected expansion in broad money (M_3) for 2003-04 is placed at 14.0 per cent. As the projected expansion of money supply is on a higher base

including the mergers that took place in the banking industry, the volume of liquidity would be adequate to meet the credit needs of the productive sectors of the economy. Consistent with this order of growth in M_3, an increase in aggregate deposits of scheduled commercial banks is set at Rs.1,79,000 crore. Non-food bank credit including investments in commercial paper, shares/debentures/bonds of PSUs and private corporate sector is projected to increase by 15.5-16.0 per cent, which should be adequate to facilitate the sustenance of growth in industrial activity during 2003-04. A re-assessment of the projected growth rate for the current year will be attempted in the mid-term review of the Monetary and Credit Policy in October 2003, by which time reliable information on the progress of the monsoon and the spread of the industrial upturn would be available.

7.22 Achieving the growth projections related to overall economic performance will be dependent on a significant increase in investment, both public and private. Such a change in expenditure composition towards higher investment could lead to the re-emergence of a current account deficit that would then enable better absorption of capital inflows for investment purposes.

MEDIUM-TERM ISSUES

Real Sector

7.23 The higher growth trajectory envisaged under the Tenth Five Year Plan would combine increased investment with improvement in efficiency. This would require shifts in the growth strategy to improve saving and investment rates, and reduce the high fiscal deficit. Raising the domestic saving rate to about 27 per cent per annum to finance the required investment effort is a daunting task at the current levels of income and this, in itself, underscores the imperatives for stepping up the growth rate of the economy. A key issue in this regard would be the intensification of reforms in social security, insurance and other conduits of long-term savings as well as the development of markets and instruments with a view to bringing about a convergence between the time preference of savers and the risk-return profiles of investors. At the same time, institutional mechanisms need to be put in place to draw the saving of the unorganised sector into formal channels.

7.24 Arresting the dissaving in the public sector and halting the pre-emption of private saving by burgeoning public sector revenue deficits is critical to the drive for mobilising finances for growth. As fiscal consolidation improves and the draft on domestic resources from the budget diminishes progressively, a larger volume of resources would be available for private investment also. This transformation would also stem the continuous erosion in public investment that has occurred in the new millennium, empowering it to anchor aggregate demand, build new productive capacities and create the enabling conditions for private investment. Reduction in the revenue deficit would also enable greater public investment for the provision of public goods that are necessary to catalyse a high rate of efficiency of private investment.

7.25 The Indian growth experience has been marked by a high correlation between domestic saving and investment. Globalisation and internationally mobile capital have tended to weaken this correlation elsewhere as developing countries have undertaken financial liberalisation to harness the growth-financing potential of foreign saving, especially when efforts to mobilise resources domestically have run up against hard constraints. The investment requirement of the Tenth Plan strategy relies on external financing to the extent of about 1.6 per cent per annum, on average. Given the past experience and the evolving openness of the economy, the order of external saving envisaged in the Tenth Plan seems reasonable.

7.26 As the Tenth Plan document notes, the key to the growth strategy is efficiency "based on unlocking of hidden capacities in the economy, unleashing repressed productive forces and entrepreneurial energies and upgrading technology in all sectors". This will require acceleration of the process of dismantling policy constraints, procedural rigidities and price distortions. It will also require that the essential institutional structure necessary for the orderly operation of the economy is strengthened significantly.

7.27 An issue of concern as highlighted by the Tenth Five Year Plan is the decline in the employment growth rate from above 2 per cent per annum during the 1980s and the early part of 1990s to 1.1 per cent in the latter part of 1990s. With the growth rate of working age population exceeding the overall population growth rate, the unemployment rate could worsen further if the economic growth envisaged does not give rise to new activities that are appropriately labour intensive.

Agriculture

7.28 The drought of 2002-03 has renewed concerns relating to the high variability of agricultural output and the adverse ramifications for overall economic activity. The monsoon dependency of *kharif* production – the main agricultural season – and the indirect dependence of the *rabi* agricultural season on storage in reservoirs has become more pronounced in recent years. Furthermore, in a country of sub-continental proportions, there are always some regions which experience drought even though at the national level moisture stress is not there. Localised droughts have a severe region-specific impact, often repetitively, as in the case of Western India which suffered three droughts during 1999-2000 to 2002-03 leading to large losses of national oilseeds production. This underscores the urgent need for water harvesting and watershed development alongside water conservation. Classification of land capability in terms of inherent characteristics, external land features and environmental factors is a key issue from the point of view of preserving fertility and planning watershed development. Crop selection should be related to the availability of water. Programmes promoting greater afforestation in the uplands would help in better water management for increasing the availability of water in currently water scarce areas. Effective social and legal institutions for management of community resources are crucial for watershed development programmes including strategies to educate, encourage and operationalise the collective participation of watershed communities.

7.29 An area of vulnerability of Indian agriculture to weather shocks is the concentration in the cropping pattern, which constrains the flexibility of supply response. Agricultural pricing policies are at a crossroad. There is considerable debate in the country today assessing their benefits in terms of ensuring food security *versus* the distortions in cropping patterns and input usage that have stemmed from a skewed incentive structure. The Minimum Support Price (MSP) system has changed the cropping pattern in favour of rice and wheat at the cost of other important components of the average consumption basket such as other cereals, oilseeds and pulses, and other foodstuff such as fruits, vegetables, poultry and the like. Moreover, the irrigation intensive rice-wheat cropping pattern in North-Western India is increasingly being recognised as unsustainable environmentally. Water logging and the disproportionate application of fertilisers has led to decline in soil fertility and an alarming drop in the underground water table. Intensive input usage is causing salinity with adverse implications in terms of long-term desertification of soil.

7.30 As the Tenth Plan document has recorded, despite the declining share of agriculture in GDP, employment in agriculture has remained virtually unchanged at around 190 million people over the last decade. With growing incidence of fragmentation, the consequent decline in the average size of land holding and subdued growth in yields, any further improvement in agricultural incomes will have to come from value addition through agro-processing or agro-based industries rather than agricultural production *per se*. Demand based agricultural production may necessitate moving away from fiscal price supports in a phased manner towards greater exposure to international terms of trade and the development of alternatives such as futures trading which result in better price discovery and risk management. A crucial prerequisite is the removal of restrictions on the physical movement of major agricultural commodities and the integration of domestic agricultural markets.

7.31 The low growth of yields during the post-reform period highlights the need for upgradation of technology. Agricultural research and development must be geared to a re-prioritisation of investment on new technologies so as to balance or supplement the traditional technologies with new advances in biotechnology. Here, public investment in agricultural research is critical. The Indian agriculture research system performed well in supporting the green revolution. Now attention needs to be given to re-focussing the research system so that agricultural diversification can be accelerated for achieving new productivity levels. Effective adoption of new technologies also requires an efficient extension system for technology dissemination. The task of extension becomes more challenging with the signing of the Agreement of Agriculture under the World Trade Organisation (WTO). This requires a flexible approach allowing specific information to be customised for different farmer-groups.

7.32 If India is to approach the growth target of the Tenth Plan, it is essential to step up the growth of agriculture significantly. Higher agricultural growth will now have to come from a much more diversified agriculture as has been the experience in other fast growing Asian countries. Agricultural diversification and accelerated agricultural growth will require much greater investment in rural infrastructure such as

roads, storage facilities, telecommunications, power, and the like. Diversified agriculture will need much more complex commercial linkages between the farm and market. A key challenge will be the financing of rural infrastructure. New approaches to public private partnerships, participation of local governments, funds sourced from dedicated levies such as the fuel cess will have to be explored.

7.33 Despite India being the second largest producer of fruits and vegetables in the world, the production of these commercial crops has been hampered by the relatively low priority given to the food processing industry and inadequate market infrastructure. This has become increasingly important in view of the WTO bindings on tariffs. Concerted measures have to be taken to promote agro-based industries with export orientation as these are comparatively labour intensive and would exploit the comparative advantage India should have in food processing. In this regard, the vital function of efficient agricultural marketing should be recognised. This underscores the need to move to a situation where an alternate system of market intermediaries is created in agricultural marketing along with the existing ones. A thorough review of adequacy of institutional arrangements in quality control, certification and trading in agriculture sector should be a national priority to take advantage of global opportunities. Under the Agricultural Produce Marketing Regulation Act, State Governments alone are empowered to initiate the process of setting up of markets for agricultural products within a defined area. In order to encourage private sector participation and investments required for development of alternative marketing infrastructure and supporting services, provisions of the corresponding State Acts would need modification.

Industry

7.34 Since the second half of the 1990s, the industrial sector has been undergoing deep-seated restructuring in order to cope with the rigours of the changing environment. There has been heightened activity in the form of mergers and acquisitions as also in the shedding of non-core operations. The significant acceleration of growth envisaged for industry in the Tenth Plan period - from 4.5 per cent in the Ninth Plan period to 10 per cent in 2002-07 - is a major challenge, given that this expansion would have to occur in a fiercely competitive environment created by the progressive removal of barriers to entry and exit, trade liberalisation, a congenial policy regime for foreign direct investment (FDI) and a progressive extension of the process of industrial liberalisation to the State level. Issues in corporate governance have assumed increasing significance with a view to avoiding/minimising corporate failures and financial irregularities as well as to strengthen management accountability. In consonance, amendments to the Companies Act, 1956, Chartered Accountants Act, 1949, Cost and Works Accountants Act, 1959 and Companies Secretaries Act, 1980 are currently underway. Indian corporate entities are increasingly faced with the need to benchmark their corporate governance practices with the best international practices.

7.35 In order to achieve the significant step-up in industrial growth, it is vital now to expand the ambit of reforms to the difficult areas concerning land laws, the labour market, bankruptcy and exit procedures. In this context, the recent amendment to the Companies Act in 2002 ushering in the National Company Law Tribunal as a single forum for winding up of companies is a noteworthy measure. The associated repeal of the Sick Industrial Companies Act (SICA) and consequent abolition of the Board for Industrial and Financial Reconstruction (BIFR) is yet to be passed. Furthermore, the Competition Act, 2002 which replaces the Monopolies and Restrictive Trade Practices (MRTP) Act recognises the need for businesses to grow and secure the advantages/ economies of scale to compete with MNCs in the global market place. Another amendment to the Companies Act has allowed for primary producers/ co-operatives to produce and market industrial products in a modern and professional manner at par with other companies. This is expected to enhance the competitiveness of co-operatives.

7.36 Inadequate project appraisal and persistent time and cost overruns have been identified as major impediments to improving the international competitiveness of Indian industry. While there has been some recent improvement in the implementation of Central Sector Projects (CSPs), the proportion of delayed projects has also increased. Delays in the completion of major CSPs has led to the huge cost escalation, which currently accounts for 59 per cent (around Rs.26,000 crore) of the actual cost of delayed projects. According to the Ministry of Statistics and Programme Implementation, control on time overruns may reduce the cost overruns by 75 per cent. Time overruns in the completion of projects are mainly on

account of problems relating to funds and land, apart from absence of feasibility studies before commencement of the projects, problems relating to award of contracts, equipment supply and civil works. Currently, the Railways have the largest number of projects that were delayed by more than five years. The power sector accounts for the predominant share (52 per cent) of cost overruns in respect of delayed projects. The implementation of projects in the road sector have started showing delays since February 2003, leading to the postponement of the scheduled date of completion of Golden Quadrilateral project to December 2005. The fiscal implications of delays in CSPs underscore the importance of the Tenth Plan strategy of placing full emphasis on the completion of partially completed or on-going projects as well as upgradation of existing capital assets before initiating new projects.

7.37 The significance of the Small Scale Industry (SSI) sector in terms of the objectives of nurturing new entrepreneurship, regional industrial growth and promotion of employment has been well recognised. In this regard, priority needs to be accorded to enhancement of investment limits, greater ancillarisation, and larger and quick credit flow to the SSI. There is a continuing need to undertake radical changes in the policy of reservation of certain products for the SSI sector which has impacted adversely upon growth and exports. Quantitative restrictions need to be replaced by an incentive structure which enables a greater market orientation of SSIs. The recent de-reservation of further 75 items for the SSI sector as well as the hike in investment limits for 51 items in the area of garments, hand tools, stationery items and drugs are steps in the right direction. The future of SSIs in India critically hinges on modernisation, technical up-gradation, and competitiveness in terms of quality and price. The flow of credit to SSIs has slowed down in the second half of the 1990s. Banks and other financial intermediaries need to support emerging SSIs more actively so that new entrepreneurship is encouraged to flourish.

7.38 Inflexibilities in the labour market have posed a serious problem for industrial restructuring and have also deterred new investment in labour using industries where India has a potential comparative advantage. There has been some progress in reforming the product markets; however, factor markets for labour and land have considerable structural rigidities. While Special Economic Zones (SEZs) may provide flexible labour markets, there is an urgent need to address the issue on a nation-wide scale so that employment intensive activities are encouraged. In the corporate sector, successful labour restructuring has brought modest successes and these initiatives are worthy of wider emulation.

Services

7.39 The services sector is emerging as the mainstay of the Indian growth process in recent years. The improvement in the performance in ‘financing, insurance, real estate and business services’ and ‘community, social and personal services’ has more than offset the deceleration recorded by ‘trade, hotels, transport and communication’ in 2002-03. The major contributory factors to services growth could be traced to the resurgence in financial services and housing finance, growing demand for transport and communication services and booming export demand particularly for software. An input-output analysis of the Indian economy reveals that 70 per cent of industrial activities (particularly, machinery, food processing, textiles, cement, leather, tobacco, steel, drugs, paper and rubber) are directly services-intensive. Thus, services are expected to continue leading the economy into the higher reaches of the growth potential of the economy, drawing from the strengthening linkages with manufacturing and the expansion of markets enabled by international commerce.

Fiscal Policy Issues

7.40 The progress of fiscal consolidation in the medium-term would need to hinge around a correction of the structural weaknesses in resource mobilisation as well as in expenditure management. Increasingly, the content of fiscal policy is being assessed by the quality of the adjustment. An improvement in the quality of fiscal adjustment would require cutting down consumption expenditure while maintaining or increasing the investment expenditure. At present, revenue expenditure accounts for nearly 85 per cent of Centre’s aggregate expenditure and only 15 per cent goes for investment purposes. Further, of the total revenue expenditure nearly one third is accounted for by interest payments, other major items being defence and subsidies. Given the composition of Government expenditure with large proportion of committed expenditure, compression of expenditure is very difficult. Subsidies are perhaps one area where considerable scope for reduction exists. During the year 2002-03, however, expenditure on subsidies as

a proportion to GDP has gone up to 1.8 per cent from 1.4 per cent in the preceding year. Thus, given such rigidities in the composition of expenditure, significant fiscal improvement will hinge increasingly on improvement in revenue collections. Deterioration in the tax-GDP ratio at the Central level that has occurred over the past decade has to be reversed. The improvement in tax administration and use of information technology should help greatly in curbing tax evasion, and hence in enhancement of revenues.

7.41 On the expenditure front, the deteriorating State finances have led to compression of social and economic overheads. This has severely limited the ability of the States to improve the physical and social infrastructure. Accordingly, developmental expenditure needs to be earmarked sector/area-wise and monitored through targets to judge the progress of reforms. This should form an integral part of the Medium-Term Fiscal Reforms Programme (MTFRP) which already encompasses fiscal consolidation, public sector enterprises reform, power sector reforms and fiscal transparency. While there is greater monitoring of the overall debt from all sources at the State level and increasing co-ordination between regulatory bodies, MTFRP should involve strict adherence to the monitorable targets.

7.42 Another important factor constraining the States' ability to undertake developmental activities is that of increasing pension payments, which rose from less than three per cent of revenue receipts in the early 1980s to about 10 per cent of the revenue receipts in 2001-02. Increasing pension liabilities of the State Governments have become an area of concern since they are not backed by any funding arrangements and have to be met through budgetary resources causing heavy drag on the State exchequer. There is a clear need for pension reform at the State-level.

7.43 Recognising that the mobilisation of adequate revenue is crucial to fiscal reforms, the Tenth Plan document envisages a rise in the Centre's tax/GDP ratio from 9.0 per cent in 2002-03 to 10.3 per cent by 2007-08. Continuous efforts to improve tax administration, including IT enablement and expansion of the tax base to include the services sector are expected to enhance the buoyancy of both direct and indirect taxes. Indirect tax reforms would be based on rationalisation of rates and withdrawal of exemptions. States' own tax revenue collections would also need to rise from 5.8 per cent in 2002-03 to 6.6 per cent of GDP by the terminal year of the Tenth Plan. In this context, the move to a unified VAT covering all goods and services assumes importance. The objective is to create a single market space and a transparent and harmonious indirect tax system which eschews distortions such as tax cascades and tax exportation. The VAT requires integration of various stages of commodity taxation between the Centre and the States. It also involves managing the problems in transition from the existing structure, including the long run effects of State VAT on the economy and on public revenue. Consensus among all the States on the principle and rates is essential so that exemptions and escape clauses in VAT rate structures and anomalies in legislation are limited.

7.44 States also need to explore alternative taxes and the scope for improvement of the tax regime and administration in the areas of stamp duties, registration fees, and motor vehicle tax, particularly with a view to preventing inter-state diversions. Certain States like Andhra Pradesh have in-built buoyancy in stamp duty by relating the duty to valuation of the property. With the increasing importance of urban infrastructure and efficiency of cities for overall economic efficiency, focussed attention has to be given by States to the improvement of city finances. This will need reforms to augment the urban tax base, particularly, through the levy and collection of property taxes and more efficient assessment procedures.

Infrastructure

7.45 The composition of expenditure as well as the stock of infrastructure assets has deteriorated with the neglect of cost recovery. The principal issue is the levy and collection of appropriate user charges on the array of social and economic services which the States provide (*e.g.*, water supply, sanitation, sewerage, transportation, education, and medical facilities). Provision for public goods has to be made from tax resources whereas private goods and services should be financed by the levy of appropriate user charges. User charges need to be indexed to input costs and the process of periodic revision should become automatic, along with appropriate provision for productivity improvements. At the same time acceptability of higher charges for such services will not be feasible unless there is greater efficiency in the delivery of these services. This requires widespread reform in the public sector - MOUs for 100 per cent metering to avoid transmission and distributional losses, setting up State Electricity

Regulatory Commissions (SERC), unbundling of generation, transmission and distribution under deadlines. The issue of user charges may well be the most important in the canvas of fiscal reforms.

7.46 Key to the envisaged industrial expansion in the medium-term is the modernisation and deepening of the physical infrastructure. In the power sector, the Electricity Act, 2003 envisages liberalisation over a wide area providing for greater freedom for private investment. In the process, consumers would eventually be free to choose their suppliers of electricity in a competitive market. The Act also envisages phasing out of cross subsidies and outlines a strategy to address the poor financial health of the SEBs. The Tenth Plan also highlights the need to restore the balance between hydro (which presently accounts for only 25 per cent of total power generation) and thermal power as well as provide a thrust to nuclear power generation.

7.47 Financing the growth of infrastructure remains a major concern. Public sector resources can be effectively leveraged through greater reliance on the execution of infrastructure projects through public-private partnerships as has been recently proposed in the Union Budget. Although the demand for funds by the corporate sector reflects the dampened investment climate in the current phase of the business cycle, the supply and the tapping of these funds for infrastructure and industrial activity in general is likely to become critical as impulses of new investment gather strength. Cross-country experiences suggest that external sources play a predominant role in financing infrastructure, at least in the early and intermediate stages. The capital market, in particular, provides an efficient conduit, enabling the channelling of saving to investors of varied risk-return profiles.

7.48 The capital markets have witnessed a drastic slowdown over the last decade, mainly due to depressed primary market activity, low investor confidence and stringent norms for public issues. In the years ahead, strengthening of the role of the capital market is essential for maintaining the flow of funds through this channel. The role of the corporate bond market in this context can hardly be overemphasised. The corporate bond market in India is marked by a low investor base, lack of a variety of instruments and an illiquid secondary market. In the primary segment, corporates are innovating new arrangements to circumvent the barriers in access to markets. These off-market financing arrangements have, however, come in the way of market development, impeding price discovery and obscuring transparency, disclosure and market discipline.

7.49 The integral part of the process of market evolution is the tapping of new savings to meet the envisaged surge that is expected in investment demand over the medium-term. Contractual savings constitute the natural sources of funds that can be deployed productively in medium and long-term investments. Pension and provident funds, and insurance companies are the natural holders of such long-term funds along with the traditional instruments of small savings such as post office savings accounts. At present, such contractual savings are largely deployed in government securities for regulatory reasons or because of the perceived absence of productive opportunities for remunerative medium and long-term investments. A similar gilt bias is observed in the behaviour of banks, despite the change in regulatory environment that has blurred the boundaries between the banks and non-banks. There is need for greater innovation in risk management by all these institutions so that they can exploit better the emerging opportunities in both industrial and infrastructure financing. Financial intermediaries must also seek new arrangements to provide opportunities for the unorganised sector to deploy their savings for productive purposes. This would need improved marketing of new saving schemes along with innovative expansion of the distribution network, including the use of traditional outlets such as post offices and other retail outlets that offer synergies with other financial products. The proposed pension scheme that has been announced for the unorganised sector constitutes an appropriate step in this direction.

External Sector Issues

7.50 Over the years ahead, the progressive correction of the anti-export bias in India's trade policies would need to be carried forward with the complete elimination of quantitative restrictions and non-tariff barriers, accelerated reduction and rationalisation of tariffs, liberalisation in the trade and payments regime and improved access to export incentives. The attainment of a current account surplus would suggest that tariff reductions could be carried out faster than envisaged earlier, without posing any significant risk to the balance of payments. In the context of the strategic export promotion policies being designed to guide an aggressive export effort, it is necessary to broaden coverage to a large

number of non-traditional items and markets which are expanding above the world average. Measures introduced to ensure timely delivery of credit to exporters and to remove procedural hassles should be strengthened. The Medium Term Export Strategy announced by the Government in January 2002 involves a comprehensive plan, taking into account the contemporary global scenario, to achieve a quantum increase in exports in the medium-term coinciding with the Tenth Plan period (2002-07). This would need to be buttressed with sector-specific strategies based on demonstrated or perceived export potential. The introduction of a comprehensive system to make tax rebates to exporters transparent and comprehensive, up-gradation of export infrastructure, trading agreements (free trade agreements and preferential trade agreements), improved access to bank credit and marketing infrastructure are other elements of the strategic export policy of the medium-term.

7.51 The export led growth experience of South-East Asian countries provides valuable lessons for countries like India where export performance is regarded as the key to the health of the balance of payments. This experience suggests that it is technology intensive items that will provide momentum to the export drive. In particular, it is important to seize the opportunities afforded by the progressive vacation of technology exports by Japan, East Asia and China. So far India's export promotion policy has been broadly neutral in respect of technology upgradation, rather than focused on specific areas of technological advantage. Moreover, some elements of industrial policy such as emphasis on indigenisation, thrust on adaptation rather than innovation considerably restrict technology intensification in exports. In this context, a conscious choice between a 'leapfrog' from low technology to high technology exports or a more "gradualist" approach has to be made, given that India is a late entrant in the race for export markets.

7.52 Export promotion policy needs to utilise the natural complementarity of Foreign Direct Investment (FDI) with export activity. In the final analysis, it needs to be recognised that definitional issues notwithstanding, it is administrative and procedural hurdles which are the biggest impediments to larger flows of FDI into India. The time lag involved in converting investment intentions to actual flows of foreign exchange, technology and know-how must be reduced to compare favourably with investment destinations which have proven attractiveness on account of the ease in investing. The global reach and marketing abilities of FDI could be effectively utilised to provide a cutting edge to the export effort. The thrust on attracting higher FDI inflows in infrastructure sector should be dovetailed into the regulatory and pricing reforms in major infrastructure services such as power and transportation.

Financial Sector Issues

7.53 The monetary policy framework is changing in response to reforms in the financial sector. The Reserve Bank's endeavour is to enhance the allocative efficiency of the financial sector and preserve price and financial stability. Striving for price stability and financial stability usually requires complementary and reinforcing policies; nevertheless the two objectives may occasionally be in conflict with each other. While internationally, economies have stabilised in terms of inflation and growth, financial cycles have become more pronounced. Besides the use of interest rates, the Reserve Bank is supporting financial stability by implementing policies to make the financial system more resilient. Through its monitoring mechanism, the Reserve Bank is not only striving to assess the potential problems but is also continuously monitoring risks at the macro level.

7.54 Recent domestic and international experience in the role of central banks as lenders of the last resort has highlighted some important issues. First, while the central bank's role in providing liquidity support instills confidence to the financial system, the actual action requires the central bank to distinguish between solvency and liquidity problems. For this, the regular availability of comprehensive information is a prerequisite. Secondly, in a deregulated financial system with progressive diversification of bank ownership, shocks tend to get transmitted more rapidly across financial institutions, especially if they do not have the comfort of the backing of sovereign ownership. While the contagion can adversely affect even strong institutions, the weaker and the more fragile institutions become relatively more vulnerable to shocks. It is, therefore, imperative that banks increase their intrinsic strengths. Thirdly, as the financial system opens up, it is vital for the central bank to be more proactive in monitoring macro risks arising out of any potential fragility in the financial system. Mechanisms that throw up early warning signals so that prompt corrective actions can be undertaken would help in preventing a crisis. Recent

experience has also brought to the fore the possibility of a technology risk translating into a liquidity risk. This underscores the importance of appropriate liquidity management systems in banks that are attuned to providing enhanced services to customers through technological innovations.

7.55 In the recent period, there have been significant improvements in the financial health of the banking system as reflected in the performance of certain key parameters. Banks have shown improved profitability, reduction in the net NPA ratio and improvement in capital adequacy ratio. The balance sheets of banks are looking healthier and the institutional infrastructure mounted in the financial system, including the Negotiated Dealing System (NDS), Credit Corporation of India Ltd. (CCIL) and screen based trading system for interest rate derivatives is poised to enable banks to manage their risks more efficiently. These actions would get a further boost with the operationalisation of the real time gross settlement (RTGS) system.

7.56 The Reserve Bank is also committed to the implementation of the “Core Principles for Effective Banking Supervision” drawn up by the Basel Committee on Banking Supervision. In order to achieve full compliance with these principles, steps have been taken in a phased manner to move towards a system of consolidated supervision, for enhancing the role of external auditors, strengthening corporate governance and increasing transparency and disclosure in the balance sheets of banks. In this process, monitoring the financial system by the Reserve Bank in an increasingly deregulated financial system is better facilitated.

7.57 While the overall policy environment has fostered a significant degree of financial soundness and banks have recorded higher profitability, mainly due to large investments in gilts, this should not lull them into a state of complacency. Banks need to recognise the potential interest rate risks and resort to larger provisioning and build-up of reserves including investment fluctuation reserves. Globally, the best managed banks are proactive in building up reserves when the profits are on the upswing. Timely write off and provisioning in respect of problem assets characterise the operation of many of the banks.

7.58 In line with international best practices, the Reserve Bank announced a timetable to move to the 90-day norm for loan impairment, effective end-March 2004. Since banks were provided a sufficient time frame to graduate to these new norms, it is expected that they would have built-in adequate levels of provisioning. Nevertheless, banks need to be on guard against any upsurge in the measured NPAs consequent upon the movement to the 90-day norm.

7.59 Recent trends in exchange rate and interest rate movements have fuelled greater demand by corporates for foreign currency loans from Indian banks. Considerable flexibility has been given to the corporates over a period of years to hedge their foreign exchange exposure in the market. A significant portion of the corporate foreign currency commitments remain unhedged on the basis of perceptions of the market and these could potentially have an impact on their overall financial position in case of unexpected developments. Accordingly, banks need to exercise caution in “unhedged” lending in foreign currency since exchange risk could turn easily into credit risk if exchange rate movements turn adverse. Banks also need to put in place a system for monitoring such unhedged external liabilities.

7.60 While the financial sector reforms have focused on improving the efficiency of the banking system, as the Tenth Plan has observed, it is important to finance activities that are of crucial importance for growth. It has been the endeavour of the Reserve Bank to improve the credit delivery mechanism by simplifying procedures, encouraging decentralised decision making and enhancing competition. Improving the flow of bank credit to the agricultural sector is a dominant objective of monetary policy by removing procedural impediments, upgrading institutional mechanisms for delivery and creating an environment where small and marginal farmers reap the full benefits of softer interest rate regime. In this regard, the recent lowering of public sector banks lending rates for agriculture to a ceiling of 9.0 per cent is expected to improve the channeling of bank credit to the farm sector. The co-operative banking sector has been playing an important role in the delivery of rural credit. In order to further improve the credit delivery, co-operative banking is being sensitised to the changing context of the financial regulation through enhanced standards of disclosure and governance.

7.61 With the gradual liberalisation of the Indian financial system and the growing integration among markets, the risks associated with banks’ operations have become increasingly complex, requiring strategic management. In keeping with the spirit of the guidelines on Asset-Liability Management (ALM) systems and on integrated risk management systems,

banks need to design their risk management architecture, taking into consideration the size, complexity of business, risk philosophy, market perception and the level of capital. Banks are also being prepared for fine-tuning the risk management systems to deal with credit and market risk. Derivatives have been introduced in the Indian financial markets for management and hedging of market risk. The menu of derivative products has been recently expanded. Guidelines on credit derivatives for management and hedging of credit risk are being framed in consultation with banks. In pursuance of the Core Principles for Effective Banking Supervision guidelines on policies and procedures in banks for identifying/ monitoring/ controlling country risk exposures are already in place. The developments in the financial markets also emphasise the need for enhancing the scope and extent of disclosures by banks with a view to rationalising the existing disclosure requirements and make these instruments effective for ensuring market discipline.

7.62 The repeated bouts of international financial crises in the 1990s, including the recent spate of corporate accounting irregularities, have increasingly brought to the fore the multiple linkages between financial liberalisation, supervision and corporate governance. Prevention of financial fragility can come only through synergistic efforts of all stakeholders, *viz*., management, depositors, debtors and owners. Corporate governance assumes importance in this context in specifying the rights and responsibilities of various stakeholders and ensuring accountability within the decision making and implementation processes. Irrespective of the choice of the model for corporate governance, the key elements have to be timely and reliable public disclosures, independence of audit committees and obligations, strengthening of criminal penalties and addressing issues raising conflict of interest.

7.63 In consonance with the emerging financial environment, there is a conscious move away from micro-supervision towards off-site surveillance and risk-based supervision in India. The impetus for this has come from two sources: the need to infuse flexibility into the regime in the context of financial liberalisation, and to minimise the costs of the regulatory and supervisory function. Country experiences, including India's own, suggest that a mix of a risk-based supervisory framework (with effective prompt corrective action), detailed disclosure norms and conscious corporate governance could minimise the costs of supervision.

7.64 In recent years, there has been a significant transformation in the operating environment of development finance institutions (DFIs). Leading DFIs are in the process of getting converted into banks and in this context, a gap is emerging in the market continuum at the long end. DFIs have played a prominent role in providing industrial finance in India, particularly during the 1980s. Until the mid-1990s they complemented rather than competed with commercial banks in providing finance to Indian corporates. Commercial banks are now expected to play a greater role in bridging the gap in demand and supply of long-term funds faced by Indian corporates. In this context, the cross-country experience yields valuable lessons and banks are already in the process of introducing structured products, largely off-market, which adapt to the risk-return profiles of corporates. In this regard, banks have to contend with institutional, operational and regulatory issues such as (i) time consuming, costly and inadequate legal infrastructure for recovery of loans, especially long-term loans, (ii) difficulties in cash management for longer-term loans under a cash credit based system, (iii) significantly higher capital charges for providing funds to corporates as opposed to investment in government securities, (iv) lack of past expertise of banks in long-term lending and the lack of information base on term lending, (v) regulatory requirement for priority sector obligation linked to bank credit rather than total assets of banks, (vi) relatively higher liquidity of long-term investments in corporate securities compared to long-term loans to corporates and greater concern for credit risk as compared to market risk. Nevertheless, banks in India are poised to enhance their role into provision of long-term financing of corporates, including in the form of multi-agency approaches.

7.65 With the process of registration of NBFCs almost over, this sector is moving towards consolidation. The mushroom growth of NBFCs has been curtailed and with the weaker units weeded out, the NBFC sector is expected to become strong and vibrant and participate in the financing of higher growth. It is, therefore, important to preserve their integrity and financial soundness so that they emerge as viable financial intermediaries in India. Towards this goal, the Reserve Bank is refining its supervisory framework based on a four pronged mechanism consisting of on-site inspections based on the CAMELS rating system, a state-of-the art technology for effective scrutiny and monitoring of the returns (COSMOS) submitted electronically, market intelligence and exception reports from Statutory Auditors.

7.66 There is a progressive diffusion of computerisation and IT in the Indian financial system. Banks are increasingly integrating their own electronic funds transfer facilities with the Reserve Bank's Electronic Funds Transfer Scheme in order to offer innovative products to their customers. Major public sector banks are moving towards Core Banking Solutions, thus paving the way for 'anywhere banking' for a growing section of the banking public. Usage of the Structured Financial Messaging Solution (SFMS) by banks would help to speed up inter-bank financial communication in a secure mode, and result in quick flow of funds and financial information across branches and even amongst different banks. The payment systems in India are in the process of integration and technological upgradation, especially in large value payments. Currently foreign exchange transactions are being cleared domestically, resulting in a marked saving in terms of transaction costs. Retail payments are also being made faster and more efficient, including in debt and equity markets. The commencement of operations in the RTGS would have a positive impact on the efficiency and speed of the payment and settlement system.

Monetary Policy Issues

7.67 Since 1997, in addition to maintaining low inflation, the revival of investment demand has been an important concern in the setting of monetary policy in India. Accordingly, ensuring adequate liquidity and a preference for soft and flexible interest rates have characterised monetary policy formulation. This monetary policy stance has been signaled through cuts in the Bank Rate, LAF rates and the CRR. The pace and magnitude of easing has, however, been conditioned by the need to ensure macroeconomic and financial stability, particularly in the context of continuing large external capital flows. The full impact of the monetary policy stance on economic activity has been constrained by the structural rigidities in the financial system, especially on account of the downward inflexibility in the interest rate structure and operating costs of financial intermediaries. The conduct of monetary policy is faced with the dilemma of surplus liquidity in financial markets together with inadequate credit demand in the context of financing sustained growth in the real sector. Banks have improved their profitability by passively investing largely in government securities, reaping trading gains with the declining yields and rising prices. In this context, the improvement in banks' post-tax profits, while welcome, does not provide much room for comfort in the medium-term.

7.68 Further refinements in operating procedures have to be carried forward, both for day-to-day liquidity management and for equitable delivery of credit. This becomes necessary in the context of the soft interest rate stance and the need to maintain adequate liquidity in financial markets, while narrowing operating spreads in policy rates as well as market related rates. With the progressive integration of different segments in the financial market, it should be possible in the medium-term to fine-tune monetary policy operations to manage market conditions through a narrow interest rate corridor. With capital flows expected to remain strong, a key issue in the future would be greater innovation in the use of available instruments to deal with the expected strong capital flows. In this regard, it needs to be recognised that sterilisation is a first stage response for ongoing liquidity management until more durable policies can be put in place to absorb capital flows for the expansion of productive capacity. Furthermore, sterilisation has in-built costs and limitations. The growing internationalisation of monetary policy arising from the cross-border integration of financial markets also emerges as an important issue. In this context the exercise of discretion in the conduct of domestic monetary policy becomes challenging. There needs to be better clarity in the rules and responsibilities of monetary policy for ensuring effective macroeconomic policy co-ordination.

7.69 The Fiscal Responsibility and Budget Management Legislation provides a framework for the appropriate 'assignment' of fiscal and monetary policies. The Bill prohibits the Reserve Bank from subscribing to primary issues of Central Government securities, effective 2006-07. The Reserve Bank will continue, however, to purchase and sell government paper in the secondary market depending upon evolving liquidity and monetary conditions, consistent with the price situation. This would work towards strengthening the pursuit of growth in an environment of low and stable inflation. Recognising the possibility of unforeseen or special circumstances that could disturb financial stability, the Bill provides for some flexibility in these arrangements. Under well defined exceptional circumstances, the Reserve Bank will be enabled to subscribe to primary issues in consultation with the Government of India if considered necessary for providing stability.

7.70 In recent years, valuable lessons have been emerging for conducting monetary policy from the experience with managing the external sector during periods of external and domestic uncertainties - the need to keep a continuous vigil on market developments, the importance of building adequate safety nets that can withstand the effects of unexpected shocks and market uncertainties. In this context, India's exchange rate policy seems to have stood the test of time. It has focused on the management of volatility without a fixed rate target or a pre-announced target or a band and the underlying demand and supply conditions are allowed to determine the exchange rate movements over a period in an orderly way. The Reserve Bank will continue to follow the approach of watchfulness, caution and flexibility by closely monitoring the developments in the financial markets at home and abroad. It will co-ordinate its market operations carefully with appropriate monetary, regulatory and other measures as considered necessary from time to time.

Concluding Observations

7.71 To sum up, the macroeconomic fundamentals of the Indian economy are strong and have acquired a distinct resilience in the face of the periodic crises that characterised the previous decades. The overall policy environment has fostered macroeconomic stability, complementing financial stability, and this has generated optimism regarding the medium-term. As regards the financial sector, progress has been made in several areas, including enhancing accountability, improving management practices and corporate governance, and managing the pressures of structural changes. Considerable headway has been made in refining the regulatory and supervisory function, and fine-tuning it to the country-specific circumstances.

7.72 The main challenge that requires constant vigil in the macroeconomic management is that of reducing high fiscal deficits. Whereas expenditure containment must remain a continuing quest, particular attention must also be given to raising the tax/GDP ratio along with concerted action to levy and collect appropriate charges for infrastructure and other services at both the Central and State levels. These actions are essential to correct and reverse the trend of increasing public sector dissavings that have emerged in recent years. Positive public sector savings are necessary to finance essential physical and social sector investments that will "crowd in" private sector investments for the achievement of self-sustaining, accelerated growth.

PART TWO : THE WORKING AND OPERATIONS OF THE RESERVE BANK OF INDIA

VIII MONETARY AND CREDIT POLICY OPERATIONS

8.1 Monetary and Credit Policy for the year 2002-03 was formulated against the backdrop of comfortable liquidity conditions, a benign inflation environment and growing strength in the balance of payments and international reserves. The objective of revitalising investment demand dominated the conduct of monetary policy even while maintaining a continuous vigil on inflation. Accordingly, the policy stance remained accommodative with a commitment to ensure adequate liquidity to meet credit demand. A preference for softening of interest rates and greater flexibility in the interest rate structure in the medium-term was retained with changes in policy rates envisaged in response to the evolving liquidity and credit situation. Despite a modest recovery in industrial activity nurtured by the co-movement of non-food bank credit, the drastic shift in macroeconomic conditions due to the onset of the drought necessitated a pre-emptive easing in the monetary policy setting. Mitigating the deleterious effects of the drought on farm output and rural incomes emerged as a dominant concern. Amidst excess supply conditions in the financial markets, a decisive easing of monetary policy was signalled through cuts in the repo rate (June and October, 2002 and March 2003), in the Bank Rate (October, 2002) and in the CRR (June and November, 2002). Interest liabilities on farm loans were deferred and agricultural loans were rescheduled to provide a measure of financial relief to the drought affected areas. Improvements in the channels of bank credit flow to various sectors were facilitated by providing greater flexibility to banks in meeting allocations of lending to the priority sector, housing, the small scale sector, micro finance vehicles and rural infrastructure. Contending with large capital inflows engaged monetary policy throughout 2002-03. Efforts to sterilise the expansionary impact of the capital flows took the form of large open market sales and continuous repo operations under the LAF.

8.2 The October 2002 Mid-term Review maintained the stance of the Annual Policy Statement of April 2002 while revising the macroeconomic outlook in the context of the drought. It drew upon the softening of interest rates in the first half of the year to pursue the downward movement further on a sustainable basis. An important objective was to prevent resurgence of inflationary pressures on account of the policy stimulus to growth.

MONETARY POLICY OPERATIONS

Interest Rate Policy

Bank Rate

8.3 Since 1997, the Bank Rate has been reactivated as the principal signalling device of the monetary policy stance across the interest rate structure in consonance with inflationary expectations and the liquidity situation. The Bank Rate was reduced in stages to 6.25 per cent in October 2002, the lowest rate since May 1973, and by a further 25 basis points in April 2003. The Bank Rate has been reduced by 500 basis points in the last five years. This is the sharpest reduction in the Bank Rate since Independence (Table 8.1).

Repo Rate

8.4 With the institution of the Liquidity Adjustment Facility (LAF), the repo rate has functioned as an informal floor for money market rates, providing a powerful signal to the market about the policy

Table 8.1 : Adjustments in Bank Rate

(Per cent)

Effective Date	Rate
1	2
January 17, 1998	11.0
March 19, 1998	10.5
April 3, 1998	10.0
April 29, 1998	9.0
March 2, 1999	8.0
April 2, 2000	7.0
July 22, 2000	8.0
February 17, 2001	7.5
March 2, 2001	7.0
October 23, 2001	6.5
October 29, 2002	6.25
April 29, 2003	6.0

Table 8.2 : Movement in LAF Rates

(Per cent)

Month	2002-03			2001-02			2000-01		
	Repo Rate	Reverse Repo	Spread@	Repo Rate	Reverse Repo	Spread@	Repo Rate	Reverse Repo	Spread@
1	2	3	4	5	6	7	8	9	10
April	6.0	–	0.58	6.75-7.0	8.75-9.00	0.50			
May	6.0	8.0	0.90	6.5-6.75	8.75	1.40			
June	5.75 (June 27)	–	0.29	6.5	8.5	0.74	–	9.0- 14.0	6.08
July	5.75	–	0	6.5	8.5	0.69	7.0-8.0	9.0-10.0	0.02
August	5.75	–	-0.03	6.5	–	0.44	8.0-15.0	15.0-16.0	-0.15
September	5.75	–	0	6.5	8.5	0.80	10.0-13.0	13.5	-0.09
October	5.50 (Oct. 30)	–	-0.02	6.5	8.5	0.90	8.0-9.75	10.25	0.49
November	5.50	7.5 (Nov. 12)	-0.05	6.5	8.5	0.47	8.0	10.0	1.28
December	5.50	–	0.08	6.5	8.5	0.58	8.0	10.0	0.76
January	5.50	7.5	0.16	6.5	–	0.13	–	10.0	2.04
February	5.50	7.5	0.21	6.5	8.5	0.23	7.5-8.0	10.0	1.47
March	5.0 (March 3)	7.0	0.86	6.0 (March 5)	8.0	0.97	7.0-7.5	9.0	0.74

– No repo/reverse repos

@ Spread is calculated as the difference between monthly average call rate and repo rate in percentage points.

LAF was introduced with effect from June 5, 2000.

preference on interest rates. Ample liquidity conditions drove down money market rates frequently below the repo rate during 2002-03 prompting a 25 basis point reduction in the repo rate in June 2002, followed by another 25 basis point paring in October 2002 and a 50 basis point cut in March 2003. The repo rate has been adjusted downwards from 8.0 per cent in March 1999 to 5.0 per cent in March 2003. Repo and reverse repo rates are decided through daily auctions conducted without any pre-announced rate and bids are accepted on a multiple price basis. Since the institution of the LAF, repo rates have anchored money market rates during periods of ample liquidity with the reverse repo rate as anchor in periods of tightness (Table 8.2).

Deposit Rates

8.5 Banks have the freedom to fix interest rates on term deposits, with flexibility in offering interest rates as approved by their Boards. The only regulated rate is on savings deposit accounts with cheque facility. The reduction in administered interest rates on small savings announced in the Union Budget 2003-04 and moderate inflation enabled a 50 basis point reduction in the savings deposit rate to 3.5 per cent per annum from March 1, 2003.

8.6 Given the reductions in the policy rates and the significant softening of money market rates and gilt yields, banks were encouraged to popularise flexible deposit rate schemes for new deposits. In order to facilitate the conversion of fixed rate deposits into variable rate schemes, banks were advised to pay depositors at the contracted rate for the period of deposit already run and waive the penalty for premature withdrawal if the same deposit was renewed at the variable rate.

Lending Rates

8.7 The downward rigidity in lending rates is reflected in spreads over the prime lending rates (PLRs). Unconscionably wide spreads are unwarranted in a period of low inflation. Moreover, they adversely impact the overall credit portfolio of banks and obscure the appropriate pricing of loans. In this context, banks were required to announce the maximum spread over the PLR for all advances except consumer credit. Information on maximum and minimum rates charged to borrowers is also required to be provided (Box VIII.1).

8.8 Banks were encouraged to switch to the all cost concept of pricing loans by explicitly declaring processing charges and service charges. In order to enhance transparency, a benchmark PLR was advocated for banks, taking into account their actual cost of funds, operating expenses, a minimum margin to cover regulatory requirement of provisioning/

Box VIII.1

Spreads around Prime Lending Rate

With the deregulation of lending rates since the early 1990s a striking characteristic of loan pricing behaviour among banks has been the wide dispersion in and around the Prime Lending Rates (PLRs). The resistance of banks to pass on some of the gains of a lower interest rate regime to borrowers has evoked concern in successive monetary policy statements since October 1996.

In the interest of customer protection and also to infuse healthy competition among banks under condition of full information/transparency, the Reserve Bank has institutionalised a system of collecting actual lending rates from scheduled commercial banks [excluding Regional Rural Banks (RRBs)] under a special quarterly return since June 2002. Information is sought on the range of the interest rates on rupee export credit as well as other types of bank credit. Banks are advised to ignore extreme values in the lending rates (up to 5 per cent of advances on either side) while submitting the information. Banks also furnish the range of interest rates in which there is concentration of loan contracts (say, 60 per cent or more) so as to obtain a sense of the general trend in lending rates. Consolidated information on actual lending rates for various bank-groups disseminated at the Reserve Bank's website reveals that only a few banks effected marginal reduction in the interest rate spreads on term loans on non-export credit. Furthermore, both PLRs and spreads varied widely across bank-groups during 2002-03. Efforts at ensuring information symmetry for the market has been reflected in a modest decline and convergence of spreads on export credit (Table).

Table : Lending Rates of Scheduled Commercial Banks

	Term Loan*		Export Credit #	
1	2	3	4	5
Category	March, 2003	June, 2002	March, 2003	June, 2002
Public Sector Banks	6.00-16.25	8.50-16.50	7.50-12.50	7.25-12.50
Private Sector Banks	5.80-23.00	6.92-22.50	7.25-16.50	7.00-16.50
Foreign Banks	5.00-20.00	5.00-19.50	5.25-16.00	9.00-16.00

* : Interest Rates on advances (above Rs.2 lakh) other than export credit (interest rate range excluding 5 per cent of business contracted at extreme rate).

\# : Pre-shipment credit for 181 to 270 days.

capital charge and the profit margin. Since all other lending rates can be determined with reference to the benchmark PLR, the system of tenor-linked PLR is to be discontinued. These initiatives are expected to bring flexibility to the interest rate structure in India and to align it with macroeconomic conditions (Box VIII.2).

Interest Rates on Export Credit

8.9 With a view to encouraging competition among banks and also to increase flow of credit to the export sector, interest rates on rupee denominated export credit were liberalised. A ceiling rate on rupee export credit linked to the relevant tenor prime lending rate (PLR) was introduced, giving banks the freedom

Box VIII.2

The Structure of Interest Rate in India : Responses to Policy Shifts

The reduction of interest rates in India has been constrained by 'stickiness' observed in the short-term. Between March 2000 and March 2003 while deposit rates for over three years maturity fell by as much as 425 basis points, short-term deposit rates (up to 90 days) declined by only 50 to 100 basis points. This phenomenon which is coincident with a flattening of the yield curve in the Government securities market, is attributable to several factors.

The reduction in the administered interest rates on small savings and provident funds enabled the decline in long-term interest rates. Stickiness in short-term interest rates is associated with the floor set by the LAF as well as a preference for short-term deposits by banks to gain flexibility in asset-liability management (ALM). Prudential limits on call borrowing and lending accentuated the demand for short-term deposits.

Structural impediments to flexibility in the interest rate structure include the high carrying costs of long-term deposits mobilised in the past by banks at fixed interest rates and non-performing assets. Long-term deposits (over 1 year) contracted at fixed rates constitute around 70 per cent of the aggregate deposits of the banking system. Advances in the form of short-term credit at fixed rate constitute around 40 per cent of the total loan portfolio. There is also a lack of depositor interest in flexible deposit schemes in an environment of low inflation and falling nominal interest rates. The carrying cost of NPA and the tendency to load additional risk premium against possibilities of further accumulation of NPAs forces up lending rates. Besides NPAs, persistence of high operating costs also results in a significant drag on commercial banks' ability to lower lending rates.

to charge rates below the prescribed rate from May 5, 2001. The ceiling interest rates on rupee export credit were reduced by one percentage point across the board, effective from September 26, 2001. The ceiling rate of PLR plus 0.5 percentage point on pre-shipment credit beyond 180 days and up to 270 days and post-shipment credit beyond 90 days and up to 180 days was deregulated with effect from May 1, 2003. In the period ahead, the ceiling rates on pre-shipment credit up to 180 days and post-shipment credit up to 90 days will also be deregulated to encourage greater competition among banks for export credit.

8.10 In April 2002, the ceiling rate on export credit in foreign currency was reduced to LIBOR plus 0.75 percentage points from LIBOR plus 1.00 percentage point with a view to improving export competitiveness. Exporters were encouraged to avail of foreign currency loans. Banks were allowed to use borrowed foreign currency funds as well as foreign currency funds generated through buy-sell swaps in the domestic foreign exchange market for extending foreign currency denominated loans to exporters (Table 8.3).

Interest Rates on Non-Resident Deposits

8.11 Interest rates on foreign currency repatriable deposits under the FCNR(B) scheme are adjusted from time to time in alignment with movements in international interest rates as well as to slow down exceptionally large inflows under these accounts. In April 2002, the ceiling rates on FCNR(B) deposits were revised downwards from LIBOR to LIBOR/SWAP rates of corresponding maturities minus 25 basis points. In April 2003, the minimum maturity period of fresh NRE deposits was raised from 6 months to 1 year in alignment with the maturity structure of FCNR(B) deposits. Effective July 17, 2003, the interest rates on fresh NRE deposits for one to three years should not exceed 250 basis points above the LIBOR/SWAP rates for US dollar of corresponding maturity. This was done to provide consistency in interest rates offered to NRIs

Table 8.3 : Interest Rates on Export Credit

(Per cent)

Period	Pre-shipment/ Post-shipment Rupee Export Credit (up to 180 days/ 90 days)	Period	Export Credit in Foreign Currency
1	2	3	4
March-2001	10.0	Mar-01	LIBOR+1.5 PP
May-2001	≤ PLR-1.5 PP	Apr-01	LIBOR+1.0 PP
September-2001	≤ PLR-2.5 PP	Apr-02	LIBOR+0.75 PP
March-2003	≤ PLR-2.5 PP	Mar-03	LIBOR+0.75 PP

PP : Percentage points.

Reserve Requirements

Cash Reserve Ratio

8.12 The cash reserve ratio (CRR) remains an important instrument for modulating liquidity conditions. The medium-term objective is, however, to reduce CRR to the statutory minimum level of 3.0 per cent. Accordingly, on a review of developments in the international and domestic financial markets, a 75 basis point reduction in the CRR during June to November, 2002 was followed by a further 25 basis points cut from June 14, 2003 taking the level of the CRR down to 4.5 per cent. The minimum daily maintenance of CRR was raised to 80 per cent of the average daily requirement for all the days of the reporting fortnight with effect from the fortnight beginning November 16, 2002. This was subsequently lowered to 70 per cent with effect from the fortnight beginning December 28, 2002. The payment of interest on eligible CRR balances maintained by banks was changed from quarterly basis to monthly basis from April 2003. The CRR has been almost halved since April 2000 resulting in cumulative release of first round resources of over Rs.33,500 crore (Table 8.4).

Statutory Liquidity Ratio

8.13 The statutory liquidity ratio (SLR) to be maintained by all scheduled commercial banks remains unchanged at a minimum of 25 per cent of net demand and time liabilities (NDTL) since October 1997. As a prudential measure to strengthen the urban co-operative banks (UCBs), the proportion of SLR holding in the form of government and other approved securities to NDTL has been increased in a phased manner. From April 1, 2003, all scheduled UCBs have to maintain the entire SLR holdings of 25 per cent of NDTL in government and other approved securities only. Similarly, regional rural banks (RRBs) were required to maintain their entire SLR holdings in government and other approved securities by March 31, 2003 with SLR holdings of RRBs in the form of deposits with sponsor banks maturing beyond March 31, 2003 being reckoned for the SLR till maturity. The maturity proceeds of such deposits would have to be converted into government securities for RRBs not reaching the 25 per cent minimum level of SLR in Government securities by that time.

Table 8.4 : Cash Reserve Ratio

(Amount in Rupees crore)

	2003-04		2002-03		2001-02		2000-01	
	CRR (Per cent)	Amount*	CRR (Per cent)	Amount*	CRR (Per cent)	Amount*	CRR (Per cent)	Amount*
1	2	3	4	5	6	7	8	9
April	4.75	0	5.5	0	8.0	0	8.0	7,200
May	4.75	0	5.5	0	7.5	4,500	8.0	0
June	4.5	3,500	5.0	6,500	7.5	0	8.0	0
July			5.0	0	7.5	0	8.25	-1,900
August			5.0	0	7.5	0	8.5	-1,900
September			5.0	0	7.5	0	8.5	0
October			5.0	0	7.5	0	8.5	0
November			4.75	3,500	5.75	6,000	8.5	0
December			4.75	0	5.5	2,000	8.5	0
January			4.75	0	5.5	0	8.5	0
February			4.75	0	5.5	0	8.25	2,050
March			4.75	0	5.5	0	8.0	2,050

* Amount stands for first round release (+)/ impounding (-) of resources through changes in the cash reserve ratio.

Standing Liquidity Facilities

8.14 The medium-term objective of monetary policy is to move away from sector-specific refinance facility. Of the two standing facilities, *viz.*, export credit refinance (ECR) and collateralised lending facility (CLF) available to scheduled banks from the Reserve Bank, the latter was withdrawn with effect from October 5, 2002. ECR is provided on the basis of banks' eligible outstanding rupee export credit, both at the pre-shipment and post-shipment stages. From April 1, 2002, ECR is provided to scheduled banks to the extent of 15 per cent of the outstanding export credit eligible for refinance at the end of the second preceding fortnight. Apportionment of normal and back-stop facilities was changed from the initial ratio of 67:33 to 50:50 from November 16, 2002. Although refinance entitlements declined during the year, this did not impact on market liquidity as utilisation of standing facilities remained very low.

8.15 The methodology for fixation of the rate for the back-stop facility was rationalised with effect from April 30, 2003. Accordingly, the back-stop interest rate is at the reverse repo cut-off rate at which funds were injected earlier during the day in the regular LAF auctions. Where no reverse repo bid is accepted, the back-stop interest rate would generally be 2.0 percentage points over the LAF repo rate of the day. On the days when no bids for repo or reverse repo auctions are received/accepted, the back-stop interest rate would be decided by the Reserve Bank on an *ad hoc* basis.

8.16 In a specific situation of a financially sound bank facing sudden liquidity problems, particularly outside the normal LAF auction timings and on days when auctions are not held, the Reserve Bank at its discretion, may extend temporary liquidity support at an interest rate 4.0 percentage points above the reverse repo rate prevailing on that day (or a rate as may be decided by the Reserve Bank), against eligible securities with adequate margin and other appropriate conditions. On April 12, 2003 the Reserve Bank extended a temporary special collateralised liquidity facility of Rs.809 crore under section 17(4)(a) of RBI Act, 1934 against the collateral of excess SLR securities with a margin of 10 per cent for four days to a particular bank to tide over temporary liquidity problems on account of adverse market sentiments and sudden withdrawal of large deposits. The amount was repaid on April 16, 2003.

Liquidity Adjustment Facility

8.17 The Liquidity Adjustment Facility (LAF), introduced in June 2000, has evolved as a flexible instrument to modulate short-term liquidity and to ensure stable conditions in the overnight/call money market. The LAF operates through repo and reverse repo auctions, thereby setting a corridor for the short-term interest rates that is consistent with monetary policy objectives. Changes in procedures of the LAF have been effected to improve operational efficiency and to move gradually from a system of segmented refinance to a more fungible system of liquidity adjustment at market related rates (Box VIII.3).

Box VIII.3

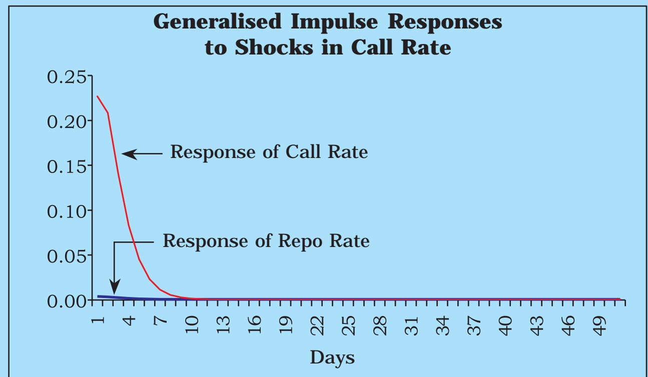
Monetary Marksmanship : Steering Financial Markets

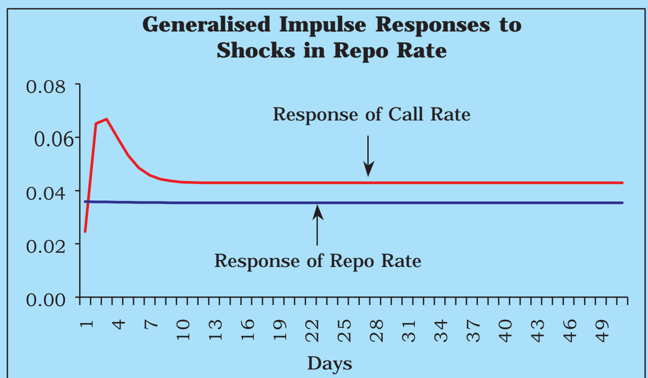
The growing sophistication of financial markets, driven by financial innovations and cross-border capital flows has impinged on monetary policy operating procedures and transmission mechanisms. Consequently, monetary authorities all over the world have had to modify short-term operational targets and instruments to steer financial market rates and liquidity consistent with policy goals.

A few stylised facts emerge from a survey of monetary policy operating procedures across central banks. First, there has occurred a progressive reduction in direct instruments of monetary control. Secondly, central banks have been engaging more actively in liquidity management in a more market based environment. Liquidity management has largely been implemented through discretionary market operations at the expense of standing facilities. Thirdly, reversed transactions, especially against domestic currency denominated assets (*e.g.* repos), have emerged as the main policy tool. Finally, there has been increased transparency in policy signals regarding desired interest rate levels. The key policy rates are essentially the overnight inter-bank rate or the "tender rate" applicable to regular operations, mainly repurchase transactions.

Developments in India in the last decade point to a greater integration of various segments of the financial sector. In 1999, an interim liquidity adjustment facility (ILAF) was introduced as a step towards a full-fledged liquidity adjustment facility (LAF), which has evolved in stages since June 2000. An important objective underlying the establishment of the LAF is the maintenance of orderly conditions in the overnight market by providing an informal corridor of the repo and the reverse-repo rates. An analysis of daily data indicates that the number of days on which the call money exceeded the upper corridor declined from 27 during 2000-01 to 16 during 2002-03. As regards the call rate falling below the corridor, the number of such days increased from 32 during 2000-01 to 91 during 2002-03. Importantly, the differential between the two rates declined sharply from 43 basis points to only five basis points over the same period.

Granger-causality tests, based on daily data for 2002-03, suggest that it is the repo rate that leads to subsequent changes in call money rates. Reverse causality from call rates to repo rates is not supported. A two variable Vector Auto Regression (VAR) comprising repo rates and call rates suggests a long-run underlying relationship between the repo rate and call rates. A fairly rapid adjustment of call rates to the repo rates following episodes of disturbance is evident. Call rates initially tend to overshoot their long-run level but revert rapidly and the adjustment process is complete within a week. In contrast, the shocks to call rates have a negligible impact on the repo rates (Charts). The findings suggest that LAF has been effective in steering financial markets towards desired objectives.





The key issue confronting the conduct of monetary policy through LAF operations is to transmit short-term interest rate signals to the long-end of the yield curve. This will determine the efficacy of monetary policy in pursuit of macroeconomic stabilisation. Some preliminary results from work in progress indicate that during April 2000 to March 2003, a 100 basis points reduction in the Bank Rate led to about 40 basis points moderation in the prime lending rate in the same month and by another 38 basis points in the subsequent months. As regards the pass-through to yields on government securities, a 100 basis points reduction in the Bank Rate induced a moderation of 66 basis points in the yield on 10-year Government paper in the same month. Thus, policy signals have an impact on the yield curve and the PLR in the desired direction *albeit* at less than the desired pace.

References

1. Borio, Claudio E. V (1997), 'The Implementation of Monetary Policy in Industrial Countries: A Survey', *BIS Economic Papers*, No. 47, July.
2. Lamfalussy, B. Alexander (1994), 'Central Banking in Transition', Per Jacobson Lecture, London.

8.18 The LAF was actively used during 2002-03 to manage the injections of liquidity due to large capital inflows. Easy liquidity conditions in the market were reflected in the large repo bids received. The average daily repo bid amount received at overnight repo auctions was significantly higher at Rs.10,315 crore as against only Rs.162 crore for reverse repos (Chart VIII.1).

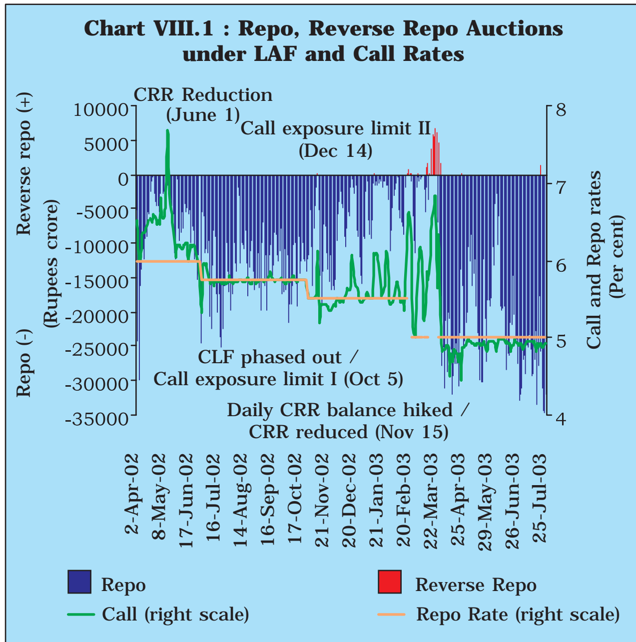


Chart VIII.1 : Repo, Reverse Repo Auctions under LAF and Call Rates

8.19 Comfortable liquidity conditions at the beginning of 2002-03 elicited substantial repo bids which, however, declined in May. The Reserve Bank responded by announcing the advancement of the CRR cut by a fortnight to June 1, 2002 which helped remove liquidity concerns and improved market sentiment. This was accompanied by private placements of government securities with the Reserve Bank, assuaging market pressures. Call rates remained a shade above the repo rate for most of June 2002. They, however, touched sub-repo levels during the last week of the month. The reduction in the repo rate on June 27, 2002 buoyed up market sentiment.

8.20 Repo bidding was heavy during July-October 2002 but the Reserve Bank accepted these bids only partially in most of the auctions (Table 8.5). Repo volumes came down in November-December due to sterilisation operations. The call rate continued to hover around the repo rate till about the middle of December.

8.21 Liquidity tightened from mid-December due to investment of Centre's surplus in its own securities (which would have otherwise flowed into the financial markets). Two successive tranches of tap issues of State loans in February-March, 2003 and advance tax outflows put further pressure on market liquidity. Average repo amounts accepted were correspondingly

Table 8.5 : Acceptance/Rejection of Repo/Reverse Repo Bids under LAF

Period	Repo				Reverse Repo			
	No. of days bids were received	No. of days all bids were rejected	No. of days of full acceptance of bids	No. of days of partial acceptance of bids	No. of days bids were received	No. of days all bids were rejected	No. of days of full acceptance of bids	No. of days of partial acceptance of bids
1	2	3	4	5	6	7	8	9
2002-03								
April	20	0	15	5	1	0	1	0
May	12	1	2	9	2	1	1	0
June	22	1	8	13	0	0	0	0
July	25	0	4	21	0	0	0	0
August	22	0	6	16	0	0	0	0
September	20	0	9	11	0	0	0	0
October	21	0	7	14	0	0	0	0
November	19	3	10	6	1	0	1	0
December	24	0	21	3	1	1	0	0
January	23	0	19	4	2	1	1	0
February	17	0	15	2	4	0	4	0
March	19	2	16	1	11	1	8	2
2003-04								
April	17	0	15	2	2	1	1	0
May	19	0	18	1	3	2	1	0
June	20	0	18	2	1	1	0	0
July	23	0	22	1	1	0	1	0

lower during January-March 2003. The repo rate cut on March 3, 2003 improved liquidity. Due to ample liquidity in the system during June-November 2002, the 14-day repo bids were relatively large but dried up from December 2002 onwards when liquidity tightened (Table 8.6).

Open Market Operations

8.22 Net open market sales (including sales to State Governments for investment of durable surplus/ reinvestment of maturity proceeds, investments in Consolidated Sinking Fund and Guarantee Redemption Fund) were higher during 2002-03 than in the previous year and in excess of the Reserve Bank's net subscription to primary issuance of government securities by Rs.17,605 crore. During April 2002, two OMO auctions for an aggregate amount of Rs.5,280 crore were conducted to stem the sharp fall in yields as well as to absorb liquidity from the system. The OMO sales of May 31-June 1, 2002 were conducted to neutralise the impact of the CRR cut of 50 basis points on June 1, 2002. OMO sales were undertaken during July and August, 2002 for sterilisation operations consequent to large inflows of foreign capital. Large OMO sales continued during November 2002-January 2003 to absorb excess market liquidity (Table 8.7). In the current year, an OMO sale was conducted on May 29, 2003, for an amount of Rs.5,367 crore to absorb the excess liquidity in the system. Further, an amount of Rs.11,470 crore was absorbed through OMO sale on August 14, 2003.

8.23 In order to ensure that a sufficient stock of marketable securities would be available in the portfolio of the Reserve Bank for conducting OMO from time to time, the Government of India converted Rs.40,000 crore of 4.6 per cent Special Securities issued earlier to the Reserve Bank into marketable securities of various maturities (3 years to 18 years) at the prevailing yields. Further, on June 12, 2003 the Government of India converted Rs.20,000 crore of Government of India Treasury Bills (Conversion) Special Securities held by the Reserve Bank into dated securities, *viz.*, 5.48 per cent Government Stock 2009, 6.05 per cent Government Stock 2019 and 6.17 per cent Government Stock 2023 for notified amounts of Rs.5,000 crore, Rs.7,000 crore and Rs.8,000 crore, respectively (Table 8.8).

Table 8.6 : Outstanding Injection (+)/ Absorption (-) through LAF Operations

(Rupees crore)

As at end of	2003-04	2002-03	2001-02
1	2	3	4
April	-22,315	-525	-11,375
May	-21,075	-12,285	4,310
June	-27,467	-24,710	–
July	-40,480	-11,965	1,875
August		-16,680	–
September		-15,865	1,410
October		-24,108	2,735
November		-15,640	-2,020
December		-5,494	250
January		-2,450	-1,110
February		-9,090	–
March		-2,415	-3,605

Note : 1. Includes fortnightly repos introduced since November 5, 2001.
2. Figures with a negative sign indicate net outstanding LAF repo balance.
3. Data based on March 31 for March and last reporting Fridays for all other months.

Table 8.7 : Primary Liquidity Flows and Open Market Operations

(Rupees crore)

Fiscal year flow up to	RBI's Net Foreign Currency Assets			Net RBI Credit to Centre			RBI's initial subscription			Net OMO Sales		
	2003-04	2002-03	2001-02	2003-04	2002-03	2001-02	2003-04	2002-03	2001-02	2003-04	2002- 03	2001-02
1	2	3	4	5	6	7	8	9	10	11	12	13
April	2,139	5,177	3,060	9,706	11,976	5,067	0	10,000	12,000	7	5,307	60
May	24,336	11,265	3,805	6,780	13,814	20,774	5,000	20,018	12,000	5,576	6,831	5,083
June	22,710	19,279	7,187	434	1,455	19,523	5,000	22,018	21,000	5,620	7,020	10,929
July	33,740	27,402	8,738	-19413	9,577	11,849	5,000	23,175	21,000	5,677	13,558	16,020
August		32,163	14,613		-9,506	5,828		23,175	21,679		20,583	16,056
September		38,898	17,169		-18,100	-617		23,175	21,679		26,938	24,914
October		46,060	19,545		-26,174	4,268		23,175	21,679		27,009	22,275
November		59,073	27,813		-27,366	11,225		23,175	25,679		38,082	22,321
December		73,664	34,936		-35,982	-5,386		23,175	25,679		42,631	30,187
January		86,468	40.918		-39,270	97		23,175	25,679		53,626	30,270
February		95,758	48,437		-45,476	-2,479		23,175	25,679		53,714	30,293
March		94,275	66,794		-28,399	-5,150		36,175	28,892		53,780	30,335

Note : Data based on March 31 for March and last reporting Friday for all other months.

Table 8.8 : Reserve Bank's Holdings of Central Government Dated Securities

(Rupees crore)

Year	Devolvement on Reserve Bank	Private Placement taken by Reserve Bank	OMO Purchases by Reserve Bank	Conversion of Special Securities into dated securities	Total addition to Stock of Reserve Bank 's investments (2+3+4+5)	Open Market Sales by Reserve Bank	Net Addition to Stock (6-7)	Outstanding Holding by the Reserve Bank (end period)*
1	2	3	4	5	6	7	8	9
1996-97	3,698	–	623	–	4,321	11,206	-6,885	6,666
1997-98	7,028	6,000	467	20,000	33,495	8,081	25,414	31,977
1998-99	8,205	30,000	–	–	38,205	26,348	11,857	42,212
1999-00	–	27,000	1,244	–	28,244	36,614	-8,370	35,190
2000-01	13,151	18,000	4,471	–	35,622	23,795	11,827	41,732
2001-02	679	28,213	5,084	–	33,976	35,419	-1,443	40,927
2002-03	5,175	31,000	–	40,000	76,175	53,780	22,395	55,438
2003-04 (Up to August 14)	–	5,000	–	20,000	25,000	17,194	7,806	83,574@

@ As on August 1, 2003. * Inclusive of securities sold under LAF.

CREDIT DELIVERY

8.24 Socio-economic objectives have governed the design of credit policies in India consistent with the imperatives for a vibrant and viable banking system. An important and abiding goal of monetary policy is to improve the credit delivery mechanism by simplifying procedures, encouraging decentralised decision making and enhancing competition. Increasing the functional freedom of banks has had beneficial effects in channelising bank credit to the priority sector and in particular to agriculture, small business, weaker sections and SSI. The rural credit system, specifically, has been the focus of policy.

Priority Sector Lending

8.25 Several measures were put in place to improve the credit delivery mechanism in the priority sector: (i) the limit on advances granted to dealers in drip irrigation/sprinkler irrigation system/ agricultural machinery, irrespective of their location, was increased from Rs.10 lakh to Rs.20 lakh under priority sector lending for agriculture; (ii) the existing overall limit of Rs.10 lakh in respect of small business was increased to Rs.20 lakh without any ceiling for working capital in order to augment credit flow to small business; (iii) the individual credit limit to artisans, village and cottage industries was increased to Rs.50,000 from the existing limit of Rs.25,000; (iv) loans to the Agri-Clinics and Agribusiness centres were included under the priority sector as 'direct finance' to agriculture; (v) para-banking activities such as leasing and hire purchase financing undertaken departmentally by banks were also classified as priority sector advances, provided the beneficiaries satisfy priority sector norms; (vi) the limit for direct housing finance was increased from Rs.5 lakh to Rs.10 lakh in rural and semi-urban areas.

8.26 Public sector banks, private sector banks and foreign banks as groups achieved the overall target, for priority sector lending (Table 8.9). The large increase in private banks' priority sector credit was primarily on account of two banks.

Housing Finance

8.27 The Statement on Monetary and Credit Policy for 2002-03 recognised the growing importance of the housing sector and its forward and backward linkages with other sectors of the economy. Banks were encouraged to increase the flow of credit to this sector.

Table 8.9 : Priority Sector Advances

(Amount in Rupees crore)

As on Last Reporting Friday	Public Sector Banks	Private Sector Banks	Foreign Banks
1	2	3	4
Mar-1998	91,319 (41.9)	11,614 (40.9)	6,940 (34.3)
Mar-1999	1,07,200 (43.5)	14,295 (41.3)	8,270 (37.1)
Mar-2000	1,27,807 (43.6)	18,348 (39.4)	9,699 (34.5)
Mar-2001	1,46,546 (43.0)	21,550 (38.1)	11,835 (34.1)
Mar-2002	1,71,185 (43.1)	21,530 (38.8)	13,414 (34.2)
Mar-2003*	2,03,095 (42.5)	34,674 (45.2)	14,596 (33.9)

Notes : 1. Figures in brackets are percentages to the net bank credit in the respective groups.
2. The target for aggregate advances to the priority sector is 40 per cent of the net bank credit for domestic banks and 32 per cent of net bank credit for the foreign banks.

* Data are provisional.

Banks were advised to allocate a minimum of 3.0 per cent of incremental deposits for housing. Moreover, the term loans extended by banks to intermediary agencies against the loans sanctioned by them were allowed to be reckoned as part of housing finance. Also, investment in bonds issued by HUDCO and the NHB exclusively for financing of housing is reckoned for priority sector targets.

8.28 Prudential requirements for housing finance by banks and investment by banks in securitised debt instruments of housing finance companies (HFCs) were liberalised to improve the flow of credit to the housing sector. Residential housing properties now attract a risk weight of 50 per cent as against 100 per cent stipulated earlier. A risk weight of 50 per cent was also assigned for the purpose of capital adequacy for investments in Mortgage-Backed Securities (MBS) of residential assets of HFCs supervised by the National Housing Bank (NHB). Such investments by banks are reckoned for inclusion in the prescribed housing finance allocation of 3.0 per cent. For the financial year 2002-03, each bank was required to compute its share of the housing finance allocation at 3.0 per cent of incremental deposits as on the last reporting Friday of March 2002 over the corresponding figure on the last reporting Friday of March 2001. In April 2003, banks were allowed to extend direct finance to the housing sector up to Rs.10 lakh to individuals in rural and semi-urban areas as part of priority sector lending. Banks had already been allowed to include loans upto Rs.10 lakh to individuals in urban/metropolitan centres for construction of houses as part of priority sector lending.

8.29 In India, the housing sector has assumed importance in recent years both on account of its growth generating potential in the context of investment demand and in view of the acute shortage of housing facilities in the country. Several fiscal incentives have been provided to boost housing demand (Box VIII.4).

Box VIII.4

Housing Finance : New Driver of Bank Credit

The importance of the housing sector in any economy is derived from its high employment potential and extensive backward and forward linkages. In addition to being one of the drivers of growth, the housing sector provides a relatively safe destination for bank credit on account of the lower than average rates of default in housing finance. Consequently, housing finance serves the dual purpose of leading recovery and providing a safe avenue for bank assets during periods of industrial slow down.

Housing shortage at the beginning of the Ninth Plan was estimated at 33 million units. According to a recent survey by the National Building Organisation, the total housing shortfall is estimated to be 19.4 million units of which 12.8 million is from rural areas and 6.6 million is from urban areas.

Pursuant to the announcement made by the Finance Minister in his budget speech of 2002-03, the National Housing Bank (NHB) initiated steps to set up a Mortgage Credit Guarantee Company which is envisaged as a joint venture having international partners and multilateral agencies with adequate experience in this field. This company will guarantee housing loans, thus proving lenders with protection against default by the borrowers. The target under the Golden Jubilee Rural Housing Finance Scheme was increased to 2.25 lakh for 2002-03 and the allocation of the *Indira Awas Yojna* is being increased by 13 per cent to Rs.1,725 crore for 2002-03. In addition, fiscal incentives in terms of income tax exemptions on interest paid and principal repaid on housing loans and on capital gains on NHB bonds have been provided.

The Reserve Bank has initiated a host of supply side measures to boost inflow of bank credit to the housing sector and to ensure the benefit of soft interest rates to borrowers:

- Contribution of Rs.100 crore to the equity capital of National Housing Bank (NHB), taking its authorised and paid-up capital to Rs.450 crore, fully subscribed by the Reserve Bank.
- Risk weight on loans against residential housing properties and Mortgage Backed Securities (MBS) of residential assets of HFCs supervised by the NHB reduced to 50 per cent from 100 per cent.
- Investments in MBS reckoned in the prescribed housing finance allocation of 3.0 per cent.
- Limit on housing loans for repairing damaged houses raised to Rs.1 lakh in rural and semi-urban areas and to Rs.2 lakh in urban areas.
- Direct finance to the housing sector up to Rs.10 lakh in rural and semi-urban areas as part of priority sector lending.

There has been a generalised decline in the interest rates charged by banks on housing loans. The rate of interest charged by the State Bank of India declined from 11 per cent in April 2002 to 9.5 per cent in May 2003. During the same period, there was a decline of 175 basis points in the interest rate charged by ICICI Bank.

As a result, there has been a surge in bank finance to the housing sector with credit flows to this sector increasing by 55 per cent in 2002-03. Housing loans extended by banks stood at 6.1 per cent of non-food gross bank credit at end-March 2003 as compared to 3.8 per cent at end-March 2001

(Contd....)

(Concld....)

and 4.6 per cent at end-March 2002. The growth of housing finance is expected to increase at much higher rates in the years ahead.

While the increase in disbursement of housing finance is heartening, cause for potential worry is that by lowering the lending rates, banks are approaching the cost of funds. In fact, banks set their lending rates lower on housing loans, and at times below PLR, due to lower risk weight. The interest rate on home loans is hovering in a range of 7.50-9.75 per cent, which is higher than the interest rate on longer term deposits of commercial banks by 1.5-3.75 percentage points. In most of the cases, banks are covering not more than 85 per cent of the cost of property within an overall ceiling of Rs.50 lakh, with differential margins separately on land and building of houses. Under these conditions, banks need to be on alert against an unbridled growth of housing finance and should take due precaution in the matter of interest rates, margin, reset period and documentation. Issues under active consideration include desirability of prescribing a benchmark rate for home loans.

Micro Finance

8.30 Micro-credit institutions and Self Help Groups (SHGs) are important vehicles for credit delivery to self-employed persons, particularly, women in rural and semi-urban areas. Issues relating to structure and sustainability, funding, regulations and capacity building for micro-credit delivery are engaging attention of the Reserve Bank. The objective has been to accelerate the flow of bank credit to micro-finance institutions while maintaining their decentralised, voluntary and non-bureaucratic character, particularly in rural and semi-urban areas. Considering the high recovery rate in respect of banks' advances to SHGs, unsecured advances given by banks to SHGs against group guarantees are currently excluded for the purpose of computation of the prudential norms on unsecured guarantees and advances.

8.31 With a view to facilitating smoother and more meaningful banking with the poor, a pilot project for purveying micro credit by linking Self-Help Groups (SHGs) with banks was launched by the NABARD in 1991-92. The scheme has since been extended to RRBs and co-operative banks. The number of SHGs linked to banks aggregated 7,17,360 as on March 31, 2003 with almost 40 per cent concentrated in Andhra Pradesh (Box VIII.5). This translated into an estimated 11.6 million very poor families brought within the fold of formal banking services. More than

Box VIII.5

Self-Help Group Linkage: The Andhra Pradesh Success Story

In India, as in other countries, micro credit groups are being recognised by policy authorities as an effective tool for achieving the distributional objectives of monetary policy. In the recent period, considerable emphasis has been placed on promotion of micro credit enterprises in view of perceived inadequacies of existing agencies in providing productive credit to those with little or no previous access to formal credit facilities. The Self-Help Group (SHG)-bank linkage model has emerged as the most dominant model of micro finance delivery in India.

A SHG is a registered or unregistered group of micro entrepreneurs with a homogenous social and economic background, voluntarily coming together to save small amounts regularly and mutually agreeing to contribute to a common fund to meet their emergency needs on mutual help basis. The group members use collective wisdom and peer pressure to ensure proper end-use of credit and timely repayment thereof. In fact, peer pressure has been recognised as an effective substitute for collaterals. Besides, financing through SHGs reduces transaction costs for both lenders and borrowers.

The Reserve Bank has put in place a facilitating environment for banks to promote SHGs. Nevertheless, progress has been uneven with significant strides towards access to bank credit and spread of micro finance across the country. The uneven spread could be gauged from the fact that almost 40 per cent of the SHGs are concentrated in Andhra Pradesh. The important role played by the State Government through District Rural Development Agencies (DRDAs) as Self-Help Promoting Institutions (SHPI) is the main reason for impressive growth in Andhra Pradesh. In other States, the role of SHPI is limited to Non-Government Organisations (NGOs) which leads to confinement of SHGs in the area of operation of these NGOs. Moreover, the Government in Andhra Pradesh had facilitated promotion of a large number of women's groups under Development of Women and Children in Rural Areas (DWCRA). The funding support received by the State Government under DWCRA helped in a massive expansion of the movement in the State. The Government of Andhra Pradesh also explored alternative options of making available access to resources to the rural poor women. Consequently, as at end-March 2003, the total number of credit linked SHGs stood at 2,81,338. Total bank loans extended to these SHGs exceeded Rs.975 crore, with commercial banks accounting for 62 per cent of the total linkage and 65 per cent of the credit extended, RRBs accounting for 35 per cent of the linkage and 33 per cent

(Contd....)

(Concld....)

of the credit and co-operatives accounting for the remaining 3 per cent of the linkage and 2 per cent of the credit. In consultation with the NABARD, the State Government attempted reorientation of the women's groups promoted under DWCRA on the lines and spirit of SHGs. This followed intensive capacity building and training support from the NABARD to the State and district-level officials for reorienting the entire movement, away from the subsidy culture to the savings-led, self-managed, participative micro-finance movement under the SHG-bank linkage programme. The SHGs cover a diverse range of activities including crop production, purchase of cloth/ yarn, weaving, share cropping, idli making, food processing, dairy, small business, fair price shops, bullock carts, draught animals, vegetable vending, saree business, pickle making, small hotels, bamboo basket making, tailoring and fruit vending. These efforts led to the emergence of large number of quality SHGs through the intervention of village animators, anganwadi workers, field-level Government functionaries as well as SHG leaders.

After reorienting the groups on SHG principles, the Government of Andhra Pradesh also undertook a well-designed exercise of grading SHGs. Those qualifying as 'A' category SHGs were entrusted to banks for financing after proper screening and rating. Simultaneously, the banks were sensitised about the need for proper rating of SHGs by NABARD. Thus, a two-fold quality check was put in place - while the DRDAs have put in place a strong system of management information systems (MIS) emanating from the villages to clusters, blocks and aggregated at the district level, the NABARD has its own MIS based on the refinance being released to the banks. The SHGs are, thus, regularly monitored and their quality is maintained with adequate support from the State Government. The record of SHGs in Andhra Pradesh for timely payment is over 95 per cent.

90 per cent of the groups linked with banks are exclusive women groups and the scheme has more than 95 per cent on-time repayment record. Cumulative disbursement of bank loans to these SHGs stood at Rs.2,049 crore as on March 31, 2003, with an average loan of Rs.28,560 per SHG and Rs.1,766 per family. There are, at present, 48 commercial banks, 192 RRBs and 264 co-operative banks associated with the SHG-bank linkage programme. This programme presently covers 523 districts across the country with the total number of participating NGOs and other agencies currently involved in this linkage being 2,800 (Table 8.10).

Credit to Agricultural Sector

8.32 The share of outstanding agricultural advances of public sector and private sector banks in bank credit has remained stable in the recent years, with the share of private sector banks showing an increase at the end of March 2003 as a result of rise in agricultural advances of some of the new generation private sector banks (Table 8.11).

8.33 Since 1994-95, public sector banks prepare Special Agricultural Credit Plans (SACP) on an annual basis. During 2002-03, the disbursements to agriculture under these Plans were Rs.33,921 crore against a projection of Rs.36,838 crore. In the recent period, policy interventions for building institutional delivery mechanisms for credit to agriculture have been supplemented by location specific innovations which involve private sector initiatives (Box VIII.6).

8.34 The recovery of direct agricultural advances of public sector banks continue to remain stable; however, the percentage of recovery improved as at the end of June 2002 (Table 8.12).

Relief for Drought affected Farmers

8.35 Failure of the South-West monsoon resulted in shortage of rainfall in the sowing month of July 2002. Moreover, nearly 60 per cent of meteorological sub-divisions in the country received deficient/scanty rainfall. The adverse impact of the drought on the *kharif* crops hampered the loan repaying capacity of the farmers. They were not only unable to service their debts but also needed further loans during the season. In order to provide relief to the affected farmers, guidelines for relief measures by banks in the districts notified by the State Governments as drought affected were issued in November 2002. Banks were advised not to recover any amount either by way of principal or interest during the year 2002-03 in respect of *Kharif* crop loans. The principal amount of crop loans was converted into term loans to be recovered over a minimum period of five years in the case of small and marginal farmers and four years in the case of other farmers. Interest due on crop loans was allowed to be deferred with no charged interest on the deferred interest. As a one-time measure, the first year's deferred interest liability on *Kharif* loans was waived completely.

Kisan Credit Cards

8.36 Pursuant to the announcement made in the Union Budget for the year 2002-03, banks were

Table 8.10 : Self Help Group and Bank Linkages : End-March 2003

(Amount in Rupees crore)

Region/ state	Commercial Banks		Regional Rural Banks		Co-operative Banks		Total	
	No. of SHGs	Bank Loan	No. of SHGs	Bank Loan	No. of SHGs	Bank Loan	No. of SHGs	Bank Loan
1	2	3	4	5	6	7	8	9
A. Northern Region								
1. Haryana	359	2.6	1,165	4.3	–	–	1,524	6.9
2. Himachal Pradesh	3,451	4.5	1,365	2.4	4,059	10.1	8,875	17.1
3. Punjab	330	1.5	141	1.1	371	1.4	842	4.0
4. Jammu and Kashmir	405	0.8	315	0.5	168	1.1	888	2.4
5. Rajasthan	8,807	16.1	11,526	24.8	2,409	5.4	22,742	46.3
6. New Delhi	52	0.4	–	–	–	–	52	0.4
Sub Total	13,404	25.9	14,512	33.1	7,007	18.0	34,923	77.1
B. North Eastern Region								
7. Assam	282	0.3	3,158	4.2	37	0.1	3,477	4.5
8. Manipur	162	0.5	–	–	–	–	162	0.5
9. Meghalaya	62	0.6	117	Neg	–	–	179	0.6
10. Sikkim	24	0.1	–	–	–	–	24	0.1
11. Tripura	2	Neg	96	0.1	6	Neg	104	0.1
12. Nagaland	–	–	15	0.1	–	–	15	0.1
13. Arunachal Pradesh	108	0.2	–	–	–	–	108	0.2
Sub Total	640	1.6	3,386	4.4	43	0.1	4,069	6.0
C. Eastern Region								
14. Bihar	2,873	4.4	5,197	7.3	91	0.4	8,161	12.1
15. Jharkhand	4,518	19.5	3,247	7.1	–	–	7,765	26.7
16. Orissa	12,451	12.7	24,621	31.8	5,200	6.6	42,272	51.0
17. West Bengal	7,731	5.8	8,287	10.2	16,629	14.4	32,647	30.5
18. A and N Islands (UT)	–	–	–	–	48	0.2	48	0.2
Sub Total	27,573	42.5	41,352	56.4	21,968	21.5	90,893	120.5
D. Central Region								
19. Madhya Pradesh	5,054	13.0	8,326	13.6	1,891	4.1	15,271	30.7
20. Chhattisgarh	565	0.4	4,286	3.7	1,912	1.2	6,763	5.4
21. Uttar Pradesh	17,151	13.3	35,644	73.1	901	1.0	53,696	87.5
22. Uttaranchal	4,780	17.4	811	3.2	262	0.1	5,853	21.1
Sub Total	27,550	44.1	49,067	93.7	4,966	6.9	81,583	144.7
E. Western Region								
23. Goa	194	0.8	–	–	46	0.3	240	1.1
24. Gujarat	8,535	9.4	4,120	5.3	1,220	1.3	13,875	16.1
25. Maharashtra	14,989	41.3	9,339	20.4	3,737	8.0	28,065	69.7
Sub Total	23,718	51.6	13,459	25.7	5,003	9.6	42,180	86.9
F. Southern Region								
26. Andhra Pradesh	1,74,992	634.1	99,558	322.2	6,788	19.1	2,81,338	975.4
27. Karnataka	23,680	43.8	21,929	60.5	16,569	39.7	62,178	144.0
28. Kerala	14,068	40.3	4,218	9.1	2,726	15.1	21,012	64.5
29. Tamil Nadu and UTP	55,436	265.6	29,859	122.2	13,889	41.8	99,184	429.5
Sub Total	2,68,176	983.8	1,55,564	513.9	39,972	115.7	4,63,712	1,613.4
Total	**3,61,061**	**1,149.5**	**2,77,340**	**727.2**	**78,959**	**172.0**	**7,17,360**	**2,048.7**

Neg. : Negligible.
Components may not add up to the total due to rounding off.
Source : National Bank for Agriculture and Rural Development.

advised to issue Kisan Credit Cards (KCCs) to cover all eligible borrowers in the agricultural sector by March 2004. Public sector banks issued 10.1 million KCCs up to March 31, 2003. As announcement in the Union Budget 2001-02, banks are required to provide a personal insurance package to the KCC holders to cover them against accidental death or permanent disability up to a maximum amount of Rs.50,000 and Rs.25,000, respectively. The premium burden for this was to be shared by the card issuing institution(s) and the Kisan Credit Card holder(s) in a ratio of 2:1. The personal insurance package linked to KCCs was operationalised in July 2001.

8.37 The Reserve Bank has commissioned the National Council of Applied Economic Research

Table 8.11 : Outstanding Agricultural Advances

(Rupees crore)

As at End-March	Public Sector Banks		Private Sector Banks	
	Amount Outstanding*	% of Net Bank Credit	Amount Outstanding*	% of Net Bank Credit
1	2	3	4	5
1998	34,304	15.7	2,746	9.7
1999	40,078	16.3	3,286	9.5
2000	46,190	15.8	4,481	9.1
2001	53,685	15.7	5,381	9.6
2002	63,083	15.8	5,406	9.5
2003	73,874	15.5	8,577	10.8

* : Data are provisional.

Note: The target for advances to agriculture is 18 per cent for the domestic banks.

(NCAER) to conduct a survey for assessing the effectiveness, coverage, weaknesses, and impact of the KCC Scheme. The impact assessment survey would cover all regions and would recommend appropriate policy actions to strengthen the scheme.

Rural Infrastructural Development Fund (RIDF)

8.38 Both public sector and private sector banks, having shortfalls in lending to priority sector/ agriculture are allocated shares for contribution to the RIDF established with the NABARD for assisting State Governments/State-owned corporations in quick

Box VIII.6

Institutional Credit to Agriculture

As a Key sector of the Indian economy, agriculture receives priority in the credit delivery mechanism of the Reserve Bank. The process of rural credit delivery commenced with the introduction of co-operatives. A formidable institutional structure has since been raised over the years for financing rural development. Nationalisation of banks in 1969 signaled the need for redefining rural sector priorities. Concomitantly, advances to certain segments of the economy were classified as priority sector credit in March 1969. Public sector banks have been formulating Special Agricultural Credit Plans (SACP) under which the banks are required to fix self-set targets for achievement during the year (April-March). The targets are generally fixed by the banks with an increase of about 20 to 25 percent over the disbursement made in the previous year. With the introduction of SACP, the flow of credit to the agricultural sector by public sector banks has increased substantially. At present, a sub-target of 18 per cent of net bank credit has been stipulated for lending to the agriculture sector by domestic scheduled commercial banks. This is inclusive of both direct and indirect finance provided by banks. With a view to ensuring that the focus of the banks on the 'direct' category of agricultural advances does not get diluted, it was stipulated in 1993 that agricultural lendings under the 'indirect' category should not exceed one-fourth of the sub-target of 18 per cent, *i.e.*, 4.5 per cent of net bank credit. All agricultural advances under direct as well as indirect categories continue to be reckoned in computing performance under the overall priority sector lending target of 40 percent of net bank credit.

Both public sector and private sector banks' shortfall in lending to priority sector/agriculture are now allocated for contribution to the Rural Infrastructure Development Fund (RIDF) established with the NABARD. The RIDF has contributed to improvement of infrastructure like irrigation, roads and bridges. Funds in the RIDF would now increasingly be used for schemes which more directly benefit the farmers rather than contributing only to rural infrastructure improvement. The existing shelf of schemes under the RIDF is accordingly being re-examined and areas which need to be given priority for sanction, *e.g.*, irrigation, water and soil conservation are being identified. RIDF assistance has also been linked to agricultural/rural reforms in the States.

In the recent period, the Reserve Bank has sought to supplement the credit interventions for agriculture by a series of initiatives like expanding the scope of priority sector lending to include financing of Agri-Clinics and Agribusiness centers, and financing purchase of land by small and marginal farmers. This has been done with a view to supplementing the existing extension network to accelerate the process of technology transfer to agriculture and providing supplementary sources of input supply and services for which, by and large, farmers presently depend on State agencies. Introduction of the Capital Investment Subsidy Scheme, Cold Storage Scheme, Food Parks which now covers rural godowns and setting up of Watershed Development Fund has enabled substantial capacity generation.

Effective 1998-99, banks have been issuing Kisan Credit Cards to farmers on the basis of their land holdings so that the farmers can use them to readily purchase agricultural inputs such as seeds, fertilisers, pesticides and draw for their production needs. This scheme aims at adequate and timely support to the farmers for their cultivation needs including purchase of inputs in a flexible and cost-effective manner. Over the last couple of years, the Kisan Credit Card Scheme has emerged as an effective tool for catering to the short-term credit requirements of the farmers.

References

1. Government of India (2000): National Agricultural Policy Document.

2. Reserve Bank of India (1997): Report of High-level Committee on Agricultural Credit.

Table 8.12 : Public Sector Banks - Recovery of Direct Agricultural Advances

(Rupees crore)

Year ended June	Demand	Recovery	Overdues	Percentage of recovery to demand
1	2	3	4	5
1999	18,204	12,337	5,867	67.77
2000	20,215	14,058	6,158	69.54
2001	22,429	15,540	6,889	69.28
2002@	19,853	14,099	5,754	71.02

@ Provisional data in respect of 22 PSBs.

completion of on-going projects relating to medium and minor irrigation, soil conservation, watershed management and other forms of rural infrastructure. The IXth tranche of RIDF has been established with a corpus of Rs.5,500 crore.

8.39 In the case of RIDF-I to VI, the rate of interest on deposits placed in the Fund was uniform for all the banks irrespective of the extent of their shortfall. Effective RIDF VII, the rate of interest on RIDF deposits is linked to the banks' performance in lending to agriculture. Accordingly, banks receive interest at rates inversely proportional to their shortfall in agricultural lending.

Credit to Women

8.40 Public sector banks were advised to earmark 5 per cent of their net bank credit as credit to women by the end of March 2004. At the end of March 2003, the aggregate proportion of credit to women in the portfolio of public sector banks stood at 3.9 per cent of net bank credit.

Credit to SSIs

8.41 At the end of March 2002, the outstanding scheduled commercial banks' credit to sick SSIs numbering 1,77,336 was Rs.4,819 crore. Of these units, 4,493 units were found to be viable and their outstanding bank credit amounted to Rs.416 crore. There were 1,67,574 non-viable units with outstanding bank credit of Rs.4,147 crore. Banks placed 621 units involving outstanding credit of Rs.89 crore under nursing programmes.

8.42 The total credit provided by public sector banks to small-scale industries (SSI) at the end of March 2003 was Rs.52,988 crore which formed 11.1 per cent of net bank credit and 26.1 per cent of the total priority sector advances of these banks. Out of these advances to SSI units, advances to cottage industries, artisans and tiny industries were Rs.26,939 crore, constituting 50.8 per cent of the advances to the SSI sector.

8.43 Public sector banks were advised to operationalise at least one specialised SSI branch in every district and centre having cluster of SSI units. At the end of March 2003, 417 specialised SSI bank branches were operationalised by the banks.

Credit to Khadi and Village Industries Commission

8.44 A consortium of select public sector banks was formed with the State Bank of India as the leader of the consortium to provide credit to the Khadi and Village Industries Commission (KVIC) under the consortium scheme of Rs.1,000 crore. These loans are provided at 1.5 per cent below the average prime lending rates of five major banks in the consortium. At the end of June 2003, an amount of Rs.357 crore was outstanding out of Rs.738 crore disbursed by the consortium under the scheme.

Government Sponsored Schemes

8.45 The total number of *Swarozgaris* assisted under the Swarnajayanti Gram Swarozgar Yojana (SGSY) during 2002-03 (up to February 2003) was 5,35,133. Bank credit amounting to Rs.781 crore and Government subsidy amounting to Rs.405 crore were disbursed under this scheme. Of the *Swarozgaris* assisted, 1,60,638 (30.0 per cent) were scheduled castes, 78,157 (14.6 per cent) were scheduled tribes, 2,57,664 (48.2 per cent) were women and 4,166 (0.8 per cent) were physically handicapped. The investment per family was Rs.22,169. Under the Swarna Jayanti Shahari Rozgar Yojana (SJSRY), a total of 16,628 applications were sanctioned during 2002-03, with disbursements amounting to Rs.41.7 crore made in 11,756 cases up to September 2002. The total number of applications sanctioned under the Scheme of Liberation and Rehabilitation of Scavengers (SLRS) during 2002-03 was 5,109. Out of this, disbursements amounted to Rs.7.3 crore in 4,253 cases as on December 31, 2002. Under the Prime Minister's Rozgar Yojana (PMRY), the number of applications sanctioned during 2002-03 was 2,26,572 involving an aggregate sanctioned amount of Rs.1,461 crore.

Differential Rate of Interest (DRI) Scheme

8.46 The outstanding advances of public sector banks under the DRI Scheme at the end of March 2003 amounted to Rs.300 crore in 3.7 lakh borrowal accounts, forming 0.1 per cent of the total advances outstanding as at the end of the previous year, which is substantially less than the target of 1.0 per cent.

Local Area Banks

8.47 The working of the Local Area banks (LAB) was reviewed during 2002-03 (Table 8.13). Attention was drawn to the weakness in the concept of the LAB model, particularly its size, capital base, inherent inability to absorb the losses which are bound to arise in the course of business, risk prone credit portfolio, inability to diversify and derisk the business model in view of size and location. It has been decided not to issue fresh licenses for establishment of LABs.

Table 8.13 : Deposits and Advances of Local Area Banks

(Rupees crore)

Item/Date	March 2003	December 2002	September 2002	June 2002
1	2	3	4	5
Deposits	113.3	106.8	102.6	99.6
Advances	76.9	70.3	67.5	66.9

Banking Ombudsman Scheme

8.48 The Banking Ombudsman Scheme, 1995 was announced in June 1995 under Section 35A of Banking Regulation Act, for expeditious and inexpensive settlement of customer complaints about the deficiencies in banking services. All commercial banks having business in India (except RRBs) and scheduled primary co-operative banks were covered under the scheme. The scheme has since been reviewed and notified in June 2002 as Banking Ombudsman Scheme, 2002. The revised scheme includes provision for establishment of a Review Mechanism, enlarging the ambit of the scheme to include RRBs and entrusting the work of arbitration involving amounts up to Rs.10.0 lakh to the Banking Ombudsman. The number of complaints received in the various Banking Ombudsman offices across the country during 2002-03 declined to 6,506 as compared with 7,022 in the previous year. The complaints pertained to collection of negotiable instruments, operation of deposit account and claim in respect of fraudulent withdrawals. During 2002-03, 2,132 complaints were rejected after scrutiny, 2,995 complaints were withdrawn/settled through conciliation, 36 complaints were settled by recommendations and awards were given in respect of 47 complaints.

Food Credit

8.49 Credit limits are authorised to the Food Corporation of India (FCI), State Governments and Union Territory authorities for procurement of foodgrains, to National Agricultural Co-operative Marketing Federation (NAFED) for procurement of pulses and oilseeds, and to the Jute Corporation of India (JCI) for raw jute procurement. The food credit provided under the consortium arrangement covers mainly rice/paddy and wheat. Procurement of coarse grains such as jowar, bajra, ragi, barley and maize is also covered at the specific instance of State Governments. In view of its size and national priority, food credit is taken as the first charge on the lendable resources of the banks and is made available without stipulation of any margin. The rate of interest charged is equal to the average of Prime Lending Rates (PLRs) of five major banks in the Food Consortium. The consortium arrangement is regulated by the Reserve Bank with regard to entry/exit of banks into/from the consortium, authorisation of food credit limits for procurement purposes, fixing percentage/shares of member banks in the consortium and the interest rate charged on food credit.

8.50 The credit limits authorised for food procurement are disbursed by a consortium of 61 banks (State Bank of India (SBI), 7 Associate Banks of SBI, 19 other public sector banks, 14 private sector banks and 20 state co-operative banks) through the consortium leader, under a 'single window' system. The share of each bank is ordinarily determined by the Reserve Bank on the basis of its share in the fortnightly average aggregate deposits of all member banks, during the preceding financial year. The rate of interest charged is 11.05 per cent (effective January 1, 2003).

8.51 With the onset of the *kharif/rabi* season, State Governments and Union Territory Authorities provide cash flow statements indicating the projections/ estimates of the production, procurement and marketable surplus. Based on these estimates, credit limits to banks are authorised taking into account the Minimum Support Price (MSP) fixed by the Government as also the admissible costs of procurement such as mandi charges, statutory taxes, loading/unloading charges and transportation charges up to the point of storage. The outstandings in the food credit accounts are always required to be covered by the stocks valued at the lower of the procurement cost or issue price (Table 8.14).

Special Financial Package for Large Value Exports

8.52 The need for medium to long-term bank credit for large export projects at internationally competitive terms was examined in the light of export competitiveness of various products. Accordingly, a special financial package for large value exports of select internationally competitive products with high value addition was drawn up in consultation with the

Table 8.14 : Food Credit

(Rupees Crore)

	Rate of Interest (Per cent)	Outstanding as on	
		July 26, 2002	July 25, 2003
1	2	3	4
Food Credit	11.05	61,437	46,032
Scheduled Commercial Banks	(from 1.1.2003)	59,077	43,277
State Co-operative Banks		2,360	2,755
NAFED (for procurement of pulses and oilseeds)	10.65 (from 1.11.2002)	722	19
Jute Corporation of India (for procurement of raw jute)	11.10 (from 1.1.2003)	Nil	Nil

Government of India for a period of one year up to September 30, 2002. As the scheme was favourably received by the exporters, it was extended up to September 30, 2003.

Flexibility In Repayment Of Pre-Shipment Credit

8.53 Repayment/prepayment of pre-shipment credit is permitted subject to mutual agreement between the exporter and the banker. Packing credit, whether availed in rupees or in foreign currency, is allowed to be repaid out of balances in Exchange Earners Foreign Currency (EEFC) account as also from rupee resources of the exporter to the extent exports have actually taken place. Flexibility is provided to the exporter to convert the drawals under rupee pre-shipment credit into pre-shipment credit in foreign currency (PCFC).

Survey by National Council of Applied Economic Research (NCAER)

8.54 A Survey conducted by the NCAER for feedback on simplification of procedures for delivery of export credit as also the level of exporters' satisfaction with bank services concluded that the level of satisfaction of exporters is fair. A Committee was constituted to sensitise commercial banks about the need to bring about further improvements in the credit delivery system on the lines suggested by the NCAER survey. Reports from banks reveal that the banks have generally complied with the suggestions made by the NCAER.

Assessment of Monetary Policy during 2002-03

8.55 The conduct of monetary policy during 2002-03 was reasonably successful in the context of its objectives. There was a reduction in the deposit rates across all maturities. Longer-term deposit rates of commercial banks declined more sharply than the short-term rates. Deposit rates of private sector banks as well as foreign banks also declined during 2002-03. PLRs of public sector banks fell modestly to 9.0 - 12.25 per cent in March 2003. Sub-PLR lending of the banking system (excluding exports, the bulk of which is at sub-PLR rates) constituted over one-third of their total lending. As many as 47 banks (comprising 23 public sector banks, 7 foreign banks and 17 private banks) reduced their PLR in the second half of the year. Notwithstanding these reductions, the effective lending rates of commercial banks reflected high spreads. Non-food bank credit recovered significantly in consonance with the rise in industrial activity. Industrial outlook surveys suggest that inventory levels are balancing out and capacity utilisation is rising as firms are looking at fresh capital investments. As activity gathers momentum, working capital requirements are expected to be a major source of demand for bank credit (Box VIII.7).

Box VIII.7

Working Capital Cycles and Demand for Bank Credit

Working capital is critical for daily management of cash flows to settle bills, wages and other variable costs. The working capital cycle is the period of time which elapses between the point at which cash begins to be expended on the production of a product and the collection of cash from sale of the product to its customers. Typically, the cycle begins with the injection of cash which is utilised for making payments to the suppliers of raw materials, workers, *etc.* Between each stage of this working capital cycle, there is a time lag. The amplitude of the working capital cycle depends on the type of activity. In general, careful management of working capital is vital for any firm, particularly where the gestation lag between the production process and realisation of the receivables is substantial. In a situation when the firm has incurred all expenditure associated with production but has not realised the value of its product, it is imperative that the firm manages its cash flows carefully to stay liquid and operational.

Working capital requirements can be financed from both internally generated resources (selling current assets) and externally acquired alternatives (borrowing or securing current assets). Mostly firms borrow on the strength of their current assets and the major sources of funds include trade credits, accruals, short-term bank loans, collateral papers, commercial papers and factoring accounts receivable. In a bank-based financial system, the loan from the bank by

(Contd....)

(Concld....)

a corporate takes the form of line of credit or overdraft. This is an arrangement between the bank and its customers with respect to the maximum amount of unsecured credit the bank will permit the borrower firm. Besides this arrangement, there are other forms of short-term financing by raising resources directly from the market through issue of commercial paper.

In the Indian context, a major part of the working capital requirements are met by bank credit. Typically, periods of spurt in industrial activity are associated with surges in non-food bank credit, *albeit*, with some lag. These lags are more prolonged in a production based business rather than in service providing firms. Commercial paper (CP) has emerged as an important source of funding working capital needs; however, it is restricted to a few large companies with triple-A corporate ratings and does not enjoy wider market acceptability. Thus, bank credit in the form of cash credit (CC) and working capital demand loan (WCDL) continues to remain the principal source of working capital requirements. An analysis of the data for large borrowers showed that working capital credit which constituted nearly 65 per cent of the total bank credit in mid-1990s, came down to nearly 55 per cent in 2002.

The CC arrangement in India is a unique system, which is highly advantageous to the borrowers as the task of cash management of the borrowers is passed on to the lending banks. Since the borrowers are free to draw from the cash credit account at any time depending on their cash requirements, it results in uncertainty in the utilisation of the cash credit limit. As such, banks are required to maintain large cash / liquid assets or resort to borrowal from the call money market to meet the sudden demand for withdrawal by the borrowers. In April 1995, under the 'Loan System' of delivery of bank credit, the CC component was restricted to a maximum of 75 per cent of the Maximum Permissible Borrowed Fund (MPBF) in respect of cases where the MPBF was up to 20 crore, with a view to bringing about an element of discipline in utilisation of bank credit by large borrowers and for gaining better control over the flow of credit. The 'Loan System' aimed at minimising the risk of cash and liquidity management on the part of the banking system caused by the volatile movement in the CC component of working capital. It was extended in phases to cover large number of borrowers with the percentage of the loan component (WCDL) being gradually increased. In October 1997, the minimum level of the loan component was prescribed at 80 per cent in respect of borrowers with working capital credit limit of Rs.10 crore and above. In view of the improved environment of short-term investment opportunities available to both corporates and banks and the banks having put in place suitable risk management systems for covering liquidity and interest rate risks, banks were allowed to increase the CC component beyond 20 per cent in October 2001. Banks are expected to appropriately price each of the two components of working capital finance, taking into account the impact of such decisions on their cash and liquidity management.

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Monetary Policy Stance for 2003-04

8.56 The increasing integration of the domestic markets and the sensitivity to impulses from the international financial markets pose new challenges for the conduct of monetary policy especially to the commitment to maintain adequate liquidity in the market with a preference for soft and flexible interest rates to the extent the evolving situation warrants.

8.57 Monetary policy for the year 2003-04 is set in conditions characterised by large accretion to foreign exchange reserves and improving prospects for agriculture with the revised expectations of a normal monsoon. Accordingly, considerable optimism characterises the prospects of real GDP growth, which was initially projected at 6.0 per cent. Inflation is expected to be in the range of 5.0 to 5.5 per cent. Non-food bank credit adjusted for investments in commercial paper, shares/debentures/ bonds of public sector units (PSUs) and the private corporate sector is projected to increase by about 15.5-16.0 per cent in order to facilitate the sustenance of growth in industrial activity.

8.58 The overall monetary and macroeconomic conditions are, at present, satisfactory and in line with policy expectations. Nevertheless, the Reserve Bank would continue to keep a constant watch on the domestic and external situation. Monetary policy for 2003-04 is guided by the objective of provision of adequate liquidity to meet credit growth and support investment demand in the economy while monitoring carefully the movements in the price level. The policy stance continues to be one of preference for a soft and flexible interest rate environment within the framework of macroeconomic stability.

IX DEVELOPMENT AND REGULATION OF FINANCIAL MARKETS

9.1 Adequate liquidity and orderly financial conditions facilitated the progress of reforms in the money, government securities and foreign exchange markets during 2002-03. In order to promote balanced development of the various segments of the money market, and to preserve its integrity and transparency, prudential limits on exposure of banks and primary dealers to call/notice money market were applied. This was accompanied by the infusion of vibrancy into the repo, commercial paper (CP), certificates of deposit (CD) and derivatives segments by easing entry conditions and providing flexibility in issuance. The deepening of the government securities market was carried forward with stricter regulation and surveillance. In the foreign exchange market, the prime objective has been to manage volatility, while there is no fixed target for the exchange rate which is determined by market forces. Liberalisation in current and capital account transactions was continued apace with a view to augment activity in the foreign exchange market, consistent with the growing openness of the economy, and to prepare market participants for greater sensitivity to volume-driven market movements. Priority was accorded during the year to modernising the technological infrastructure for markets in the form of automated screen-based trading under the Negotiated Dealing System (NDS) and risk minimising mechanism for efficient clearing and settlement under the Clearing Corporation of India Limited (CCIL).

MONEY MARKET

9.2 The basic objective of money market reforms continues to be the development of a proper short-term rupee yield curve with sufficient liquidity in all segments. The Reserve Bank has been following a four-fold strategy. First, with a view to transforming the call/notice money market into a pure inter-bank market, a phased exit of non-banks from the call/notice money market was started in May 2001. As the implementation of Stage I did not cause any strain in the call/notice money market and in view of the encouraging progress in NDS/CCIL, the process of moving towards a pure inter-bank call money market was accelerated with the implementation of the Stage II in June 2003. Secondly, prudential limits were assigned on call exposure during 2002-03. The objective is to ensure that banks use the call/notice money market to finance only temporary mismatches. Thirdly, with the liquidity adjustment facility (LAF) emerging as a primary instrument for modulating day-to-day liquidity conditions and providing a corridor for market play, the sector-specific standing liquidity support to the banks and primary dealers was rationalised. Fourthly, measures (discussed below) were taken to make other money market instruments freely accessible to non-bank participants. These measures were intended to improve depth, efficiency and transparency in money market operations.

Call/Notice Money Market

9.3 Large exposures to call/notice money borrowings, which are uncollateralised by nature, carry potential danger of systemic instability arising out of defaults. It also impedes the development of other segments of the money market and constrains the Reserve Bank's ability to influence short-term interest rates.

9.4 In the call/notice money segment, the thrust of reforms was to establish limits on exposure of banks and primary dealers in order to facilitate balanced development of various segments of the money market. The limit on maximum daily call/notice money borrowings at two per cent of aggregate deposits at the end of March of the previous financial year, that had been placed on Urban Co-operative Banks (UCBs) was extended to State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs) on April 29, 2002. Furthermore, prudential limits on borrowing and lending in call/notice money market were stipulated for scheduled commercial banks (SCBs) with a view to preserving the integrity of the financial system and facilitating the development of the repo market. A two-fold strategy was adopted in order to ensure that these banks do not face any disruption in their asset-liability management (ALM). Borrowers and lenders were allowed to unwind their positions by October 4, 2002. Second, the application of caps on banks in the call/notice money market was undertaken in two stages, commencing from the fortnights beginning October 5, 2002 and December 14, 2002, respectively. Any bank facing mismatches was allowed to approach the

Reserve Bank for temporary access to the call/notice money market in excess of the stipulated limit. An increased access over stipulated norms was also permitted for a longer period for banks with fully functional and satisfactory ALM systems.

9.5 Effective December 14, 2002, scheduled commercial banks were allowed to lend up to 25 per cent of their owned funds, on a fortnightly average basis, and up to 50 per cent of such funds on any day during a fortnight. Similarly, they were allowed to borrow up to 100 per cent of their owned funds or two per cent of aggregate deposits, whichever is higher, on a fortnightly average basis and up to 125 per cent of their owned funds on any day during a fortnight. Primary dealers (PDs) were allowed to lend up to 25 per cent of their net owned funds (NOF) on average basis during a reporting fortnight from October 5, 2002. A two-stage call/notice money borrowing restriction on primary dealers of up to 200 per cent and up to 100 per cent, respectively, of their NOF as at the end-March of the preceding financial year would become effective, contingent upon greater deepening of the repo market.

9.6 In view of the encouraging results from the functioning of NDS and CCIL and to facilitate further deepening of repo/term money market, the process of moving towards a pure inter-bank call/notice money market was accelerated. Accordingly, Stage II of the transition was made effective from the fortnight beginning June 14, 2003. Non-bank participants were allowed to lend, on an average in a reporting fortnight, only up to 75 per cent of their average daily lending in the call/notice money market during 2000-01 (Table 9.1). The Reserve Bank may consider providing temporary permission to lend higher amounts in the call/notice money market for a specific period on a case-by-case basis.

9.7 It was made mandatory for all NDS members to report all their call/notice money market deals on NDS from the fortnight beginning May 3, 2003. This will help to improve transparency and strengthen efficiency in the market. Deals done outside NDS have to be reported within 15 minutes on NDS, irrespective of the size of the deal or whether the counterparty is a member of the NDS or not. Full compliance with the reporting requirement to NDS will be reviewed in September 2003. In case there is repeated non-reporting of deals by an NDS member, those non-reported deals may be considered invalid from a future date.

Certificates of Deposit

9.8 In order to impart transparency and flexibility to secondary market transactions, banks and financial institutions (FIs) were required to issue CDs in dematerialised form from June 30, 2002 without prejudice to the Depositories Act, 1996. Existing CDs in physical form had to be converted into demat form by October 2002. Earlier, the Fixed Income Money Market and Derivatives Association of India (FIMMDA) issued standardised procedures, documentation and operational guidelines on June 20, 2002 for issue of CDs in both physical and dematerialised forms. In order to increase the investor base, the minimum size of issues of CDs by banks and FIs was reduced to Rs.1 lakh in June 2002. Furthermore, with a view to providing more flexibility in pricing of CDs and giving

Table 9.1 : Time Table for Pure Inter-bank Call/Notice Money Market

Stages	Time Table announced	Progress Achieved so far
1	2	3
Stage I	It was announced in April 2001, effective May 5, 2001, non-bank institutions (*i.e.*, financial institutions, mutual funds and insurance companies) would be allowed to lend, on an average in a reporting fortnight, up to 85 per cent of their average daily lendings in the call/notice money market during 2000-01.	Implemented
	Permission to corporates to route their call transactions through primary dealers was available up to June 30, 2001.	Implemented
Stage II	It was announced in April 2002, the limit of non-bank lendings in the call/notice money market would be scaled down to 75 per cent of their average daily lendings in the call/notice money market during 2000-01, the effective date of which would be announced when NDS/CCIL becomes fully operational and widely accessed.	Implemented with effect from fortnight beginning June 14, 2003.
Stage III	It was announced in April 2001 that effective 3 months after Stage II, access of non-banks to the call/notice money market would be 40 per cent of their average daily lendings in the call/notice money market during 2000-01.	Not yet implemented.
Stage IV	It was announced in April 2001 that effective 3 months after Stage III, access of non-banks to the call/notice money market would be 10 per cent of their average daily lendings in the call/notice money market during 2000-01.	Not yet implemented.

additional choice to both investors and issuers, CDs were permitted to be issued as coupon-bearing instruments. Banks were allowed to issue CDs on a floating rate basis provided the methodology of computing the floating rate was objective, transparent and market-based.

Commercial Paper

9.9 Banks and FIs have the flexibility to provide credit enhancement for a CP issue by way of standby assistance/credit, backstop facility based on their commercial judgement, subject to prudential norms. In order to provide further flexibility to both issuers and investors in the CP market, non-bank entities, including corporates,were allowed to provide unconditional and irrevocable guarantee for credit enhancement for CP issue to enable flexibility to both issuers and investors. The issuer should fulfil the eligibility criteria prescribed for issuance of CP and the guarantor has to have a credit rating of at least one notch higher than that of the issuer from an approved credit rating agency. The offer document for CPs should disclose the net worth of the guarantor company, the names of the companies to which the guarantor has issued similar guarantees, the extent of the guarantees offered by the guarantor company, and the conditions under which the guarantee will be invoked. Banks have been allowed to invest in CPs guaranteed by non-bank entities, provided their exposure remains within the regulatory ceiling for unsecured exposures.

Derivatives

9.10 In pursuance of the recommendations of the Working Group on Rupee Derivatives (Chairman : Shri Jaspal Bindra), banks and primary dealers were permitted to undertake transactions in exchange traded interest rate derivatives in June 2003. Trading in futures contracts in notional 10-year Government of India bonds, notional 91-day Treasury Bills and 10-year zero coupon bonds commenced at the National Stock Exchange on June 24, 2003. In the first phase, only interest rate futures have been introduced and banks were allowed to hedge interest rate risk inherent in the government securities portfolio. Primary dealers were allowed to take hedging as well as trading positions. Banks can seek membership of stock exchanges for the purpose of transacting in proprietary positions. Extension of hedging to other items of the balance sheet, participation of regulated entities in interest rate derivatives with non-linear pay-offs as well as allowing banks to hold trading positions are slated for the next phase. The Reserve Bank is also actively considering harmonising the regulatory, legal and prudential treatment of OTC and exchange traded interest rate derivatives.

Collateralised Borrowing and Lending Obligation

9.11 Collateralised Borrowing and Lending Obligation (CBLO) was operationalised as a money market instrument through the Clearing Corporation of India Ltd. (CCIL) on January 20, 2003. The CBLO has original maturity between one day and up to one year. The regulatory provisions and accounting treatment for CBLO are the same as those applicable to other money market instruments. In order to develop CBLO as a money market instrument, it has been exempted from CRR subject to banks maintaining minimum CRR of three per cent. As on July 31, 2003, 52 members were admitted in CCIL's CBLO segment. The total turnover in CBLO during January 20, 2003 – July 31, 2003 stood at Rs.7,925 crore amounting to a daily average turnover of Rs.74 crore. The active participants include select co-operative banks and an insurance company. In the recent period, select public sector banks and a mutual fund have also become active in this segment.

Repo Market

9.12 The successful and non-disruptive transition of the call/notice money market into a pure inter-bank market is contingent on the development of the repo market so as to provide a stable collateralised funding alternative. The eligibility requirement of maintaining an SGL account with the Reserve Bank for participation in the repo market, however, excluded a large number of potential users of repos.

9.13 The eligibility to participate in the repo market was expanded with effect from March 3, 2003 to include non-SGL account holders like non-banking financial companies, mutual funds, housing finance companies and insurance companies. These entities were permitted to access the repo market through their "gilt accounts" maintained with the custodians. Since they do not maintain current and SGL accounts with the Reserve Bank, necessary precautions were built in to ensure "Delivery *versus* Payment" (DvP) and transparency while restricting the repos to government securities only. Repos between a custodian and its own clients as well as between clients of the same custodian are not permitted as DvP cannot be ensured for these transactions.

Box IX.1

Repo Accounting

Ready forward or Repurchase Agreements (Repo) are contracts whereby the seller of securities agrees to buy the securities at a pre-specified date and price. Repo contracts are a popular way to raise resources for the entities having sufficient stock of securities. Typically, as repo transactions are collateralised in nature, the rates are lower than the clean lending rates of equivalent tenors. Although any security can be sold as collateral under a repo transaction, only Government of India dated securities, Treasury Bills and State Government bonds are the eligible underlying instruments for undertaking repo transactions in India.

Although repo transactions are in the nature of buy and sell of securities, they essentially enable borrowing and lending of cash. Despite being a money market instrument, the legal nature of the transaction (*i.e.*, buy and sell) has to be reflected in the investment accounts of both the buyer and the seller since the buyer of securities gets clear and absolute title over the securities acquired through repo. This leads to complications in accounting of repo transactions. In view of the possibility of influencing the investment portfolio through repo transactions, participants were previously allowed to conduct repo transactions only in securities held in their 'held for trading' portfolio. Furthermore, market participants followed different norms with respect to accounting for repo transactions. With the increasing use of repos in the wake of limits on non-bank participation in inter-bank call/notice money markets, a uniform accounting as well as documentation policy is a pre-requisite for the development of the repo market.

The Reserve Bank, in consultation with Fixed Income Money Markets and Derivatives Association of India (FIMMDA) issued comprehensive guidelines for uniform accounting of repo/reverse repo transactions on March 24, 2003. The salient features of the repo accounting guidelines are:

- The legal character of repo under the current law, *viz.*, as outright purchase and outright sale transactions is kept intact.
- The first leg of the repo should be contracted at prevailing market rates. Accrued interest received/paid in a repo/reverse repo transaction and the clean price (*i.e.*, total cash consideration *less* accrued interest) should be accounted for separately and distinctly.
- Securities will exit and enter the investment account of the seller at the book value.
- The buyer of securities will mark to market the securities acquired under reverse repo transactions as per the investment classification of the security.
- While the buyer will book the coupon during the period of the repo, the coupon will not accrue to the seller during the period of the repo.
- Participants may consider entering into bilateral Master Repo Agreement as per the documentation finalised by FIMMDA.

9.14 Several other measures were taken to widen and deepen the repo market and to give funding access to the non-bank entities who are being gradually phased out from the call market. Reporting of all transactions on the NDS and their settlement through CCIL was made compulsory to ensure transparency. A Master Repo Agreement was finalised for use of market participants. Permitting rollover of repos is under active consideration. In order to strengthen the institutional infrastructure, uniform accounting norms for repo and reverse repo transactions were prescribed to the market participants on March 24, 2003 (Box IX.1).

GOVERNMENT SECURITIES MARKET

9.15 Since the early 1990s, the Reserve Bank has been engaged in the deepening and widening of the primary and secondary segments of the government securities market in order to obviate the need for monetisation of fiscal deficits, as part of reforms in monetary-fiscal coordination. Significant steps taken by the Reserve Bank in the recent period include elongation of maturity, development of new benchmark government securities by consolidating new issuances in key maturities, enhancing fungibility and liquidity by reissuances of existing loans, promoting retailing of government securities, introduction of floating rate bonds, announcement of a core calendar and enhanced transparency of the Central Government's borrowing programme.

Diversification of instruments

9.16 In July 2002, there was an issuance of Floating Rate Bonds, which is an effective instrument for hedging interest rate risk in the context of the elongation of the maturity profile of Government debt. For the first time, on July 17, 2002 a 10-year bond was issued with put and call option exercisable on or after 5 years from the date of issue. The issuance of two 30-year Government bonds in August and October 2002 provided additional flexibility to market participants.

9.17 Operational and prudential guidelines on separate trading for registered interest and principal

of securities (STRIPS) are being formulated. Dates for consolidation of coupon strips (March 25/September 25 and May 30/November 30) would be aligned with coupon payment dates in future issuances. The coupon payment dates of 6.01% GS 2028, issued on August 7, 2003, were aligned to March 25/September 25. Primary Dealers (PDs) which meet certain laid down financial criteria would be authorised to undertake stripping and reconstitution of securities. The Reserve Bank's Public Debt Office (PDO) would act as a registry for stripped bonds.

9.18 Measures were introduced on May 20, 2002 to accelerate the process of holding of securities in the dematerialised mode and to reduce the scope for trading in government securities in physical form which leads to possible irregularities through non-delivery. They included compulsory holding of government securities in demat form by all regulated entities, limiting the number of gilt accounts or dematerialised accounts to be maintained by such entities to one and total prohibition on transactions in physical form with any broker entity. In connection with demating of securities through constituent secondary general ledger (CSGL) and to eliminate possibility of "excess" securities being created, specific action points were drawn up for a system of more frequent and effective reconciliation of Government loans.

Negotiated Dealing System

9.19 The Negotiated Dealing System (NDS) has stabilised since its inception on February 15, 2002. Almost all market participants have joined NDS and Subsidiary General Ledger (SGL) transactions at the Public Debt Office (PDO), Mumbai are now on electronic mode through NDS. Similarly, bids in LAF, Treasury Bills and Central Government dated securities auctions are being received electronically through NDS, which has resulted in reducing auction bid processing time. The advancement of bid submission time in Treasury Bills and Central Government auctions from 2.30 pm to 12.30 pm and electronic bidding has facilitated the announcement of the auction results within market hours. To provide wider access to the data on the government securities market, information on trades captured by the NDS is being disseminated through the Reserve Bank's website since October 25, 2002 on near real time basis. In the next phase of the NDS, it will be integrated with the securities accounts, servicing of debt and primary issuance with countrywide access through the Indian financial network (INFINET).

Clearing Corporation of India Limited

9.20 The Clearing Corporation of India (CCIL) commenced operations with transactions in government securities as well as Rupee/US dollar foreign exchange spot and forward deals since November 12, 2002. Effective April 1, 2003 all transactions in government securities in the Public Debt Office (PDO), Mumbai are now being settled through CCIL which has resulted in significantly reduced funding requirement for every member and mitigation of liquidity risk. An independent assessment of the CCIL's risk management system was conducted by an expert from the European Central Bank. The overall assessment was that the CCIL's system is good and its management competent. Suggestions for further improvements include: (i) reconsideration of the legal status of CCIL as a credit institution to obtain better protection; (ii) conducting stress tests of CCIL's risk management under extreme catastrophic scenarios; (iii) development of a clear legal framework for finality of multilateral netting; and (iv) introduction of real time gross settlement system (RTGS) at an early date.

Trading on Stock Exchanges

9.21 Buying and selling of government securities through the stock exchanges (National Stock Exchange (NSE), Stock Exchange Mumbai (BSE) and Over the Counter Exchange of India (OTCEI) was allowed with effect from January 16, 2003 on an anonymous screen-based order-driven basis to facilitate countrywide access and wider participation in the government securities markets. This measure was aimed at reducing time and cost in trade execution by matching orders on a strict price and time priority, and enhancing the operational and informational efficiency of the market as well as its transparency, depth and liquidity. The volumes are, however, still meagre.

Regulatory Oversight

9.22 In the wake of certain irregularities in government securities transactions by some of the DCCBs and UCBs in government securities transactions, monitoring the developments in the government securities market has become critical from the point of view of systemic stability. The measures initiated include:

- recommending supersession of the boards of the co-operative banks and filing of criminal complaints where losses have been incurred by banks;

- imposition of penalty in cases of major violations and issuance of show-cause notices in cases of minor transgressions;
- introduction of quarterly audit certificates on investment transactions in government securities of DCCBs/UCBs;
- compulsory dematerialised holdings of securities for all regulated entities; single dematerialised account together with a designated funds account to ensure availability of clear funds and sufficient securities before putting through the transactions; and,
- prohibition of all transactions in physical form with any broker.

Primary Dealers

9.23 The primary dealer (PD) system has been in operation for the last eight years. At the end of 2002-03, there were 18 primary dealers in the government securities market. During 2002-03, the PDs absorbed 63 per cent of auctioned primary issues of government securities and 65 per cent of Treasury Bill auctions as against 65 per cent and 83 per cent, respectively, during the preceding year, reflecting a more aggressive interest by other investors. While call money borrowings remained a steady source of finance for their gilt investments, the average daily utilisation of liquidity support by the PDs was well below the levels in 2001-02. This reflected the ample liquidity available in the system during the year. With the development of the repo market and measures taken to facilitate repo transactions, it is expected that the repo market will provide a major source of funds for PDs' operations.

9.24 Primary dealers are required to maintain minimum capital of 15 per cent of aggregate risk weighted assets, covering credit risk and market risk. At the end of March 2003, the Capital to Risk Weighted Assets Ratio (CRAR) of the PD system was significantly higher than the prescribed minimum capital requirement (Table 9.2). The market risk capital is maintained at higher of the estimates of standardised model and the Value-at-Risk (VaR) method. In January 2002, PDs were advised to follow a prudent dividend distribution policy so as to build up sufficient reserves even in excess of regulatory requirements which can act as a cushion against any adverse interest rate movements in the future. The financial strength of the PDs has been monitored at regular intervals.

Table 9.2 : Select Indicators of the Primary Dealers

(Amount in Rupees crore)

Item	End March 2003@	End March 2002	End March 2001
1	2	3	4
Number of PDs	18	18	15
Total Capital (NOF)	5,048	4,380	3,184
Total assets	19,931	17,225	14,772
Of which: Government Securities	14,585	11,961	10,401
Government Securities as percentage of total assets	73.2	69.4	70.4
PD system turnover (Outright)	7,32,143	6,52,127	3,16,915
Market turnover (Outright)	27,55,482	24,23,933	11,44,291
PD turnover to Outright Market Turnover (per cent)	26.6	26.9	27.7
Liquidity Support limits	3,000 (Normal)	4,000 (Normal)	6,000
	1500 (Backstop)	2,000 (Backstop)	
CRAR (per cent)	30.90	38.40	40.90

@ Unaudited in respect of one PD.
NOF : Net Owned Funds

9.25 Keeping in view the growing systemic importance of PDs, they were brought under the purview of the Board for Financial Supervision (BFS) in 2002-03. Besides off-site supervision through prescribed periodic returns, on-site inspection of each PD is also conducted.

9.26 With a view to enlarging the funding avenues for their operations, PDs were allowed to avail of FCNR(B) loans from banks within an overall limit of 25 per cent of their NOF to supplement their funding sources, subject to the foreign exchange risk on such loans being hedged at all times at least to the extent of 50 per cent of exposure.

9.27 Operational guidelines were issued to enable PDs to undertake Portfolio Management Services (PMS) for entities other than those regulated by the Reserve Bank. The undertaking of PMS activity is subject to prior approval of the Reserve Bank and obtaining of certificate of registration from the Securities and Exchange Board of India (SEBI), besides compliance with operational guidelines.

FOREIGN EXCHANGE MARKET

9.28 Reforms in the foreign exchange market were carried forward to deepen various segments of the market and impart sophistication to its functioning. Market participants were allowed greater flexibility of operations in both spot and forward segments,

especially in managing risks. Alongside the introduction of new instruments, significant liberalisation was effected in international current and capital transactions. These efforts are intended to prepare the market for equilibrating significantly higher volumes, and for improving the process of price discovery, supported by the ongoing modernisation of the technological infrastructure. The development of the foreign exchange market in India has been facilitated by the stance of exchange rate policy – underlying demand and supply conditions are allowed to determine exchange rate movements in an orderly manner.

9.29 Authorised Dealers (ADs) were allowed to hedge their exchange risk without limit while undertaking foreign currency-rupee swaps with residents in India with long-term exposures in foreign currency or rupee. Limits continue to exist for swap transactions which allow customers to assume a foreign exchange liability. Moreover, ADs were advised against offering of swaps involving leveraged structures.

9.30 The cap on booking of forward contracts by ADs on behalf of exporters and importers on the basis of the last three years' average performance was raised to US $ 100 million (subject to the facility not exceeding 25 per cent of the eligible limit). Corporates with genuine exposures were allowed to approach the Reserve Bank for booking forward contracts beyond this cap. ADs were permitted to rebook cancelled forward contracts in respect of all foreign exchange exposures falling due within one year. This facility is only available to customers who submit details of exposure and unhedged portion thereof.

9.31 Banks with a minimum CRAR of 9 per cent were allowed to offer foreign currency rupee options on a back-to-back basis from July 7, 2003. ADs with adequate internal control, risk monitoring/ management systems, mark to market mechanism and fulfilling certain other stipulated criteria were allowed to run an option book after obtaining one time approval from the Reserve Bank. Writing of options by customers is not permitted.

9.32 Foreign banks operating in India were allowed to hedge their Tier I capital in Indian books without any restriction on timing of the hedge transaction. To enlarge the scope of forward contracts, ADs were permitted to offer forward cover for inflows under foreign direct investment and for foreign exchange exposures denominated in foreign currency but settled in Indian rupees; they were also allowed to offer cross currency forward cover for FCNR(B) deposits.

9.33 In conformity with global anti-money laundering regulations, the Money Transfer Services Scheme was modified. Only licensed overseas entities with a good credit rating and well established Anti-Money Laundering Systems can act as principals. The Indian agent should be an AD, Full Fledged Money Changer, or registered NBFC. A collateral equivalent to three days' drawings or US $ 50,000 (whichever is higher) has to be maintained by the overseas principal with a designated bank in India in the name of the Indian agent. Amount in excess of US $ 50,000 can be furnished by the principal in the form of bank guarantee. A cap of US $ 2,500 has been placed on individual transactions under the scheme while the number of remittances that can be received by a single individual is restricted to 12 during a year. Amounts exceeding Rs.50,000 must be paid by means of cheque/demand draft/postal order or credited directly to the beneficiary's account.

Exchange and Payments Reforms

9.34 Contemporaneous with the progressive broadening and deepening of the foreign exchange market since the mid-1990s, significant progress has been made in liberalising external current and capital transactions. During 2002-03, significant relaxations were allowed for overseas investments and remittances abroad by banks, corporates and resident individuals. Domestic entities were allowed to retain considerable proportions of their earnings abroad to meet future foreign exchange requirements. Policy initiatives to improve the inflows of foreign direct investment, foreign portfolio investment, non-resident deposits and external commercial borrowings were built upon.

(a) Facilities for Exporters and Importers

9.35 A number of measures were taken to improve exchange arrangements to facilitate foreign trade. Merchant exporters/traders and manufacturer exporters of stipulated goods were allowed to realise export proceeds within an extended period of 365 days subject to certain conditions till September 2003. Units in special economic zones (SEZs) were freed from time limits for such realisations. Other facilities for units in SEZs include permission to undertake job work abroad, receive payment in form of precious metals for export of jewellery, netting off of export receivables against import payments, and capitalisation of import payments.

9.36 Status Holder exporters may credit up to 100 per cent of their eligible receipts of foreign exchange

in their Exchange Earners' Foreign Currency (EEFC) accounts. Exporters were also allowed to use the balance in their EEFC accounts for repayment of packing credit advances to the extent exports have actually taken place, and to extend trade related loans/ advances to overseas importers out of their EEFC balances. Hiring of warehouses abroad by exporters was simplified and it can be permitted by ADs without the need to seek the approval of the Reserve Bank. Exporters of sea food and other perishable food products were allowed to avail of rejection risk insurance cover from an insurer outside India.

9.37 The value limit for which submission of documentary evidence for imports is obligatory was enhanced to US $ 25,000 from US $ 5,000. Furthermore, in respect of companies listed on the stock exchanges with net worth not less than Rs.100 crore, public sector companies, Government of India departmental undertakings, and autonomous scientific or academic institutions audited by the Comptroller and Auditor General (CAG), banks may accept exchange control copy of bill of entry or a certificate from the Chief Executive Officer (CEO) or Auditor of the company in respect of receipt of goods imported, *in lieu* of bill of entry (if the value of goods imported is less than US $ 100,000). With a view to simplifying the procedure for import, the limit for advance remittance without bank guarantee for all current account payments was revised upwards to US $ 100,000 or its equivalent, from the earlier limit of US $ 25,000.

9.38 Authorised Dealers were empowered to approve proposals, within specified parameters, for buyers' credit and suppliers' credit not exceeding US $ 20 million per import, and to open standby letters of credit on behalf of their importer constituents for import of goods permissible under the EXIM policy.

(b) Facilities for Residents

9.39 Norms on release of foreign exchange were liberalised and the maximum permissible amounts were raised for purposes such as medical treatment abroad, private visits abroad, use of payment cards abroad, procurement of books and other items through Internet. With a view to enabling residents to avail of foreign exchange for medical treatment without any irritants and loss of time, release of foreign exchange up to an amount of US $ 50,000 or its equivalent was allowed, without any estimate from a hospital/doctor. This limit was enhanced to US $ 100,000, with effect from July 17, 2003. Release of foreign exchange up to US $ 10,000 to residents was permitted without prior permission of the Reserve Bank for private visits to any country (except Nepal and Bhutan, where Indian rupees can be used). Remittances by residents up to US $ 500 or its equivalent were allowed for transactions permissible under EXIM policy on the basis of mere declaration. International Credit Card (ICC)/ATM Card/Debit Card holders were allowed to use their cards while on holidays outside India to meet their expenses subject only to the credit card limit (as opposed to the limit for private travel), as also for purchase of item of import and when in India, for making payment in foreign exchange for purchase of books and other items through Internet. Furthermore, residents maintaining a foreign currency account with an AD in India or a bank abroad, are free to obtain ICCs issued by overseas banks and other reputed agencies. The restrictions on use of international credit card for purchase of prohibited items continues.

9.40 Resident individuals were permitted to open Resident Foreign Currency (Domestic) [RFC(D)] Accounts with a bank in India and deposit foreign exchange earnings repatriated to India through banking channel out of export of goods and/or services, royalty or honorarium. They were also allowed to open/credit the RFC(D) account with amounts (a) saved from outside India; (b) received as honorarium during the trip outside India; (c) received as gift from persons on visit to India; and (d) received from a person on a visit to India for services rendered in India. These accounts are not interest bearing and there is no ceiling on the balances that can be built up in these accounts. The balances held in these accounts can be used for any purpose for which foreign exchange can be bought from a bank in India. Residents were also allowed to remit foreign exchange for purchase of foreign securities under the employees stock option (ESOP) scheme without limit.

(c) Facilities for Overseas Investment

9.41 The norms for overseas investment were relaxed for banks, corporates and individuals. Listed Indian companies and mutual funds were permitted to invest in companies listed on a recognised stock exchange abroad but with shareholding of at least 10 per cent in an Indian company listed on a recognised stock exchange in India, provided such investment does not exceed 25 per cent of the company's net worth. Resident individuals were also permitted to invest in these companies without any monetary limit. Mutual funds, which were hitherto permitted to invest in ADRs/GDRs of the Indian

companies and rated debt instruments within an overall cap of US $ 500 million, were permitted to invest in equity of overseas companies, subject to the overall cap of US $ 1 billion.

9.42 Banks were accorded greater flexibility in funds management. Earlier, they were allowed to invest up to 50 per cent (as against the existing ceiling of 25 per cent) of their unimpaired Tier 1 capital or US $ 25 million in overseas money market instruments and/or debt instruments. They are now free to undertake investments in overseas money market instruments and/or debt instruments subject to the limits approved by their board of directors. Investment norms for undeployed FCNR(B) funds were also liberalised. ADs were allowed to invest these funds in long-term fixed income securities in overseas markets, subject to rating requirements.

9.43 Companies with a proven track record were allowed to make investment in a foreign entity abroad engaged in any *bona fide* business, without prior approval of the Reserve Bank, by purchasing foreign exchange in the market up to 100 per cent of their net worth (not exceeding US $ 100 million).

9.44 In order to encourage Indian companies to list ADRs/GDRs on overseas exchanges, resident shareholders of Indian companies were permitted to receive the sale proceeds of conversion of shares to ADRs/GDRs in foreign currency. The sale proceeds can also be credited to their EEFC/RFC(D) accounts or to their rupee accounts. Indian companies were also allowed to retain ADR and GDR proceeds abroad for any period to meet their future foreign exchange requirements. In case of ADR/GDR proceeds pending utilisation/repatriation, they may be invested in certain categories of deposits and monetary instruments abroad. Indian companies were permitted to sponsor issues of ADRs/GDRs with an overseas depository against the shares held by its shareholders.

9.45 In order to facilitate increased floating stock of shares of large Indian companies with capital base of Rs.1,000 crore or more, the threshold limit for investments by FIIs/NRIs under the portfolio investment scheme was enhanced from the existing two per cent to 0.5 per cent below the limit up to which non-resident investments are permitted in such companies. Indian companies were allowed to remit the redemption proceeds of the non-convertible debentures (NCDs)/partial convertible debentures (PCDs) issued by them to non-resident Indians (NRIs)/ overseas corporate bodies (OCBs).

9.46 An 'automatic route' for prepayment of external commercial borrowings was introduced during the year. The norms for prepayment of External Commercial Borrowings (ECBs) were simplified by allowing prepayment without any limit out of balances held in EEFC account as well as out of local resources/market purchases. Corporates raising ECBs were allowed to retain the funds abroad, subject to some stipulations.

9.47 Corporates who have set up overseas offices were allowed to acquire immovable property of their staff abroad for business as well as for residential purposes with prior permission from the Reserve Bank.

(d) Facilities for Non Resident Indians (NRIs) and Persons of Indian Origin (PIOs)

9.48 With a view to further liberalising the exchange control regulations and providing additional facilities to NRIs/PIOs, more powers were delegated to ADs. Initially they were allowed to remit specified amount out of NRO account of non-residents for purposes like education (US $ 30,000), medical treatment (US $ 100,000) and sale proceeds of immovable property (US $ 100,000). There was further delegation of power to banks to remit up to US $ 1 million in a calendar year out of balances held in NRO accounts, subject to payment of taxes/submission of undertaking.

9.49 Furthermore, the lock-in period for repatriation of sale proceeds of immovable property was removed and the NRIs were permitted to credit their current income to their NRE accounts for easy repatriability. They were also provided freedom to repatriate excess money remitted towards purchase of shares, surplus money on account of non-allotment/cancellation of flats/plots/bookings and redemption proceeds of non-convertible debentures (NCDs)/partially convertible debentures (PCDs) (that were issued under FERA). ADs in India were allowed to issue international credit cards to NRIs and PIOs and they were also permitted the settlement of charges on usage of such cards through funds in Non-Resident (Ordinary) Rupee Account. The current income like rent, dividend, pension, interest, *etc.*, of NRIs was allowed to be credited to their Non-Resident (External) Rupee Accounts.

(e) Foreign Exchange Clearing

9.50 An important element in the infrastructure for the efficient functioning of the foreign exchange

market is the clearing and settlement of inter-bank dollar-rupee transactions. The CCIL offers a multilateral netting mechanism for inter-bank spot and forward dollar-rupee transactions. As a Central Counter Party (CCP) guaranteeing trade settlement, the CCIL interposes as a buyer to each seller and as a seller to each buyer in a defined trade through a process called novation thereby giving rise to two contracts from the single original contract between the two parties. Live operations for clearing and settlement of spot and forward dollar-rupee transactions commenced on November 12, 2002. While the US dollar leg of transactions is settled through CCIL's account with its settlement agent in the US, the rupee leg is settled through the member banks' current accounts maintained with the Reserve Bank. During the period November 12, 2002 to March 31, 2003, 91 settlements have taken place covering 2,01,614 settled transactions amounting to over US $ 137 billion. During April-July, 2003, 75 settlement constituting 2,02,206 settled transactions amounting to over US $ 141 billion have taken place. The CCIL has lines of credit amounting to US $ 275 million from a foreign bank and Rs.700 crore from seven Indian banks to take care of any unforeseen contingency. This new facility for clearing and settling dollar-rupee transactions in India is likely to provide substantial cost and time benefits to banks.

Outlook

9.51 The Reserve Bank has pursued a process of consultation with market participants in its endeavour to deepen and widen the financial markets so as to enhance allocative efficiency, preserve financial stability and improve the transmission of monetary policy. The objective is to ensure balanced development of various segments of the financial market as also to preserve integrity and transparency of market operations. The operationalisation of the CCIL, NDS and CFMS combined with the advanced stage of implementation of centralised PDO and the RTGS system would contribute to efficient functioning of the markets. Simultaneously, efforts are underway to reduce market overlap and to develop segments which cater exclusively to specific classes of instruments and participants. This will enhance efficiency and contain risk in a systemic sense.

9.52 The progress of money market reforms so far has been satisfactory and without undue strains on market conditions. The transformation of the call/notice money market into a pure inter-bank market is progressing and the accessibility of non-banks would be further reduced before being eventually phased out. The implementation of borrowing restrictions on primary dealers in call/notice money market is contingent on further developments in the repo market. A wider array of hedging instruments have been made available to the market as banks and PDs have been permitted to undertake exchange traded futures and foreign currency-rupee OTC options with suitable safeguards.

9.53 In the government securities market, various measures are being undertaken to widen the base of repo transactions by extending coverage to CSGL account holders, and to allow rollover of repo contracts using the same securities between the same counter-parties. Allowing sale of securities purchased under repo, widening of the repo market to all entities including corporates and extending the eligibility to all debt instruments including rated corporate bonds are some of the measures under active consideration. Furthermore, a “when issued” market for government securities would help efficient price discovery in the primary auctions. Widening of the instrument base through introduction of inflation indexed bonds and STRIPS in the government securities market is in progress. Measures to further develop the retail market for government securities using PDs and banks are being considered. The scheme of trading of government securities on stock exchanges through order-matching screen-based trading has been introduced and ways of enhancing investor interest are being examined. The implementation of the next phase of the PDO-NDS project involving integration with security settlement system and primary markets operations, automation and inter-connectivity of PDOs, electronic maintenance of record of ownership will represent a step forward in improving the government securities market.

9.54 With regard to the foreign exchange market, the Reserve Bank will continue to follow the approach of preparing the market for transacting rising volumes of international transactions. A key priority is to avoid disruptive shifts in volatility and market sentiment. Accordingly, the Reserve Bank will continue its stance of watchfulness, caution and flexibility by closely monitoring the developments in the markets at home and abroad, with appropriate monetary, regulatory and other measures as considered necessary from time to time.

X FINANCIAL REGULATION AND SUPERVISION

10.1 Recent international financial developments have underscored the critical role of the regulatory and supervisory function in ensuring the health and stability of the financial system. The impact of technological advancement, financial liberalisation and the degree of integration between domestic and international financial markets has rendered the conduct of oversight of the financial system a highly complex task. Regulatory and supervisory functions constitute a range of services to the community covering the establishment of specific rules of behaviour for participants in the financial system, monitoring the observance of the rules, and general supervision of the behaviour of financial entities. The rationale for financial regulation lies in the economic costs imposed on the society by financial market failure. The adverse consequences include threat to systemic stability, the potential for gridlocks due to adverse selection and moral hazard problems as well as undermining the substantial benefits which would otherwise accrue from correction of market imperfections, reduced transaction costs, and providing people with a financial system they can trust.

10.2 In India, progressive strengthening of the regulatory and supervisory framework has been a key element of financial sector reforms. There has been significant progress in achieving international best practices in banking regulation and supervision. Within the process of convergence with best practices, fine-tuning is undertaken keeping in view the country-specific circumstances. The process of refining the crucial functions of regulation and supervision of the financial system in India gathered further momentum in 2002-03 in the context of dramatic shifts in the macroeconomic and financial environment. The focus of policy initiatives during the year was on streamlining banking operations, upgrading risk management systems, enhancing the level of compliance by banks with the Accounting Standards and operationalising consolidated accounting practices. A major development in the evolving institutional infrastructure for financial regulation was the enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 which is expected to improve the recovery of non-performing loans. Policies for regulation and oversight of the financial system were guided by the objectives of increasing operational efficacy of monetary policy, redefining the regulatory role of the Reserve Bank, strengthening prudential norms and developing the technological and institutional infrastructure.

THE BOARD FOR FINANCIAL SUPERVISION (BFS)

10.3 The Board for Financial Supervision (BFS), formed in November 1994 under the aegis of the Reserve Bank, is responsible for an integrated system of supervision of banks, financial institutions (FIs) and non-banking financial companies (NBFCs) regulated by the Reserve Bank. The Board functions as a Committee of the Central Board of the Reserve Bank with Governor as Chairman, a Deputy Governor as Vice Chairman, and other Deputy Governors and four Directors of the Central Board as members.

10.4 During 2002-03 (July-June), the BFS held 11 meetings. It reviewed the performance of regulated financial entities on the basis of 101 Inspection reports of banks/FIs. Of these reports, 73 (26 public sector banks (PSBs), 20 private sector banks, 17 foreign banks, eight FIs, one local area bank and a consolidated report on Local Head Offices of the State Bank of India) related to the position on March 31, 2002 while other reports pertained to earlier or later periods. A major thrust of the supervisory review process is to ensure that the summary of the inspection reports of all the banks is placed before the BFS at least once during the period of 12 months ending March 31 every year. The Board also reviewed the monitoring of bank frauds, house-keeping in PSBs, including reconciliation of entries in inter-branch accounts, inter-bank accounts (including *Nostro* accounts) and balancing of the books of accounts. The performance of Primary Dealers (PDs) as a group was reviewed by the BFS. Besides delineating the course of action to be pursued in respect of institution-specific supervisory concerns, the BFS provided guidance on several regulatory and supervisory policy decisions. The Board also reviewed the overall position of overseas operations of Indian banks as on March 31, 2002 based on portfolio inspection of the records available at head offices of the banks in India.

10.5 A comprehensive review of the Indian banking system in respect of domestic operations based on quarterly data reported by banks in 2002-03 and half-yearly reports on Macro-Prudential Indicators (MPIs), highlighting the linkages among institutions, markets and sectors of the economy, was placed before the BFS. At the initiative of the BFS, studies were also conducted on the impact on capital adequacy of converting excess SLR holdings into loan assets, capital market exposures of banks and the differences in the provisioning norms being followed by Indian banks and those applicable to banks in the US under their Generally Accepted Accounting Principles (GAAP). Another important study conducted under the direction of the BFS was the analysis of slippages of NPA accounts from sub-standard to doubtful/loss category (Box X.1).

10.6 Keeping in view the emerging supervisory concerns, six banks in the old private sector group and five banks in the new private sector group were placed under monthly monitoring. Under this system, certain key financial parameters of the banks like capital to risk-weighted assets ratio (CRAR), exposure to sensitive sectors, managerial problems and promoters' share holdings are analysed at the end of each month to monitor the progress made by them. Supervisory concerns in respect of these banks identified through the analysis of key financial parameters were placed before the BFS every month for its consideration and for providing guidance. This exercise has resulted in an improvement in the performance of most of these banks. The scope of monthly monitoring is being expanded to include the progress in recovery of NPAs.

10.7 In the area of fraud monitoring and prevention, information on background, *modus operandi*, causes and actions taken by the banks and the Reserve Bank in respect of frauds of Rs.1 crore and above and the follow-up of 39 large value frauds (Rs.10 crore and above) reported by banks and FIs during 1996 to 2000 were submitted to the BFS on a quarterly basis during the year.

10.8 Corporate governance is becoming crucial for banks and FIs to promote effective risk management and financial stability. The banks' Board of Directors and their committees bear the primary responsibility of providing adequate checks and balances, introducing proper systems and procedures for risk containment, evolving early warning systems and ensuring prompt corrective action. The report of the Consultative Group of Directors of Banks/FIs (Chairman: Dr. A S Ganguly) on Corporate Governance was examined by the BFS and based on the recommendations, actions to be taken by public and private sector banks were grouped separately and advised to the banks in June 2002 (Box X.2).

10.9 The Sub-Committee (Audit), set up by the BFS to review the policies governing audit, held two meetings during the year and examined the recommendations of the Committee on Computer Audit. Their report was forwarded to banks for implementation. The Sub-Committee (Audit) also examined suggestions made by the Central Vigilance Commission on the need to strengthen the internal

Box X.1

Guidelines for Preventing Slippage of NPA Accounts

At the behest of the BFS, a study was conducted on slippage of non-performing accounts from sub-standard to doubtful/loss categories. A suggested framework of recommendations, prepared on the basis of the study, was circulated among banks for feedback and comments. Based on the response to these draft recommendations, the final recommendations for preventing slippage of NPA accounts were forwarded to banks in September 2002. A system of early recognition with timely and adequate intervention was suggested.

In this context, it was also suggested that banks may introduce a new asset category called "Special Mention Accounts" between 'Standard' and 'Sub-standard' for their own internal monitoring and follow-up, in line with international best practices but keeping in view the local requirements. An asset may be transferred to this category once the earliest signs of sickness/ irregularities are noticed. This would help banks to look at accounts with potential problems in a focused manner right from the onset of the problem, so that monitoring and remedial actions can be more effective. Banks which already have a designated asset category on the lines of 'special mention assets' may continue the same on the basis of their internal norms.

Special mention assets would not require provisioning, as they are not classified as NPAs. Their main purpose is to alert management to the possibility of such an account turning bad, thus triggering preventive action well in time. These guidelines are aimed at providing a common minimum framework to tackle the problem of slippage of NPAs and it is expected that banks will work out their strategic responses in keeping with the broad thrust of the guidelines.

Box X.2
Current Issues in Corporate Governance

As part of the on going financial sector reforms, the Boards of banks and FIs have been given greater autonomy to lay down guidelines and procedures to enhance transparency and disclosure, to contain risk and for asset-liability management. The Consultative Group of Directors of Banks and Financial Institutions (Chairman: Dr. A. S. Ganguly), set up by the Reserve Bank, reviewed these aspects and recommended measures to make the supervisory role of the Boards of banks and FIs more effective. These recommendations have been benchmarked against international best practices as enunciated by the Basel Committee on Banking Supervision. In June 2002, a list of actions to be undertaken by banks was indicated to banks. These included due diligence procedures for appointment of directors on the boards of private sector banks, and role and responsibilities of independent/non-executive directors.

The Securities and Exchange Board of India (SEBI) had constituted a Committee on Corporate Governance. Their recommendations were forwarded to the Reserve Bank with a request to consider issuing appropriate guidelines to banks with a view to harmonising the existing requirements with the SEBI Committee requirements. Banks which have issued shares to the public and are listed on stock exchanges were advised to form committees to look into redressal of shareholders' complaints and to provide un-audited financial results on half yearly basis to their shareholders with summary of significant developments. It was observed that the procedures in regard to appointment and removal of external auditors are more stringent in banks than those recommended by the SEBI Committee.

The Joint Parliamentary Committee (JPC) on Stock Market Scam and Matters Related Thereto observed that it is imperative for the banks to follow strategies and techniques basic to the tenets of sound corporate governance. These are capable and experienced directors, efficient management, coherent strategy and business plan, and clear lines of responsibility and accountability. The JPC also endorsed the recommendations of the Advisory Group on Banking Supervision (Chairman: Shri M. S. Verma) submitted in May 2001 and desired that the same be implemented expeditiously. Banks have to attach priority to strengthen their Management Information System (MIS) and internal control mechanisms to comply with these requirements.

Other corporate governance measures to be taken by banks relate to strengthening of the risk management framework, review of connected lending and constitution of various committees in conformity with corporate governance standards. They are also required to develop mechanisms to ensure percolation of their strategic objectives and corporate values throughout the organisation.

The Reserve Bank has set up an Internal Working Group to examine Auditing and Corporate Governance Issues in Banks. The Internal Working Group would consider issues addressed by the Sarbanes-Oxley (SOX) Act, 2002 of the US and the Reports of the Committee on Corporate Audit and Governance (Chairman: Naresh Chandra), the Consultative Group of Directors of Banks/Financial Institutions (Chairman: Dr. A.S. Ganguly), the Advisory Group on Banking Supervision (Chairman: M.S. Verma), the Advisory Group on Accounting and Auditing (Chairman: Y.H. Malegam), and the Advisory Group on Corporate Governance (Chairman: Dr. R.H. Patil).

The Internal Working Group would explore the possibility of setting up of an Advisory Group in the Reserve Bank. The Advisory Group would advise the Reserve Bank on a regular basis the measures to improve quality control, ethics, independence and other standards relating to the preparation of audit reports of banks; and, pass judgement and comments on the quality and sufficiency of systems.

audit system of banks and the recommendations of the Working Group constituted to review the eligibility norms for empanelment of audit firms as statutory auditors and other audit related issues.

SCHEDULED COMMERCIAL BANKS

Prudential Norms

Income Recognition/Asset Classification

10.10 Banks were advised in May 2002 that they should not recognise income on accrual basis in respect of (a) the projects where financial closure had been achieved and formally documented, (b) projects sanctioned before 1997 with original project cost of Rs.100 crore or more where financial closure was not formally documented and (c) projects sanctioned before 1997 with original project cost of less than Rs.100 crore where financial closure was not formally documented. In February 2003, banks were advised to recognise income on accrual basis in respect of these three categories of projects under implementation which are classified as 'standard'.

Provisioning Norms

10.11 In the recent period, there has been a concerted endeavour to converge to the best international practices in provisioning (Table 10.1). Banks are required to make 100 per cent provision for the net debit position in their inter-branch accounts in respect of unreconciled entries outstanding for more than six months, with effect from the year ending March 31, 2004, as against the existing period of one year.

Table 10.1: Regulatory Framework

Variable	1992-93	2000-01	2001-02	2002-03
1	2	3	4	5
Capital to Risk-weighted Assets Ratio (per cent)				
Domestic banks with international business	4	9	9	9
Foreign banks	8	9	9	9
Non-performing assets (period overdue)				
Sub-standard assets	4 Q	2 Q	180 days	180 days #
Doubtful assets (period for which remained sub-standard)	24 M	18 M	18 M	18 M @
Provisioning Requirements (per cent)				
Standard assets	-	0.25	0.25	0.25
Sub-standard assets	10	10	10	10
Doubtful assets (unsecured portion)	100	100	100	100
Loss assets	100	100	100	100

90 days from March 31, 2004.
@ 12 months from March 31, 2005.
Q Quarters; M Months.

10.12 Banks are required to make provisions, with effect from the year ended March 31, 2003, on the net funded country exposures on a graded scale ranging from 0.25 to 100 per cent, depending upon the risk categories prescribed in the country risk management (CRM) guidelines. They are also required to disclose, as a part of the 'Notes on Accounts' to the balance sheet as on March 31 each year, their category-wise country risk exposures and the extent of aggregate provisions held against them. With a view to reducing the level of long pending entries outstanding in the Clearing Adjustment Accounts, banks were allowed, as a one-time measure, to net off entries representing clearing differences receivable against entries representing clearing differences payable upto Rs. 500 each which are outstanding for more than three years. Banks were also advised to write-off aggregate net debit position of clearing differences.

Investments by Banks

10.13 With a view to building up of adequate reserves to guard against any possible reversal of the interest rate environment in future due to unexpected developments, banks were advised to build up an Investment Fluctuation Reserve (IFR) of a minimum of five per cent and a maximum of 10 per cent of the investment held in the Available for Sale (AFS) and Held for Trading (HFT) categories of the investment portfolio within a period of five years commencing from the year ended March 31, 2002. In order to give a further impetus to banks, IFR would continue to be treated as Tier II capital but would not be subject to the ceiling of 1.25 per cent of the total risk-weighted assets. For compliance with the capital adequacy norms, however, Tier II capital including IFR would be considered up to a maximum of 100 per cent of total Tier I capital, effective March 31, 2003 onwards.

Guidelines on Infrastructure Financing

10.14 In view of the critical importance of the infrastructure sector, revised guidelines on financing of infrastructure projects were issued in February 2003. Accordingly, any credit facility in whatever form extended by lenders (*i.e.,* banks, FIs or NBFCs) to an infrastructure facility as broadly defined in the guidelines would be treated as 'infrastructure lending'. Furthermore, credit exposure to a single borrower and to borrowers belonging to a group may exceed the prudential exposure norm of 15 per cent and 40 per cent, respectively, of the bank's capital funds by an additional five and 10 percentage points (*i.e.,* up to 20 per cent and 50 per cent, respectively), provided the additional credit exposure is on account of infrastructure lending. Banks may assign a concessional risk weight of 50 per cent, for capital adequacy purposes, on investment in securitised paper pertaining to an infrastructure facility, subject to compliance with certain conditions specified in the revised guidelines.

Norms for Foreign Banks

10.15 Effective March 31, 2002, foreign banks were brought on par with Indian banks for the purpose of computing prudential credit exposure ceiling by redefining 'capital funds' as defined under capital adequacy standards. Since some foreign banks' exposures exceeded the revised prudential exposure limits, specific relaxation was allowed in respect of merger/acquisition of different borrowing companies. The excess exposure may be continued with till March 31, 2004. Similarly, excess exposure on existing fund and non-fund based facilities such as term loans, investments in bonds/debentures and performance guarantees may continue till their expiry/maturity. Foreign banks are not allowed to assume fresh exposure to single/group borrowers beyond the prudential credit exposure limits. The requests of the banks for meeting priority sector lending target breaching prescribed exposure norms will be approved on a case-to-case basis.

NPA Management of Banks

One-Time Settlement/Compromise Schemes

10.16 Subsequent to the introduction of the SARFAESI Act, 2002, the Reserve Bank issued fresh guidelines for one-time settlement scheme in January 2003 for compromise settlement of chronic NPAs up to Rs.10 crore in PSBs. These guidelines cover: (a) all NPAs in all sectors, irrespective of the nature of business, which have become doubtful or loss assets as on March 31, 2000 with outstanding balance of Rs.10 crore and below on the cut-off date; (b) NPAs classified as sub-standard as on March 31, 2000, which have subsequently become 'doubtful' or 'loss' assets; and (c) cases in which the banks have initiated action under the SARFAESI Act, 2002 and also cases pending before Courts/Debt Recovery Tribunals (DRTs)/Board for Industrial and Financial Reconstruction (BIFR), subject to consent decree being obtained from the Courts/DRTs/BIFR. The last date for receipt of applications from borrowers under the scheme is September 30, 2003.

10.17 Guidelines for the special One-Time Settlement (OTS) scheme for loans up to Rs.50,000 to small and marginal farmers by PSBs were operative up to December 31, 2002. They were extended up to March 2003 in view of requests received from banks and the drought/flood situation in various parts of the country.

Lok Adalats

10.18 The Reserve Bank issued guidelines to commercial banks and FIs to enable them to make increasing use of *Lok Adalats*. They were advised to participate in the *Lok Adalats* convened by various DRTs/DRATs for resolving cases involving Rs.10 lakh and above to reduce the stock of NPAs.

Debt Recovery Tribunals

10.19 The Debt Recovery Tribunal (Procedure) Rules 2003 were amended substantially regarding application fee and plural remedies for better administration of the Recovery of Debts due to Banks and Financial Institutions Act, 2002. The passage of the SARFAESI Act, 2002 has provided the necessary impetus for banks and FIs to hasten the recovery of the dues (Box X.3).

Box X.3

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

The Government enacted t*he Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002,* which provides, *inter alia*, for enforcement of security interest for realisation of dues without the intervention of courts or tribunals. The Government has also notified the Security Interest (Enforcement) Rules, 2002 to enable secured creditors to authorise their officials to enforce the securities and recover the dues from the borrowers. PSBs and FIs have been advised to take action under the Act and report compliance to the Reserve Bank.

Since the Act provides for sale of financial assets by banks/FIs to securitisation companies (SCs)/reconstruction companies (RCs), guidelines have been issued to ensure that the process of asset reconstruction proceeds on sound lines. These guidelines, *inter-alia*, prescribe the financial assets which can be sold to SCs/RCs by banks/FIs, procedure for such sales (including valuation and pricing aspects), prudential norms for the sale transactions (*viz.*, provisioning/valuation norms, capital adequacy norms and exposure norms) and related disclosures required to be made in the Notes on Accounts to balance sheets.

The IFCI, along with other banking and FIs, incorporated an asset reconstruction company called 'Asset Care Enterprise Ltd.' (ACE) in June 2002 with an authorised capital of Rs.20 crore. IFCI Ltd. contributed a major share in ACE Ltd. (Rs.2.45 crore or 49.0 per cent of the initial paid-up capital of Rs.5.00 crore), followed by Punjab National Bank (26.0 per cent), Tourism Finance Corporation of India (14.2 per cent), Life Insurance Corporation of India (10.0 per cent) and Madhya Pradesh Consultancy Organisation (0.8 per cent). The Company has already applied to the Reserve Bank seeking necessary registration as an asset reconstruction company. More recently, the IDBI, the ICICI Bank, the SBI and few other banks have jointly promoted the Asset Reconstruction Company (India) Ltd. (ARCIL) with an initial authorised capital of Rs.20 crore and paid-up capital of Rs.10 crore. The three major sponsors, *viz.*, IDBI, ICICI Bank and SBI, will hold 24.5 per cent each of the share capital in ARCIL. The balance 26.5 per cent shareholding would be from small private sector banks. Similar asset reconstruction/management companies are also being proposed by other institutions/banks. IDBI has already proposed to transfer some NPAs to ARCIL.

The SARFAESI Act has served as an important tool for banks and FIs in the recovery of the dues. Under the Act, PSBs issued 32,043 notices for an outstanding amount of Rs.11,447 crore till end-May 2003. The total recoveries by PSBs till end-May 2003 aggregated Rs.436 crore from 8,676 cases. Nine FIs under the regulatory and supervisory domain of the Reserve Bank served notices in respect of 182 companies involving aggregate outstanding dues of Rs.9,046 crore as at end February 2003. The total recoveries by FIs till end-February 2003 aggregated Rs.25.2 crore.

Credit Information on Defaulters and Role of Credit Information Bureau

10.20 In order to alert the banks and FIs and put them on guard against defaulters to other lending institutions, recent efforts of the Reserve Bank have focussed on developing a credit information bureau in the country (Table 10.2). The information on defaulting non-suit filed doubtful and loss accounts of Rs.1 crore and above is disseminated on half-yearly basis (March 31 and September 30) while that on suit-filed accounts is published as on March 31 every year and is updated on quarterly basis. The defaulters' list of non-suit filed accounts has been disseminated as on March 31, 2002 to banks and FIs for their confidential use. The list of suit-filed accounts as on March 31, 2002 was published in electronic form and placed on the Reserve Bank website followed by quarterly updates up to September 30, 2002. The wilful defaulters' list (suit-filed accounts) of Rs.25 lakh and above as on March 31, 2002 was published in electronic form and also placed on the Reserve Bank's website. The wilful defaulter's list (containing suit-filed and non-suit filed accounts) for the quarter ended June 30, 2002 was given to banks/FIs for their confidential use and the list of suit-filed accounts has been placed on the Reserve Bank's website.

Risk Management

Bank Financing of Equities and Investment in Shares

10.21 During 2002-03, banks were required to review their risk management systems pertaining to capital market exposures and exposures to stock broking entities/market makers. The review would assess the efficiency of the risk management systems in place in the bank, the extent of compliance with the guidelines issued and would identify the gaps in compliance for initiating appropriate steps.

Guidelines on Country Risk Management (CRM)

10.22 With a view to moving forward in complying with the *Core Principles for Effective Banking Supervision,* guidelines on country risk management and provisioning thereof were issued to banks requiring:

- formulation of well-documented and clearly defined Country Risk Management (CRM) policies by banks;
- identification, measurement, monitoring and controlling of country exposure risks and specifying responsibility and accountability of the various levels;

Table 10.2 : Recent Initiatives on Credit Information on Defaulters

Year	Measure
1	2
1999	Working Group (Chairman: Shri N.H. Siddiqui) set up in June to explore the possibility of setting up Credit Information Bureau (CIB) in India; submitted its Report in November.
2000	Credit Information Bureau of India Limited (CIBIL) set up in August for collecting, processing and sharing credit information on borrowers.
2001	Working Group (Chairman: Shri S.R.Iyer) set up in December to examine the possibility of the CIB performing the role of collecting and disseminating information on suit-filed accounts and the list of defaulters; submitted its Report in January 2002.
2002	Banks and FIs advised in June to submit periodic data on suit-filed accounts of Rs.1 crore and above till December 2002 and suit filed accounts of wilful defaults of Rs.25 lakh and above till the quarter ending December 2002 to the Reserve Bank as well as to CIBIL and thereafter to CIBIL only.
	To broad-base credit information/data with CIBIL, banks and FIs advised on October 1 to furnish information in respect of suit-filed accounts between Rs.1 lakh and Rs.1 crore from the period ended March 2002 in a phased manner to CIBIL only.
	Periodic data relating to non-suit filed accounts for defaulter lists to continue to be submitted to the Reserve Bank only as hitherto.
	Banks and FIs advised on October 1 to obtain consent of borrowers and their guarantors for disclosure of their names in case of default, and submit progress returns thereon to CIBIL.
2003	In view of the constraints expressed by banks in adhering to the time schedule for obtaining the consent clause, revised schedule advised in February for obtaining the consent clause and submission of returns to CIBIL by September 2004 and December 2004, respectively.

- institution of contingency plans and clear exit strategies to be activated at times of crisis; and,
- rigorous application of the 'Know Your Customer' (KYC) principle in international activities which should not be compromised by availability of collateral or shortening of maturities.

Guidance Notes on Management of Credit and Market Risk

10.23 As a step towards enhancing and fine-tuning the existing risk management practices in banks, draft Guidance Notes on Credit Risk Management and Market Risk Management were issued and placed on the website for wider discussion. These Guidance Notes were based on the recommendations of two Working Groups constituted by the Reserve Bank drawing experts from select banks and FIs. In the light of the feedback received, revised Guidance Notes were issued to banks for upgrading their risk management systems. These notes have kept in view banks' own requirements, dictated by the size and complexity of business, risk philosophy, market perception and the expected level of capital. In recent years, the management of operational risk has also assumed importance (Box X.4).

Supervisory Initiatives

Off-site Monitoring and Surveillance

10.24 Off-site monitoring and surveillance (OSMOS) function was established in 1995 with the primary objective of analysing the financial position of banks in between on-site inspections. A comprehensive OSMOS became fully operational in 1997. Since then, the scope and coverage of the off-site returns have been enhanced significantly. In view of the recent initiatives on consolidated supervision, country risk management and risk-based supervision, certain additional data needed to be collected through the off-site returns. Accordingly, an upgraded OSMOS system, including new returns as well as enhancing the coverage of the existing ones, has been implemented from the quarter ended June 2003.

Consolidated Supervision

10.25 Guidelines on consolidated supervision were issued to banks for implementation with effect from the year ended March 2003 (Box X.5). Banks were advised to ensure strict compliance commencing from the year ended March 31, 2003. This would enable the Reserve Bank in adhering to the *Core Principles for Effective Banking Supervision.*

Box X.4

Management of Operational Risk

The operational risk faced by banks has increased manifold, *inter alia,* due to an expansion in the size of their operations and increased exposure to various sectors and activities. Operational risk arises out of deficiencies in internal systems and controls, systems failures and non-adherence to prescribed procedures. Its management has gained importance because of the scale of losses that banks have suffered on account of deficiencies in internal controls. Banks, particularly those operating in international markets, are beginning to apply the same quality of management attention to operational risk as to well developed areas of credit and market risks. Some of these banks have already developed operational risk rating matrices, similar to bond credit rating.

Internal control (segregation of duties, clear management reporting lines and operating procedure) and internal audit are the primary means to mitigate operational risk. Internationally, as well as in India, banks have not been able to evolve any scientific method for quantifying operational risk. This may be due to lack of historical data.

The Reserve Bank's guidelines on "Risk Management Systems in Banks" provide simple benchmarks based on business activity such as gross revenue, fee income and operating costs in the absence of any sophisticated models. Under the New Capital Accord, banks would be required to earmark capital for operational risk. In its comments on "A New Capital Adequacy Framework" released in April 2000, the Reserve Bank noted that banks should devote the necessary resources to quantify the level of operational risks and incorporate them into the assessment of their overall capital adequacy. Banks would be required to focus more closely upon their internal control systems, particularly towards clearing of backlog in balancing of books and inter branch and *nostro* accounts reconciliation.

The New Capital Accord provides a range of options of increasing sophistication for providing explicit capital for operational risk. These evolutionary approaches have built-in incentives to encourage banks to continuously improve their risk management and measurement capabilities and undertake more accurate assessment of regulatory capital.

Box X.5

Guidelines for Consolidated Accounting to Facilitate Consolidated Supervision

In the recent period, there has been an increased focus on empowering supervisors to undertake consolidated supervision of bank groups. Moreover, the *Core Principles for Effective Banking Supervision* issued by the Basel Committee on Banking Supervision (BCBS) have underscored this requirement as an independent principle. Accordingly, the Reserve Bank set up a multi-disciplinary Working Group in November 2000 (Chairman: Shri Vipin Malik) to examine the feasibility of introducing consolidated accounting and other quantitative methods to facilitate consolidated supervision.

On the basis of the recommendations of the Working Group, the components of consolidated supervision to be implemented by the Reserve Bank include Consolidated Financial Statements (CFSs) for public disclosure and Consolidated Prudential Reports (CPRs) for supervisory assessment of risks which may be transmitted to banks or other supervised entities by other Group members. Moreover, there would be application of certain prudential regulations like capital adequacy and large exposures/risk concentration on group basis. Initially, consolidated supervision has been mandated for all groups where the controlling entity is a bank. In due course, banks in mixed conglomerates would be brought under consolidated supervision where (i) the parents may be non-financial entities, (ii) the parents may be financial entities falling under the jurisdiction of other regulators like Insurance Regulatory and Development Authority (IRDA) or SEBI or, (iii) the supervised institution may not constitute a substantial or significant part of the group.

10.26 All banks under the purview of consolidated supervision of the Reserve Bank, whether listed or unlisted, were advised to prepare and disclose consolidated financial statements (CFSs) from the financial year commencing from April 1, 2002 in addition to their single financial statements. The CFSs are required to be prepared in accordance with the Accounting Standards 21, 23 and 27 prescribed by the Institute of Chartered Accountants of India (ICAI). Banks coming under the purview of consolidated supervision would also need to prepare consolidated prudential reports (CPRs) in addition to CFSs. CPRs were initially introduced on half-yearly basis from March 31, 2003 as part of the off-site reporting system on the lines of the existing DSB returns for banks. The banks should prepare the CPR adopting the same principles as laid down in Accounting Standards 21, 23 and 27. The CPR should contain information and accounts of related entities which carry on activities of banking or financial nature and should not include group companies engaged in insurance or non-financial activities. Prudential norms/limits similar to those as applicable to banks are prescribed for compliance by the consolidated bank.

Prompt Corrective Action (PCA)

10.27 The scheme of prompt corrective action (PCA) was developed for pre-emptive adjustments by troubled banks to early signs of financial vulnerability (Table 10.3). The scheme is in operation, initially for a period of one year from December 2002. Continuation or otherwise of the PCA framework as well as modification in the trigger levels or actions to be taken will be reviewed in December 2003.

Risk Based Supervision

10.28 To ensure a smooth transition to Risk Based Supervision (RBS) and to facilitate the requisite preparation, commercial banks were involved in a consultative process to identify the support required by them in this regard. The Risk Profile Template (RPT) has been tried by banks for undertaking self-assessment of risks and found suitable. Training of

Table 10.3 : Prompt Corrective Action

Year	Measure
1	2
1999	A draft note on Prompt Corrective Action (PCA) was prepared and forwarded to select banks for their views.
2000	A Discussion Paper on PCA was released by the Reserve Bank in July to envisage the possibility of introducing such a system for India based on the following three trigger points - CRAR, net NPA to net advances ratio and return on assets.
2001	The Scheme was sent to the Government of India in April for their views before implementation.
2002	The Scheme was back tested on a few select banks in July.
2002	The Scheme was circulated among banks in December, advising them to take steps to avoid coming under the purview of PCA.

commercial bank officers as well as the Reserve Bank supervisory staff at the training colleges of the Reserve Bank has made considerable progress. On-location and dedicated programmes on risk based supervision and risk management have also been conducted for banks. The RBS Manual has been prepared for use by the Reserve Bank supervisory staff. The pilot run of risk-based supervision of select banks was initiated during the quarter April-June 2003.

10.29 The financial turmoil during the second half of the 1990s in Asia and subsequently in several emerging economies provoked much reflection on ways to strengthen the global financial system. As part of its surveillance work, the International Monetary Fund (IMF) assesses financial system soundness in its member countries through the preparation of Financial System Stability Assessments (FSSA). Several national and international institutions have also initiated or intensified monitoring work. Towards this objective, several countries, including India, have undertaken efforts towards developing macro-prudential indicators (MPIs) for monitoring the health of the financial system (Box X.6).

Supervisory Rating of Banks

10.30 Some changes were made to the system of rating banks under CAMELS/CALCS models keeping in view the importance of frauds monitoring and prevention. Compliance in the area of fraud monitoring and prevention would carry more weight while rating banks.

Other Structural and Regulatory Measures

Fair Practices Code for Lenders

10.31 Guidelines in regard to Fair Practices Code for Lenders were framed and the banks/all-India FIs

Box X.6

Macro-Prudential Indicators (MPIs): Salient Features

The ability to monitor financial sector soundness presupposes the existence of valid indicators of the health and stability of financial systems. These macro-prudential indicators (MPIs) matter for several reasons. They allow assessments to be based on objective measures of financial soundness. Publicly available MPIs enhance disclosure of key financial information to the markets. Moreover, MPIs adhering to internationally agreed standards facilitate monitoring of the financial system at the global level, especially in view of the magnitude and mobility of international capital, and the risk of contagion of financial crises. MPIs, in essence, comprise both aggregated micro-prudential indicators of the health of individual financial institutions and macroeconomic variables associated with financial system soundness. Financial crises often occur when both types of indicators point to vulnerabilities.

In the Indian context, the mid-term Review of Monetary and Credit Policy of October 2000 indicated that a half-yearly financial stability review using MPIs would be prepared. Accordingly, a pilot review of MPIs was prepared for the half-year ended March 2000, followed by regular half-yearly reviews from September 2000 onwards for internal circulation. The scope and coverage of MPIs were enhanced in the review for the half-year ended March 2002. The salient features of the review for the half-year ended March 2003 are given below:

- Top five banks accounted for almost 43 per cent of the assets of the banking system.
- Growth in regulatory capital outstripped the growth in risk-weighted assets.
- Combined CRAR of the banking system increased to 12.8 per cent as at end-March 2003 from 12.0 per cent as at end-March 2002.
- Investment in SLR securities exhibited high growth.
- Gross non-performing loans (NPL) declined by 1.6 per cent. Due to high provisioning, net NPLs declined by 9.8 per cent.
- For the first time, ratio of gross NPL to gross advances of the banking system declined below 10.0 per cent and ratio of net NPL to net advances below 5.0 per cent.
- Credit utilisation ratio (*i.e.*, ratio of balances outstanding to limits sanctioned) by large industrial borrowers (Rs.10 crore and above) went up from 56.0 per cent at end-March 2002 to 63.1 per cent at end-March 2003, reversing the recent declining trend.
- Return on equity, at over 18 per cent, turned out to be the highest in the last six years. Return on assets stood at over 1.0 per cent for the system as a whole.
- Profits from treasury operations represented one of the key sources of income for the banking system, accounting for almost one-third of total operating profits.
- The banking system's short-term assets were in excess of short-term liabilities (with asset to liability ratio at 107.5 per cent).
- For the banking system as a whole, the degree of credit concentration (in terms of credit extended to top 20 corporates as percentage of total credit) declined from 33.4 per cent as at end-March 2002 to 30.0 per cent as at end-March 2003.

have been advised to adopt these guidelines (Box X.7). The Fair Practices Code, duly approved by their Board of Directors, should be put in place in respect of all lending prospectively not later than August 1, 2003. Banks and FIs have the freedom of enhancing the scope of the guidelines without sacrificing the spirit underlying them. The Board of Directors should also lay down the appropriate grievance redressal mechanisms within the organisation to resolve disputes arising in this regard. A periodical review of the compliance of the Fair Practices Code and the functioning of the grievances redressal mechanism may be submitted to the Board at regular intervals.

Setting up of New Private Sector Banks

10.32 M/s. Kotak Mahindra Finance Ltd., a non-banking finance company, which was granted a licence for banking business in February 2003, commenced operations with effect from March 22, 2003 (Table 10.4).

Box X.7

Lenders' Liability Laws – Fair Practices Code for Lenders

In August 2002, the Government of India had constituted a Working Group to study Lenders Liabilities Laws of the USA and their full implications on the borrowers, lenders, regulators and other stakeholders. The Group, which was also advised to consider provisions and experience of other countries, submitted its report in October 2002. Salient features of the guidelines on Fair Practices Code for Lenders issued to banks are as follows:

Applications for Loans and their Processing

Loan application forms in respect of priority sector advances up to Rs.2 lakh should include information such as fees/charges payable for processing and pre-payment options so that a meaningful comparison with that of other banks can be made and informed decision can be taken by a borrower. Banks and FIs should devise a system of giving acknowledgement for receipt of all loan applications. The time frame within which loan applications up to Rs.2 lakh will be disposed of should also be indicated in acknowledgement of such applications. Additional details/ documents, if required, should be intimated to the borrowers immediately. In the case of rejection of loan applications of small borrowers seeking loans up to Rs.2 lakh, the main reason(s) for rejection should be conveyed in writing, within stipulated time.

Loan Appraisal and Terms/Conditions

Lenders should ensure that there is proper assessment of credit application by borrowers. Margin and security stipulation should not be used as a substitute for due diligence on credit worthiness of the borrower. Terms and conditions and other caveats governing credit facilities given by banks/FIs arrived at after negotiation should be recorded in writing and duly certified. A copy of the loan agreement along with all enclosures quoted in the loan agreement should be furnished to the borrower. As far as possible, the loan agreement should clearly stipulate credit facilities that are solely at the discretion of lenders such as drawings beyond the sanctioned limits, honouring cheques issued for the purpose other than specifically agreed to in the credit sanction and disallowing drawal on a borrowal account on its classification as a non-performing asset or on account of non-compliance with the terms of sanction. It should also be specifically stated that the lender does not have an obligation to meet further requirements of the borrowers on account of growth in business without a proper review of credit limits.

Lenders should ensure timely disbursement of loans sanctioned in conformity with the terms and conditions governing such sanction; give notice of any change in the terms and conditions including interest rates and service charges; and, ensure that changes in interest rates and charges are effected only prospectively.

Post-disbursement Supervision

Post-disbursement supervision by lenders, particularly in respect of loans up to Rs.2 lakh, should be constructive with a view to taking care of any "lender-related" genuine difficulty that the borrower may face. Before taking a decision to recall / accelerate payment or performance under the agreement or seeking additional securities, lenders should give notice to borrowers, as specified in the loan agreement, or a reasonable period if no such condition exists in the loan agreement. Lenders should release all securities on receiving payment of loan or realisation of loan subject to any legitimate right or *lien* for any other claim lenders may have against borrowers. If such right of set-off is to be exercised, borrowers shall be given notice with full particulars about the remaining claims and the documents under which lenders are entitled to retain the securities till the relevant claim is settled/paid.

In addition, lenders should refrain from interference in the affairs of the borrowers except for what is provided in the terms and conditions of the loan sanction documents (unless new information, not earlier disclosed by the borrower, has come to the notice of the lender). For recovery of loans, the lenders should not resort to undue harassment, *viz.*, persistently bothering the borrowers at odd hours or use coercion. Consent or objection to a request for transfer of borrowal account, either from the borrower or from a bank/FI, should be conveyed within 21 days from the date of receipt of request.

Table 10.4 : Recent Initiatives on New Private Sector Banks

Year	Measure
1	2
1998	Committee established to review licensing policy.
2001	Revised guidelines for entry of new banks in the private sector issued in January.
	High-level Advisory Committee (Chairman: Dr. I.G.Patel) established to scrutinise *prima facie* eligibility.
	Two applicants - Shri Ashok Kapur and two other banking professionals with *Rabobank* Netherlands and M/s. Kotak Mahindra Finance Ltd., a non-banking finance company – recommended for eligibility in June.
2002	In-principle approval issued to these two applicants in February, valid for one year.
2003	M/s. Kotak Mahindra Finance Ltd. commenced operations on March 22 and included in the Second Schedule to the Reserve Bank of India Act, 1934 with effect from April 12.
	The other applicants with *Rabobank* Netherlands have been granted extension of time till November to complete all necessary formalities and to commence banking operations.

Off-shore Banking Units

10.33 The Government of India introduced Special Economic Zones (SEZs) with a view to providing an internationally competitive and a hassle-free environment for export production. For the first time, Offshore Banking Units (OBUs) were permitted to be set up in SEZs. These units would be virtually foreign branches of Indian banks but located in India. These OBUs, *inter alia,* would be exempted from cash reserve requirements and would be able to provide finance to SEZ units and SEZ developers at international rates of interest (Box X.8).

Measurement of Credit Exposure of Derivative Products

10.34 The exposure of banks by way of non-funded credit limits was hitherto capped at 50 per cent of such limits or outstandings, whichever is higher. The exposure to derivative products such as Forward

Box X.8

Setting up of Off-shore Banking Units

The salient features of the Scheme for setting up of OBUs in SEZs are:

- All banks operating in India, authorised to deal in foreign exchange, are eligible to set up OBUs, with a preference for banks having overseas branches and experience of running OBUs. Each of the eligible banks would be permitted to establish one OBU in one SEZ which would essentially carry on wholesale banking operations.
- Banks would be required to obtain prior permission of the Reserve Bank for opening an OBU in a SEZ under Section 23 (1)(a) of the Banking Regulation Act, 1949. The parent bank's application for branch licence should itself state that it proposes to conduct business at the OBU branch in foreign currency only. The OBUs would operate and maintain their balance sheet only in foreign currency. They would not be allowed to deal in Indian rupees except for having a special rupee account out of convertible funds to meet their day to day requirements. These branches would be prohibited from participating in domestic call, notice, term and other money markets and payment systems.
- Since OBUs would be branches of Indian banks, no separate assigned capital for such branches would be required. With a view to enabling them to start their operations, however, the parent bank would be required to provide a minimum of US $ 10 million to its OBU.
- The Reserve Bank would grant exemption from cash reserve ratio (CRR) requirements to the parent bank with reference to its OBU branch. Banks are, however, required to maintain SLR in respect of their OBU branches; requests for exemption, if any, will be considered for a specified period.
- The sources for raising foreign currency funds would be only external. Funds can be raised from resident sources to the extent such residents are permitted under the existing exchange control regulations to invest in/maintain foreign currency accounts abroad. Deployment of funds would be restricted to lending to units located in SEZs and SEZ developers. Foreign currency requirements of corporates in the domestic area can also be met by the OBUs. If funds are lent to residents in the Domestic Tariff Area (DTA), existing exchange control regulations would apply to the beneficiaries in DTA. OBUs may be allowed to invest their surplus funds outside India under the investment policy framed for this purpose by the Board of Directors of the bank concerned.
- All prudential norms applicable to overseas branches of Indian banks would apply to the OBUs. The OBUs would be required to follow the best international

(Contd....)

(Concld....)

practice of 90 days payment delinquency norm for income recognition, asset classification and provisioning. The OBUs may follow the credit risk management policy and exposure limits set out by their parent banks, duly approved by their Boards. Separate open position limits for each currency will have to be prescribed by the banks' Boards.

- The OBUs would be required to scrupulously follow "Know Your Customer (KYC)" and other anti-money laundering instructions issued by the Reserve Bank. To ensure strict compliance with anti-money laundering instructions, OBUs are prohibited from undertaking cash transactions and transactions with individuals.
- The OBUs would be required to maintain separate *nostro* accounts with correspondent banks, which would be distinct from *nostro* accounts maintained by other branches of the same bank.
- The loans and advances of OBUs would not be reckoned as net bank credit for computing priority sector lending obligations.
- Deposits of OBUs will not be covered by deposit insurance.

Rate Agreements (FRAs) and Interest Rate Swaps (IRS) was captured by applying the conversion factors to notional principal amounts as per the original exposure method. Effective April 1, 2003 in addition to reckoning non-fund based limits at 100 per cent, banks have to include forward contracts in foreign exchange and other derivative products at their replacement cost value in determining individual/group borrower exposure. Following the Basel Committee on Banking Supervision's paper on *International Convergence of Capital Measurement and Capital Standards,* 1988, banks have been encouraged to follow the Current Exposure Method which is an accurate method of measuring credit exposure in a derivative product.

Accounting Standards

10.35 The Reserve Bank has been continuously making efforts to ensure convergence of its supervisory norms and practices with the international best practices. In regard to accounting standards issued by the Institute of Chartered Accountants of India (ICAI), banks in India are generally complying with most of these standards (Box X.9).

Box X.9

Accounting Standards for Compliance by Banks

A Working Group was constituted under the Chairmanship of Shri N.D. Gupta, former President of the ICAI, to recommend steps to eliminate/reduce gaps in compliance by banks with the accounting standards (AS) issued by the ICAI. The Working Group examined compliance by banks with the AS 1 to 22, which were already in force for the accounting period commencing from April 1, 2001, as also AS 23 to 28 which were to come into force for subsequent periods. The Group observed that banks in India are generally complying with most of the accounting standards except the following eight accounting standards, leading to qualification in the financial statements:

Accounting Standard	Pertaining to
5	Net Profit or Loss for the period, prior period items and changes in accounting policies
9	Revenue recognition
11	Accounting for the effects of changes in foreign exchange rates
15	Accounting for retirement benefits in the financial statements of employers
17	Segment reporting
18	Related party disclosures
21	Consolidated financial statements
22	Accounting for taxes on income

The Statutory Central Auditors' observations in the Auditors' Reports attached to the balance sheets on banks' non-compliance with some of the AS could affect the confidence of users of the financial statements in the integrity of the published results. Accordingly, the Group made recommendations for compliance by banks with the AS. Detailed guidelines on the basis of the Group's recommendations have been issued by the Reserve Bank. The Working Group did not make any recommendation on AS 11 (Accounting for effects of changes in foreign exchange rates) as the ICAI was in the process of revising it. The ICAI has been requested to furnish appropriate clarifications on the accounting standards in line with the Working Group's recommendations. With the issue of the guidelines and adoption of the prescribed procedures, there should normally be no need for any Statutory Auditor for qualifying the financial statements of banks for non-compliance with the AS. Thus, it is essential that both banks and the Statutory Central Auditors adopt the prescribed guidelines and procedures. Whenever specific difference of opinion arises among the auditors, the Statutory Central Auditors would take a final view and persisting differences, if any, can be sorted out with prior consultation with the Reserve Bank, if necessary.

Underwriting by Merchant Banking Subsidiaries of Commercial Banks

10.36 Banks/subsidiaries were, hitherto, required to ensure that the funded and non-funded commitments (including investments and devolvement on account of underwriting and other commitments like stand-by facilities) relating to a single legal person or entity did not exceed 25 per cent of the net owned funds of the bank/subsidiary which was subsequently reduced to 15 per cent. Banks were also required to ensure that the commitments under a single underwriting obligation did not exceed 15 per cent of an issue. With a view to providing a level-playing field to the merchant banking subsidiaries of banks, it was decided that the existing ceiling on underwriting commitments would not be applicable to merchant banking subsidiaries of banks. These subsidiaries, regulated by the SEBI, would consequently be governed by the norms on the various aspects of the underwriting exercise taken up by them. The prudential exposure ceiling on underwriting and similar commitments of banks would, however, remain unchanged and continue to be reckoned within the norms prescribed by the Reserve Bank on overall borrower/issue size limits.

Advances to Self Help Groups (SHGs) against Group Guarantee

10.37 Unsecured advances given by banks to SHGs against group guarantees would be excluded for the purpose of computation of the prudential norms on unsecured guarantees and advances (*i.e.,* 20 per cent of banks' outstanding unsecured guarantees together with total of outstanding unsecured advances should not exceed 15 per cent of total outstanding advances).

Insurance Business by Banks

10.38 According to the existing guidelines for entry of banks into insurance business, banks were not allowed to undertake referral business through their network of branches. Under the referral arrangement, banks provide physical infrastructure within their select branch premises to insurance companies for selling their insurance products to the banks' customers with adequate disclosure and transparency and, in turn, earn referral fees on the basis of premia collected. Banks have now been permitted to enter into referral arrangements with insurance companies, subject to certain conditions to protect the interests of their customers.

Discounting/Rediscounting of Bills by Banks

10.39 After considering the recommendations of the Working Group on Discounting of Bills by Banks (Chairman: Shri K.R. Ramamoorthy), revised guidelines were issued to banks (Box X.10).

Bank Finance for PSU Disinvestment Programme of Government of India

10.40 Banks were advised in August 2002 that if the shares of the disinvested PSU, against which bank finance is proposed to be extended, are illiquid due to lock-in period/restrictive clauses, the successful bidder to whom the bank proposes to extend finance, should obtain necessary approval from the Government of India and other regulatory agencies exempting such equity holdings from these restrictions. On a review, banks have been allowed to extend finance to the successful bidders - even though the shares of the disinvested company acquired/to be acquired by the successful bidder are subjected to a lock-in period/other such restrictions which affect their liquidity - subject to fulfilment of the specified

Box X.10

Revised Guidelines on Discounting of Bills

- Banks may sanction working capital limits as also bills limits to borrowers after proper appraisal of their credit needs and in accordance with the loan policy as approved by their Board of Directors.
- Banks are required to open letters of credit (LCs) and purchase/discount/ negotiate bills under LCs only in respect of genuine commercial and trade transactions of their borrower constituents who have been sanctioned regular credit facilities by them.
- For the purpose of credit exposure, bills purchased/ discounted/negotiated under LCs or otherwise would be reckoned as exposure on the bank's borrower constituent. Accordingly, the exposure should attract a risk-weight appropriate to the borrower constituent (*viz.,* 100 per cent for firms, individuals, corporates) for capital adequacy purposes.
- Banks have been permitted to exercise their commercial judgment in discounting of bills of services sector. Banks would need to ensure that actual services are rendered and accommodation bills are not discounted. Services sector bills should not be eligible for rediscounting.

conditions. The concerned bank must make a proper appraisal and exercise due caution about credit worthiness of the borrower and the financial viability of the proposal.

10.41 Banks are precluded from financing investments of NBFCs in other companies and inter-corporate loans/deposits to/ in other companies. On review, banks were advised that special purpose vehicles (SPVs) satisfying the following conditions would not be treated as investment companies and, therefore, would not be considered as NBFCs, and hence would be eligible for bank finance for PSU disinvestments of Government provided they: (a) function as SPVs with not less than 90 per cent of their total assets as investment in securities held for the purpose of holding the ownership stake; (b) do not trade in these securities except for block sale; and, (c) do not undertake any other financial activities.

Trading in Government Securities on Stock Exchanges

10.42 With a view to encouraging wider participation of all classes of investors, including retail investors in Government securities, trading of the dated Government of India securities was allowed through a nation wide anonymous, order-driven, screen-based trading system in the stock exchanges in the same manner in which trading takes place in equities. This facility would be available in addition to the present Negotiated Dealing System (NDS) of the Reserve Bank. Accordingly, effective January 16, 2003, trading of dated Government of India securities in dematerialised form is being allowed on automated order driven system of the National Stock Exchange (NSE), The Stock Exchange, Mumbai (BSE) and Over the Counter Exchange of India (OTCEI). The scheme will subsequently be extended to the Government of India Treasury Bills and State Government securities.

10.43 In view of familiarity with the systems, processes and procedures, it was decided to adopt the equity trading model for trading of Government securities on the exchanges. As in the case of equities, banks as institutional investors can undertake transactions only on the basis of giving and taking delivery of securities. Besides, they were directed to obtain specific approval from their Board to enable them to trade in the Stock Exchanges and frame and implement a suitable policy to ensure that operations in securities on the above stock exchanges are conducted in accordance with the norms laid down by the Reserve Bank/SEBI and the respective stock exchanges.

Interest Rates on Advances

10.44 Banks had been advised to switchover to a system of charging interest on advances at monthly rests, effective April 1, 2002, to facilitate adoption of 90 days norms for recognition of loan impairment from the year ending March 31, 2004. They were given the option to compound interest at monthly rests effective either from April 1, 2002 or July 1, 2002 or April 1, 2003. With effect from July 1, 2002, banks were supposed to ensure that the effective rate does not go up merely on account of the switchover to the system of charging/ compounding interest at monthly rests and increase the burden on the borrowers. Interest at monthly rests shall be applied to all running accounts (*e.g.* Cash Credit, Overdraft, Export Packing Credit Accounts), all new and existing term loans and other loans of longer/fixed tenor but not to agricultural advances.

Empanelment of Audit Firms as Statutory Auditors

10.45 In order to review the norms for empanelment of audit firms for their appointment as statutory auditors as well as the number of audit firms that were allotted to each PSB, a Working Group consisting of representatives from select PSBs, IBA, ICAI, Government of India, Comptroller and Auditor General of India and the Reserve Bank was constituted in December 2001. The Working Group's recommendations have been accepted by the Sub-Committee (Audit) of the BFS and will be made applicable from 2004-05 (Box X.11).

Guidelines for Uniform Accounting for Repo/ Reverse Repo Transactions

10.46 A review of the accounting practices for repo/ reverse repo transactions revealed divergences among market players. Accordingly, uniform accounting guidelines for repo/reverse repo transactions were finalised, in consultation with Fixed Income Money Market and Derivatives Association (FIMMDA), and were applicable from the financial year 2003-04. On implementation of the guidelines, market participants may undertake repos from any of the three categories of investments, *viz.,* Available for Sale (AFS), Held for Trading (HFT) and Held to Maturity (HTM). The legal character of repo under the current law as outright purchase and outright sale transactions is kept intact. The buyer of the securities under the reverse repo transactions can reckon the approved securities acquired for the purpose of SLR during the period and mark to market the securities as per the investment classification of the security. In case of entities not

Box X.11

Empanelment of Audit Firms

The major recommendations of the Working Group for eligible audit firms are:

- minimum seven full-time chartered accountants with the firm (as against six) of which five should be full-time partners, each with a minimum continuous association of 15, 10, 5, 5 and 1 years with the firm.
- a professional staff of 18 (as against 15).
- a minimum standing of 15 years (as against 10 years).
- a minimum statutory bank/branch audit experience of 15 years (as against 8 years).
- at least one partner or paid chartered accountant with CISA/ISA or any other equivalent qualification.

A team of 4, 5 or 6 audit firms may be allotted to each PSB based on its assets and liabilities of the previous year, *i.e.,* up to Rs.50,000 crore, above Rs.50,000 crore and up to Rs.1 lakh crore, and above Rs.1 lakh crore, respectively (as against allotting a team of 5 and 6 audit firms to banks with a deposit base up to Rs.10,000 crore and above Rs.10,000 crore, respectively).

Available vacancies every year are to be filled in the ratio of 8:2 (as against 9:1 earlier) among experienced and new audit firms. The system of carrying over the names of unallotted experienced audit firms and giving them a preference in allotment in the following year may be discontinued.

following any investment valuation norms, the valuation of securities acquired under reverse repo transactions will be in accordance with the valuation norms followed by them in respect of securities of similar nature. Securities sold under repo and purchased under reverse repo are to be disclosed by banks in the "Notes on Accounts" to the balance sheet. The guidelines would not, for the present, apply to repo/reverse repo transactions under the Liquidity Adjustment Facility (LAF) with the Reserve Bank.

'Know Your Customer' - Identification of Depositors

10.47 'Know Your Customer' (KYC) guidelines relating to identification of depositors were issued on August 16, 2002. Banks have to put in place systems and procedures to control financial frauds, identify money laundering and suspicious activities, and for scrutiny/monitoring of large value cash transactions. They have also been advised to be vigilant while opening accounts for new customers to prevent misuse of the banking system for perpetration of frauds. Taking into account recent developments, both domestic and international, the extant instructions on KYC norms and cash transactions were reinforced with a view to safeguarding banks from being unwittingly used for the transfer or deposit of funds derived from criminal activity (both in respect of deposit and borrowal accounts), or for financing of terrorism.

Operational Developments

Amalgamation/Merger of Banks

10.48 In view of the erosion of the net worth of the Nedungadi Bank Ltd., the Reserve Bank notified the draft scheme of its amalgamation with Punjab National Bank on November 13, 2002. The Scheme of Amalgamation came into force on February 1, 2003.

10.49 Under the Scheme of Amalgamation and in terms of Section 44A of the Banking Regulation Act, 1949, the Indian branches of Standard Chartered Grindlays Bank Ltd. (SCGB) were merged with the Indian branches of Standard Chartered Bank (SCB). Accordingly, SCGB was descheduled in August 2002 in terms of Clause (b) of sub-Section (6) of section 42 of the Reserve Bank of India Act, 1934.

Indian Banks' Operations Abroad

10.50 During 2002-03 (July-June), the number of Indian banks with overseas operations remained at nine; of these, eight banks are in the public sector and one bank is in the private sector. With the closure of one branch of the State Bank of India in the USA, the total number of overseas branches of the nine Indian banks was reduced to 93. The number of Representative Offices of Indian banks abroad increased to 17 with the opening of Representative Offices in London and New York by ICICI Bank Ltd., in Dubai by HDFC Bank Ltd. and in Shenzen (China) and Ho Chi Minh City (Vietnam) by Bank of India. On the other hand, the State Bank of India closed down its Representative offices in Ho Chi Minh City (Vietnam), Sao Paulo (Brazil) and Jakarta (Indonesia).

Foreign Banks' Operations in India

10.51 At present, there are 36 foreign banks operating in India with 206 branches. Approval for opening 17 additional branches in India was given to existing foreign banks under the branch expansion programme for 2002-03. Out of this, eight branches

have been opened up to June 2003. The foreign banks also have 26 Representative Offices in India. Four banks, *viz.,* Commerzbank, Dresdner Bank AG, KBC Bank and The Siam Commercial Bank P.C.L. have wound up their banking operations in India. The Overseas-Chinese Banking Corporation Ltd. and the Toronto Dominion Bank are also in the process of closing down their Indian operations.

Scheduled Commercial Banks' Performance

10.52 Scheduled commercial banks (SCBs) improved their profitability in 2002-03. Net profits (as a ratio of total assets) increased from 0.8 per cent during 2001-02 to 1.0 per cent during 2002-03, largely due to higher non-interest income and lower interest expenses. Non-interest income increased from 1.6 per cent of total assets in 2001-02 to 1.9 per cent in 2002-03 on account of treasury operations. Reflecting the soft interest rate environment, interest income as well as interest expenses (both as a ratio to total assets) moderated during the year to 8.4 per cent and 5.6 per cent, respectively. The reduction in the interest expenses ratio (around 22 basis points) was relatively sharper than that on the income side (around four basis points) suggesting that decline in lending rates was not commensurate with that in deposit rates. Banks were able to contain their operating expenses at 2.3 per cent of their total assets (Table 10.5).

10.53 The improvement in performance indicators was widespread across banks, with 70 banks (out of a total of 93) registering an increase in their net profits ratio. None of the public sector banks recorded an increase in their interest expenses ratio (Table 10.6).

Table 10.5: Operational Results of Scheduled Commercial Banks : Key Ratios

(Per cent)

Ratio to Total Assets	2002-03	2001-02
1	2	3
Earnings before Provisions and Taxes (EBPT)	2.42	1.98
Profits after Tax (PAT)	1.03	0.75
Total Income	10.29	10.03
Interest Income	8.39	8.43
Non-interest Income	1.90	1.60
Total Expenditure	7.86	8.05
Interest Expenses	5.59	5.81
Operating Expenses	2.27	2.23
Provisions and Contingencies	1.39	1.23

Note: Data are provisional and relate to domestic operations only.

10.54 At the end of March 2003, almost all SCBs (92 out of a total of 93) complied with the regulatory requirement of CRAR of nine per cent. The number of banks with CRAR in excess of 15 per cent increased to 36 at end-March 2003 from 30 at end-March 2002, mainly on account of foreign banks (Table 10.7).

10.55 There was a further improvement in the NPAs position of banks, both in relation to assets and advances (Table 10.8). This reflected, *inter alia,* recent initiatives at improving recovery. Group-wise, foreign banks had the lowest NPA ratios, followed by the State Bank group.

10.56 The number of banks with net NPAs (as a proportion of net advances) above 10 per cent fell from 23 during 2001-02 to 12 during 2002-03 (Table 10.9).

Table 10.6: Operational Results of Scheduled Commercial Banks during 2002-03

(Number of Banks Showing Increase in Ratios during the Year)

Ratio to Total Assets	Public Sector Banks		Private Sector Banks		Foreign Banks	All Banks
	SBI Group	Nationalised Banks	Old	New		
1	2	3	4	5	6	7
Earnings before Provisions and Taxes (EBPT)	7	19	10	6	12	54
Profits after Tax (PAT)	7	17	16	7	23	70
Total Income	1	5	2	5	12	25
Interest Income	–	1	1	4	12	18
Non-interest Income	6	13	7	7	13	46
Total Expenditure	–	1	–	3	13	17
Interest Expenses	–	–	–	3	11	14
Operating Expenses	2	7	10	8	23	50
Provisions and Contingencies	6	15	8	5	10	44

Note : Data are provisional and relate to domestic operations only.

Table 10.7: Capital to Risk-weighted Asset Ratio (CRAR) of SCBs: end-March 2003

(Frequency Distribution)

CRAR	Public Sector Banks		Private Sector Banks			
	SBI Group	Natio-nalised Banks	Old	New	Foreign Banks	All Banks
1	2	3	4	5	6	7
Negative	–	–	–	–	–	–
	(–)	(–)	(2)	(–)	(1)	(3)
Between	–	–	–	1	–	1
0 and 9 per cent	(–)	(2)	(–)	(–)	(–)	(2)
Between	–	1	3	2	–	6
9 and 10 per cent	(–)	(2)	(2)	(2)	(3)	(9)
Between	8	16	13	5	8	50
10 and 15 per cent	(8)	(14)	(12)	(6)	(13)	(53)
15 per cent and	–	2	5	1	28	36
above	(–)	(1)	(7)	(–)	(22)	(30)
Total	**8**	**19**	**21**	**9**	**36**	**93**
	(8)	**(19)**	**(23)**	**(8)**	**(39)**	**(97)**

Note : Data are provisional.
Figures in brackets relate to position as at end-March 2002.

CO-OPERATIVE BANKING

10.57 Co-operative credit institutions occupy an important position in the financial system in terms of reach, volume of operations and objectives. The co-operative credit system can be broadly classified into urban co-operative and rural co-operative banks. The rural co-operatives play a pivotal role in the rural credit delivery system, whereas the urban co-operative banks aim at mobilising savings from the middle-and low-income groups and purvey credit towards the weaker sections. UCBs and rural co-operative credit banks are supervised by the Reserve Bank and the NABARD, respectively. Both are regulated by State Governments in regard to certain types of functions; in addition, multi-state UCBs are regulated by the Union Government.

Table 10.9: Net NPLs to Net Advances of SCBs

(Frequency Distribution)

	Public Sector Banks		Private Sector Banks		
	SBI Group	Nation-alised Banks	Old	New	Foreign Banks
1	2	3	4	5	6
1996-97					
Up to 10%	5	12	22	9	36
Above 10% and up to 20%	3	6	3	–	1
Above 20%	–	1	–	–	2
2000-01					
Up to 10%	8	14	16	8	31
Above 10% and up to 20%	–	5	4	–	6
Above 20%	–	–	3	–	5
2001-02					
Up to 10%	8	16	17	8	25
Above 10% and up to 20%	–	3	3	–	5
Above 20%	–	–	3	–	9
2002-03 P					
Up to 10%	8	18	19	8	28
Above 10% and up to 20%	–	1	1	–	4
Above 20%	–	–	1	1	4

P Provisional.

Policy Initiatives

10.58 Since 2001-02, the Reserve Bank has undertaken a series of measures directed towards strengthening the financial position of the UCBs, such as applying capital adequacy standards, prescribing an asset-liability management framework, enhancing the proportion of holding of Government and other approved securities for the purpose of SLR, restriction on bank finance against the security of corporate shares and debentures. During 2002-03, these efforts were reinforced.

Table 10.8: Non-Performing Assets (NPAs) of SCBs: end-March 2003

(Per cent)

	Public Sector Banks		Private Sector Banks		Foreign Banks	All Banks
	SBI Group	Nationalised Banks	Old	New		
1	2	3	4	5	6	7
Ratio of NPAs to Total Assets						
Gross NPAs to Total Assets	3.6	4.7	4.4	5.1	2.5	4.2
	(4.5)	(5.3)	(5.3)	(5.1)	(2.5)	(4.8)
Net NPAs to Total Assets	1.4	2.2	2.6	2.3	0.8	1.9
	(2.1)	(2.8)	(3.3)	(2.1)	(0.8)	(2.4)
Ratio of NPAs to Advances						
Gross NPAs to Gross Advances	9.2	10.1	9.1	10.2	5.3	9.5
	(11.8)	(11.5)	(11.3)	(11.0)	(5.6)	(11.0)
Net NPAs to Net Advances	3.9	5.1	5.7	4.8	1.7	4.5
	(5.7)	(6.4)	(7.5)	(4.8)	(1.9)	(5.8)

Note : Data are provisional and relate to domestic operations only.
Figures in brackets relate to position as at end-March 2002.

Strengthening the Co-operative Credit System

10.59 UCBs were advised in June 2002 that all purchase/sale transactions in Government securities should necessarily be through their SGL account with the Reserve Bank or through a Constituent SGL account with the designated agencies or in a dematerialised account with the depositories. UCBs were warned against dealing with brokers as counter-parties and advised to have their transactions in Government securities subjected to concurrent audit every quarter by chartered accountants and to confirm that the investments as reported by the bank were, in fact, owned and held by the bank. In line with the international best practice, it was decided to reduce the period of default for reckoning an advance as 'non-performing' from the existing 180 days to 90 days with effect from March 31, 2004.

10.60 With a view to strengthening the management system of UCBs, new urban banks are required to have at least two Directors with requisite professional qualifications or adequate experience in banking. This requirement was extended to existing UCBs as well. UCBs were earlier advised that all types of loans and advances granted by them to their Directors and their specified relatives and to concerns in which the directors or their relatives are interested should not, in the aggregate, exceed 10 per cent of the demand and time liabilities (DTL) of the bank. This limit was initially reduced to five per cent effective December 2002. A complete ban is to be imposed on such advances effective October 1, 2003.

10.61 Fully/partially computerised UCBs were advised to introduce an electronic data processing (EDP) audit system. All UCBs are required to have an audit committee of the Board for overseeing and providing directions to internal audit/inspection machinery of the UCB. The Audit Committees are also required to examine and follow up the observations and suggestions made in the inspection reports of the Reserve Bank and Statutory Audit reports.

10.62 Based on the recommendations of the Joint Parliamentary Committee (JPC) which enquired into the irregularities in capital market transactions, UCBs were advised that

- they have to take action for removing the deficiencies pointed out in the Reserve Bank inspection reports within a maximum period of four months from the date of the inspection report, and provide a certificate to that effect, failing which penalty will be imposed for non-compliance;
- the Audit Committee of the Board of Directors of UCBs should review the internal audit/statutory audit reports and the Reserve Bank's inspection reports and monitor action taken; and
- UCBs should appoint concurrent auditors.

Supervisory Initiatives

10.63 To strengthen the system of supervision on UCBs, the Reserve Bank introduced a system of Off-Site surveillance on scheduled UCBs on March 31, 2001. Furthermore, the system of classifying UCBs as 'weak' was also modified with effect from March 31, 2002. A new system of grading based on their level of CRAR, level of net NPAs, record of losses and compliance with liquidity requirements was introduced. A system of supervisory rating for UCBs under the CAMELS model has been instituted. This rating system will initially be introduced for the scheduled UCBs commencing from the year ending March 31, 2003. A simplified rating system is also being introduced for non-scheduled UCBs with effect from March 31, 2004.

Disclosures in Balance Sheet

10.64 In order to impart greater transparency in the balance sheet and profit and loss accounts, UCBs with deposits of Rs.100 crore or more were advised to disclose the following information as 'Notes on Accounts' to their balance sheet, effective from the year ending March 31, 2003: (a) CRAR, (b) movement of CRAR, (c) investment (book value, face value and market value), (d) advances against real estate, construction business and housing, (e) advances against shares and debentures, (f) advances (both fund-based and non-fund based) to directors, their relatives, companies/firms in which they are interested in, (g) average cost of deposits, (h) NPAs (gross and net), (i) movement in NPAs, (j) profitability (interest income to working funds, non-interest income to working funds, operating profit to working funds, return on assets, business per employee and profit per employee), (k) provisions made towards NPAs and depreciation in investments, (l) movement in provisions towards NPAs, depreciation in investments and standard assets, and (m) foreign currency assets and liabilities.

Balance Sheet Indicators of Urban Co-operative Banks

10.65 As on March 31, 2003, there were 2,104 UCBs, inclusive of 89 salary earners' banks. Around 79 per cent of these UCBs are located in five States, *viz.,* Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu. During the period 2002-03 (April-March), four UCBs, *viz.,* Solapur Janata Sahakari Bank Ltd., Solapur, Bharati Sahakari Bank Ltd., Pune, Thane Bharat Sahakari Bank Ltd., Thane and Zoroastrian Co-operative Bank Ltd., Mumbai were included in the Second Schedule to the Reserve Bank of India Act, 1934. At end-March 2003, the total number of scheduled UCBs was 56, spread over the six states, *i.e.,* Andhra Pradesh, Goa, Gujarat, Karnataka, Maharashtra and Uttar Pradesh.

10.66 Deposits and advances of scheduled UCBs increased marginally during the year, and their growth was significantly lower than that of the commercial banking system. This could be attributed to risk aversion of depositors in view of problems faced by a few large UCBs in the recent past. A positive aspect of the performance of the UCBs was a reduction in net NPAs, both in absolute terms as well as a proportion to net advances, reflecting the recent supervisory initiatives (Table 10.10).

Table 10.10 : Key Financial Indicators of Scheduled UCBs

(Amount in Rupees crore)

Category	end-March 2003*	end-March 2002	Variation (Per cent)
1	2	3	4
Number of UCBs	56	52	
Paid-up share capital	627	545	15.0
Reserves	2,195	1,931	13.7
Deposits	36,380	35,215	3.3
Loans and advances	23,943	23,308	2.7
Investments in Government and other approved securities	10,487	8,630	21.5
Gross NPAs	7,378	6,968	5.9
Gross NPAs to total loans and advances (per cent)	30.8	29.9	0.9
Net NPAs	2,465	2,979	- 17.3
Net NPAs to net loans and advances (per cent)	10.3	12.8	- 2.5

* Data as at end-March 2003 are unaudited and provisional.

FINANCIAL INSTITUTIONS

10.67 During 2002-03, the main focus of policy initiatives of the Reserve Bank for select all-India financial institutions[1] (FIs) was on imparting operational flexibility, strengthening the prudential regulatory and supervisory framework, and improving accounting and auditing standards. The Government undertook restructuring packages for some of the FIs, taking into account their financial performance, rising NPAs, adverse market conditions for raising resources, and challenges posed by commercial banks under a competitive environment.

Prudential Norms

Capital Adequacy

10.68 In line with the international practice and the norms applied for banks, the risk weight assigned to housing loans extended by FIs to individuals against the mortgage of residential housing properties was reduced from 100 per cent to 50 per cent. Investments by the FIs in the Mortgage Backed Securities (MBS) carry a risk weight of 50 per cent (in addition to the 2.5 per cent risk weight for market risk) provided that the assets underlying the MBS are the residential loan assets of the housing finance companies which are recognised and supervised by the National Housing Bank and satisfy the terms and conditions listed separately by the Reserve Bank. The loans granted by FIs against the security of commercial real estate would continue to attract 100 per cent risk weight. If the assets underlying the MBS also include commercial properties, then investment by FIs in such MBS would attract 100 per cent risk weight. The risk weights for the housing loans granted by the FIs to their own employees would, however, remain unchanged at 20 per cent for loans fully covered by superannuation benefits and mortgages of flats/ houses. Loans extended by FIs against the guarantee of a bank attract a risk weight of 20 per cent in computation of CRAR of the lending FI. The remaining amount of loan, if any, would normally attract 100 per cent risk weight.

Exposure Norms

10.69 For the purpose of exposure norms, the entire loan transaction of an FI should be reckoned as an

[1] The all-India financial institutions include Industrial Development Bank of India (IDBI), IFCI Ltd., Industrial Investment Bank of India Ltd. (IIBI), Tourism Finance Corporation of India Ltd. (TFCI), Infrastructure Development Finance Company Ltd. (IDFC), Export-Import Bank of India (Exim Bank), National Bank for Agriculture and Rural Development (NABARD), National Housing Bank (NHB) and Small Industries Development Bank of India (SIDBI).

exposure on the borrowing entity and not on the bank guaranteeing the loan so as to correctly reflect the degree of credit concentration. Before commencement of disbursement, the exposure would be either the sanctioned limit or the extent up to which the FI has entered into commitment with the borrowing entity in terms of the agreement. After commencement of disbursement, the exposure would be the aggregate of the outstanding amount plus the undisbursed or undrawn commitment.

10.70 The norms relating to credit exposures were modified and, as in the case of banks, the FIs are required to (i) reckon non-fund based exposures at 100 per cent value and (ii) include forward contracts in foreign exchange and other foreign exchange derivative products at their replacement cost in determining the individual/group borrower exposures. FIs were encouraged to switch to the Current Exposure Method for determining individual/group borrower exposures.

Asset Classification

10.71 As per the existing norms, the asset classification of the projects under implementation falling under Category II (time overrun for projects with original project cost of Rs.100 crore or more) is required to be decided with reference to the 'deemed date of completion'. Provisions held by FIs in respect of such accounts should not be reversed even in cases where certain accounts might become eligible for upgradation to the 'standard' category as per the deemed date of completion of the Category II projects.

Connected Lending

10.72 Occurrences of "connected lending" by FIs has been engaging the attention of the Reserve Bank. Guidelines were, therefore, issued to FIs in this regard, relating to credit facilities to the Directors; non-fund facilities on behalf of the Directors; loans and advances to relatives of the FIs' Directors or to the Directors of other FIs/banks and their relatives; loans and advances to officers of FIs or to their relatives; time-frame for recovery of loans; effect of non-recovery within the stipulated time; remission of the liabilities of the borrowers; interpretation of the transactions; non-participation of the interested Directors in the proceedings; and award of contracts by the FIs.

Classification and Valuation of Investments

10.73 Clarifications in regard to equity investments issued as a part of project finance proposal were provided. The preference shares acquired by conversion of loans/debentures in the nature of advance could be viewed as loan equivalent. In cases where there was no loan outstanding against a borrower company which had issued the shares, the record of dividend receipt on the preference shares should be examined to determine the asset classification of the preference shares, as per record of recovery. If the dividend on preference shares is not received within 180 days from the date of closing of annual accounts of the issuing company, the shares should be treated as NPA and provided for accordingly. As regards non-project related and redeemable preference shares which are eligible to be kept in the HTM category within the 25 per cent ceiling, these could be valued at acquisition cost/amortised cost, subject to provisioning for permanent diminution, if any, in value for which payment of dividend would also be a relevant factor. The investments in the units of closed-ended schemes of mutual funds could be included in the HTM category only if such units are not listed on the Stock Exchange. Units of closed-ended schemes of mutual funds, if listed on the Stock Exchange, should be placed in the AFS or HFT category.

10.74 As regards valuation of equity in the nature of advance in AFS category, the equity shares should be considered to be in the nature of advances if these equity shares were issued as part of a proposal for project finance. In cases where no loan against the company issuing the shares is outstanding, the equity shares in the nature of advance, should be valued at market price, if listed and quoted, provided the latest market quotation was not more than 30 days old as on the date of valuation. The market price in such cases should not be based on a solitary or small value transaction but on price observed in a reasonable volume transaction, between two independent parties in an arms-length relationship. “Thinly traded shares” should be valued as per the extant norms. The unquoted equity shares or where current quotations are not available, should be valued at “break up” value (without considering revaluation reserves, if any) derived from the company’s latest balance sheet. In case, the latest balance sheet is not available, the shares should be valued at Re. 1 per company. For the purpose of deriving break up value, the balance sheet used should not be older than one year (21 months in respect of companies, which close their accounts on dates other than 31 March) from the date of valuation.

Supervisory Measures

Consolidated Accounting and Supervision

10.75 Drawing from the recommendations of the Working Group on Consolidated Accounting (Chairman: Shri Vipin Malik), final guidelines were issued to FIs, which prescribed the group-wide prudential norms for capital adequacy, large exposures and liquidity gaps for the FIs to be implemented effective April 1, 2003 (July 1, 2003 in the case of NHB). FIs were also advised to build up requisite MIS to enable development of the database. Accordingly, FIs with subsidiaries have initiated steps towards consolidated accounting. Listed FIs have already commenced preparation/publishing Consolidated Annual Accounts as a part of their Annual Report, as mandated by the Accounting Standard 21 of ICAI, effective from the financial year 2001-02. The Reserve Bank's guidelines seek to make such publication mandatory even by non-listed FIs from April 1, 2003 onwards.

Supervisory Rating System for the FIs

10.76 A supervisory rating model was introduced with effect from the annual financial inspections conducted with reference to the position as on March 31, 2002 (June 30, 2002 in the case of the National Housing Bank). The Model is based on CAMELS components. The basic purpose of assigning supervisory ratings is to provide a summary measure of the performance and health of the financial institution concerned for requisite supervisory intervention.

Other Regulatory and Structural Measures

Rotation of Auditors

10.77 In view of instances of appointment of auditors for long periods, FIs were advised to ensure rotation of the partner of the audit firm conducting audit, if the firm continues for more than four years.

Computer Audit

10.78 Pursuant to the directions of the Audit Sub-Committee of the BFS, a "Committee on Computer Audit" was constituted in October 2001 with members from the Reserve Bank, ICAI and select commercial banks. The mandate of the Committee was to draw up a standardised checklist for conducting computer audit to enable the banks to ensure that requisite controls are applied by their computerised branches and the auditors verify them and report thereon. The Committee's recommendations, which have been accepted by the BFS, classified the possible areas of audit interest in the Information System (IS) environment into 15 broad categories and has prepared 'standardised checklists' under each category to facilitate the conduct of computer audit. The issues elaborated in the checklists would give a fair idea about areas that need to be controlled. These checklists would be in the nature of guidelines and FIs would be free to develop more elaborate checklists to conduct IS Audit suitable to the IT environment in which they operate.

Transactions in Dematerialised Form

10.79 FIs were required to fully comply with the Reserve Bank's instructions to necessarily hold their investments in Government securities portfolio in either SGL (with the Reserve Bank) or Constituents' Subsidiary General Ledger (CSGL) or in a dematerialised account with depositories. Only one CSGL or dematerialised account can be opened by any such entity. In case the CSGL accounts are opened with a scheduled commercial bank or state co-operative bank, the account holder has to open a designated funds account (for all CSGL related transactions) with the same bank. In case a CSGL account is opened with any of the non-banking institutions, the particulars of the designated funds account (with a bank) should be intimated to that institution. The entities maintaining the CSGL/designated funds accounts will be required to ensure availability of clear funds in the designated funds accounts for purchases and sufficient securities in the CSGL account for sales before putting through the transactions. No further transactions by a regulated entity should be undertaken in physical form with any broker with immediate effect. A specific timeframe has been separately indicated for each category of regulated entities to comply with these guidelines.

Review of Operations

On-site Inspection

10.80 The Reserve Bank continued to undertake annual on-site inspection of nine FIs. During 2002-03, the supervisory process for all nine FIs with reference to their position as on March 31, 2002 and June 30, 2002 in the case of NHB was initiated and completed, including submission of reviews to the BFS.

Off-site Surveillance System

10.81 A Prudential Supervisory Reporting System (PSRS) for ongoing off-site supervision, introduced in July 1999 as part of the integrated supervisory strategy, has been rechristened as FID-OSMOS. The FIs are required to submit off-site returns using the software input module provided to them for this purpose. A review of the performance of the FIs based on the off-site returns submitted by them is presented to the BFS on a quarterly basis.

Capital to Risk-weighted Assets Ratio (CRAR)

10.82 All FIs, except IFCI Ltd. and IIBI Ltd., had a CRAR much above the norm of nine per cent as at end-March 2003. The IFCI's erosion of capital reflects asset liability mismatches arising out of bunching of repayments as also the requirement for meeting heavy provisioning due to high NPAs and consecutive financial losses. Furthermore, raising of resources in a cost-effective manner had become difficult due to downgrading of IFCI by the rating agencies. In order to mitigate this problem and augment its capital, a capital restructuring package was initiated by the Government. In the case of IIBI, accumulation of high NPAs and provisioning thereof, coupled with the problem of declining profitability explains its low CRAR (Table 10.11).

Table 10.11 : CRAR and Net NPA of Select FIs (end-March 2003)

Financial institution	CRAR (Per cent)	Net NPA (Rupees crore)	Net NPA to net loans (Per cent)
1	2	3	4
Term-Lending Institutions (TLIs)			
IDBI	18.7	7,157	15.8
IFCI	-2.9	5,983	34.8
EXIM Bank	26.9	184	2.2
IIBI	3.5	819	40.3
TFCI	20.8	152	20.5
IDFC	57.1	3	0.1
All TLIs	**15.9**	**14,298**	**18.8**
Refinancing Institutions (RFIs)			
NABARD	41.6	1	0.0
NHB	22.3	0	0.0
SIDBI	43.9	473	3.8
All RFIs	**39.3**	**474**	**0.7**
All FIs	**22.3**	**14,772**	**10.6**

Source : Respective FIs.

Non-Performing Assets

10.83 The net NPAs of all-India FIs increased during 2002-03 due to slow economic recovery, sectoral bottlenecks and adverse domestic/ international market conditions (Table 10.11). IDFC Ltd., NHB and NABARD continued to maintain nil or negligible NPAs.

Restructuring of Liabilities of IDBI and IFCI Ltd.

10.84 The Union Government has initiated restructuring of two FIs, *viz.,* IDBI and IFCI Ltd. As part of the restructuring exercise, PSBs and FIs who had exposures to the IDBI were assured about the payment of contracted interest rates up to original maturity by the Government. The IDBI, in turn, was given an assurance by the Government that it will meet the difference between the originally contracted interest rate and the agreed interest rate of eight per cent by the banks and FIs till the original maturity period. Besides, all PSU banks and FIs agreed to rollover their investments in IDBI bonds for a further similar period of maturity at the prevailing interest rate during the time of rollover. The characteristics of bonds, *viz.,* SLR/ Non-SLR will remain unchanged. As part of the corporatising exercise, the Industrial Development Bank (Transfer of Undertaking and Repeal) Bill, 2002 was introduced in the Lok Sabha on December 4, 2002 which seeks to convert IDBI into a banking company. The Bill also seeks SLR exemption for a period of five years from the appointed day. The Bill was referred to the Standing Committee on Finance, which recommended exemptions from banking regulations such as SLR and CRR for five years and certain tax exemptions for the newly converted banking company. The Cabinet approved the amendments to the Bill on August 11, 2003 to incorporate provisions in the Bill to ensure that the new banking company also continues to be a development bank which will provide term lending to large, medium and small industries.

10.85 As part of the restructuring package in respect of liabilities of IFCI Ltd., the Government decided to take over all Government-guaranteed SLR bonds and retail borrowings of investors below Rs.1 lakh. Furthermore, the Government decided to service the loans from Asian Development Bank (ADB) and KfW. The package includes conversion of 20 year zero-coupon operationally convertible debentures/bonds worth Rs.1,811 crore into quasi-equity instruments, and conversion of preference capital into 20 year maturity at a coupon rate of 0.10 per cent per annum. Besides, the Life Insurance Corporation of India and the State

Bank of India - the major institutional shareholders in IFCI Ltd. - have agreed to reinvest Rs.200 crore each for 20 years at the coupon rate of six per cent per annum. Similarly, the IDBI has also agreed to reinvest Rs.100 crore on similar terms and conditions.

Corporate Debt Restructuring (CDR) Mechanism

10.86 The Corporate Debt Restructuring (CDR) mechanism became operational from March 2002 with the execution of the Inter-Creditor Agreement (ICA) on February 25, 2002 by 47 institutions/banks. Sixty-one institutions comprising all-India FIs (12), PSBs (27) and private sector banks (22) have signed the ICA. The UTI (among FIs), seven private sector banks (small in operation) and 41 foreign banks are yet to sign. During 2002-03, the CDR Standing Forum met two times, the Core Group five times and the Empowered Group 16 times. Of the 71 applications received (four from 2001-02), the CDR Cell referred all the cases to the Empowered Group within the stipulated time of 30 days. The Empowered Group approved final schemes in respect of 41 cases in which aggregate assistance by financial system amounted to Rs.38,638 crore; 18 cases were rejected and the remaining 12 cases are being processed (Box X.12).

NON-BANKING FINANCIAL COMPANIES

Registration of NBFCs

10.87 At end-June 2003, a total of 37,859 applications were received by the Reserve Bank for grant of Certificate of Registration (CoR). Of these, approval was granted to 13,863 applications, including 725 applications of companies authorised to accept/hold public deposits.

Policy Initiatives

Regulation of Non-Banking Financial Companies

10.88 Keeping in view the soft interest rate regime, the maximum rate of interest that NBFCs (including *Nidhi* companies and Chit Fund companies) can pay on their public deposits was reduced from 12.5 per cent to 11.0 per cent per annum with effect from March 4, 2003. The minimum rate of return payable by the residuary non-banking companies (RNBCs) to their depositors was also revised downwards (Table 10.12).

Box X.12

Corporate Debt Restructuring

Based on the experience in other countries like the U.K., Thailand and Korea, a Corporate Debt Restructuring (CDR) system was evolved in India. Detailed guidelines were issued in August 2001 for implementation by banks and FIs. The objective of the CDR framework is to facilitate a timely and transparent mechanism for restructuring the corporate debts of viable entities facing financial difficulties, outside the purview of BIFR, DRT and other legal proceedings. In particular, the framework aims at preserving viable corporates that are affected by certain internal and external factors and minimise the losses to the creditors and other stakeholders through an orderly and coordinated restructuring programme.

Pursuant to the announcement in the Union Budget 2002-03, a High-Level Group was constituted under the Chairmanship of Shri Vepa Kamesam, Deputy Governor, Reserve Bank with representatives from banks, FIs and industry to suggest measures to make the operations of the CDR mechanism more efficient. Based on the recommendations made by the High-Level Group and in consultation with Government of India, a revised CDR scheme was finalised and issued to banks for implementation with following salient features:

- It will cover only multiple banking accounts/ syndication/consortium accounts with outstanding exposure of Rs.20 crore and above.
- It will be a voluntary system based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA).
- In no case, requests of any corporate indulging in wilful default, fraud or misfeasance, even in a single bank, will be considered for restructuring.
- CDR will have a three-tier structure consisting of the CDR Standing Forum and its Core Group (the policy making body), CDR Empowered Group (the functional group deciding on the restructuring of the cases referred to CDR mechanism) and the CDR Cell (the secretariat to the CDR system).
- Under the earlier guidelines issued in August 2001, accounts classified as 'standard' and 'sub-standard' in the books of the lenders were eligible for restructuring under the CDR mechanism. The revised scheme provides for restructuring of accounts which are classified as 'doubtful' in the books of the lenders.
- One of the important elements of the DCA between the debtor and the creditors would be 'stand-still' agreement binding for 90 days, or 180 days by both sides. Under this clause, both the debtor and

(Contd....)

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creditor(s) shall agree to a legally binding 'stand-still' whereby both the parties commit themselves not to take recourse to any legal action during the 'stand-still' period. This would be necessary for enabling the CDR System to undertake the necessary debt restructuring exercise without any outside intervention, judicial or otherwise. During pendency of the case with the CDR system, the usual asset classification norms would continue to apply. The process of reclassification of an asset should not stop merely because the case is referred to the CDR Cell. If restructuring under the CDR system takes place, the asset classification status should be restored to the position which existed when the reference to the Cell was made.

- The revised guidelines provide exit options for lenders who do not wish to commit additional financing or wish to sell their existing share.
- The CDR Empowered Group shall have the right to convert a portion of the restructured amount into equity while deciding the restructuring package.

Of the 71 applications received by the CDR system since inception, final schemes have been approved in 41 cases involving Rs.38,638 crore. Almost 62 per cent of the amount approved pertains to units in the iron and steel industry (Table).

Table : Cases Referred and Approved under the CDR Mechanism

(Cumulative Position up to June 30, 2003)

(Rupees crore)

Industry	Cases Referred to CDR		Cases Approved under the CDR Mechanism	
	No. of Units	Amount involved	No. of Units	Amount involved
1	2	3	4	5
1. Textile	15	2,165	8	1,539
2. Petrochemicals/ Chemicals	9	5,669	6	4,064
3. Iron and Steel	8	28,001	6	23,861
4. Paper	4	216	3	175
5. Infrastructure	1	236	1	236
6. Non-ferrous Metals	5	967	1	119
7. Cement	2	1,962	2	1,962
8. Ceramic	3	203	3	203
9. Sugar	7	1,482	3	985
10. Power	5	3,612	2	2,966
11. Electronics/Electrical	1	583	–	–
12. Engineering	3	188	2	155
13. Rubber	1	113	1	113
14. Glass	1	27	1	27
15. Fertilisers	2	2,510	1	2,206
16. Hotels	1	27	1	27
17. Others	3	5,775	–	–
Total	**71**	**53,736**	**41**	**38,638**
Memo				
Cases Rejected	18	7,252		
Cases Pending	12	7,846		

Asset Liability Management (ALM)

10.89 The ALM guidelines, issued in June 2001, are applicable to NBFCs (engaged in and classified as equipment leasing, hire purchase finance, loan, investment and residuary non-banking companies) meeting the criteria of asset base of Rs.100 crore (whether accepting/holding public deposits or not) or holding public deposits of Rs.20 crore or more (irrespective of their asset size) as per their audited balance sheet as of March 31, 2001. The Chit Fund and *Nidhi* Companies have been kept out of the purview of these guidelines. The guidelines became fully operational on March 31, 2002. A system of half-yearly reporting was put in place beginning with the position as on September 30, 2002 for only those NBFCs which hold public deposits.

Table 10.12 : Minimum Interest Rates on NBFC Deposits

(Per cent per annum)

Type of Deposit Schemes	Rate of return before April 1, 2003	Rate of return effective April 1, 2003
1	2	3
Daily deposit scheme	4	3.5
Deposits received in lump sum or at monthly/ longer intervals	6	5

Transactions in Government Securities

10.90 The facility of holding Government securities in physical form was withdrawn. As in the case of FIs, all NBFCs were advised to invariably hold their investments in Government securities either in Constituents' Subsidiary General Ledger Account (CSGL) or in a dematerialised account with depositories. The NBFCs were prohibited from undertaking Government securities transaction/s in physical form with any broker.

Exposure of NBFCs to the Capital Market

10.91 NBFCs holding public deposits of Rs.50 crore and above and RNBCs with aggregate liabilities to depositors of Rs.50 crore and above as on March 31, 2002 or thereafter were directed to furnish information relating to their exposure to the capital market, at quarterly intervals, within one month of the close of the quarter.

Exemptions

10.92 Venture capital fund companies holding Certificate of Registration (CoR) from the SEBI have been exempted from the provisions of Sections 45-IA (obtaining CoR), 45-IB (maintenance of liquid assets) and 45-IC (creation of reserve fund) of the Reserve Bank of India Act, 1934 as also from the directions of the Reserve Bank on acceptance of public deposit and prudential norms for NBFCs, provided they are not accepting/holding public deposits. The stock broking companies, which are not holding public deposits as defined under the Reserve Bank regulations and registered with the SEBI, have also been similarly exempted.

Investment by RNBCs in UTI

10.93 Keeping in view the bifurcation of UTI as a result of which the mutual fund activities of UTI have come under the purview of SEBI (Mutual Funds) Regulations, 1996 the facility provided to RNBCs to invest in UTI units up to the entire sub-limit of 10 per cent of the aggregate liabilities to the depositors was withdrawn. Investment by RNBCs in the mutual funds including UTI will continue to be within the ceiling of 10 per cent of the aggregate liability and subject to the sub-ceiling of two per cent of such liabilities for any one mutual fund.

Permission to NBFCs for Entry into Insurance Business

10.94 Consequent upon issue of final guidelines for entry of NBFCs into insurance business in June 2000, the Reserve Bank permitted five NBFCs to participate in insurance business on risk-sharing basis. Two NBFCs were granted permission to undertake both life and general insurance business while the other three NBFCs were permitted to undertake only life insurance business with risk participation. One company was permitted to engage both in insurance agency business as well as to make strategic investment in equity of an insurance company up to 10 per cent of its owned fund. Four companies were granted permission to conduct only insurance agency business, while two others were permitted to make only strategic investment in the equity of an insurance company.

Other Initiatives

10.95 The Reserve Bank undertook several measures for the benefit of depositors:

- Pursuing with State Governments for enactment of legislation for protection of interest of depositors in financial establishments.
- Undertaking extensive publicity campaign using the print and electronic media to educate the depositors.
- Conducting training programmes for personnel/ executives of NBFCs in order to familiarise them with the objectives, genesis and focus of the Reserve Bank regulations.
- Conducting seminars for the civil and police personnel of the State Governments.
- Conducting training programmes/seminars for the auditors, in association with the ICAI, to familiarise them with the directions and regulations of the Reserve Bank as applicable to the NBFCs as also the directions applicable to statutory auditors of the NBFCs.
- Holding meetings with the top Civil and Police officials of the State Governments and also other regulators like the Registrar of Companies and Department of Company Affairs of the Central Government wherein issues of common concern are discussed.

Inspection of NBFCs

10.96 During the period 2002-03 (April-March), a total of 934 (292 deposit taking companies and 642 non-deposit taking companies) registered NBFCs were inspected. In addition to the inspections, the Reserve Bank also conducted 1,722 snap scrutiny exercises.

Performance Indicators

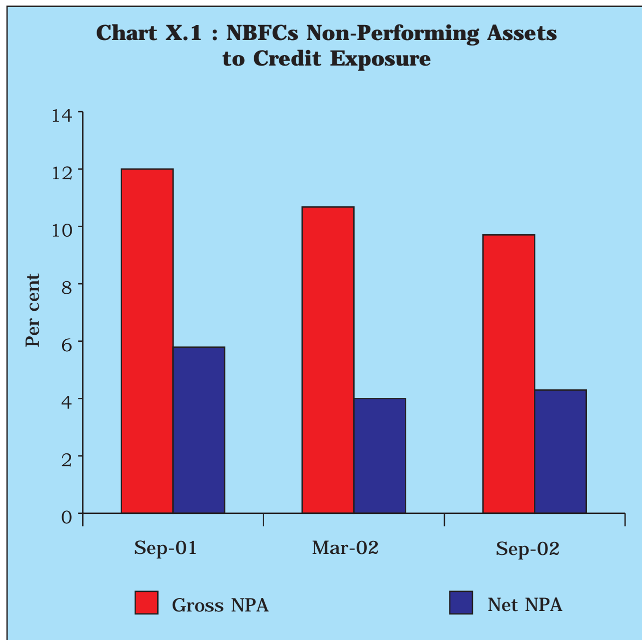
Capital Adequacy

10.97 The norms relating to capital adequacy have been made applicable to NBFCs accepting or holding public deposits with effect from March 31, 1998. At the end of September 2002, almost 94 per cent of the NBFCs reported a CRAR equal to or in excess of the stipulated minimum of 12 per cent with as many as 74 per cent reporting a CRAR above 30 per cent (Table 10.13).

Table 10.13 : Capital to Risk-weighted Assets Ratio (CRAR) of NBFCs

CRAR	Number of NBFCs		
	September 2002	March 2002	September 2001
1	2	3	4
Less than 12%	37	43	53
12% and less than 30%	120	131	131
30% and above	439	489	491
Memo:			
Total Reporting NBFCs	**596**	**663**	**675**

Chart X.1 : NBFCs Non-Performing Assets to Credit Exposure



Non-Performing Assets

10.98 The gross and net NPAs of reporting companies have been showing a declining trend. The gross NPAs, which formed 12.0 per cent of the credit exposure in September 2001, came down to 9.7 per cent in September 2002. Over the same period, the net NPAs came down from 5.8 per cent to 4.3 per cent of credit exposure (Chart X.1).

Outlook

10.99 Over the medium-term, the conduct of financial regulation and surveillance in India would progress from micro-regulation to macro-management, supported by a tightening of prudential norms and improvements in the functioning of the financial markets. A clearer definition of the regulatory role of the Reserve Bank is emerging within the broader debate on the conflict of interest between ownership and regulation. Co-operative banking is being sensitised to the changing context of financial regulation through enhanced standards of disclosure and governance, and a disentangling of the existing regulatory overlap.

10.100 The supervisory strategy of the Board for Financial Supervision would increasingly blend on-site inspection, off-site surveillance, enhanced role of external auditors and strengthening of corporate governance. Banks need to prepare for switching fully to risk-based supervision by 2003 by identifying information gaps in the compilation of risk profiles and training of personnel. The supervisory follow-up process will then involve a monitorable action plan including remedial actions and timely corrective steps.

10.101 Banks are being encouraged to improve the reliability and robustness of their risk management, management information and supervisory reporting systems. A scheme of prompt corrective action based on early warning triggers is evolving as a supervisory tool and would increasingly be adapted to country-specific circumstances. In addition to macro-prudential indicators of financial vulnerability being reviewed in India, financial soundness indicators have been proposed as early warning signals. The Reserve Bank and the Government have initiated a wide range of legal reforms to enable the regulatory and supervisory regime to keep pace with advancements in information and communication technology.

XI PUBLIC DEBT MANAGEMENT

11.1 Debt management in 2002-03 continued to be directed at minimising cost, keeping in view the rollover risk, within the overall objectives of monetary policy. The borrowing programmes of the Central and State Governments were completed successfully with gross market borrowings of Rs.1,81,979 crore. The Central Government mobilised market borrowings to the tune of Rs.1,51,126 crore (net Rs.1,04,118 crore) during 2002-03 as against Rs. 1,33,801 crore (net Rs.92,302 crore) in the preceding year. The gross and net borrowings through dated securities amounted to Rs.1,25,000 crore and Rs.97,580 crore, respectively while Rs.26,126 crore (gross) and Rs.6,538 crore (net) were raised through 364-day Treasury Bills. The gross and net market borrowings of the State Governments amounted to Rs.30,853 crore and Rs.29,064 crore in 2002-03 as compared with Rs.18,707 crore and Rs.17,261 crore in the preceding year, respectively. Comfortable liquidity conditions due to increased capital flows, absence of pressures on account of credit off-take, and reductions in CRR combined with appropriate private placements, facilitated the smooth completion of a large market borrowing programme. The weighted average cost of borrowings declined significantly during the year, benefiting from falling yields due to easy liquidity conditions and low inflation.

11.2 The Reserve Bank continued to combine private placements with open market operations to meet the twin objectives of managing liquidity in the system and containing volatility in the secondary market. New initiatives in debt management included pre-payment of external debt against issue of domestic debt, a debt-swap scheme for the State Governments and a debt buy-back scheme which involved buying back of high cost and illiquid securities issued in the past in exchange of new securities at the prevailing market yield. Comprehensive restructuring of the scheme of Ways and Means Advances (WMA) and overdraft (OD) for States was also undertaken during 2002-03.

CENTRAL GOVERNMENT

Ways and Means Advances

11.3 The Ways and Means Advance (WMA) limits of the Centre were maintained at Rs.10,000 crore for the first half (April-September) and Rs.6,000 crore for the second half (October-March) of 2002-03. The daily average utilisation of WMA and overdraft (OD) was, however, significantly lower (Table 11.1). From the middle of December 2002 to March 31, 2003, the Government of India consistently maintained a surplus balance with the Reserve Bank mainly due

Table 11.1: Overdraft Position of the Central Government

(Rupees crore)

Month	2003-04 (so far)			2002-03			2001-02		
	Range of Overdraft	No. of Days	No. of Occasions	Range of Overdraft	No. of Days	No. of Occasions	Range of Overdraft	No. of Days	No. of Occasions
1	2	3	4	5	6	7	8	9	10
April	1,642-9,656	6	2	144-6,300	13	2	556-14,193	10	1
May	900-5,867	8	3	734-7,773	12	2	199-5,346	8	2
June	875-8,349	5	2	359-5,154	9	3	303-2,173	10	1
July	383-5,288	11	4	85-3,893	13	4	30-7,267	16	4
August				25-3,863	10	2	4,454-6,399	6	1
September				–	–	–	1,856-4,383	7	1
October				–	–	–	103-2,635	10	1
November				–	–	–	356-7,581	13	2
December				39-1,711	2	2	627-5,393	6	2
January				–	–	–	120-4,138	17	4
February				–	–	–	145-4,383	10	1
March				–	–	–	–	–	–
Total				**25-7,773**	**59**	**15**	**30-14,193**	**113**	**20**

Table 11.2 : A Profile of Treasury Bills

(Rupees crore)

Type of T-Bill	Weighted average cut-off yield (%)		Gross amount		Net amount		Outstanding amount	
	2002-03	2001- 02	2002-03	2001- 02	2002-03	2001- 02	2002-03	2001- 02
1	2	3	4	5	6	7	8	9
14-day	–	7.13	–	1,100	–	(-)300	–	–
91-day	5.73	6.88	26,402	20,216	4,626	3,171	9,627	5,001
182-day	–	8.44	–	300	–	(-)1,300	–	–
364-day	5.92	7.30	26,126	19,588	6,538	4,588	26,126	19,588

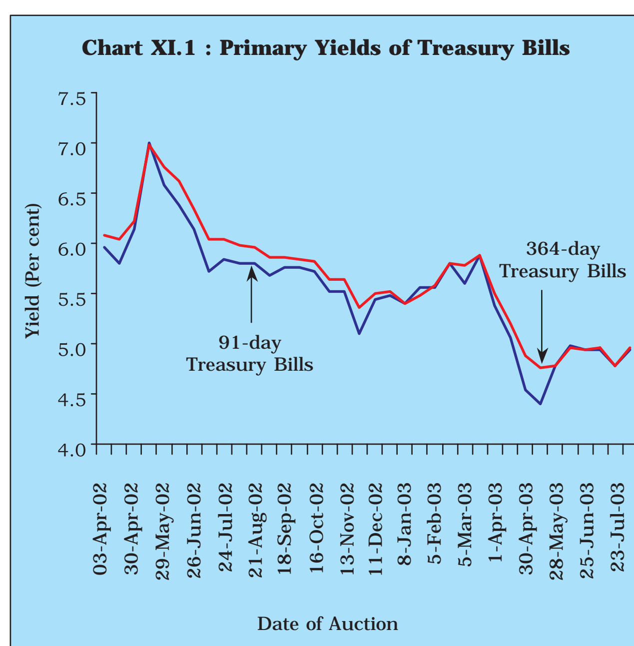
to increased Treasury Bill issuance, repayments by States under the debt swap scheme, and higher inflow through Relief Bonds. The daily average surplus balance during the period mid-December 2002–March 2003 was Rs.11,117 crore and ranged from Rs.982 crore to Rs.24,508 crore. The surpluses were invested in dated securities transferred from the Reserve Bank's investment account.

Treasury Bills

11.4 Currently, the Reserve Bank issues only 91-day (weekly, on Wednesdays) and 364-day Treasury Bills (fortnightly, on the Wednesday preceding the reporting Friday). The day of payment of both the Treasury Bills has been adjusted so as to synchronise them and to provide continuity in the maturity profile with adequate fungible stock. To make the Treasury Bill market vibrant and to provide an additional avenue of investment to the non-bank entities, the notified amount of the 364-day Treasury Bills was increased to Rs.1,000 crore with effect from April 3, 2002. The notified amount for auction of 91-day Treasury Bills was enhanced temporarily from Rs.250 crore to Rs.1,000 crore from December 11, 2002 to January 29, 2003 to absorb excess liquidity. As liquidity tightened in January 2003, the notified amount was reduced to Rs.500 crore for the rest of the financial year. The acceptance in the auction of 91-day Treasury Bills was less than the notified amount on two occasions (February 26, and March 12, 2003) due to substantially higher yield expectations of the market.

11.5 The gross amounts raised through 91-day and 364-day Treasury Bills were higher during 2002-03 (Appendix Table V.8). There was no devolvement on the Reserve Bank in any auction of the Treasury Bills during 2002-03 (Table 11.2).

11.6 With effect from December 11, 2002, the auction format of 91-day Treasury Bills was changed to the multiple price auction method from uniform price auction to encourage more responsible bidding from the market participants. There was a general



decline in yields at auctions of both 91-day and 364-day Treasury Bills during the year (Chart XI.1). During May 2002 and in the last quarter of 2002-03, the rates firmed up because of tight liquidity conditions. During November 2002 to January 2003, on the other hand, a surfeit of liquidity pushed the yields on 91-day and 364-day Treasury Bills below the repo rate. Temporary tightness in the overnight rates had led to an inversion in the short-term yield curve with cut-off yield in 91-day Treasury Bill being higher than the cut-off for 364-day Treasury Bill on February 5, 2003. This was corrected in the subsequent auction on February 19, 2003.

11.7 Comfortable liquidity conditions were reflected in the enthusiastic market response in each of the Treasury Bill auctions (Table 11.3).

11.8 During the current year so far (up to August 6, 2003) the primary yield of 91-day and 364-day Treasury Bills declined by 97 and 94 basis points, respectively, from their March-end levels. Since April

Table 11.3 : Treasury Bills - Response in Primary Market @

Months	91-day		364-day	
	No. of bids received	BR/NA*	No. of bids received	BR/NA*
1	4	5	8	9
2002				
January	130	2.57	126	2.58
February	112	3.24	134	3.60
March	101	2.74	93	3.37
April	140	2.91	180	2.52
May	113	2.69	134	2.54
June	95	2.28	132	3.02
July	135	2.65	120	2.52
August	99	2.12	122	3.17
September	98	2.30	106	3.05
October	120	2.33	139	2.54
November	98	2.46	113	2.36
December	174	2.88	140	3.37
2003				
January	204	2.35	108	2.48
February	135	2.26	97	2.46
March	124	2.00	77	1.54
April	197	4.13	125	2.65
May	124	1.94	118	1.88
June	155	1.91	123	2.51
July	132	3.05	105	2.15

@ As per dates of auction.

* Ratio of competitive bids Received (BR) to Notified Amount (NA).

23, 2003, the primary yields of both 91-day and 364-day Treasury Bills fell below the repo rate, mainly due to abundant liquidity. The notified amount of 91-day Treasury Bills was enhanced from Rs. 500 crore to Rs. 1,500 crore for eight auctions from August 6, 2003 to September 24, 2003 keeping in view the prevailing liquidity conditions in the system.

Dated Securities

11.9 The Central Government raised a gross amount of Rs.1,25,000 crore and a net amount of Rs.97,580 crore during 2002-03 through issuance of dated securities (Appendix Table V.7). The gross and net market borrowings increased by 9 per cent and 11 per cent, respectively, over the preceding year. The ratio of net market borrowing through dated securities to the gross fiscal deficit moved up to 67.1 per cent in 2002-03 from 62.2 per cent in 2001-02.

11.10 Out of 31 issues of dated securities during the year, 12 were new issues while 19 were reissues, in line with the policy of passive consolidation of domestic debt. Out of 117 outstanding marketable dated securities of Rs.6,73,905 crore, 29 securities with minimum outstanding amount of Rs.10,000 crore or more now account for 54 per cent of the total outstanding amount.

11.11 Of the total market borrowing programme, Rs.94,000 crore was raised through auction of dated securities (25 auctions) and the balance of Rs.31,000 crore (six issues) through private placements with the Reserve Bank - Rs.6,000 crore (one issue) in April 2002 to meet large unanticipated requirements of the Central Government, Rs.12,000 crore (three issues) in May 2002 when the market experienced tight liquidity conditions and uncertainty due to border tensions and Rs.13,000 crore (two issues) for prepayment of external debt in February, 2003. There were devolvements of Rs.5,175 crore during the year. Net open market sales amounting to Rs.53,780 crore during the year more than offset the monetary impact of private placements and devolvements.

11.12 The issuance of half yearly indicative calendars for the core component of the Government of India's market borrowing programme was introduced in 2002-03 to provide transparency and thereby enable the market participants to improve their investment planning. The issuance calendar was mostly adhered to.

11.13 The response at primary auctions was generally positive, with average bid cover ratio of 2.0, except on two occasions - in May and June, 2002 - when the amounts under auction devolved partly on Primary Dealers (PDs) and the Reserve Bank (Box XI.1).

11.14 To reduce the bidding risk of market participants, the Reserve Bank used uniform auction format on an experimental basis, mainly for new types of instruments like Floating Rate Bonds (FRBs), bonds with option features and very long tenor bonds of 30 years maturity. The method was also used for fixed coupon securities in April 2002, but huge liquidity and aggressive bidding resulted in the cut-off yield being well below the prevailing market yields.

11.15 The policy of elongation of maturity of government securities was persevered with. The maximum maturity of securities issued was extended to 30 years in 2002-03 as compared with 25 years in 2001-02. There was a marginal fall in the weighted average maturity of securities issued during the year. This occurred mainly because of the issuance of securities for prepayment of foreign debt on maturity matched basis for an average tenor of 9.3 years. The weighted average maturity of the outstanding loans,

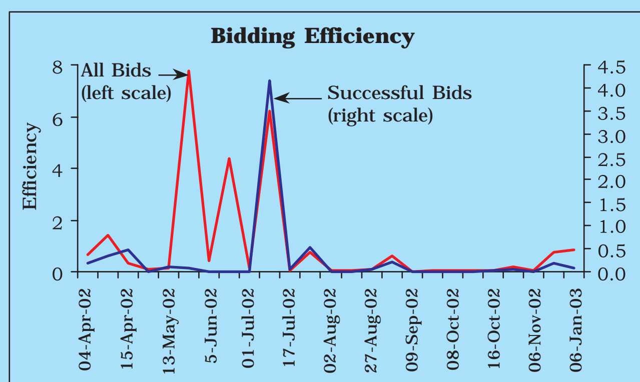
Box XI.1

Bidding Pattern in Auctions of Government of India Securities 2002-03

The bid-to-cover ratio (BCR), the ratio of the total amount of bids received at the auction to the notified amount, depends on the liquidity scenario and the interest rate expectations. The average BCR during 2002-03 was 2.0 as compared with 2.6 during 2001-02. Out of 25 auctions, BCR was above 3.0 in four auctions (seven out of 25 auctions during 2001-02) showing less aggressive bidding as compared with the previous year. BCR was lower during May-July 2002 due to tight liquidity and uncertain interest rate conditions.

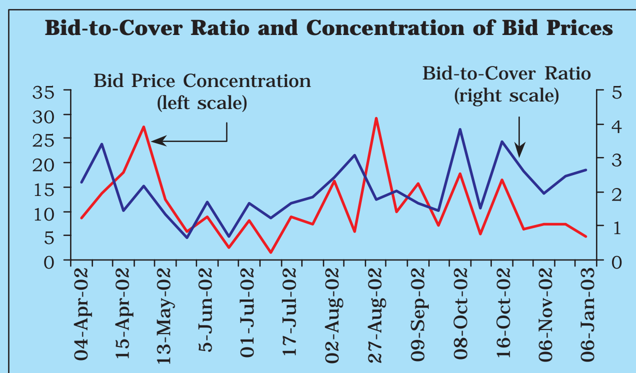
Bidding Efficiency

Bidding efficiency can be measured in terms of dispersion of the bid prices around a cut-off price, weighted by the share of the bid amounts. The lower the dispersion, the more efficient is the bidding by the participants. Bidding efficiency was higher (indicated by relatively low dispersion) during most part of 2002-03 except May-July 2002. The bidding efficiency was low in the auction of Floating Rate Bond 2017 held on July 1, 2002 due to interest rate uncertainties as the coupon is reset half yearly (Chart).



Concentration of Bid Price

Concentration of bid price, measured by the Herfindahl index of bid prices multiplied by the total number of bids, is an indicator of the uniformity of market expectations. Higher the index, more is the concentration of bid price. Higher concentration around the expected cut-off price/ yield is desirable. Concentration has generally been high (except in the auctions of 8.35% GS 2022 on May 13, 2002 and FRB 2017 on July 1, 2002), implying efficient bidding for most part of the year. Concentration of bid price has been found to follow the trend in BCR, indicating that when demand is high, the market has a reasonably uniform view on bond yields (Chart).



Performance of Uniform Price Auction Method

During 2002-03, out of the 25 auctions in government dated securities, six were held on the basis of uniform price method and remaining 19 were conducted through multiple price or discriminatory method. In a discriminatory auction, successful winning bids are filled at the bid price while in the uniform price auction, the successful bidders pay a flat price, called the cut-off price. As bidders tend to alter the bidding behaviour depending upon whether uniform price mode or multiple price mode is used, opinions are divided as to which of the two methods is superior. The US Treasury uses uniform price auction for issuing two and five-year securities. In a majority of countries, securities are auctioned using discriminatory auction method. Spain, on the other hand, uses a mixed uniform-discriminatory format in which winning bids above the average winning bid are charged uniformly at average bid while other winning bids pay respective prices.

The average BCR for the six uniform price auctions of dated government securities held in India during 2002-03 at 2.05 worked out marginally higher than the average BCR of 2.04 for multiple price auctions. The average bid price concentration for the six uniform price auctions worked out lower at 7.75 as compared to 11.91 for multiple price auctions.

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2. Das, S. R., Sunderam, R.K. (1996): "Auction Theory: A Summary with Applications to Treasury Bills Auctions", *Financial Markets, Institutions and Investments* 5(5), 1996.
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Table 11.4 : Yield and Maturity of Central Government Securities Issued during the Year

Years	Range of YTMs at Primary Issues (per cent)			Weighted Average Yield (Per cent)	Range of Maturity of Loans (Years)	Weighted Average Maturity (years)	Weighted Average Maturity of outstanding stock (years)
	Under 5 years	5-10 years	Over 10 years				
1	2	3	4	5	6	7	8
1997-98	10.85-12.14	11.15-13.05	–	12.01	3-10	6.6	6.5
1998-99	11.40-11.68	11.10-12.25	12.25-12.60	11.86	2-20	7.7	6.3
1999-00	–	10.73-11.99	10.77-12.45	11.77	5-19	12.6	7.1
2000-01	9.47-10.95	9.88-11.69	10.47-11.70	10.95	2-20	10.6	7.5
2001-02	–	6.98-9.81	7.18-11.00	9.44	5-25	14.3	8.2
2002-03	–	6.65-8.14	6.84-8.62	7.34	7-30	13.8	8.9
2003-04 (up to August 7, 2003)	–	5.03-5.76	5.09-6.35	5.94	8-29	15.8	9.0

however, went up as the share of securities under 5 years declined. On the other hand, the share of securities with maturity over 10 years increased from 18 per cent on March 31, 1998 to 39 per cent at the end of March 2003. The weighted average cost of dated securities issued during 2002-03 declined by 210 basis points to 7.34 per cent, reflecting availability of ample liquidity in the system, low inflationary expectations and the accommodative monetary policy stance (Table 11.4).

11.16 The outstanding securities across the maturity buckets has become more evenly distributed over the years (Table 11.5). This is due to issuances with more than 10-year maturity having substantially increased since 1997-98, while issuances for maturities less than 5 years have been declining.

11.17 During 2002-03, the primary issuance of dated securities was significantly higher in the above 15-year maturity bucket (Table 11.6).

Table 11.5 : Maturity Profile of Central Government Securities

(Per cent)

	Outstanding Stock			Issued During the Year		
	Under 5 Years	5-10 Years	Over 10 Years	Under 5 Years	5-10 Years	Over 10 Years
1	2	3	4	5	6	7
1997-98	41	41	18	18	82	0
1998-99	41	42	16	18	68	14
1999-00	37	39	24	0	35	65
2000-01	27	47	26	6	41	53
2001-02	31	36	33	2	24	74
2002-03	26	35	39	0	36	64

Table 11.6 : Primary Issuance of Central Government Securities for Different Maturities

(Rupees crore)

Year	5- year	10-year	15-year	20-year
1	2	3	4	5
1999-00	3,000	10,500	11,500	-
2000-01	6,000	22,500	19,000	7,000
2001-02	2,000	21,000	9,000	13,213
2002-03	-	29,000	30,000	13,000
2003-04 (up to August 7, 2003)	-	6,000	8,000	4,000

11.18 The scheme of non-competitive bidding, which was introduced in January 2002 to facilitate investment by retail and mid-segment investors in Central Government securities, was made an integral part of the borrowing programme since October 2002. During 2002-03, out of a total reserved amount of Rs.4,050 crore, the non-competitive bidders were allotted Rs.1,302 crore, amounting to 32.2 per cent of the reserved amount. In the individual auctions, the response of non-competitive bidders varied from 8 per cent to 88 per cent of the reserved amount.

11.19 In line with the policy of ensuring sufficient securities in the portfolio of the Reserve Bank to conduct open market operations (OMO), the Government of India converted Rs.40,000 crore of 4.6 per cent Special Securities held in the Reserve Bank's portfolio into marketable securities of various maturities (3 to 18 years) at the prevailing yields in 2002-03. The outstanding balance of the Special Securities has accordingly diminished (Table 11.7). Another conversion of the Government of India Special Securities amounting to Rs.20,000 crore into

Table 11.7 : Reserve Bank's Stock of Central Government Securities

(Rupees crore)

Year (end-March)	Outstanding Dated Securities	Special Securities Issued to RBI in Conversion of Ad-hoc Treasury Bills	Total Out-standing*
1	2	3	4
1996-97	6,666	1,21,818	1,28,484
1997-98	31,977	1,01,818	1,33,795
1998-99	42,212	1,01,818	1,44,030
1999-00	35,190	1,01,818	1,37,008
2000-01	41,732	1,01,818	1,43,550
2001-02	40,927	1,01,818	1,42,745
2002-03	55,438	61,818	1,17,256
2003-04 (As on August 1, 2003)	83,574	41,818	1,25,392

* Inclusive of securities sold under LAF.

three dated securities on June 12, 2003 brought down the outstanding stock of Special Securities held by the Reserve Bank.

11.20 The repayment schedule of outstanding market loans of the Central Government indicates that the repayments are evenly spread without any bunching (Table 11.8).

Table 11.8 : Repayment Schedule of Outstanding Central Government Securities (As on March 31, 2003)

(Rupees crore)

End-March	Amount outstanding
1	2
2003-04	32,910
2004-05	34,316
2005-06	35,631
2006-07	36,894
2007-08	41,151
2008-09	40,223
2009-10	45,195
2010-11	53,109
2011-12	45,610
2012-13	46,255
2013-14	40,191
2014-15	27,588
2015-16	36,857
2016-17	36,130
2017-18	37,000
2018-19	16,632
2019-20	11,000
2020-21	11,000
2021-22	13,213
2022-23	13,000
2026-27	15,000
2032-33	5,000

Table 11.9 : Interest Rate Profile of the Outstanding Central Government Securities (As on March 31, 2003)

Range of Interest Rate (Per cent)	Outstanding Amount (Rupees crore)	Share in Total
1	2	3
5.73 - 5.99	12,378	1.84
6.00 - 6.99	44,684	6.63
7.00 - 7.99	79,654	11.82
8.00 - 8.99	29,643	4.40
9.00 - 9.99	51,992	7.72
10.00 - 10.99	84,572	12.55
11.00 - 11.99	2,12,243	31.49
12.00 - 12.99	1,25,047	18.56
13.00 - 14.00	33,692	5.00
Total	**6,73,905**	

11.21 The interest rate profile of the outstanding stock of the Central Government is skewed with over two-third of the contracted debt carrying over 10 per cent interest (Table 11.9).

11.22 The budget estimate of the net market borrowing of the Central Government through dated securities for the year 2003-04 is placed at Rs.1,07,320 crore. Including repayments of Rs.32,910 crore, the gross market borrowing through dated securities amounts to Rs.1,40,230 crore, an increase of 12.2 per cent over the previous year's level. The calendar for the first half covering 50.6 per cent of the market borrowing programme was announced on March 31, 2003 (Table 11.10).

11.23 During the current year so far (up to August 7, 2003), the Central Government raised gross amount of Rs.88,434 crore (net Rs.61,316 crore), including Rs.14,434 crore raised on account of buy-back of Government securities; and Rs.5,000 crore was through private placement. On May 19, 2003, a Floating Rate Bond 2014 was issued for the notified amount of Rs.5,000 crore. The maximum amount for non-competitive bidding was raised from Rs. 1 crore to Rs. 2 crore from this auction onwards. The cut-off yield was at 5.09 per cent, 14 basis points above the variable base rate. Under the modified design of floating rate bonds, the variable base rate is determined on the basis of average cut-off yield emerging in the preceding three auctions of 364-day Treasury Bills instead of preceding six auctions earlier. It also provides for annual reset of variable base rate for fixation of coupon as against half yearly reset earlier. The coupon payment, however, continue to

Table 11.10 : Indicative Calendar and Actual Borrowings through the Dated Securities for first half of 2003-04

(Amount in Rupees crore)

	Proposed Auction Calendar				Actual Borrowings		
	Period of auction	Amount		Maturity Period of the Security (Years)	Date of Auction	Amount	Maturity Period of the Security (Years)
	1	2		3	4	5	6
1.	April 3-9, 2003	9,000	(i)	10 to 14-year security for Rs.5,000 crore	April 8, 2003	5,000	11.02
			(ii)	20-year and above security for Rs.4,000 crore	April 8, 2003	4,000	20.00
2.	April 16-22, 2003	7,000	(i)	15 to 19-year security for Rs.5,000 crore	April 22, 2003 April 22, 2003	5,000 2,000	14.69 29.35
			(ii)	20-year and above security for Rs.2,000 crore	April 22, 2003 April 22, 2003	3,000 P* 2,000 P*	14.69 29.35
3.	May 2-8, 2003	9,000	(i)	10 to 14-year security for Rs.6,000 crore	May 3, 2003 May 3, 2003	6,000 3,000	10.33 18.93
			(ii)	20- year and above security for Rs.3,000 crore			
4.	May 14-20, 2003	5,000	(i)	10 to 14-year security for Rs.5,000 crore	May 19, 2003	5,000	11.00
5.	June 2-8, 2003	9,000	(i)	5 to 9 –year security for Rs.6,000 crore	June 3, 2003 June 3, 2003	6,000 3,000	8.84 25.00
			(ii)	20-year and above security for Rs.3,000 crore			
6.	July 1-7, 2003	9,000	(i)	10 to 14 year security for 5,000 crore	July 1, 2003 July 1, 2003	5,000 4,000	10.79 15.94
			(ii)	15 to 19-year security for Rs.4,000 crore	July 1, 2003	3,000 *	24.92
7.	July 14-21, 2003	5,000	(i)	15 to 19-year security for Rs.3,000 crore	July 15, 2003 July 15, 2003	6,000 * 3,000 *	16.46 29.12
			(ii)	20-year and above security for Rs. 2,000 crore			
8.	August 1-7, 2003	9,000	(i)	5 to 10-year security for Rs.6,000 crore	August 7, 2003 August 7, 2003	6,000 3,000	8.00 24.63
			(ii)	20-year and above security for Rs.3,000 crore			
9.	September 1-7, 2003	9,000	(i)	10 to 14-year security for Rs.5,000 crore			
			(ii)	15 to 20-year security for Rs.4,000 crore			
	Total	**71,000**				**74,000**	

* Additional borrowings over and above the indicative calendar.

P Private Placement with RBI.

remain semi-annual. The weighted average yield and maturity of dated securities issued during the current year so far (up to August 7, 2003) works out to 5.94 per cent and 15.84 years, respectively.

STATE GOVERNMENTS

Ways and Means Advances

11.24 The Reserve Bank provides WMA to States with a view to help them tide over temporary mismatches in cash flow. The WMA limits are fixed by the Reserve Bank from time to time. Drawing from the recommendations of the Ramachandran Committee (2002) and consultations with the State Governments, the Reserve Bank revised the Scheme of Ways and Means Advances for the States, effective March 3, 2003 to give them the benefit of higher limits in the last month of the fiscal year. The revised normal WMA limits have been computed by taking into account the average of revenue receipts for the three

Table 11.11 : Normal WMA Limits of States

(Rupees crore)

	State	WMA Limits 1996 (effective from August 1, 1996)	WMA Limits 1999 (effective from March 1, 1999)$	WMA Limits 2001 (effective from February 1, 2001)	WMA Limits 2002 (effective from April 1, 2002)	WMA Limits 2003 (effective from March 3, 2003)*
	1	2	3	4	5	6
	Non-Special Category States					
1.	Andhra Pradesh	168	288	463	520	620
2.	Bihar	118	195	220	245	305
3.	Chhattisgarh		82	91	100	130
4.	Goa	17	24	25	50	50
5.	Gujarat	118	243	393	445	485
6.	Jharkhand		51	57	75	105
7.	Haryana	50	99	167	180	205
8.	Karnataka	134	228	331	375	460
9.	Kerala	101	144	215	225	270
10.	Madhya Pradesh	134	221	244	275	345
11.	Maharashtra	252	483	685	760	905
12.	Orissa	101	141	159	185	215
13.	Punjab	101	141	200	235	240
14.	Rajasthan	101	202	288	310	365
15.	Tamil Nadu	185	281	402	415	570
16.	Uttar Pradesh	286	531	559	630	755
17.	West Bengal	168	235	295	360	420
	Sub Total	2,033	3,589	4,794	5,385	6,445
	Special Category States					
1.	Arunachal Pradesh	17	28	35	50	50
2.	Assam	67	114	161	180	210
3.	Himachal Pradesh	34	59	92	115	135
4.	Manipur	17	25	38	50	50
5.	Meghalaya	17	25	30	50	50
6.	Mizoram	17	25	28	50	50
7.	Nagaland	17	26	40	50	55
8.	Tripura	17	31	46	55	60
9.	Uttaranchal		19	19	50	65
	Sub Total	202	352	489	650	725
	Total	**2,234**	**3,941**	**5,283**	**6,035**	**7,170**

$ Report of the Informal Advisory Committee on WMA to State Governments (Chairman: Shri B.P.R. Vithal, November 1998).
* Report of the Advisory Committee on WMA to State Governments (Chairman: Shri C. Ramachandran, January 2003).

fiscal years 1999-2000, 2000-01 and 2001-02 and then applying a multiplication factor of 3.19 for the non-special category States and 3.84 for the special category States. The total normal WMA limits effective from March 3, 2003 at Rs.7,170 crore was 18.8 per cent higher than the earlier limit of Rs.6,035 crore (Table 11.11).

11.25 The special WMA continues to be linked to the investments made by State Governments in Government of India securities. A lower and uniform margin of 5 per cent (compared with the 10 to 15 per cent margin earlier) would be applied on the market value of the securities for determining the operating limit of special WMA. The States would have to avail of special WMA limits first at a rate of one per cent below the Bank Rate before seeking accommodation under the normal WMA limits. The number of days that a State can be in overdraft (OD) has been extended to 14 consecutive working days from the earlier 12 consecutive working days. The OD regulation for State Governments has been made more stringent. With effect from April 1, 2003, the State Governments cannot remain in OD for more than 36 working days in a quarter (Table 11.12).

11.26 The outstanding WMA and OD of the State Governments was lower by 52.9 per cent in 2002-03 as compared with the previous year. For a majority of the States, the utilisation of WMA and OD came down significantly in 2002-03, indicating improved management of cash flows (Table 11.13).

Table 11.12 : WMA to State Governments - Earlier and the New Arrangements

Item	Earlier Arrangement	New Arrangement
1	2	3
Normal WMA		
1. Methodology for Computation of Limit	Average of revenue receipts and capital expenditure of the latest three years multiplied by a ratio of 2.4 for non-special category States and 2.9 for special category States.	Average of only revenue receipts of latest three years multiplied by a ratio of 3.19 for non-special category Sates and 3.84 for special category States.
2. Aggregate Normal WMA Limits	**Rs.6,035 crore**	**Rs.7,170 crore**
i) Non-Special Category States	Rs.5,385 crore	Rs.6,445 crore
ii) Special Category States	Rs.650 crore	Rs.725 crore
3. Rate of interest	Bank Rate	Bank Rate for the period of 1-90 days and 1 per cent above the Bank Rate for the period beyond 90 days.
Special WMA		
4. Computation of limits (Margin)	15 per cent* 10 per cent**	5 per cent uniformly.
5. Rate of interest	Bank Rate	1 per cent below the Bank Rate.
6. Use of Special WMA	This is availed of after Normal WMA.	To be availed of before utilising Normal WMA limit.
Overdraft Regulation Scheme		
7. No. of consecutive working days a State can be under OD (excluding holidays)	12	14
8. No. of working days in a quarter a State can be in OD	–	36
9. No. of consecutive working days OD can be in excess of the Normal WMA limit	5	5
10. Rate of interest	Bank Rate *plus* 2 per cent	OD up to 100 per cent of Normal WMA at 3 per cent above the Bank Rate and for OD exceeding 100 per cent of Normal WMA at 6 per cent above the Bank Rate.

* For securities with residual maturity of more than 10 years.
** For securities with residual maturity of less than 10 years.

11.27 The weekly average utilisation of WMA and OD during 2003-04 (up to July 2003) was lower, mainly due to higher small savings collections and larger market borrowing (Table 11.14). Stricter OD regime with higher rate of interest has presumably reduced States' resort to OD. There has, however, been a sharp increase in States' resort to special WMA as States are allowed to avail of special WMA before seeking accomodation under the normal WMA.

Market Borrowings of State Governments

11.28 States resorted to large volumes of market borrowings in 2002-03. States raised Rs.30,853 crore (Rs.27,880 crore through tap issuances and Rs.2,973 crore through auctions), an increase of 65 per cent over Rs.18,707 crore (Rs.15,942 crore through tap issuances and Rs.2,765 crore through auctions) during 2001-02 (Table 11.15). The interest rates on tap issues ranged between 6.60-7.80 per cent with a spread fixed in the range between 38-52 basis points over the corresponding secondary market yield of Government of India dated securities (Table 11.16). The cut-off yields on auctions ranged between 6.67-8.00 per cent with a spread ranging between 20-76 basis points over the corresponding secondary market yield of Government of India dated securities. Of the States that used the auction method, some were able to mobilise loans at

Table 11.13 : Utilisation of WMA and Overdrafts by State Governments

	States	WMA		Overdraft (OD)			
		2001-02	2002-03	2001-02		2002-03	
		No. of days	No. of days	No. of Occasions	No. of days	No. of Occasions	No. of days
	1	2	3	4	5	6	7
	Non-Special Category States						
1.	Andhra Pradesh	336	72	24	173	6	33
2.	Bihar	265	1	16	123	0	0
3.	Goa	219	266	11	68	9	66
4.	Gujarat	307	219	11	72	13	47
5.	Haryana	299	64	16	70	4	21
6.	Karnataka	40	157	0	0	1	1
7.	Kerala	359	330	27	222	28	196
8.	Madhya Pradesh	290	251	15	173	22	176
9.	Maharashtra	332	301	15	129	17	154
10.	Orissa	364	329	31	258	21	189
11.	Punjab	259	214	17	120	11	53
12.	Rajasthan	309	329	23	169	21	151
13.	Tamil Nadu	359	326	24	152	13	73
14.	Uttar Pradesh	217	229	13	88	14	79
15.	West Bengal	365	318	28	253	28	260
16.	Chhattisgarh	0	0	0	0	0	0
17.	Jharkhand	1	0	0	0	0	0
	Special Category States						
1.	Arunachal Pradesh	13	27	0	0	0	0
2.	Assam	365	121	19	312	24	315
3.	Himachal Pradesh	342	252	29	233	27	181
4.	Manipur	365	333	19	331	19	350
5.	Meghalaya	0	78	0	0	1	1
6.	Mizoram	270	184	10	81	4	24
7.	Nagaland	188	297	8	72	19	143
8.	Tripura	86	28	0	0	0	0
9.	Uttaranchal	142	180	10	85	9	41

competitive rates (Punjab and Andhra Pradesh) while others had to pay higher rates (Kerala and Jammu and Kashmir) (Table 11.17).

11.29 The provisional net allocation for the State Governments under their market borrowing programme during 2003-04 is kept at Rs. 24,000 crore

Table 11.14 : WMA, Special WMA, Overdraft and Investment in Treasury Bills (Weekly Averages)

(Rupees crore)

Month	Normal WMA			Special WMA			Overdraft			Investment in Treasury Bills		
	2003-04	2002-03	2001-02	2003-04	2002-03	2001-02	2003-04	2002-03	2001-02	2003-04	2002-03	2001-02
1	2	3	4	5	6	7	8	9	10	11	12	13
April	2,145	2,924	3,925	989	835	666	1,088	2,987	1,863	3,894	1,652	2,832
May	1,816	2,961	2,638	941	480	345	445	1,428	681	4,987	2,404	3,483
June	1,179	3,007	2,223	937	559	331	204	1,022	508	6,232	3,670	4,664
July	2,160	3,295	2,875	1,138	658	491	612	1,252	863	4,095	2,727	4,219
August		2,058	2,798		507	539		817	911		4,367	2,916
September		2,875	3,542		610	760		924	1,851		4,389	1,764
October		3,238	3,586		709	652		1,860	1,693		3,156	1,704
November		3,673	3,730		704	769		1,575	1,990		2,396	1,595
December		4,454	4,244		833	950		1,407	2,292		2,440	1,232
January		3,982	4,217		922	951		1,431	2,024		3,299	1,067
February		3,352	3,506		493	922		1,351	1,733		3,371	1,437
March		2,806	3,746		832	839		715	2,447		3,301	955

Table 11.15 : Market Borrowings of State Governments in 2002–03

(Rupees crore)

	States	Gross Borrowings	Repayment	Net Borrowings	Gross Amount raised by Auction	Gross Amount raised through Tap Sale
	1	2	3	4	5	6
1.	Andhra Pradesh	3,401	175	3,226	545	2,857
2.	Arunachal Pradesh	34	0	34	–	34
3.	Assam	911	23	888	–	911
4.	Bihar	1,335	135	1,200	–	1,335
5.	Chhattisgarh	464	15	449	–	464
6.	Goa	155	0	155	–	155
7.	Gujarat	2,537	68	2,469	445	2,092
8.	Haryana	756	41	714	–	756
9.	Himachal Pradesh	698	14	684	–	698
10.	Jammu and Kashmir	596	18	576	70	526
11.	Jharkhand	455	46	409	–	455
12.	Karnataka	1,611	101	1,510	200	1,411
13.	Kerala	1,237	103	1,134	445	792
14.	Madhya Pradesh	1,137	40	1,097	247	890
15.	Maharashtra	1,074	74	1,000	509	565
16.	Manipur	77	8	69	–	77
17.	Meghalaya	87	0	87	–	87
18.	Mizoram	118	0	118	–	118
19.	Nagaland	178	11	167	–	178
20.	Orissa	1,308	106	1,202	–	1,308
21.	Punjab	1,141	79	1,062	85	1,056
22.	Rajasthan	2,383	119	2,264	–	2,383
23.	Sikkim	20	0	20	–	20
24.	Tamil Nadu	2,325	186	2,139	275	2,050
25.	Tripura	121	9	113	–	121
26.	Uttar Pradesh	3,237	299	2,938	–	3,237
27.	Uttaranchal	950	16	934	–	950
28.	West Bengal	2,506	101	2,405	153	2,353
	Total	**30,853**	**1,789**	**29,064**	**2,973**	**27,880**

including additional allocation of Rs. 4,000 crore. Taking into account the repayment of Rs. 4,145 crore, the gross (provisional) allocation amounts to Rs. 28,145 crore. During the current year so far (up to August 11, 2003), an aggregate amount of Rs. 22,896 crore has been raised by the State Governments under the market borrowing programme.

11.30 The weighted average yield recorded a decline of 1.71 percentage points in 2002-03 (Table 11.18). The State wise maturity profile of outstanding State Governments' market loans suggests that almost 75 per cent of the loans are in the maturity bucket of 5-10 years (Table 11.19).

11.31 The distribution of annual repayment of the State Governments' market loans is even but weighted at the longer end (Table 11.20).

11.32 As in the case of the Centre, the profile of the outstanding stock of the State Governments in terms of interest rate ranges indicates that over two-third of loans are contracted at interest rates of 10 per cent and more (Table 11.21).

Debt Restructuring

11.33 The Union Budget for 2003-04 has envisaged measures for debt restructuring as a part of fiscal consolidation. They encompass pre-payment of external debt, buy-back of loans by the Government from the banks on voluntary basis and restructuring of State Governments' debt to the Centre through a debt swap scheme.

11.34 Pre-payment of 'high-cost' currency pool loans from the World Bank and the loans from the Asian Development Bank and switching of this amount with domestic loans would reduce the cost to the Central Government. Accordingly, the Central Government prepaid foreign currency loans to these institutions

Table 11.16 : Market Borrowings Raised through Tap Issuance

	Name of the State	Tap Issue					
		April 23-26, 2002 7.80%	August 19, 2002 7.80%	December 23, 2002 6.80%	February 4, 2003 6.60%	February 25-26, 2003 6.95%	March 12-17, 2003 6.75%
	1	2	3	4	5	6	7
1.	Andhra Pradesh	387	443	0	809	876	342
2.	Arunachal Pradesh	8	5	3		14	4
3.	Assam	89	177	119		303	223
4.	Bihar	184	327	227		299	298
5.	Chhattisgarh	56	155	0		137	115
6.	Goa	34	27	48		34	11
7.	Gujarat	344	240	361		694	453
8.	Haryana	130	78	169		289	90
9.	Himachal Pradesh	104	150	100	100	175	69
10.	Jammu and Kashmir	61	46	30	212	90	87
11.	Jharkhand	88	97	65		129	76
12.	Karnataka	150	300	352		457	151
13.	Kerala	0	251	197		258	86
14.	Madhya Pradesh	109	370	0		281	130
15.	Maharashtra	328	237	0		0	0
16.	Manipur	10	28	21		14	5
17.	Meghalaya	21	29	20		13	4
18.	Mizoram	10	14	81		10	3
19.	Nagaland	36	53	74		7	7
20.	Orissa	154	280	187		353	334
21.	Punjab	212	127	0		451	266
22.	Rajasthan	249	426	284		713	712
23.	Sikkim	0	6	4		10	0
24.	Tamil Nadu	309	406	146		729	460
25.	Tripura	25	35	24		20	17
26.	Uttar Pradesh	433	814	542		849	599
27.	Uttaranchal	57	23	286		292	292
28.	West Bengal	384	229	0		902	838
	Total	**3,974**	**5,374**	**3,341**	**1,121**	**8,398**	**5,671**

Table 11.17 : Market Borrowings Raised through Auctions

(Amount in Rupees crore; cut-off yield in per cent)

	Name of State	2002-03		
		Date of Auction	Amount	Cut-off
	1	2	3	4
1.	Andhra Pradesh	27.06.02	250	7.90
		10.12.02	295	6.67
2.	Gujarat	27.06.02	245	7.83
		30.10.02	200	7.33
3.	Jammu and Kashmir	27.06.02	70	8.00
4.	Karnataka	27.06.02	200	7.90
5.	Kerala	11.04.02	225	8.00*
6.	Madhya Pradesh	18.11.02	247	6.94
7.	Maharashtra	27.06.02	279	7.83
8.	Punjab	18.11.02	85	6.80
9.	Tamil Nadu	30.10.02	275	7.30
10.	West Bengal	30.10.02	153	7.35
	Total		**2,973**	

* Reissue

amounting to US $ 3.0 billion. The possibility of further repayments of external debt is being explored.

11.35 The buy-back of high coupon loans by the Central Government from banks and debt-swap by the State Governments are the two schemes aimed at restructuring the domestic debt. The scheme of

Table 11.18 : Yield of State Government Loans Issued during the Year

(Per cent per annum)

Year	Range	Weighted Average
1	2	3
1995-96	14.00	14.00
1996-97	13.75-13.85	13.83
1997-98	12.30-13.05	12.82
1998-99	12.15-12.50	12.35
1999-00	11.00-12.25	11.89
2000-01	10.50-12.00	10.99
2001-02	7.80-10.53	9.20
2002-03	6.67-8.00	7.49

Table 11.19 : Maturity Profile of Outstanding State Government Loans (As on March 31, 2003) P

(Rupees crore)

State	Under 5 years	5-10 years	Total
1	2	3	4
1. Andhra Pradesh	2,942	11,315	14,257
2. Arunachal Pradesh	30	106	136
3. Assam	960	2,717	3,678
4. Bihar	2,966	5,560	8,526
5. Chhattisgarh	0	803	803
6. Goa	91	521	612
7. Gujarat	1,360	6,291	7,651
8. Himachal Pradesh	225	1,759	1,983
9. Haryana	723	2,016	2,739
10. Jammu and Kashmir	365	1,434	1,800
11. Jharkhand	0	948	948
12. Karnataka	1,302	5,746	7,047
13. Kerala	1,904	4,606	6,510
14. Maharashtra	2,282	5,150	7,432
15. Madhya Pradesh	2,078	4,567	6,644
16. Manipur	100	252	352
17. Meghalaya	138	413	551
18. Mizoram	65	262	326
19. Nagaland	199	691	890
20. Orissa	2,111	4,769	6,880
21. Punjab	1,014	3,039	4,054
22. Rajasthan	2,145	7,671	9,816
23. Sikkim	77	164	241
24. Tripura	121	462	582
25. Tamil Nadu	2,324	6,676	9,000
26. Uttaranchal	0	1,178	1,178
27. Uttar Pradesh	5,601	13,547	19,148
28. West Bengal	2,528	6,754	9,282
Total	**33,648**	**99,418**	**1,33,066**

P : Provisional.

debt buyback, as announced in the Union Budget for 2003-04, was implemented on July 19, 2003. Government of India bought back 19 high cost,

Table 11.20 : Repayment Schedule of Outstanding State Government Loans (As on March 31, 2003)

(Rupees crore)

Year	Amount*
1	2
2003-04	4,145
2004-05	5,123
2005-06	6,274
2006-07	6,551
2007-08	11,554
2008-09	14,400
2009-10	16,511
2010-11	15,870
2011-12	22,032
2012-13	30,605

* Outstandings are likely to increase on account of issue of power bonds by State Governments with retrospective effect from October 1, 2001.

Table 11.21 : Interest Rate Profile of Outstanding State Government Loans (As on March 31, 2003)

Range of Interest Rate (per cent)	Outstanding Amount (Rupees crore)	Percentage to Total
1	2	3
Less than 7 per cent	19,585	14.72
7.00-7.99	11,030	8.29
8.00-8.99	8,004	6.02
9.00-9.99	5,411	4.07
10.00-10.99	14,563	10.94
11.00-11.99	17,062	12.82
12.00-12.99	31,269	23.50
13.00 and above	26,142	19.65
Total	**1,33,066**	

illiquid securities worth Rs. 14,434 crore (face value), by paying a premium of Rs. 3,472 crore. In lieu of these securities, four liquid securities were issued. The buy-back was conducted through a novel auction process whereby participants were able to revise their offers in a live interactive mode. The buy-back was conducted on a voluntary basis and banks were allowed additional income-tax deduction to the extent such business income was used for provisioning of their NPAs.

11.36 Under the debt-swap scheme mutually agreed to between the Central and the State Governments, all State loans from the Centre bearing coupons in excess of 13 per cent would be swapped with market borrowings and small savings proceeds at prevailing interest rates over a period of three years ending in 2004-05. As a consequence, States are expected to save at least Rs.81,000 crore in interest and deferred loan repayments over the residual maturity period of the loans. In 2002-03, 25 State Governments (excluding Maharashtra, Sikkim and West Bengal) were permited to prepay high cost debt from the Centre, partly out of small savings collections and partly through fresh market borrowings of Rs.10,000 crore conducted in two tranches in February and March 2003. The scheme has been continued in 2003-04. During the current year so far (up to August 12, 2003), the State Governments raised Rs. 15,000 crore from the market for this purpose. Another tranche of debt swap for Rs. 8,000 crore has been announced.

11.37 The major risk associated with the management of public debt is the size of the debt itself and the pressure on account of its servicing. The high debt accumulation since the mid-1990s has created a heavy debt servicing burden. Various policy

Box XI.2

Debt Restructuring

Fiscal adjustments through debt restructuring aim at mitigating the burden associated with unsustainable debt-GDP ratios and rising debt servicing. It involves a combination of debt conversion and debt reduction strategies by employing instruments like debt-swap, debt buyback, rescheduling, debt relief and concessional refinancing.

The theoretical rationale for explicit debt reduction is based on the premise that if the debt exceeds the country's repayment ability in the future, expected debt service is likely to be an increasing function of the country's output level. When the country is unable to service its debt in full, the incentive to invest in the debtor country declines. This effect is known as debt overhang. Economic performance is affected by the debt overhang through crowding out, lack of access to international financial markets, and the effects of the debt on the general level of uncertainty in the economy. The debt overhang thus acts like an implicit marginal tax on investment. The principal benefit of reduction in debt overhang is the improvement in investment incentives for private investors and liquidity relief, in addition to capital gains to creditors. The success of debt restructuring process depends on whether the country is on the right or wrong side of the "debt laffer curve". If the country is on the wrong side of the debt laffer curve, debt restructuring (*via* buyback) may prove counterproductive and may not decrease the debt service payments.

The three basic approaches of debt restructuring are market buy-backs, debt swaps and debt reduction agreements. The attractiveness of debt buybacks depends on whether they pay larger expected rates of return than other assets, and how the returns are distributed. Debt buy-backs yield an expected return equal to the risk-free interest rate, if distortions in sovereign lending are removed. Debt swaps are financial contracts that obligate one party to exchange a set of payments it owns for another set of payments owned by another party. They enable the country to bring forward in time the discounted benefits of a future debt write down. The kind of domestic liability that the government employs to finance the swap matters considerably. As long as the budget is continuously balanced, debt for bond swaps have no impact beyond that of a private sector debt repurchase. Money financed swaps, on the other hand, can lead to a situation of excess liquidity which can have other macroeconomic consequences. If debt swaps lead to an accumulation of domestic debt which is monetised subsequently, there would be a threat to domestic inflation.

Since the late 1980s, many highly indebted countries have devoted considerable resources to repurchasing some of their outstanding debt at a discount on the secondary market. Countries like the Philippines, Mexico, Venezuela and Brazil had negotiated many market-driven deals for restructuring of debt which involved reduction in banks' claims at a price broadly in line with that prevailing in the secondary market. Subsequently, the holders of the debt being restructured have experienced an appreciation in the value of restructured claims. This appreciation also helped in improving the preception of country risk. Cross-country experiences in debt restructuring suggest that debt restructuring leads to lower debt servicing obligations and reduction in the debt overhang.

References

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2. Detragiache, E (1991), "Sensible Debt Buybacks for Highly Indebted Poor Countries", *World Bank Policy, Research and External Affairs* Working Paper No. WPS 621.

measures evolved over the years which, *inter alia*, included market related primary issuance of government securities, introduction of varied instruments and alignment of the maturity period of new issues of debt while keeping in view redemption pattern of existing debt stock. The objective of the recent initiatives in debt restructuring is to resolve the problem of the debt overhang and strengthen fiscal consolidation (Box XI.2).

Scheme for Settlement of State Electricity Boards (SEB) dues

11.38 Based on the recommendation of Ahluwalia Committee (2001), a scheme for one-time settlement of outstanding dues of the State Electricity Boards (SEBs) to Central Power Sector Undertakings (CPSUs) was finalised. Under the scheme, the State Governments will issue 15-year bonds worth about Rs.30,000 crore to the CPSUs for the outstanding dues at a nominal tax-free interest rate of 8.5 per cent per annum repayable over 10 years after a moratorium period of five years. Subject to the approval of the Reserve Bank, 10 per cent of the bonds can be off-loaded in the market each year for trading. The Tripartite Agreements (TPA) in this regard have been signed among the Government of India, the Reserve Bank and 25 State Governments (Box XI.3).

Box XI.3

Power Bonds: One Time Settlement of Dues of State Electricity Boards

The State Electricity Boards (SEBs) have reached the verge of financial collapse owing to mismanagement, high transmission and distribution losses, irrational tariffs, degraded plant and machinery, and bloated workforce, reflected in the rising overdues of Central Public Sector Undertakings (CPSUs). The Expert Committee on the one-time settlement of State Electricity Board Dues (Chairman: Shri. M.S. Ahluwalia, 2001) suggested that a one-time settlement of outstanding dues should be attempted by shifting the burden of clearing these dues to State Governments while providing a package of relief and also a set of penalties and incentives favouring discipline and future reforms. The Committee recommended signing of Tripartite Agreements (TPA) among the Ministry of Finance, the Reserve Bank and the respective State Governments in this regard. The Scheme of One Time Settlement of SEB dues by way of securitisation to the CPSUs, as recommended by the Ahluwalia Committee, is being implemented.

Current Dues

If payments for the current dues of CPSUs are not received from the SEBs by the due date (within 90 days from date of billing), the amounts will be paid by the Government of India (GoI) to the CPSUs. The GoI in turn will get the amounts from the State Government through issue of payment instruction to the Reserve Bank to transfer funds from the respective State's account to GoI account. The Reserve Bank will act as per the specific instructions to be given by the GoI regarding amounts to be deducted under the TPA on each occasion. The payments of the current dues will be made subject to availability of funds in the account of the State Government.

Securitisation of past dues - Issue of Power Bonds

The Committee recommended that the overdues of the SEBs (till a cut-off date) should be securitised and power bonds should be issued by the State Governments to the CPSUs. The Reserve Bank as debt manager to the States should manage the issue of the bonds. The bonds would be issued with retrospective effect from October 1, 2001 at a nominal tax-free interest rate of 8.5 per cent per annum to the respective CPSU in 20 equal parts to facilitate trading and redemption of the bonds and each part will carry a fixed tenor with bullet redemption, the last being on April 1, 2016. The bonds should be issued in demat form to the original investors and interest will be paid half-yearly on April 1 and October 1 of each year. Furthermore, the bonds can be sold in the market only with specific prior approval of the Reserve Bank on each occasion and will enjoy SLR status when acquired by banks/institutions in the secondary market. The servicing of the bonds will not be done during the period of stoppage of payments on behalf of the State Government concerned. To facilitate early redemption of the bonds by the States, the bonds would have a call option usable at any point of time on or after five years of issue of the Power Bonds for part or full redemption with notice period of two months. TPAs have been signed with 24 States on March 20, 2003.

Conference of State Finance Secretaries

11.39 The Reserve Bank has been organising the Conference of State Finance Secretaries since November 7, 1997. These conferences are held biannually to discuss the issues and problems related to cash and debt management of the State Governments. The Conference has emerged as an important single point forum for interaction among State Governments, Government of India, Planning Commission, Comptroller and Auditor General, Controller General of Accounts and the Reserve Bank. In the 10th Conference held on June 7, 2002, important issues like difficulties in the market borrowings of the State Governments, overdraft regulation scheme for States and finances of local bodies were deliberated upon. The Reserve Bank's customer service to Central and State Governments and the accounting and reconciliation procedure of the State Government transactions were also discussed. The major issues and recommendations in regard to the Draft Report of the Group on Interest Burden of States and Draft Report of the Group to Assess the Fiscal Risk of State Government Guarantees were also discussed. In the 11th Conference held on January 9, 2003, recommendations of the Advisory Committee on WMA of State Governments (Ramachandran Committee) were discussed and accepted with some modifications. A Group of Finance Secretaries was constituted to study the pension liabilities of the State Governments. Discussions on the Report of the Group to assess the Fiscal Risk of State Government Guarantees (2002) addressed the need to assign fiscal risk to different guarantees and their implications for State finances. The 12th Conference of State Finance Secretaries was held on August 1, 2003. The major issues deliberated upon in the Conference were defaults in the servicing of guaranteed bonds, market borrowings of State Governments, infrastructure financing, restructuring

of State level PSUs, One-time Settlement of SEB dues and other administrative and technological issues relating to Government transactions. A one day interactive workshop on cash management was also organised by the Reserve Bank on August 2, 2003 for the benefit of the State Government officials.

Technical Advisory Committee

11.40 During 2002-03, two meetings of the Technical Advisory Committee (TAC) were held in July 2002 and June 2003. Apart from the general market developments, some specific issues discussed during the 15th meeting of the Committee related to : extension of facility to gilt account holders, screen based trading in Government securities through exchanges, review of the Liquidity Adjustment Facility (LAF) and re-examination of the scheme of non-competitive bidding facility. In the 16th meeting of this Committee held on June 10, 2003, the issues pertaining to introduction of 'when issued market', interest rate derivatives, report of the Inter-departmental Group on Forward Sale of Securities acquired under OMO, capital indexed bonds, introduction of 28-day Treasury Bills and retailing of government securities were discussed.

Outlook

11.41 The conduct of debt management continues to be driven by the objectives of reducing costs and elongating maturities while ensuring the smooth completion of the Centre's and States' borrowing programmes. The process of debt consolidation and efforts at enhancing the benchmarking of securities would be persevered with. Undue elongation of the maturity profile could increase interest rate risks. Accordingly, the issue of capital indexed and more floating rate bonds are under active consideration. It is expected that stripping of government securities will be operationalised after the Government Securities Act is passed in the Parliament. In the case of Treasury Bills, as in the past, the amounts offered in the auctions would be modulated keeping in view the liquidity conditions. In the secondary market, measures like rollover of repo and operationalisation of DVP III settlement system, measures to further develop the retail market for government securities using the PD network and banks would be accelerated. The Reserve Bank would develop the debt markets further through over the counter (OTC) as well as exchange traded interest rate derivatives (interest rate futures trading has commenced since June 24, 2003). Efforts are underway to introduce interest rate options on exchanges, broaden the eligible underlying to other items in the balance sheet for hedging through derivatives and permit market making to those banks that have the required risk management capabilities. Initiatives are being taken to harmonise regulations in respect of OTC derivatives with exchange traded interest rate derivatives.

XII CURRENCY MANAGEMENT

12.1 The core central banking function of note issue and management of currency in circulation is performed by the Reserve Bank with the objectives of ensuring adequate availability of notes and coins in the economy and maintaining the quality of notes in circulation. This is done through its 18 regional Issue Offices/sub-offices and a wide network of currency chests, repositories and small coin depots spread across the country. In 2002-03, the sub-offices of the Issue Department at Bhopal and Chandigarh and the currency chest at Jammu were converted into full-fledged Issue Offices. Sixty-four additional currency chests and 46 additional small coin depots were opened during the year. The demand for notes and coins was addressed by sending remittances to currency chests and by issue of notes and coins over the counters of Issue Offices. With improvements in the supply position of fresh notes and coins, efforts were directed towards improving the quality of notes in circulation through a number of measures. Adequate supply of fresh notes to bank branches during episode of liquidity stress was ensured by keeping the vaults of Issue Offices open beyond office hours and also on sundays/public holidays.

Table 12.1 : Notes and Coins

(Value in crore of Rupees/Pieces in million)

Denomination	End-March 2003		End-March 2002	
	Pieces	Value	Pieces	Value
1	2	3	4	5
Rs.2	2,416	483	2,493	498
Rs.5	3,479	1,739	2,724	1,362
Rs.10	9,088	9,088	11,989	11,989
Rs.20	1,713	3,425	766	1,531
Rs.50	7,038	35,191	7,120	35,601
Rs.100	11,539	1,15,386	11,804	1,18,041
Rs.500	1,876	93,813	1,370	68,512
Rs.1,000	160	15,971	72	7,179
Total	**37,309 (-2.7)**	**2,75,096 (12.4)**	**38,338 (7.3)**	**2,44,713 (15.2)**

Note: Figures in brackets are percentage variations over the previous year.

Notes in Circulation

12.2 The slowdown in rural economic activity in 2002-03 resulted in a deceleration in the value of notes in circulation. In volume terms, there was a decline of 2.7 per cent in circulation of notes, mainly because of the Reserve Bank's efforts to increase notes of Rs. 20 and Rs. 500 denominations in *lieu* of notes of Rs. 10 and Rs.100 denominations, respectively. The major decline in volume was in Rs.10 denomination notes (Table 12.1). Indents for fresh notes were met by the printing presses to the extent of more than 90 per cent in terms of volume and more than 100 per cent in terms of value.

Clean Note Policy - Quality of Notes in Circulation

12.3 In pursuance of the Clean Note Policy, efforts for improving the quality of notes in circulation were directed towards replacing soiled notes in circulation by fresh or reasonably good quality notes. Key measures in this regard included mechanisation of note processing-cum-verification and eco-friendly destruction of soiled notes, widening of the currency chest network, non-stapling of note packets, speeding up handing over and taking over of remittances by the chests, and continuation of anti-counterfeit steps.

12.4 The process of mechanisation, which began on an experimental basis in 1998 by installation of Currency Verification and Processing Systems (CVPSs) at Bhopal and Chandigarh Offices, was carried forward with the installation and commissioning of higher capacity CVPSs (of 50,000 to 60,000 bank notes per hour) at all the Issue Offices. In addition to the 22 CVPSs purchased during Phase I, 20 more machines were purchased during the year under Phase II. The old lower capacity machines at Chandigarh and Bhopal were replaced with new higher capacity machines under buy-back arrangements, taking the total number of CVPSs in the Issue Offices to 48. As a result, the processing capacity during the year increased by about 1,755 million pieces. The working of the machines at all the sites has stabilised; on an average, the machines provided 90 per cent of the rated output. In the recent period, considerable emphasis has been placed on non-stapling of notes in banks to improve the quality of notes (Box XII.1).

12.5 In order to enable the disposal of soiled notes in an environment friendly manner, Shredding and Briquetting Systems (SBSs) have been installed and made operational at all centres. A total of 18 Shredding and Briquetting Machines were purchased during 2002-03, taking the total number of SBSs to 24.

Box XII.1

Non-stapling of Notes

In 1996, the Reserve Bank issued instructions to all banks to stop stapling of fresh note packets. In 1998, the instructions were reiterated in the case of re-issuables. Since the instructions were not being implemented by the banks, the Reserve Bank issued a directive in November 2001, under Section 35 A of the Banking Regulation Act, 1949 to all banks prohibiting stapling of bank notes, tendering soiled notes to the Reserve Bank in unstapled condition and issuing only clean notes to the public. Notes in unstapled condition facilitate easy processing of soiled notes under the mechanised environment of the Reserve Bank.

With stapling being an old age practice and a stitched note packet being equated with accuracy of 100 notes in a packet, there have been some misapprehensions on the part of banks' cashiers regarding handling of unstapled notes. The general rule is that a packet, whether stitched or banded, must contain 100 note pieces. The Reserve Bank has, therefore, instructed banks that their chests should hold the balance only in unstapled condition and the amount of stapled note balances should be treated as non-chest balance. The Reserve Bank has also launched a publicity campaign on the benefits of non-stapling through films and press advertisements.

All banks have been advised to secure note packets with paper/polymer bands or twines instead of wire staples. As a supplement to this system, banks are required to install dual display note counting machines for the satisfaction of their staff as well as their customers. The Reserve Bank's inspectors have been given guidelines to include an assessment on the quality of sorting of notes by branches. By end-July 2003, more than 4,400 currency chests had destapled the stock of notes lying in their vaults.

12.6 The Reserve Bank launched a special drive for a faster disposal of soiled notes accumulated in the vaults of its offices as well as in currency chests. The total disposal of soiled notes during 2002-03 was to the tune of 15.6 billion pieces as compared with 10.6 billion pieces during the previous year. In view of the continuous withdrawal of soiled notes from circulation, the accumulation of soiled notes in the Issue Offices and currency chests has been contained to 4,132 million pieces at end-July 2003 as compared with 4,121 million pieces at end-July 2002. The time lag between receipt and disposal of soiled notes also narrowed considerably. Furthermore, to provide an incentive to the banks maintaining currency chests and to ensure better customer service, chest-maintaining branches have been allowed to levy a service charge of Re.1 per packet (irrespective of denomination) on the cash that is deposited by the non-chest branches. The cash tenders by regional rural banks and co-operative banks under Remittance Facility scheme have been exempted from service charges.

12.7 The mopping up of soiled and mutilated notes of Re.1, Rs.2 and Rs.5 denominations and distribution of coins was maintained. The Issue Offices launched campaigns through mobile vans and bank branches to encourage people to get such notes exchanged either for coins or notes. Issue Offices were allowed to send coin remittances through reputed private transport operators without being accompanied by cash department staff. Banks were advised to keep open identified currency chests on sundays for exchange of soiled and mutilated notes and also for distribution of coins. With a view to supplementing the efforts of the banking network in distribution of coins, the Reserve Bank would take the help of other organisations which have a wide network such as post offices, railways and State-run transport undertakings. A pilot scheme was launched in Maharashtra and Goa in association with the postal authorities under which the General Post Office collects coins from the Reserve Bank's office against payment and sends them to the post offices for distribution to the public. The scheme has been widely appreciated by the public. Other regional offices have been advised to put similar arrangements in place.

Counterfeit Notes

12.8 In order to mitigate the difficulties faced by the public on account of counterfeit notes, the Reserve Bank has undertaken several measures to enhance public awareness. A film on security features of Rs.100 denomination notes was produced in addition to the film on Rs.500 denomination notes and was telecast on Doordarshan and other TV channels. Banks were advised to establish Forged Note Vigilance Cells at their Head Offices for dissemination, monitoring and implementation of the Reserve Bank's instructions on forged notes.

12.9 Tracking of new type of forgeries and scrutiny in association with the Security Paper Mill and Note Printing Presses is an important step. The Reserve Bank's main thrust continues to be on dissemination of security features of bank notes to the public and other agencies like banks, Government departments, police and intelligence agencies (Box XII.2).

12.10 Enhanced security features in the form of improved public features and machine-readable features in bank notes are being incorporated in consultation

Box XII.2

New Security Features in Bank Notes

Security features of bank notes need to be reviewed and upgraded from time to time in order to take advantage of research and technology in the field to combat counterfeiting. The notes issued in any series/design by the Reserve Bank continue to be legal tender for all time, although over a period, notes in a particular series/design may not be seen any more because of discontinuance of printing issues in that series/design. In some countries, where the volume of notes in circulation is small, a new design replaces an old design every 5-6 years and the old design is discontinued as legal tender. In such a situation, prevention of counterfeiting is strengthened. In India, while it is difficult to remove an old design by way of withdrawing its legal tender, the Reserve Bank is attempting to phase out the old design by not re-issuing it once it comes to the currency chests or the Reserve Bank's offices.

Although the predominant reason for new security features is to make counterfeiting difficult, they also assume importance in the context of the mechanised cash processing activities by high-speed currency verification and processing systems (CVPSs). The success of these systems in achieving the authenticity and rated capacity depends greatly on the notes having machine-readable security features.

The Government of India and the Reserve Bank are currently in the process of introducing additional security features in the existing design of bank notes.

with the Government of India. The notes in the Ashoka Pillar Series, *i.e.*, Ashoka Pillar in watermark window, are being phased out from circulation as they do not contain adequate anti-counterfeit security features as compared with the Mahatma Gandhi series notes which were introduced in 1996 (Box XII.3).

12.11 The number of counterfeit notes detected at the Reserve Bank's regional offices and branches of commercial banks increased sharply during 2002-03. The increase was mainly on account of Rs.100 denominations, partly offset by lower detections of Rs.500 denominations. The value of counterfeit notes detected at Rs.3.5 crore during 2002-03 was higher than in the previous year (Table 12.2). The value of forged notes detected as a proportion to the total value of notes in circulation remained miniscule.

Table 12.2 : Forged Notes Detected at the Reserve Bank Offices and Bank Branches

	2002-03		2001-02	
Denomination	Pieces	Value (Rs.)	Pieces	Value (Rs.)
1	2	3	4	5
Rs. 1,000	39	39,000	13	13,000
Rs. 500	35,398	1,76,99,000	53,661	2,68,30,500
Rs. 100	1,72,597	1,72,59,700	67,168	67,16,800
Rs. 50	3,488	1,74,400	3,013	1,50,650
Rs. 20	34	680	72	1,440
Rs. 10	198	1,980	588	5,880
Total	**2,11,754**	**3,51,74,760**	**1,24,515**	**3,37,18,270**

Establishment of Currency Chests

12.12 The Reserve Bank has been endeavouring to increase the number of chests in view of the need for

Box XII.3

Phasing Out of Ashoka Pillar Series Notes

Portraits of human beings have been recognised as a strong security feature on bank notes all over the world. The watermark with a human face is a unique and an inimitable feature which provides the desired light and shade effects. In particular, a human face brings into focus the shine/gleam in the eyes. The portraits involve deep engravings with very minute details and are difficult to counterfeit. The choice of the personality from the security point of view should be such that the face should be expressive and should have lots of lines and folds so that there is an ample scope of engravings of different depths, which would be difficult for counterfeiters. The Government and the Reserve Bank, therefore, introduced a portrait of Mahatma Gandhi on bank notes as well as in the watermark window.

The notes in Mahatma Gandhi series were introduced in 1996. Some additional security features like windowed security thread, latent (hidden) denominational image, micro printing, registration mark and raised identification mark for identification of a denomination by visually impaired were also incorporated in these notes as anti-counterfeiting measures. The printing of notes with Ashoka Pillar emblem on notes and in watermark window was then discontinued. The notes in Ashoka Pillar series circulating among the public had deteriorated in quality. Moreover, in the absence of advanced security features in the Ashoka Pillar series notes, the public was finding it difficult to identify counterfeit notes of this series. The Government and the Reserve Bank, therefore, decided to phase out the Ashoka Pillar series notes from circulation. Accordingly, the Reserve Bank Issue Offices and currency chest branches of commercial banks have been instructed not to re-issue these notes to the public. These notes shall, however, continue to be legal tender. Furthermore, the Ashoka Pillar emblem, a national symbol and pride, continues to be printed on the notes of Mahatma Gandhi series.

Table 12.3: Number of Currency Chests

Name of Agency	Number of Currency Chests	
	end-March 2003	end-March 2002
1	2	3
Treasuries	417	454
State Bank of India (SBI)	2,117	2,081
SBI Associate banks	1,002	998
Nationalised banks	897	843
Private sector banks *	32	26
Co-operative banks	1	1
Reserve Bank	20	19
Total	**4,486**	**4,422**

* Including six chests of the Jammu & Kashmir Bank Ltd.

expanding distribution channels for fresh notes and coins and mopping up soiled notes from circulation. During 2002-03, 64 currency chests were established, taking their total to 4,486. At present, currency chests are predominantly held by the State Bank of India and its associate banks (around 70 per cent of the total) (Table 12.3). Efforts are being made to encourage other public sector banks (who hold around 20 per cent of the total chests) to open more currency chests in order to enhance their storage capacity and reduce the pressure on the Reserve Bank's Issue Offices. Furthermore, conversion of repositories into currency chests is in progress. The number of repositories came down to 193 from 265 in the previous year. The Reserve Bank is also encouraging the private sector and foreign banks to establish currency chests. 15 private sector banks have been granted chest facility so far. As a measure of safeguard, each bank is granted a limit for holding balances in its chest(s) depending upon its net worth.

Computerisation of Issue Office Accounts

12.13 Efforts are underway to design, develop and implement an Integrated Computerised Currency Operations and Management system. Computerisation will cover issue accounting, resource planning and distribution of currency, cash department operations, note exchange counters in Issue Department, claims section, currency chest reporting and management information systems in the Regional and Central Offices. The development of the application software is being outsourced.

Currency Museum

12.14 The Reserve Bank has envisaged the establishment of a Monetary Museum in Mumbai with display and archival facilities which would house contemporary and ancient monetary artefacts and coins capturing the history of currency in India. The website for the proposed Monetary Museum has now been made a part of the Reserve Bank website.

Bharatiya Reserve Bank Note Mudran Private Limited

12.15 The Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL), incorporated as a wholly owned subsidiary of the Reserve Bank, was set up in 1996 to take over the work of the new note press project. The company, which was awarded an ISO 9001:2000 certification in March 2001, became a private limited company from February 24, 2002. The company has two printing presses at Mysore (Karnataka) and Salboni (West Bengal), both of which have been fully operational since March 1999 and September 1999, respectively. Each of these presses has an annual capacity in single shift to print 4,770 million pieces of notes of all the denominations, *i.e.*, of Rs.5, Rs.10, Rs.20, Rs.50, Rs.100, Rs.500 and Rs.1000. The note presses are equipped with modern facilities for printing, process control, accounting and quality check in a secure environment for production of bank notes.

Outlook

12.16 The Reserve Bank would pursue its objective of meeting the currency demand of the economy and improving the quality of notes. Installation of additional Currency Verification and Processing Systems would be undertaken to ease the accumulation of soiled notes in the Issue Circles. Constant surveillance over the system of distribution of notes and coins would be strengthened with a view to enlarging/improving the distribution of fresh notes and coins. Innovative measures like distribution of coins through post offices would be expanded. Customer service would be upgraded through mobile issue of coins and introduction of Rs.10 coins. Enhanced security features in the form of improved public features in bank notes are being devised to prevent counterfeiting. These features will be complementary to the process of mechanisation of currency operations.

XIII PAYMENT AND SETTLEMENT SYSTEMS AND INFORMATION TECHNOLOGY

13.1 The information technology revolution has thrown up powerful synergies with banking and finance. In particular, there are four key areas in which the financial system has experienced the benefits of the technology revolution: product development, market infrastructure, risk control and market reach. In the process, technology has changed the contours of three major functions of financial intermediaries: access to liquidity, transformation of assets and monitoring of risks. The Indian financial system is adapting itself to these developments and is acquiring a customer-centric focus. The proliferation of Automated Teller Machines (ATMs), networking of these ATMs and Shared Payment Network based ATMs have been features which have been welcomed by the banking public. Other innovations already within the domain of banks and financial systems in India include Internet Banking, Electronic Funds Transfer and 'Anywhere/ Anytime Banking', all of which have a high level of technology embedded in the systems offering these services. Many of the older banks are moving towards the implementation of Core Banking or Clustered Solutions which would contribute significantly towards increasing customer satisfaction. In all this, business process re-engineering becomes an essential concomitant to ensure best results out of technology enhancement.

13.2 In recent years, the Reserve Bank has assigned priority to upgrading the technological infrastructure of the Indian financial system. Efforts have been made to modernise clearing and payment through Magnetic Ink Character Recognition (MICR) based cheque clearing, Electronic Clearing Services and Electronic Funds Transfer (ECS and EFT) and the Centralised Funds Management System (CFMS). A key prerequisite for the development of the financial system is a modern, efficient, integrated and secure payment and settlement system. The goal is to put in place systems which conform to international standards and best practices. The strategy adopted by the Reserve Bank consists of:

- Development, consolidation and integration of payment systems.
- Encouragement of movement towards efficient electronic mode of payments.
- Making the net settlement systems more secure.
- Implementation of a Real Time Gross Settlement (RTGS) System for minimising systemic risk.
- Increased efficiency of the paper based clearing systems.

13.3 In order to provide policy direction to the process of reforms in payment and settlement systems, the apex level National Payments Council met three times during the year and provided key inputs on various aspects like EFT based systems and usage of networks for domestic message transfers. The major policy decisions taken at the meetings included:

- Using wireless links to overcome the last mile connectivity issue for bank/branch networks;
- Integrating the Structured Financial Messaging Solution (SFMS) with banks' own application software;
- Two-way inter-city clearing among the 17 centres where the Reserve Bank has its Deposit Account Departments (DADs);
- Integrating the EFT Scheme of the Reserve Bank with internal funds transfer schemes of individual banks;
- Implementing the Funds Transfer module of the CFMS contingent upon the Public Key Infrastructure (PKI) based security and digital signature based message transfers;
- Core banking solutions by banks;
- Implementing National Settlement System (NSS);
- Shared Payment Network for ATMs by Third Party (non-banks).

Payment Systems

13.4 At present, key large value payment systems such as the Negotiated Dealing System (NDS) and foreign exchange clearing adhere fully to the Core Principles for Systemically Important Systems of the

Table 13.1 : Characteristics of Payment Systems in India

Type	Characteristics of Transaction	Mode	Compliance with Core Principles	Other Key Features
1	2	3	4	5
Large Value Payment Systems				
Inter-Bank Clearing	Inter-bank instruments	Paper based; debit instruments	Partial	Deferred Net System (DNS); Mechanised settlement
High Value Clearing	Customer instruments	Paper based; debit instruments	Partial	DNS; Mechanised clearing and settlement
NDS	Inter-institutional transactions	Electronic mode; DVP	Full compliance	Secured DNS; Guaranteed settlement
Forex Clearing	Inter-bank transactions	Electronic mode	Full compliance	Secured DNS; Guaranteed settlement
RTGS (proposed)	Inter-bank transactions	Electronic mode	Full compliance	Real Time Gross Settlements
Retail Payment Systems				
MICR Clearing		Paper based; debit instruments	Partial	DNS; Mechanised clearing and settlement
Non-MICR Clearing		Paper based; debit instruments	Partial	DNS
ECS-Credit	Bulk; one to many funds transfer	Electronic mode; credit transfer	Partial	DNS; Automated Clearing House (ACH)
ECS-Debit	Bulk; many to one funds transfer	Electronic mode; debit transfer	Partial	DNS; ACH
EFT	One to one fund transfer	Electronic mode; credit transfer	Partial	DNS; ACH
Cards	Customer transactions	Electronic mode; credit cards, debit cards, smart cards	Partial	DNS; Automated clearing and settlement

Bank for International Settlements (BIS). Retail payment systems comply partially with the Core Principles (Table 13.1). Efforts are on to make these systems also fully compliant to the Core Principles by providing a legal basis for netting and provision of risk reduction measures for netting systems.

Large Value Payment Systems

13.5 The Inter-Bank Cheques Clearing system, the High-Value Cheques Clearing systems, the NDS and the Inter-Bank Foreign Exchange Transactions Clearing and Settlement System (Forex Clearing) constitute the main Large Value Payment Systems (LVPS) of the country. All of these are considered as Systemically Important Payment Systems (SIPS). These systems constitute 68 per cent of the total value of transactions processed in the major payment systems (Table 13.2).

Retail Payment Systems

13.6 Retail Payment Systems account for a substantial portion of the country's funds flows in terms of volume, with 99 per cent of the total volume of payment transactions. The major components of the retail payment systems include the MICR Cheques Clearing Systems (MICR Clearing) now

Table 13.2 : Payment System Indicators : Annual Turnover in 2002-03

Component	Volume (000s)	Value (Rupees crore)	Features
1	2	3	4
Systemically Important Payment Systems (SIPS)			
1 Inter-bank Clearing	1,039 (1,026)	60,65,825 (67,52,166)	
2 High Value Clearing	7,207 (6,988)	28,86,263 (21,66,757)	Cheques of Rs. 1 lakh and above
3 NDS	144	1,32,128	Settlement through CCIL
4 Forex Clearing @	200	6,58,035	Settlement through CCIL
Total SIPS (1 to 4)	8,590	97,42,251	
Others			
5. MICR Clearing	4,79,189 (5,52,332)	18,43,726 (21,03,992)	At 27 centres
6. Non-MICR Clearing	3,61,400 (3,38,953)	27,45,307 (19,65,583)	Includes all other paper based clearings
7. Electronic Clearings	23,660 (17,770)	10,222 (6,123)	Comprises of ECS and EFT
Total Others (5 to 7)	8,64,249 (9,09,055)	45,99,255 (40,75,698)	
Grand Total	**8,72,839**	**1,43,41,506**	

@ Forex Clearing started live operations only during 2002-03 and data pertain to December 2002-March 2003.

Note: Figures in brackets are data for 2001-02.

available at 27 commercially important centres and the Non-MICR Cheques Clearing Systems (Non-MICR Clearing) in 1,020 centres. Other emerging retail systems include the Electronic Clearing Systems (ECS) (comprising of the ECS-Credit and the ECS-Debit Systems) in operation at 45 centres, the Electronic Funds Transfer System (the EFT System) available at 15 centres, Card Payment Systems (including credit, debit and smart card based systems) and the ATM based retail delivery systems. ECS (Credit Clearing) registered a rise of 26 per cent in terms of volume while ECS (Debit Clearing) recorded an even larger growth of 63 per cent. There was a ten-fold rise in EFT transactions in both volume and value terms.

13.7 The Reserve Bank is in the process of implementing the National Electronic Funds Transfer (NEFT) System - a nation-wide electronic funds transfer system - to provide for transfer of funds electronically across a large number of bank branches in the country. As a first step, a Special Electronic Funds Transfer (SEFT) System was implemented with effect from April 1, 2003. The System is designed to provide for same day inter-bank transfer of funds between accounts maintained in any of the designated participating branches which are networked so that SEFT messages could be transmitted electronically. SEFT provides for multiple daily settlements, with three settlement cycles on weekdays (at 12:00 noon, 2:00 p.m. and 4:00 p.m.) and two settlements on Saturday (at 12:00 noon and 2:00 p.m.). The System also facilitates timely funds settlement for the T+2 based rolling settlement introduced for settlement of securities at the stock exchanges.

Payment System Infrastructure and Utilities

13.8 The Reserve Bank established a secure, closed user group network infrastructure for the financial system - Indian Financial Network (INFINET) - in 1999 along with the SFMS. During 2002-03, the network was upgraded in the form of higher capacity inter-city terrestrial communication lines. By end-March 2003, 158 members of the INFINET had set up their gateways, with connectivity to the central Inter-Bank Payment Systems Gateway of the Reserve Bank at Mumbai. The CFMS also commenced its operations from the central Gateway during 2002-03. There were 54 banks using the facilities of CFMS at end-March 2003.

13.9 Backup systems were set up for the Payment Systems Processing Centre which provide processing capabilities for the NDS, CFMS, SSS, SFMS and RTGS. To address connectivity related disruptions, all members are required to provide a separate connection to the backup site in addition to the main site. The main site and the back-up site are inter-connected with sophisticated high-capacity dark fibres to ensure uninterrupted connectivity. This would ensure synchronised databases at both the sites to ensure business continuity with the least time gap and uninterrupted communication even if one of the connectivity points between the member and the Reserve Bank were to fail.

Settlement Systems

13.10 The imperative for ensuring the integrity of settlement systems stems from the need to minimise risks inherent in payments. The settlement of foreign exchange clearing operations, which commenced from November 2002, is guaranteed by the Clearing Corporation of India Ltd. (CCIL). Effective May 1, 2003, all inter-institutional over-the-counter (OTC) transactions in Government securities, whether outright or repo, are traded through the NDS only. Other initiatives taken during the year to promote safe settlement systems included:

- MICR-based clearing, with facilities for capturing the images of cheques, extended to Mangalore and Patna during the year, taking the total number of MICR based clearing centres to 27.
- Backup MICR centres set up in Delhi and Kolkata during the last quarter of 2002-03 as a part of disaster management and business continuity plans for clearing houses managed by the Reserve Bank in all metropolitan centres.
- Amendments to the Negotiable Instruments Act, 1881, providing for cheque truncation and e-cheques aimed at reduction in time taken for cheque realisation.
- Multi-Application smart card project under the aegis of the Ministry of Communications and Information Technology with active participation of the Indian Institute of Technology (IIT), Mumbai, industry participants and banks being supported by the Reserve Bank.

13.11 The BIS Working Group on Securities Settlement Systems, a joint Group of the International Organisation of Securities Commissions (IOSCO) and the Committee on Payment and Settlement Systems

Box XIII. 1

Core Principles for Securities Settlement Systems

With securities markets becoming an increasingly significant channel for intermediating flow of funds between borrowers and lenders, Securities Settlement Systems (SSSs) have assumed critical importance in financial markets. In view of soaring trading and settlement volumes in securities markets, weaknesses in SSSs can impact not only on the securities markets themselves but can also spill over to other payment systems of which SSS is a sub-set or has inter-linkages. This underscores the need for international standards to promote improvements in the safety and efficiency of SSSs.

The first major initiative in this direction was the Group of Thirty's Report "Clearing and Settlement Systems in the Worlds' Securities Markets" (1989). A decade later, the Committee of Payment and Settlement Systems (CPSS) of the BIS created a Task Force comprising 28 central bankers and securities regulators. The Task Force identified minimum standards that would enhance financial stability, reduce risks, increase efficiency and provide adequate safeguards for investors.

SSSs, *i.e.*, the "full set of institutional arrangements for confirmation, clearance and settlement of securities trades and safe keeping of securities" cover corporate bonds, money market instruments and gilt edged securities. A set of 19 recommendations of the Task Force is designed for the management of diverse kinds of risks associated with securities markets, *viz.,* legal risk, pre-settlement risk, settlement risk, operational risk and custody risk. Other issues associated with SSSs relate to governance of central counterparties and depositories, access criteria for SSSs, transparency of operations and procedures, efficiency of operations, standardisation of communication procedures, regulation and oversight of SSSs by regulators and risk reduction in cross border settlements.

Reference

Recommendations for the Securities Settlement Systems, BIS (2000).

(CPSS), released its recommendations in the form of the Core Principles for Securities Settlement Systems (SSS). The Reserve Bank would make the significantly important securities settlement systems conform to these Principles (Box XIII.1).

Legal Framework

13.12 An indicative draft for the Payment and Settlement System Bill was approved by the Committee on Payment Systems (Chairman: Dr R H Patil), providing adequate legal framework for the regulation and supervision of the evolving payment and settlement systems (Box XIII.2).

Information Technology (IT) in the Reserve Bank

13.13 All activities of the Reserve Bank are getting increasingly IT-enabled. The implementation of IT in the Reserve Bank is based on the mission "IT for Overall Efficiency and Excellence". The Reserve Bank aims to bring in transaction processing and analytical capabilities at the desk top of each official in order to equip the functionaries to complete transactions in a

Box XIII.2

Committee on Payment and Settlement Systems

A set of "Core Principles for Systemically Important Systems" was developed under the aegis of the BIS in 2001. The Reserve Bank has been taking steps towards achieving these international best practices as part of the overall reforms in the financial system.

In the absence of an appropriate legal framework for the conduct, regulation and supervision of payment and settlement systems in the country, most of the systems currently function under the Contracts Act, 1881. "Finality of settlement" needs to be precisely defined in view of the increasing concern about systemic risks. Furthermore, the financial sector all over the world, including India, has adopted "multilateral netting" as the primary means of settling payment obligations among the participants. This lacks precise legal foundations and has led to increased settlement risk, especially in the face of default and insolvency. It is in this context that the Core Principles focus on the need for an explicit legal framework for payment and settlement systems.

The Committee on Payment Systems, constituted by the Reserve Bank under the chairmanship of Dr. R.H. Patil with a broad based representation from the banking industry, recommended enactment of a separate statute for regulation and supervision of the payment and settlement systems in the country. The draft Bill approved by the Committee provides for a legal base for netting, finality of netting and powers to formulate regulations. It also provides for separate roles for the Reserve Bank (as a regulator, operator, system provider and participant), apart from separation of operation functionalities and provision for multiple players.

timely and accurate manner and to make informed decisions. This will also usher in a Less-Paper Office. Furthermore, the Reserve Bank is committed to providing efficient customer service to the Governments, banks, financial institutions and general public, using the tools and solutions offered by information and communication technology.

13.14 The overall system architecture for the Reserve Bank comprises the following components:

- Operational capability at the desk top of each official;
- Integrated application systems at each functional unit (*viz.,* the department);
- An On-Line Analytical and Decision Support System and an Enterprise Knowledge Management System (EKMS) at the institution level; and,
- Multi-channel delivery of services to customers of the Reserve Bank through branch-, tele- and internet-banking.

13.15 For the Central Office Departments of the Reserve Bank, the existing disparate systems are being integrated and enhanced using Relational Data Base Management System (RDBMS) based solutions. The Off-Site Monitoring and Surveillance System (OSMOS) and the Computerised-OSMOS (COSMOS) have already reached a high level of IT-enhancement. For transactions in Government and bank accounts as well as other accounts maintained with the Reserve Bank, an Integrated Accounting System (IAS) is being developed along with the RTGS project. For the Public Debt Offices (PDO) and internal debt management system, a centralised system encompassing the PDO/ NDS/SSS system was implemented during 2002-03. The Centralised Data Base Management System (CDBMS), a data warehouse, was also implemented. The first phase of enhanced systems was implemented in key functional areas such as external investments and operations, regulation and supervision of urban banks, human resource development and general administration. Initial processes have been put in place in the areas of monetary policy operations, exchange control and currency management, including issue offices.

13.16 In addition to computerised operations, Inter-Active Voice Recorder based systems for account enquiries are available in many regional offices of the Reserve Bank as a part of the strategy for enhancing the level of customer service. Touch-screen based inter-active Information Kiosks were installed in several regional offices and the Central Office Building during 2002-03. Computerisation strategies in the Reserve Bank are driven by a four pronged approach (Table 13.3).

Table 13.3: Information Technology Implementation in the Reserve Bank

Component	Impact
1	2
Standardisation of hardware, operating systems, system software, netware platforms and data bases	Integration of and inter-operability between functional areas
Developing human resources for using, maintaining and administrating the hardware, software and netware systems	Increased productivity
Outsourcing of both development and maintenance of software and facilities management	Systemic efficiency in managing complex computer and application systems
Establishment of a Disaster Recovery Management System (DRS) and Business Continuity Plans (BCP)	Continued availability of technology services with least disturbance in terms of time and data

13.17 In terms of hardware, common, shared, high-end and high-availability servers were installed at each Regional Office of the Reserve Bank in 2002-03. These systems are equipped with fault tolerant systems and are capable of being scaled upwards in case of enhanced requirements, so as to avoid quick obsolescence.

13.18 Local Area Networks (LANs) have been made operational in each building of the Reserve Bank in all centres. Communication across different buildings of the Reserve Bank takes place through the Wide Area Network (WAN) facilities provided by the INFINET. Communication across functional units and various offices takes place through the Corporate e-mail system. Functionaries at various levels are able to log on to the Internet. For critical and sensitive areas of operation, the SFMS is proposed to be used to facilitate message based information transfer on a secure basis and Straight Through Processing (STP).

13.19 As part of Disaster Recovery Systems (DRS) and Business Continuity Plans (BCP), steps were initiated during the year to ensure that all the critical areas of operation would remain unaffected in any unforeseen exigency. These efforts would culminate in the establishment of a Data Centre which would be a small replica of all the processing capabilities of the Reserve Bank as a whole. This will facilitate quick recovery and resumption of operations.

Box XIII.3

Indian Financial Systems Codes

The INFINET, VSAT-based satellite and leased line network, is for the exclusive use of the banking and financial sector. Standardisation of message formats is a concurrent objective along with optimising the use of the INFINET. Consequently, the Structured Financial Messaging Solution (SFMS) has emerged as the Electronic Data Interchange (EDI) system for banks, allowing exchange of secure and structured messaging within the banks and between banks using the INFINET.

After a detailed study of message formats available in other systems such as the Society for Worldwide Inter-bank Financial Telecommunication (SWIFT), UN/EDIFACT and COMET standards, the choice has devolved on SWIFT message formats for intra- and inter-bank communication message transmission with suitable modifications. Alongside, the Indian Financial Systems Code (IFSC), a uniform coding structure, was developed to uniquely identify every bank branch in the country in routing of payment messages and Straight Through Processing (STP). The pattern adopted has also been drawn from that used by the SWIFT. The IFSC system can also be effectively used for national routing of SWIFT international messages with the help of a suitable interface at INFINET.

The IFSC has been designed as an 11-digit alpha-numeric routing number. This is in consonance with the number of digits in the SWIFT coding system which follows the ISO standard (9362) for identifying banks/branches. The composition of bank code and branch code is as follows:

Table : Indian Financial Systems Code

Character Position	Information	Remarks
1	2	3
First Four Characters	Bank Code	Same as Swift (ISO 9362)
Fifth Character	Zero	Reserved for future Use
Last six characters	Branch Code	Banks can use their existing codes with no blank spaces (zeroes prefixed)

The four-digit alphanumeric codes for banks are the same as registered with SWIFT. In the last six spaces, most banks use the Basic Statistical Returns (BSR) codes allotted by the Reserve Bank for reporting statistics while some use their own existing internal branch codes. As a member of the INFINET, the Reserve Bank would use SFMS for financial and non-financial communication between its own offices and the banking and financial sector. For this purpose, the Reserve Bank has assigned IFSC codes for its own departments in the Central Office and Regional Offices.

13.20 In order to address each constituent of the INFINET/SFMS system uniquely, a system of Indian Financial System Codes (IFSC) was designed during 2002-03, similar in approach to that of SWIFT (Box XIII.3).

13.21 One of the important requirements in any system using technology with shared access systems over networks is security. Accordingly, Public Key Infrastructure (PKI) based digital signatures are proposed for all users in the Reserve Bank, using the certification process of the IDRBT which has been approved to function as a Certification Authority (CA) under the Information Technology Act, 2000. The Reserve Bank would function as a Registration Authority (RA) (Box XIII.4).

Box XIII.4

Registration Authority

The Controller of Certifying Authorities (CCA) of the Ministry of Communications and Information Technology, Government of India issues licences to the Certification Authority under the IT Act, 2000. The Certification Authority (CA) may be any organisation willing to take on the responsibility of participating in the Public Key Infrastructure (PKI). The Certifying Authority is assisted by the Registration Authority which is created at the level of the organisations subscribing to the services of the CA.

The Registration Authority office is responsible for:

- Enforcement of the practices prescribed in the Certificate Practice Statement which is the bye-law of the PKI.
- Receipt and scrutiny of the subscriber applications for issue of Digital Certification for signing and encryption facilities.
- Maintenance of records of natural expiry of the certificates and alerts for renewals and information / documents relating to the subscriber's application.
- Certificate revocation processes and ensuring that the applications forwarded to the CA for certification at any point of time have not featured in the compromised list.
- Maintenance of the audit trails of RA activity.

Outlook

13.22 The Reserve Bank will continue with its efforts to establish a modern, robust, efficient, secure, and integrated payment and settlement system for the country. Significant milestones in this path are the Negotiated Dealing System for transactions in Government securities and the Clearing Corporation of India. The INFINET would emerge as the communication backbone of the financial system. The operationalisation of RTGS System would enable real time funds transfers across different banks and thereby provide for optimal utilisation of funds.

13.23 Introduction of National EFT as a form of credit based funds transfer, and the National Settlement System (NSS) providing for centralised settlement of all net settlements across different clearing houses at a single location, would facilitate funds management for banks. Preparatory work is underway for the migration from SWIFT to IP based protocols. Message formats for new applications as part of SFMS, such as for NSS and RTGS, are likely to be introduced during 2003-04. The finalisation of EFT regulations would help in providing an appropriate framework of safe, secure and sound payment and settlement systems.

13.24 Adequate security is an area of priority in the roadmap envisaged for a modern, technology-intensive payment and settlement system, especially one functioning in a highly networked environment. Legal changes to deal with electronic data interchange and legal wherewithal for participants in the payment system are on the anvil. These changes are intended to enable the benchmarking of payment and settlement systems against international standards. All these would ultimately result in the use of synergies between technology and payment systems to ensure overall efficiency of the financial sector.

13.25 The future of banking and finance hinges around the exploitation of opportunities thrown up by the technology explosion. This requires the combined efforts of all participants in the financial system. In December 2001 the Reserve Bank set out its vision of the road ahead in the document entitled "Payments System in India", to share this vision with all participants and the nature and direction of reforms needed to achieve it. The collective goal should be to make use of synergies between technology and finance to maximise the benefits to society.

XIV HUMAN RESOURCES DEVELOPMENT AND ORGANISATIONAL MATTERS

14.1 The response of the Reserve Bank to the challenges imposed by the changing economic and business environment has been reflected in its approach to human resource management, notwithstanding the rigidities confronting it. The traditional institutional structure and culture has sometimes operated as a drag on human resource development, particularly in skill development, management change and career planning. This has been counteracted by recruiting skilled manpower from the open market to a certain extent, including some lateral induction of experts and redeployment of existing staff in new activities after suitable training. A major challenge is to develop the special competencies and skills for an environment of deregulation and openness driven by growing sophistication of operations and ever-expanding frontiers of information technology. In this milieu, building and reinforcing a corporate vision and culture that fosters creativity and recognises talent and merit is critical.

Training and Skill Enhancement

14.2 The three training colleges of the Reserve Bank, *viz.,* Bankers Training College, Mumbai, Reserve Bank Staff College, Chennai, and College of Agricultural Banking, Pune cater to the Reserve Bank's training needs and that of the banking industry. A Committee of the Principals of the three training colleges, the Chief General Manager, Human Resources Development Department and a faculty member from each College was constituted for regular exchange of ideas and to deliberate on the various matters of mutual interest.

Bankers Training College (BTC), Mumbai

14.3 Being the premier institution in the field of banking studies, the BTC introduced new programmes on foreign exchange management, treasury management, integrated risk management and credit management for trainers from other training institutions. It also conducted senior level programmes in areas such as management of balance sheets of banks, operational risk management, latest developments in payment systems, corporate debt restructuring, new regulatory initiatives like Prompt Corrective Action (PCA) and New Capital Accord for the benefit of the senior officers in commercial banks and the Reserve Bank. The College faculty continued to extend faculty support to other training institutions. Details pertaining to its activities including information on Advisory Council, faculty, and calendar of programmes are available on the Reserve Bank's web site (http://www.rbi.org.in/training). The BTC conducted collaborative training with Administrative Staff College of India (ASCI), Hyderabad and Jawaharlal Nehru Institute of Development Banking in the areas of risk based supervision.

Reserve Bank Staff College (RBSC), Chennai

14.4 The RBSC, catering to the training and developmental needs of Reserve Bank officers, has been constantly upgrading the contents of its programmes. In a bid to relate to live situations in the office, The RBSC developed several case studies for training purposes and forwarded them to the Regional Offices. The RBSC conducted off-site programmes for officers of the Department of Banking Supervision, the Department of Non-Banking Supervision, the Department of Banking Operations and Development, and the Urban Banks Department at Bangalore and Hyderabad. The College conducted its pilot programme on "Integrated Risk Management" in August 2002.

College of Agricultural Banking, Pune

14.5 Maintaining its pro-agricultural stance, the College of Agricultural Banking (CAB) diversified its training activities to other areas of banking such as information technology and human resources management. The CAB conducted 16 off-site programmes for the officers of Urban Co-operative Banks (UCBs), District Central Co-operative Banks (DCCBs), State Co-operative Banks (StCBs), Regional Rural Banks (RRBs), Reserve Bank and State level financial institutions. It also extended faculty support to other institutions. The College conducted 37 new programmes during the year, besides conducting nine international programmes for officers of Western Province and Regional Development Banks in Sri Lanka. The College was associated with a study of the existing Management

Information System (MIS) in 29 scheduled UCBs. The College was also associated with the University of Reading, U.K. in a research project, which is funded by the Department for International Development (DFID), UK. The project is titled “Towards ensuring sustainable financial services for the poor through improved capacity building”.

Zonal Training Centres

14.6 The Zonal Training Centres (ZTCs) at the four metropolitan centres cater exclusively to the training needs of the Reserve Bank’s employees in Class III and Class IV. Based on the recommendations of the Working Group constituted to review the training facilities for Class III and Class IV staff and the plan of action drawn for its implementation, ZTCs conducted programmes on functional areas, information technology and behavioural areas. ZTCs also conducted short duration programmes on various facets of HRD *i.e.*, motivation, inter-personal skills, communication and team building. To increase awareness of the Class III employees about the Indian economy, monetary policy and the challenges confronting the Reserve Bank in regulating and supervising the country’s financial system, a broad-spectrum programme of one-week duration was introduced. A programme on health awareness was introduced for Class IV employees. The development programme for Class IV employees includes topics on personal effectiveness, team work and work ethics. The importance of customer service, staff regulation, facilities available are also part of the curriculum. Programmes on investment and retirement planning for Class III and Class IV employees are regularly conducted at the ZTCs. In the recent period, off-site programmes are also conducted by ZTCs. In the recent period, ZTCs have conducted Integrated Development Programmes for Class III staff redeployed out of the Cash Department.

14.7 The number of training programmes conducted and the level of participation at the various training institutions is shown in Table 14.1. The decline in the number of programmes and participants in the College of Agricultural Banking, Pune may be attributed to the fact that the college had to cancel/ merge programmes on account of inadequate nominations.

Deputation of officers for training in India and abroad

14.8 During 2002-03, 452 officers were deputed by the Reserve Bank to participate in training programmes, seminars and conferences organised by external management/banking institutions in India. The areas of training covered included human resources management, risk management, international banking and foreign trade, labour laws, trade unionism, agricultural finance and micro finance. Furthermore, the Reserve Bank deputed 39 officers for exposure in select commercial banks under the scheme of Commercial Bank Training.

Table 14.1 : Initiatives by Reserve Bank Training Colleges

Colleges	2002-2003		2001-2002		2000-2001		1999-2000	
	No. of Progra-mmes	No. of Partici-pants	No. of Progra-mmes	No. of Partici-pants	No. of Progra-mmes	No. of Partici-pants	No. of Progra-mmes	No. of Partici-pants
1	2	3	4	5	6	7	8	9
RBSC	139	3,013	125	2,795	140	2,949	109	2,489
BTC	146	3,422	115	2,532	113	2,436	95	2,137
CAB	173	3,461	179	3,777	153	3,179	124	2,596
ZTCs (CLASS III)	153	2991	131	2,576	100	2,013	86	1,660
ZTCs (CLASS IV)	31	535	26	470	17	313	16	312

14.9 The Reserve Bank deputed 204 Officers to attend training courses, seminars, conferences and workshops, conducted by banking and financial institutions in 32 countries abroad. The important areas of training related to bank supervision, derivatives, risk management, reserve management, financial programming and policies, macroeconomic management, forecasting and financial sector issues.

14.10 Under the Golden Jubilee Scholarship Scheme for higher studies abroad, four officers were selected in 2002-03 for pursuing higher studies abroad. The four selected officers have opted to pursue courses in Investment Management in the City University Business School, London; MBA in finance from Leeds University, U.K., financial and commercial regulation from the London School of Economics, London; and financial markets from the Illinois Institute of Technology, USA. The total number of officers deputed under the scheme stands at 67.

14.11 The Reserve Bank also deputes officers of outstanding merit for pursuing short duration training in the area of management development/executive development/general management. Three officers were selected in 2002-03 for such training. Three officers were granted sabbatical under the scheme for grant of sabbatical to senior officers. One officer was sponsored for Ph.D studies at Chennai University during 2002-03. One officer was deputed to Bank for International Settlements (BIS), Basle under the

Visiting Fellowship scheme. Three Officers were granted study leave (one officer in India and two abroad) under the scheme for higher studies for officers of the Reserve Bank.

Training in Computer Technology

14.12 The Reserve Bank continued to provide incentives to staff members to acquire qualification in the field of computers. The scheme of Base Level Computer training for officers and Class III employees introduced by the Reserve Bank in November 1995 to meet the increasing training needs in this area was further liberalised. Regional Offices and Central Office departments were delegated powers to depute officers and Class III employees to reputed computer training institutions to gain working knowledge of computers. Up to the end of June 2003, 3062 Class III employees and 1351 officers were trained. Furthermore, with a view to enable the officers to acquire more proficiency and skills in computer related areas which are directly linked to their job performance, 90 officers in various offices and central office departments were imparted training under the Scheme by the end of June 2003. In addition, 68 officers were deputed during 2002-03 to various external training institutions such as Indian Institute of Management, Administrative Staff College of India, National Institute of Bank Management, Management Development Institute, Xavier's Labour Research Institute and Institute for Development and Research in Banking Technology.

Training imparted to officials from other countries

14.13 During 2002-03, 295 officials from 11 countries *viz.*, Bhutan, Bangladesh, Iran, Maldives, Nepal, Nigeria, Philippines, Sri Lanka, Sudan, Tanzania and Uganda were trained or provided study attachment facilities at the Bank's training establishments or Central Office departments.

14.14 Under the SAARCFINANCE Staff Exchange Programme two officers from the Nepal Rastra Bank (NRB), four officers from the Bank of Bangladesh and 12 officers from the Central Bank of Sri Lanka (CBS) visited the Reserve Bank during 2002-03 (July-June). The Bank of Bangladesh organised a seminar on "Microcredit Operations" in which two senior officers from the Reserve Bank participated. The SAARCFINANCE, formally recognised with approved terms of reference (ToR), is a network of South Asian Association for Regional Cooperation (SAARC) Central Bank Governors and Finance Secretaries which works towards strengthening exchange of ideas on national macroeconomic policies and promoting understanding of global developments and their implications for the SAARC region.

Human Resource Initiatives

Modification in Officers' Promotion Policy

14.15 In order to have a degree of flexibility in the promotion policy so that the zone of consideration covers the minimum number of freshers required, it was decided, with the approval of the Committee of the Central Board, that the eligibility criterion of three years service in the present grade for promotion to the immediate higher grade may be relaxed up to two years service if an adequate number of candidates is not available for interview as per the norms prescribed in the promotion policy. Furthermore, the selection process for promotion of officers to Grades 'B' and above up to Grade 'E' was modified to take into consideration the selection interview and evaluation of the best three reports of the immediately preceding 5 years, provided all the five reports pertain to the existing grade. In case the number of reports available in the existing grade is less than five, the best three of the available four reports are to be reckoned for the selection process. In case an officer has put in three years or less in the existing grade, the actual number of reports available is taken for the selection process.

Modification in Performance Appraisal System

14.16 A comprehensive review of the Performance Appraisal System was undertaken with the help of an expert consultant. A Committee of Chief General Managers was also constituted to go through all the views and suggestions received in connection with the revision of Performance Appraisal System (PAS). As per the recommendations of this committee, it was decided to modify the performance appraisal system, effective from the performance year 2002-03. Under the modified performance appraisal system, the officers from Grade A to Grade E are to be assessed on 10 different competencies which have been identified keeping in view their job profile, level of responsibility and the position they hold. Performance / competencies are to be appraised on a five point scale with each competency having a weight of four. With a view to achieving objectivity and uniformity, a vocabulary was provided to facilitate distinguishing different levels of identified competencies on a five point rating scale. The vocabulary is common for all departments except the Legal Department for which

separate vocabulary has been provided, keeping in mind the special nature of its functions.

Exit Interviews

14.17 A scheme of Exit Interview was introduced with the objective of identifying the reasons for an officer seeking separation from the Reserve Bank's service prior to superannuation, analysing the information and initiating corrective steps as may be necessary. The scheme is applicable to all categories of officers, irrespective of the length of service and the reasons for separation. The objective of the scheme is not to create hindrance in the process of separation but to see if the officer can be helped to overcome his or her difficulty or misunderstanding, if any.

Summer Placement Scheme

14.18 For the year 2002-03, 25 students were selected out of 276 who applied for summer placement. These summer interns are from diverse disciplines. Under the decentralised arrangements, Regional Offices at Ahmedabad, Bangalore, Chennai, Kolkata, New Delhi, Kanpur and Lucknow also administer the scheme in their respective areas.

Promotion of Hindi

14.19 The Reserve Bank continued to create awareness of Hindi among employees by way of intensifying training programmes in various fields under the Official Language Policy. Annual Programme on Hindi received from Government of India, was implemented successfully. Workshops were organised for senior officers in Regional Offices of Kolkata, Guwahati, Hyderabad and Patna. A targeted translation training programme, the first of its kind, for non-Hindi staff was conducted under the auspices of the Zonal Training Centre, Belapur. The use of Hindi on computers has increased in the Reserve Bank. Besides word processing, Hindi has been interfaced with application development as well as e-mail and corporate e-mail. The size of the Hindi website has grown considerably along with the number of hits to the site. The Reserve Bank set up an information desk in its Rajbhasha Department for systematically storing the processed data required from time to time by various levels of management. A revised and enlarged edition of Banking Glossary (English-Hindi), published by the Reserve Bank, has been widely welcomed by the banking sector. The Reserve Bank continued to publish its headline publications bilingually. The Bankers Training College improved the quality of its quarterly magazine called *"Chintan Anuchintan".* Celebrations were held in the Reserve Bank to commemorate Hindi Day on September 14, 2002 with larger participation of employees in various programmes.

Industrial Relations

14.20 Industrial relations in the Bank remained by and large peaceful during the year 2002-03. The last wage settlements expired on November 1, 2002 and consequently the trade unions representing workmen employees in Classes III and IV as also the Associations of Officers submitted fresh demands for revision of pay scales. Meetings have been held with the recognised Association/Federation of employees on various matters.

Recruitment

14.21 During the year 2002, the Reserve Bank recruited 134 employees, of which 34 were from Scheduled Castes (SCs) and Scheduled Tribes (STs) categories constituting 25.4 per cent of total recruitment (Table 14.2).

14.22 The total staff strength as on December 31, 2002 was 28,884 compared with 29,922 a year ago. Of the total staff, 5347 belonged to Scheduled Castes and 2085 belonged to Scheduled Tribes (Tables 14.3 to 14.6).

14.23 During the calendar year 2002, the Bank's Liaison Officer for SC/ST employees conducted inspection of reservation rosters maintained at the Reserve Bank's 13 offices *viz*. Ahmedabad, Bhopal, Bhubaneswar, Belapur, Chandigarh, Chennai, Jaipur, Kanpur, Kolkata, Nagpur, New Delhi, Pune and Thiruvananthapuram. Meetings between Management and the representatives of the All India Reserve Bank Scheduled Caste/Scheduled Tribe and

Table 14.2 : Recruitment During 2002 (January 1, 2002 to December 31, 2002)

Category	Total Recruited	Of which		Percentage	
		SC	ST	SC	ST
1	2	3	4	5	6
Class I	76	12	7	15.8	9.2
Class III	13	3	1	23.1	7.7
Class IV	45	9	2	20.0	4.4
of which					
(a) Sweepers	18	5	–	27.8	–
(b) Others	27	4	2	14.8	7.4
Total	**134**	**24**	**10**	**17.9**	**7.5**

Table 14.3 : Total Staff Strength

	Category- wise Strength						Per cent to Total Strength	
	Total Strength		SC		ST		SC (4 to 2)	ST (6 to 2)
Cadre	December 31, 2002	December 31, 2001	December 31, 2002	December 31, 2001	December 31, 2002	December 31, 2001	December 31, 2002	
1	2	3	4	5	6	7	8	9
Class I	7,261	7,342	835	785	249	229	11.5	3.4
Class III	12,570	13,324	1,894	2,038	1,058	1,091	15.1	8.4
Class IV	9,053	9,256	2,618	2,919	778	798	28.9	8.6
Total	**28,884**	**29,922**	**5,347**	**5,742**	**2,085**	**2,118**	**18.5**	**7.2**

Buddhist Employees Federation were held on three occasions during the year to discuss issues relating to implementation of reservation policy in the Reserve Bank. In accordance with the Central Government policy effective from September 8, 1993, the Reserve Bank has provided reservation to Other Backward Classes (OBCs). The representation of OBCs in the Reserve Bank was 115 (1.58 per cent) in Class I, 117 (0.93 per cent) in Class III, and 405 (4.47 per cent) in Class IV as on December 31, 2002.

Table 14.4 : Category-wise Actual Staff Strength as on December 31, 2002

Class	Actual Strength
1	2
Class I	
1. Senior Officers in Grade F	72
2. Senior Officers in Grade E	237
3. Senior Officers in Grade D	384
4. Officers in Grade C	948
5. Officers in Grade B	1,571
6. Officers in Grade A	3,237
7. Treasurer	16
8. Deputy Treasurer	127
9. Assistant Treasurer	669
Total Strength in Class I	**7,261**
Class III	
1. Clerk Gr. I	3,681
2. Clerk Gr.II	6,607
3. Stenographer	368
4. Typist	729
5. Teller	395
6. Class III (Others)	790
Total Strength in Class III	**12,570**
Class IV	
1. Peon	1,807
2. Mazdoor	2,292
3. Class IV (Others)	4,954
Total Strength in Class IV	**9,053**
Total Strength in the RBI	**28,884**

14.24 The total strength of ex-servicemen in the Bank at the end of December 2002 stood at 121 in Class I, 523 in Class III and 1,085 in Class IV. The total number of physically handicapped employees in Class I, Class III and IV cadres in the Bank stood at 65, 295 and 147 respectively at the end of 2002.

Premises Department

14.25 Apart from the traditional functions like improving the ambience in work places and residential colonies, provision of infrastructural facilities for installation of Currency Verification and Processing Systems (CVPS) and Shredding and Briquetting Systems in 18 offices were completed. Closed Circuit Television Surveillance Systems (CCTV) were commissioned in five more office buildings bringing the total number of offices with CCTV System to nine.

Inspection of Offices/Departments in the Reserve Bank

14.26 Management Audit and Systems Inspection of Regional Offices/Central Office Departments is carried out at interval of 18 to 24 months. While the scope of the Systems Inspection is to examine compliance with extant policies, guidelines and manual provisions, Management Audit (MA) within the Reserve Bank focuses on evaluating efficiency, economy, effectiveness, delegation and co-ordination. Within this process, a risk based strategy has been evolved under which high risk-prone areas in the functioning of offices are identified for intensive deployment of inspection resources. The performance of internal inspections and compliance is monitored by a Committee of Executive Directors under the overall supervision and guidance of Inspection and Audit Sub-Committee (IASC) of the Central Board. Information Systems Audits are conducted on a regular basis. A Policy document on Information Systems Audit has been approved by the Central Board.

Table 14.5 : Central Office Department-wise Strength of Staff as on December 31, 2002

	Department / Office	Class I	Class III	Class IV
	1	2	3	4
1.	Department Administration and Personnel Management (DAPM)	124	139	69
2.	Department of Banking Operations and Development (DBOD)	122	116	85
3.	Department of Banking Supervision (DBS)	124	42	25
4.	Department of Currency Management (DCM)	41	32	23
5.	Department of Economic Analysis and Policy (DEAP)	218	242	107
6.	Department of Expenditure and Budgetary Control (DEBC)	55	106	41
7.	Department of External Investments and Operations (DEIO)	50	43	14
8.	Department of Statistical Analysis and Computer Services (DESACS)	174	235	104
9.	Department of Government and Bank Accounts (DGBA)	59	80	34
10.	Department of Information Technology (DIT)	84	23	19
11.	Department of Non-Banking Supervision (DNBS)	58	13	10
12.	Exchange Control Department (ECD)	113	178	83
13.	Human Resources Development Department (HRDD)	23	22	8
14.	Internal Debt Management Department (IDMD)	26	16	9
15.	Industrial and Export Credit Department (IECD)	32	29	16
16.	Inspection Department (ID)	52	21	11
17.	Legal Department (LD)	32	20	18
18.	Press Relations Division (PRD)	7	7	6
19.	Premises Department (PD)	65	60	54
20.	Reserve Bank Services Board (RBSB)	13	14	8
21.	Rural Planning and Credit Department (RPCD)	83	48	42
22.	Secretary's Department	35	24	34
23.	Urban Banks Department (UBD)	91	46	47
	Total	**1,681**	**1,556**	**867**

Table 14.6 : Office-wise Strength of Staff as on December 31, 2002

	Department/Office	Class I	Class III	Class IV
	1	2	3	4
1.	Ahmedabad	303	574	382
2.	Bangalore	342	683	385
3.	Belapur	113	266	323
4.	Bhopal	136	110	113
5.	Bhubaneswar	149	241	235
6.	Chandigarh	155	120	122
7.	Chennai	606	967	704
8.	Guwahati	175	346	268
9.	Hyderabad	308	461	371
10.	Jaipur	207	427	324
11.	Jammu	56	37	51
12.	Kanpur	250	669	539
13.	Kochi	40	93	55
14.	Kolkata	543	1673	1040
15.	Lucknow	137	221	133
16.	Mumbai	841	1554	1462
17.	Nagpur	244	635	380
18.	New Delhi	501	1060	609
19.	Panaji, Goa	10	8	3
20.	Patna	223	543	387
21.	Pune-CAB-CRDC	41	55	91
22.	Thiruvananthapuram	200	271	209
	Total	**5,580**	**11,014**	**8,186**

14.27 During the period July 2002-June 2003, Management Audit and Systems Inspection of 24 Regional Offices/Central Office Departments was conducted. Likewise, Information Systems Audit of 19 Regional Offices/Central Office Departments was conducted.

Library

14.28 The Central Library of the Reserve Bank, attached to the Department of Economic Analysis and Policy, plays an important role in the collection, storage and dissemination of information within the Bank. The Library has a comprehensive collection of books, journals, working papers, reports, CD ROMs and other documents. The Library maintains electronic databases of all these documents (OPAC – Online Public Access Catalogue) which can be accessed through Intranet from the Central Office building at http://172.16.6.1/opac.html and from all other offices of the Bank at http://10.21.1.68. PROQUEST Business Periodicals service is available online (for terminals having access to Internet through the Reserve Bank's leased line) from all locations from the address http://www.il.proquest.com/pqdauto. Access to IBID (India Business Insight Database) is

also available online (for terminals having access to Internet through the Reserve Bank's leased line) from all locations from the address http://ibid.informindia.co.in. Access to Elsevier Science Direct Service for Elsevier Science Journals subscribed in the Central Library is also available from site http://www.sciencedirect.com. The size of the Library database is 98,009 records covering books and other documents. It subscribes to 498 print and 1,800 CD ROM journals. The Library provides Current Awareness Services, for all new documents added in the Library as well as selected articles from professional journals through the Intranet on a regular basis. The Central Library also provides information services and support to various departments, training colleges and libraries in other offices of the bank.

Asian Clearing Union

14.29 The Reserve Bank hosted the 32nd Annual Meeting of the Asian Clearing Union (ACU) on June 16, 2003. The central bank Governors of Bangladesh, Bhutan, India, Iran, Myanmar, Nepal, Pakistan and Sri Lanka participated in the meeting. Two senior level officials from the Central Bank of Thailand also participated as observers. In the meeting, the Governors exchanged information on the monetary and economic conditions in their respective countries and also discussed the future role of the ACU. The review of the future role of ACU was necessitated in the context of developments taking place in the region including formation of several groups for trade promotion and economic cooperation. The meeting also elected the Governor of the Central Bank of Iran as the Chairman and the Governor of the Central Bank of Pakistan as the Vice-Chairman of the Asian Clearing Union for the calendar year 2004.

14.30 Formed in 1974, the Asian Clearing Union (ACU) at present has eight members - Bangladesh, Bhutan, India, Iran, Myanmar, Nepal, Pakistan and Sri Lanka. The ACU is headquartered in Tehran. The objectives of ACU are multilateral settlement of current account payments, conservation of foreign exchange, promotion of monetary cooperation among central banks, increasing relationships among the banking systems of member countries and providing currency swap arrangements.

Dissemination Policy

14.31 Transparency, stringent standards of quality and timeliness are the three cornerstones of the Reserve Bank's dissemination policy. During the year under review, the Reserve Bank disseminated information through traditional and newer media. Apart from press releases, publications, notifications, frequently asked questions (FAQs), advertisements and the website, it organised meetings, workshops and seminars for interactions with special audiences. Information kiosks and intranet sites were also used for communicating with the general public visiting the Reserve Bank premises.

14.32 During the year, the Reserve Bank continued its efforts to discourage stapling of currency notes and to disseminate information relating to 7 per cent Savings Bonds through its advertising campaigns. In an attempt to attract the best talent, the Reserve Bank showcased its role and functions as also the work environment in a video film, power-point presentation and brochure. These were displayed during pre-placement talks for on-campus recruitment.

14.33 From October 2002, the Negotiated Dealing System (NDS)'s real-time information on trades in Government securities (including Treasury Bills and Repos) and call/notice/term money was made available through the Reserve Bank's website. The information includes trade details, market watch and quotes available. Data can be accessed either through the Reserve Bank's main website www.rbi.org.in or through a special URL www.nds.rbi.org.in. The site has become a major source of information on current prices of Government securities for the retail investors, mainly, co-operative banks and regional rural banks in remote areas. The website also began displaying information on the maximum and minimum interest rates on advances charged by banks. Beginning February 2003, the website publishes information on banks' minimum and maximum interest rates on rupee export credit as well as other credit. Updated on a quarterly basis, the information includes bank-group wise range of median interest rates on credit above Rs. two lakh other than export credit as well as other credit above Rs. two lakh under demand and term loans.

14.34 In the year 2002, the Reserve Bank's website was benchmarked against sites of some other central banks and supranationals by an independent London-based consultant. As against five stars for best practices, the Reserve Bank's site was rated four stars in three parameters, three stars in six parameters and three stars in overall effectiveness. Improvements relating to the design, navigation and technology were implemented during the year. Suggestions relating to content, especially the site for the common man, are under implementation.

14.35 The Reserve Bank's website continued to remain a major source of information. Over 9,500 users registered themselves for receiving information through e-mail. As many as 10,018 visitors use personalisation service to access the information available on the Reserve Bank's site in the form they want. The number was 3,019 last year. During the year under review, the Reserve Bank issued 1,336 press releases and added 653 mega-bytes (MBs) of material to its website taking the volume of information available on the website to 5.5 giga-bytes (GB). On an average, around 1.94 GB data is accessed every day by users.

14.36 Regional Offices in Chennai, Ahmedabad, Bangalore, New Delhi, Mumbai (including in the Central Office building), Hyderabad, and Chandigarh installed information kiosks in the reception area. The kiosks facilitate access of visiting public in the office premises to information emanating from the Reserve Bank as well as from the respective offices. The kiosks in Mumbai, for instance, use as screen saver, the six films produced by the Reserve Bank for education of the general public. The films depict security features of currency notes, non-stapling of currency notes and an advisory to the depositors of non-banking finance companies. These kiosks also provide for an email facility so that the user can e-mail the information for further use.

14.37 Several offices and departments set up helpdesks to clarify doubts raised by the general public through e-mail/telephone/fax. The nodal officers manning the helpdesks replied to the queries relating to their departments. The helpdesks also served as an effective medium of communication between the general public and the various departments/offices of the Reserve Bank. Notice boards, including electronic moving display boards, were put up at strategic points in some offices to display information of interest/relevance to customers, including citizens' charter. Boxes were also installed to receive customer complaints. Wide publicity was given at the regional level to the Grievances Redressal Mechanism. The mechanism provides a forum to the public to seek redressal of their complaints against any department of the Reserve Bank.

Customer Service Measures

14.38 Based on the recommendation of the Indian Banks' Association (IBA), the ceiling for immediate credit of outstation/local cheques was enhanced from Rs.7,500 to Rs.15,000. Guidelines relating to extension of such facility to all individual depositors without laying any stipulation for minimum balance for the purpose, proper conduct of account of customer, charging of interest for the period for which the bank is out of funds in the event of cheque being returned unpaid and publicity of the availability of such facilities at branches were provided to banks.

14.39 With respect to savings bank account, banks were advised to inform customers regarding the requirement of minimum balance and any subsequent changes in this regard. Banks were allowed to open savings bank accounts in the names of State Government departments/bodies/agencies in respect of grants/subsidies released for implementation of various programmes/schemes sponsored by State Governments on production of authorisation from the Government departments concerned.

14.40 During the year, efforts were made for better customer service in the fields of currency management, clearing mechanism, exchange control and supervision. Regional Offices took initiatives for successful implementation of the Clean Note Policy. These measures are covered in Section XII.

14.41 Training programmes and workshops on Note Refund Rules and detection of forged notes were conducted by Regional Offices for officials of the Central Bureau of Investigation, Enforcement Directorate, Central Customs and Excise, Bharat Sanchar Nigam Limited and also for officials of private banks and financial institutions. The Reserve Bank's Chandigarh office deputed officials to institutions for blind people to educate the visually impaired about the features of genuine notes.

14.42 The National Clearing Cells at Hyderabad and Kanpur reduced the number of days in the electronic clearing service cycle from 6 to 5 so that the final settlement could be effected one day earlier. Some Regional Offices conducted seminars/workshops/ presentations for commercial banks, UCBs to explain advantages of the Straight Through Processing (STP), zero clearing difference initiatives, issues in electronic clearing service, electronic funds transfer and disaster recovery preparedness.

14.43 Almost all Regional Offices organised seminars/workshops/conferences to educate Authorised Dealers on the latest exchange control regulations, including FEMA 1999, so that they could render better customer service. Some Regional Offices issued press releases indicating the names of Authorised Dealers in the State and the procedure

for release of foreign exchange for various purposes with a view to improving public awareness on liberalised rules for using foreign exchange and to reduce references to the Reserve Bank.

14.44 During the year under review, the efforts to sensitise officials of State governments, Economic Offences Wing, the local police, *etc.*, about the need for coordination among various authorities for protection of depositors continued at the Regional Office level. Some Regional Offices also organised familiarisation programmes/ workshops/seminars for auditors of non-banking finance companies (NBFCs) to explain their role and responsibility in the regulation and supervision of NBFCs.

14.45 Workshops were also organised by some Regional Offices on "Modernisation of Treasury and Payment Accounting System for Treasury Officers" to familiarise senior functionaries of various State Governments to have efficient control of Government funds. Surveys were conducted on the procedure adopted by various banks for recovery of loans under Government sponsored schemes and the problems faced by them.

Initiatives by Department of Economic Analysis and Policy (DEAP)

14.46 The Reserve Bank persevered in its objective of providing analytical research on macroeconomic and financial developments in the Indian economy during 2002-03 with continuous upgradation in technological inputs to ensure timely, comprehensive and accurate information and analysis. Consistent with this objective, the Department of Economic Analysis and Policy (DEAP) set out a Vision Statement in September 2002 indicating the major challenges that the Reserve Bank is likely to face in the near future in the context of the changing macroeconomic policy environment and the measures to deal with those challenges. A research agenda covering the effective inputs for the policy vision was also prepared.

14.47 Important publications released during the year were the Annual Report, 2001-02, Report on Trends and Progress of Banking in India, 2001-02 and a Study on Finances of Sate Governments. The Report on Currency and Finance, 2001-02 attempted an evaluation of the policy reforms since the early 1990s. A document titled, 'Macroeconomic and Monetary Developments in 2002-03' was also released along with the Statement on Monetary and Credit Policy. It provides the macroeconomic background for policy formulation. In addition to the monthly dissemination of key economic and financial information in the Reserve Bank's Bulletin (and weekly dissemination through its Weekly Statistical Supplement), the fifth issue of the 'Handbook of Statistics for the Indian Economy' was released during the year. The Handbook database, which is a storehouse of information on various aspects of the Indian economy, provides data in the electronic form as also on a user-friendly RDBMS platform. The Reserve Bank of India Occasional Papers, the research publication of the Reserve Bank, was revitalised with the issue of special annual volumes. The Reserve Bank Staff Studies, which was introduced in January 1991 to provide an outlet for in-house research efforts but discontinued in September 2000, was also revived in January 2003. Meant for internal circulation, the Staff Studies provide an avenue for well-researched internal notes (non-confidential in nature). Eight studies have been brought out under the revised series. The DEAP also assists other departments in the Reserve Bank in bringing out their publications.

14.48 The Development Research Group (DRG), which was constituted in the Reserve Bank in November 1991, continued to serve as a forum for constructive debate and interaction among professional economists and policymakers. The DRG has so far published 23 studies and a DRG Discussion Paper since its inception on a wide range of subjects relating to real, social, monetary, fiscal, banking and external sectors. During the year, studies initiated under the DRG included interest rate modelling and forecasting in India, bank portfolio changes and the monetary policy transmission mechanism, forecasting currency demand in India, supply response in Indian agriculture, targeting efficiency in the public distribution system, the effect of private remittances in India and bank soundness and macroeconomic policy. Furthermore, under the Reserve Bank's Endowment Scheme, financial support was provided to various institutions for the purposes of research and training in areas of interest to the Bank.

14.49 The DEAP coordinated the visit of two external experts *viz.*, Prof. T. N. Srinivasan of Yale University and Prof. Raghuram Rajan of Chicago Business School, who submitted a report on the research agenda of the Bank, addressing, *inter alia,* the institutional framework for strengthening the research activities of the Reserve Bank.

14.50 During 2002-03, the Reserve Bank was closely associated with the Ministry of Finance,

Government of India in hosting the meeting of the Group of Twenty (G-20) countries, which aims at promoting international financial stability through informal discussions, preparation of case studies and reviews of policy issues of relevance to the members. The G-20 Deputies deliberated on a range of issues of common concern to the G-20 members including measure for extending the benefits of globalisation, Sovereign Debt Restructuring Mechanism (SDRM), domestic policy requirements for regeneration of international capital flows, combating financing of terrorism, standards and codes, and enhancing the effectiveness of aid.

14.51 In order to align the present foreign direct investment (FDI) reporting system of India with the international reporting system by including equity capital of unincorporated entities, reinvested earnings and inter company debt transactions, the Reserve Bank was actively involved with the Government of India in preparing the 'Report of the Committee on the Compilation of Foreign Direct Investment in India'. As a follow up of the Report, a Technical Monitoring Group was set up for speedy implementation of the recommendations made by the earlier Committee and the first Action Taken Report was submitted to the Government of India in June 2003. Accordingly, data on FDI have been revised since 2000-01 with expanded coverage to include besides equity capital, reinvested earnings and 'other direct capital' (inter-corporate debt transactions between related entities). A 'Technical Group on External Debt Statistics' was reconstituted in October 2002 with members from the Reserve Bank and the Government of India to take a fresh look on the definitional aspects, accounting procedures and institutional arrangements concerning collection, monitoring and reporting of the external debt statistics of India consistent with international best practices. An "Ad-hoc Group on Prepayment of External Debt" was constituted in January 2002 with members from the Reserve Bank and the Government of India to deliberate on the issues on conceptualisation/identification of high cost debt including guaranteed debt and prepayment of selected corporate debt. The Government retired high cost loans during the year based on the recommendations of the Group. The Reserve Bank is actively involved in various Groups on issues relating to the World Trade Organisation and General Agreement on Trade in Services (GATS).

14.52 To implement the recommendations of the National Statistical Commission (NSC), the Reserve Bank was identified as an implementing agency by the Government of India. There were 40 recommendations of the NSC relating to financial and external sector to be implemented by the Reserve Bank. Out of the 40 recommendations, 37 recommendations have already been complied with.

14.53 Seminars were arranged in memory of late Prof. P. R. Brahmananda and late Prof. M. J. Manohar Rao of the University of Mumbai. Delegates from Universities/Institutions, other financial institutions and Government bodies attended the seminar.

Initiatives by Department of Statistical Analysis and Computer Services (DESACS)

14.54 Several initiatives were undertaken to refine and improve the primary compilation of information on macroeconomic parameters for which the Reserve Bank is the primary source. As recommended by the National Statistical Commission, the methodology of compilation of data on international investment position (IIP) was re-oriented with a view to generating IIP with a time lag of six months. Moreover, given the requirement under the Special Data Dissemination Standards (SDDS), annual estimates of IIP of India as on March 1997 to March 2002 were compiled and presented in the Reserve Bank's website as per the format and timeliness prescribed by the International Monetary Fund (IMF).

14.55 A new reporting system, *viz.*, Non Resident Deposit – Comprehensive Single Return (NRD-CSR) was introduced by the Reserve Bank in April 2003 as a single, comprehensive reporting framework for non-resident Indians' deposit schemes. For this purpose, a software package was developed by the Reserve Bank and provided to the banks to assist them in reporting data on non-resident deposits. The Reserve Bank also conducted workshops for the benefit of bank officials to ensure proper data reporting at various centres.

14.56 The package for electronic reporting of R-Return transactions to the Reserve Bank by banks, *i.e.*, Foreign Exchange Transactions – Electronic Reporting System (FET-ERS) was upgraded to include information on short-term external debt of maturity up to 180 days as recommended by the National Statistical Commission (NSC). The revised software also includes a module for compilation of quick estimates as well as more disaggregated data on trade in services as per Extended Balance of Payments (EBOP) classification. Beta testing of the software has been completed for implementation at all Authorised Dealers' offices.

14.57 The "Technical Group on Re-examination of Data Reporting system on Software Exports", which was formed in pursuance of the recommendations of the National Statistical Commission, has submitted its Report in March 2003. The Group suggested a comprehensive survey (in the nature of a census) every three years and a representative survey (every quarter) for developing a comprehensive information database on software and IT exports from the country.

14.58 As part of the implementation of the Bank for International Settlements (BIS) system for compilation of International Banking Statistics (IBS) of the banks in India, the quarterly data on international assets and international liabilities of banks were released in the form of Consolidated Banking Statistics (CBS) and Locational Banking Statistics (LBS). The Reserve Bank became the third among the central banks in developing countries (after Taiwan and Turkey) to be included in the International Banking Statistics of the BIS. A workshop on IBS was conducted for officials of all authorised commercial/co-operative banks in order to ensure quality, coverage and timeliness of IBS data.

14.59 The third phase of the enterprise data warehouse project, the Central Database Management System (CDBMS), comprising System Integration and Development was completed during the year. Four selected subject areas covering analytical information requirement in the areas of macro-economic research, monetary and liquidity management, financial sector supervision and regulation were implemented in this phase. The site has been made operational and opened for access to users from within the Reserve Bank across different centres. The process of enriching the site with more reports, universes and data cubes based on user feedback is underway.

Parliamentary Committees

14.60 Dr. Bizay Sonkar Shastri, Chairman, National Commission on SCs and STs, visited the Reserve Bank on December 9, 2002 and had discussions with Shri Vepa Kamesam, Deputy Governor, Executive Directors and senior officials.

14.61 The Committee of Parliament on Official Languages (3rd Sub Committee), headed by Shri Pradeep Kumar, Director, visited the Reserve Bank on January 10, 2003. The Committee had discussions with Deputy Governors Shri G.P. Muniappan, Dr. Rakesh Mohan, Executive Directors and other senior officials.

14.62 Senior Officials of the Bank at the Regional Offices at Bhubaneswar, Bangalore, Ahmedabad, Bhopal, Lucknow, Patna and from the Central Office, Mumbai appeared before Standing Committees of Parliament on Finance, Industry and Estimate Committee, during the year on various occasions.

14.63 Parliamentary Committee on Agriculture, headed by Shri S. S. Palanimanickam, during their visit to Mumbai, held discussions with Deputy Governor, Shri Vepa Kamesam and other senior officials on May 24, 2003.

Central Board and its Committees

14.64 Seven meetings of the Central Board were held during the year, of which five meetings were held at the traditional centres, *viz.* Mumbai, New Delhi (two meetings), Chennai and Kolkata and two were held at non-traditional centres, *viz.* Hyderabad and Guwahati. 48 weekly meetings of the Committee of the Central Board were held during the year at Mumbai. The Committee of the Central Board attended to the current business of the Reserve Bank. The discussions at the meetings of the Central Board broadly covered matters pertaining to general superintendence and direction of the Reserve Bank's affairs in diverse fields such as currency management, information technology, human resource development, banking supervision, monetary and credit policy and the Reserve Bank's accounting policy. The Central Board also reviewed the functions of Local Boards, taking into account the changes in the Reserve Bank's role in supervision over the financial system as also the changing organisational structure of the Reserve Bank.

14.65 One meeting of the Staff Sub-Committee, four meetings of the Inspection and Audit Sub-Committee (IASC) and three meetings of the Building Sub-Committee were held during the year. These Sub-Committees of the Central Board have been constituted to assist the Central Board in direction of the affairs of the Reserve Bank. The Building Sub-Committee advised the Bank during the year on various matters including construction / structural rehabilitation of office buildings and staff quarters, augmentation/renovation of air conditioning plants and lifts in office buildings. The Staff Sub-Committee considered the proposals for sanction of additional posts in all categories of staff in various Departments and Regional Offices of the Reserve Bank during the year. The Committee also considered matters concerning manpower planning.

Central Board/Local Boards

14.66 Dr. Bimal Jalan was re-appointed as Governor of the Reserve Bank for a further period of two years commencing from November 22, 2002 and ending on November 21, 2004.

14.67 Dr. Y. V. Reddy, Deputy Governor relinquished charge of his office on July 31, 2002 on his appointment as Executive Director, IMF.

14.68 Dr. S. Narayan, Finance Secretary, Ministry of Finance, New Delhi was nominated as the Government nominee Director on the Central Board under Section 8(1) (d) of the Reserve Bank of India Act, 1934 with effect from August 7, 2002 in place of Shri C. M. Vasudev.

14.69 Dr. Rakesh Mohan took over as Deputy Governor of the Reserve Bank from September 9, 2002 for a period of three years.

14.70 Dr. Ashok Lahiri, Member, Local Board, Southern Area resigned from the Local Board on his appointment as Chief Economic Adviser, Government of India on October 17, 2002.

14.71 Shri G. P. Muniappan Deputy Governor relinquished the charge of his office on expiry of his term on May 31, 2003.

14.72 Smt. K. J. Udeshi took over as Deputy Governor of the Reserve Bank on June 10, 2003 for the period upto October 12, 2005 or until further orders.

14.73 Shri Vepa Kamesam was reappointed as Deputy Governor of the Reserve Bank for the period from July 1, 2003 and upto September 23, 2003 or until further orders.

14.74 Shri D. C. Gupta, Finance Secretary and Secretary (Expenditure), Government of India, Ministry of Finance, New Delhi was nominated as the Government nominee Director on the Central Board under Section 8(1) (d) of the Reserve Bank of India Act, 1934 with effect from July 21, 2003 in place of Dr. S. Narayan.

14.75 Shri P. N. Khanna, Member, Local Board (Northern Area) passed away on August 26, 2002.

14.76 Shri R. Jankiraman, former Deputy Governor passed away on May 18, 2003.

Appointment/Retirement of Executives

14.77 Shri S. L. Parmar, Executive Director retired from the Reserve Bank's service from the close of business on January 31, 2003.

14.78 Shri P. B. Mathur, Executive Director retired from the Reserve Bank's service from the close of business on February 28, 2003.

14.79 Smt. Shyamala Gopinath, Shri Y. S. P. Thorat and Shri P. K. Biswas were appointed as Executive Directors with effect from March 1, 2003. While or Shri Thorat and Shri Biswas took over charge on March 1, 2003, Smt. Gopinath assumed charge of her office on June 27, 2003 on her return from deputation with the IMF, Washington.

14.80 Shri Mohammad Tahir, Executive Director retired from the Reserve Bank's service from the close of business on March 31, 2003.

14.81 Smt. Usha Thorat was appointed as Executive Director with effect from April 1, 2003.

14.82 Shri K. L. Khetarpaul, Executive Director voluntarily retired from the Reserve Bank's service from the close of business on June 10, 2003.

14.83 Smt. K. J. Udeshi, Executive Director voluntarily retired from the Reserve Bank's service as at the close of business on June 10, 2003 on her appointment as Deputy Governor of the Reserve Bank.

14.84 Shri A. V. Sardesai was appointed as Executive Director with effect from June 12, 2003.

Foreign Dignitaries

14.85 Mr. E. Asiedu-Mante, Deputy Governor of Bank of Ghana, visited the Reserve Bank on July 23, 2002 and had discussions with Shri Vepa Kamesam, Deputy Governor, Executive Directors and senior officials of the Reserve Bank.

14.86 Mr. Dai Xianglong, Governor, Peoples' Bank of China, visited the Reserve Bank on November 26, 2002 and met Governor and Deputy Governors. He also addressed the senior officials of the Reserve Bank.

14.87 Prof. Jagdish Bhagwati, Columbia University, NewYork, visited the Reserve Bank to deliver the Twelfth C.D. Deshmukh Memorial Lecture on December 12, 2002.

14.88 Sir Howard Davies, Chairman, Financial Services Authority, U.K., visited the Reserve Bank from January 6 to 7, 2003 and held discussions with Deputy Governor Shri G.P. Muniappan on U.K. operations of Indian banks.

14.89 Prof. Ronald I Mckinnon of Stanford University, USA, visited the Reserve Bank from January 9 to 11, 2003. He had discussions with

Dr. Rakesh Mohan, Deputy Governor and addressed a seminar on January 11, 2003.

14.90 Mr. Mohsin Khan, Director, IMF, visited the Reserve Bank from January 29 to 31, 2003. He held discussions with Dr. Rakesh Mohan, Deputy Governor and also addressed a seminar on January 31, 2003.

14.91 A team of officials from the Bank of Uganda, headed by Dr.Gabriela Braun, visited the Reserve Bank on February 4, 2003 and had discussions with senior officials of the Bank.

14.92 A team from the World Bank, headed by Mr. Mark Baird visited the Reserve Bank and held discussions with Dr. Rakesh Mohan, Deputy Governor on February 7, 2003.

14.93 A delegation of Cooperative Bankers in Poland, headed by Mr. Eugeniusz Lasz Kiewicz, President of the National Union of Cooperative Banks, Poland, visited the Reserve Bank on February 12, 2003 and had discussions with officials.

14.94 A German delegation, headed by Mr. Ernst Welteke, President, Bundesbank, visited the Reserve Bank on February 28, 2003 and had discussions with Dr. Rakesh Mohan, Deputy Governor.

14.95 A group of officials from the Secretariat of the South Asian Federation of Stock Exchanges (SAFE), representing Bangladesh, Bhutan, Shri Lanka, Nepal and Pakistan visited the Reserve Bank on March 7, 2003 and had interaction with senior officials of the Reserve Bank.

14.96 Mr. Kenneth S. Rogoff, Director (Research) IMF visited central office on 18th July 2003 and had discussions with Governor, Deputy Governors and senior officials of the Bank. He also addressed a seminar.

Auditors

14.97 The Government of India appointed M/s. Chandabhoy & Jassoobhoy, Mumbai, M/s. P. B. Vijayaraghavan & Co., Chennai, M/s. P.K. Mitra & Co., Kolkata, M/s. J. L Sengupta & Co., Kolkata, M/s. S. N. Nanda & Co., New Delhi and M/s. Khimji Kunverji & Co., Mumbai as auditors of the Reserve Bank for the year 2002-03. While the first three audit firms were re-appointed, the latter three have been appointed for the first time by the Central Government.

XV THE RESERVE BANK'S ACCOUNTS FOR 2002-03

15.1 The key financial results of the Reserve Bank's operations during the year are presented in this section.

INCOME AND EXPENDITURE

15.2 The trends in gross income, expenditure and net disposable income of the Reserve Bank over the last five years are displayed in Table 15.1.

Table 15.1: Trends in Gross Income, Expenditure and Net Disposable Income

(Rupees crore)

Item	2002-03	2001-02	2000-01	1999-2000	1998-99
1	2	3	4	5	6
Total Income (Gross)	23,185.64	24,690.34	21,848.87	21,960.97	19,220.33
Less transfer to :					
(i) Contingency Reserve	6,733.92	6,996.04	6,202.57	6,554.50	8,917.65
(ii) Asset Development Reserve	890.31	827.91	704.78	711.55	1,274.59
Total (i + ii)	7,624.23	7,823.95	6,907.35	7,266.05	10,192.24
Total Income (Net)	15,561.41	16,866.39	14,941.52	14,694.92	9,028.09
Total Expenditure	6,723.41	6,542.39	5,587.52	5,340.92	4,545.09
Net Disposable Income	8,838.00	10,324.00	9,354.00	9,354.00	4,483.00

Appropriation of Net Disposable Income

15.3 The net disposable income of the Reserve Bank for the year 2002-03 amounted to Rs.8,838.00 crore (Table 15.2).

Surplus transferable to Government of India

15.4 The surplus transferable to the Central Government for the year 2002-03 amounted to Rs.8,834.00 crore, inclusive of Rs.1,717.00 crore towards interest differential on special securities converted into marketable securities. The transfer on account of interest differential is intended to compensate the Government for the difference in interest expenditure, which the Government had to bear consequent on the conversion.

Table 15.2 : Disposable Income

(Rupees crore)

Item	2002-03	2001-02	2000-01	1999-2000	1998-99
1	2	3	4	5	6
Total Income (Net)	15,561.41	16,866.39	14,941.52	14,694.92	9,028.09
Total Expenditure	6,723.41	6,542.39	5,587.52	5,340.92	4,545.09
Net Disposable Income	8,838.00	10,324.00	9,354.00	9,354.00	4,483.00
Less : Transfer to Funds *	4.00	4.00	4.00	4.00	4.00
Surplus transfer to Government *of which*	8,834.00	10,320.00	9,350.00	9,350.00	4,479.00
i) Towards Normal Transfer	7,117.00	8,841.00	7,871.00	7,871.00	3,000.00
ii) Interest differential on account of conversion of special securities into marketable securities	1,717.00	1,479.00	1,479.00	1,479.00	1,479.00

* An amount of Rupees one crore each transferred to NIC (LTO) Fund, NRC(LTO) Fund, NRC(Stabilisation) Fund and NHC(LTO) Fund during each of the five years.

Table 15.3 : Gross Income

(Rupees crore)

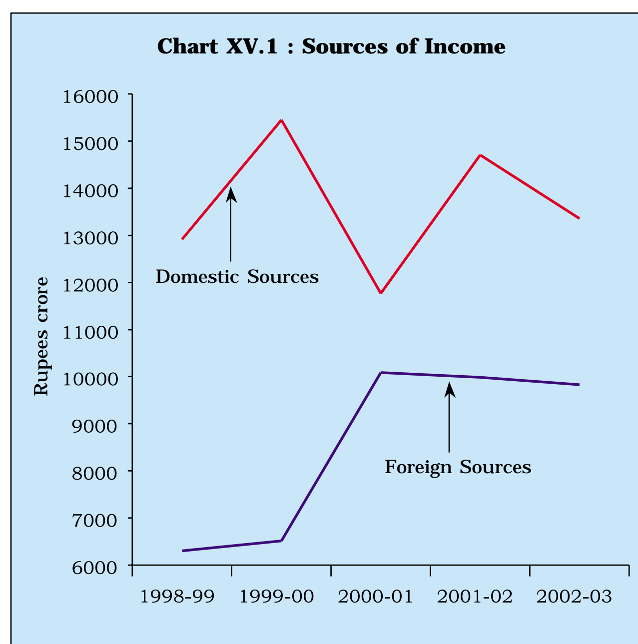
Item	2002-03	2001-02	2000-01	1999-2000	1998-99
1	2	3	4	5	6
A. Foreign Sources					
Interest, Discount, Exchange, Commission	9,826.65	9,986.46	10,086.08	6,514.73	6,306.59
B. Domestic Sources					
Interest	13,064.77	14,492.14	11,314.12	14,928.38	12,642.96
Discount	0.08	10.92	211.59	323.11	87.74
Exchange	0.09	0.08	0.85	0.14	0.19
Commission	279.42	189.51	210.37	185.62	175.02
Rent realised and others	14.63	11.23	25.86	8.99	7.83
Total – Domestic	13,358.99	14,703.88	11,762.79	15,446.24	12,913.74
Total Income (Gross)	**23,185.64**	**24,690.34**	**21,848.87**	**21,960.97**	**19,220.33**

INCOME

15.5 The gross income of the Reserve Bank for the year 2002-03 (July-June), was Rs.23,185.64 crore which was lower by Rs.1,504.70 crore (6.1 per cent) as compared to the previous year's total income of Rs.24,690.34 crore. The fall in income from domestic sources was due to fall in domestic assets and lower interest rates. The fall in income from foreign sources was due to reduction in international interest rates. The sources of income are set out in Table 15.3.

15.6 The share of transfer to Contingency Reserve, Asset Development Reserve and surplus transfer to government as a percentage to total income is given in Table 15.4.

15.7 Income from foreign and domestic sources is compared in Chart XV.1.



Earnings from Foreign Sources

15.8 Data relating to earnings from foreign sources are given in Table 15.5.

Table 15.4 : Contingency and Asset Development Reserves and Surplus Transfer to Government

(Rupees crore)

Item	2002-03	2001-02	2000-01	1999-2000	1998-99
1	2	3	4	5	6
Total Income (Gross)	23,185.64	24,690.34	21,848.87	21,960.97	19,220.33
Contingency Reserve	6,733.92	6,996.04	6,202.57	6,554.50	8,917.65
	(29.04)	(28.34)	(28.39)	(29.85)	(46.40)
Asset Development Reserve	890.31	827.91	704.78	711.55	1,274.59
	(3.84)	(3.35)	(3.22)	(3.24)	(6.63)
Surplus transfer to Government	**8,834.00**	**10,320.00**	**9,350.00**	**9,350.00**	**4,479.00**
	(38.10)	**(41.80)**	**(42.79)**	**(42.57)**	**(23.30)**

Note : Figures in brackets indicate percentage to total income.

Table 15.5: Earnings from Foreign Sources

(Rupees crore)

Particulars	Amount as on		Variation	
	June 30, 2003	June 30, 2002	Amount	Percentage
1	2	3	4	5
Foreign Currency Assets (FCA)	3,65,000.98	2,67,333.18	97,667.80	36.53
Gold	17,182.40	16,272.39	910.01	5.59
Special Drawing Rights (SDR)	6.09	46.57	(-)40.48	(-)86.92
Total Foreign Exchange Reserves (FER)	**3,82,189.47**	**2,83,652.14**	**98,537.33**	**34.74**
Average FCA	3,17,297.00	2,23,565.45	93,731.55	41.93
Net Earnings	**9,826.65**	**9,986.46**	**(-)159.81**	**(-)1.60**
Capital Gain on Securities	1,329.28	1,335.15	(-) 5.87	(-)0.44
Depreciation on Securities	(-)392.82	(-)549.59	156.77	28.53
Net Capital Gain/Loss on Securities	936.46	785.56	150.90	19.21
Net Earnings excluding Capital Gains/Losses	**8,890.19**	**9,200.90**	**(-)310.71**	**(-)3.38**
Unrealised Appreciation on Securities	1,888.12	781.81	1,106.31	141.51
Memo Items :				
Net Earnings in percentage terms (on average FCA)	3.10	4.47		
Net Earnings in percentage terms (excluding Capital Gain/Loss on average FCA)	2.80	4.12		

15.9 During the year 2002-03, the return on foreign currency assets excluding capital gains less depreciation decreased to 2.8 per cent from 4.1 per cent during 2001-02 because of lower interest rates abroad. However, taking into account the capital gain on securities, the net earnings went up from 2.8 per cent to 3.1 per cent during 2002-03. The foreign securities held in the Reserve Bank's portfolio are valued at the end of every month at the lower of book value or market rate. If the market rate is lower than the book value, depreciation to the same extent is provided for. Appreciation is neither taken to profit and loss account nor to the reserves.

Income from Domestic Sources

15.10 Domestic income decreased by Rs.1,344.89 crore (9.1 per cent) from Rs.14,703.88 crore in 2001-02 to Rs.13,358.99 crore in 2002-03. Data relating to earnings from domestic sources are given in Table 15.6.

Table 15.6: Earnings from Domestic Sources

(Rupees crore)

Particulars	Amount as on		Variation	
	June 30, 2003	June 30, 2002	Amount	Percentage
1	2	3	4	5
Domestic Assets	1,54,812.91	1,86,226.62	(-)31,413.71	(-)16.87
Weekly average of Domestic Assets	1,56,365.36	1,94,553.57	(-)38,188.21	(-)19.63
Net Earnings after depreciation on securities@	13,358.99	14,703.88	(-)1,344.89	(-)9.15
	(642.81)	(631.90)		
of which :				
(i) Profit on Sale of Securities	4,798.03	3,060.04	1,737.99	56.80
(ii) Interest on Securities	7,100.29	9,004.25	(-)1,903.96	(-)21.14
(iii) Interest on Loan and Advances	1,013.63	2,122.92	(-)1,109.29	(-)52.25
(iv) Other Earnings	447.04	516.67	(-)69.63	(-)13.48
Memo Items :				
Net Earnings in percentage terms (on average domestic assets)	8.54	7.56		
Net Earnings in percentage terms (excluding profit on sale of securities)	5.47	5.98		

@ : Figures in brackets are depreciation on securities.

Table 15.7: Expenditure

(Rupees crore)

	Item	2002-03	2001-02	2000-01	1999-2000	1998-99
	1	2	3	4	5	6
I.	**Interest Payment**	**1,990.09**	**2,334.99**	**1,994.80**	**1,971.88**	**1,976.64**
	of which :					
	a) Scheduled Banks	1,483.02	1,838.57	1,660.83	1,656.18	1,652.76
	b) Payment in lieu of service charges on borrowings from IMF payable to Government of India	–	–	–	7.82	45.51
II.	**Establishment**	**1,488.86**	**1,304.36**	**870.85**	**846.75**	**683.59**
III.	**Non-Establishment**	**3,244.46**	**2,903.04**	**2,721.87**	**2,522.29**	**1,884.86**
	of which:					
	a) Agency charges	1,352.41	1,207.84	1,160.70	1,193.62	924.02
	b) Security printing	1,433.09	1,304.49	1,122.78	1,068.44	733.96
Total [I+II+III]		**6,723.41**	**6,542.39**	**5,587.52**	**5,340.92**	**4,545.09**

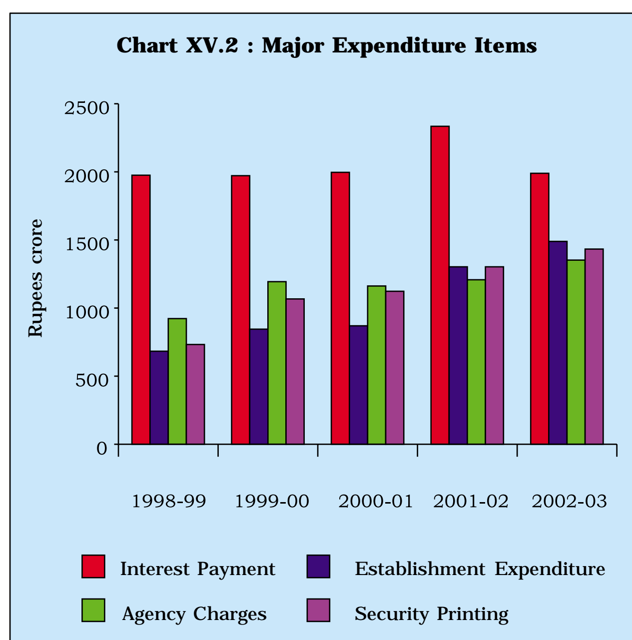
15.11 Profits booked on sale of securities amounted to Rs. 4,798.03 crore in 2002-03 representing an increase of Rs. 1,737.99 crore over the previous year. The net open market operations sales amounted to Rs.53,780 crore in 2002-03 as compared to Rs.30,335 crore in 2001-02. The interest income on ways and means advances showed decrease of Rs.339.98 crore during 2002-03 from Rs.952.48 crore in 2001-02 to Rs.612.50 crore in 2002-03, reflecting decreased recourse by the Central Government to this facility and also lower bank rate. Interest earnings from loans and advances to banks/financial institutions declined by Rs.769.31 crore from Rs.1,170.44 crore in 2001-02 to Rs.401.13 crore in 2002-03, due to lower utilisation of refinance facility by Primary Dealers/Scheduled Commercial Banks combined with lower interest rates applicable on these advances.

EXPENDITURE

15.12 Total expenditure of the Reserve Bank increased by Rs.181.02 crore (2.8 per cent) from Rs.6,542.39 crore in 2001-02 to Rs.6,723.41 crore in 2002-03 (Table 15.7 and Chart XV.2).

Interest Payment

15.13 Interest payment decreased by Rs.344.90 crore (14.8 per cent) from Rs.2,334.99 crore in 2001-02 to Rs.1,990.09 crore in 2002-03 due to reduction in rate of CRR and lower interest rates payable on eligible CRR balances.



Establishment Expenditure

15.14 Establishment expenditure increased by Rs.184.50 crore (14.1 per cent) from Rs.1,304.36 crore in 2001-02 to Rs.1,488.86 crore in 2002-03 as a result of increased provisioning with respect to gratuity and pension funds. As per the actuarial valuation the provisioning in this regard was to the extent of Rs.616.67 crore during 2002-03 as against Rs.440.80 crore during the previous year.

Non-Establishment Expenditure

15.15 Expenditure on security printing, comprising cost of printing of currency notes, cheque forms *etc.*, increased by Rs.128.60 crore (9.9 per cent) from Rs.1,304.49 crore in 2001-02 to Rs.1,433.09 crore in 2002-03, mainly due to upward revision in rates of printing currency notes, increase in quantum of notes printed and larger component of higher denomination notes of Rs.100 and above consistent with the clean note policy.

BALANCE SHEET

Liabilities

National Industrial Credit (Long Term Operations) Fund

15.16 There were no operations in the National Industrial Credit (Long Term Operations) Fund (established under Section 46-C of the RBI Act, 1934) during 2002-03 except the credit of Rs.1.0 crore to the Fund out of Reserve Bank's income.

National Housing Credit (Long Term Operations) Fund

15.17 The National Housing Credit (Long Term Operations) Fund was established by the Reserve Bank in terms of Section 46D(1) of the Reserve Bank of India Act, 1934 in January 1989. A token contribution of Rs.1.0 crore was made to the Fund out of Reserve Bank's income during 2002-03.

Deposits - Banks

15.18 'Deposits - Banks' represent balances maintained by the banks in current account with the Reserve Bank mainly for maintaining Cash Reserve Ratio (CRR) and as working funds for clearing adjustments.

Deposits - Others

15.19 'Deposits - Others' include deposits from financial institutions, employees' provident fund deposits, surplus earmarked pending transfer to the Government and sundry deposits.

Other Liabilities

15.20 'Other Liabilities' include the internal reserves and provisions of the Reserve Bank and net credit balance in the RBI General Account. These liabilities have increased by Rs.9,112.06 crore (8.3 per cent) from Rs.1,09,243.95 crore as on June 30, 2002 to Rs.1,18,356.01 crore as on June 30, 2003 mainly on account of increase in the levels of internal reserves.

15.21 The reserves, *viz.*, Contingency Reserve, Asset Development Reserve, Currency & Gold Revaluation Account and Exchange Equalisation Account reflected in 'Other Liabilities' are in addition to the 'Reserve Fund' of Rs.6,500 crore held by the Reserve Bank as a distinct balance sheet head.

Currency and Gold Revaluation Account and Exchange Equalisation Account

15.22 Gains/losses on valuation of foreign currency assets due to movements in the exchange rates and/ or prices of gold are not booked in profit and loss account but in a separate account called Currency and Gold Revaluation Account (CGRA), the balance in which represents accumulated net gain on valuation of foreign currency assets and gold. During 2002-03, there was an accretion of Rs.265.64 crore to the CGRA, thus increasing the balance to Rs.51,276.41 crore as on June 30, 2003 from Rs.51,010.77 crore as on June 30, 2002. The CGRA at the end of June 2003 was equivalent to 13.4 per cent of foreign currency assets and gold holdings of the Reserve Bank, as against 18.0 per cent at the end of June 2002. This was mainly on account of increase in the foreign currency assets and also appreciation of the rupee against the US dollar. The balances in Exchange Equalisation Account (EEA) represents provision made for exchange losses arising out of forward commitments. The balance in the EEA as on June 30, 2003 stood at Rs.567.25 crore. The balances in CGRA and EEA which are part of 'Other Liabilities' in the Balance Sheet as at the close of last five accounting years are given in Table 15.8.

Table 15.8: Balances in Currency and Gold Revaluation Account and Exchange Equalisation Account

(Rupees crore)

As on June 30	Currency and Gold Revaluation Account	Exchange Equalisation Account
1	2	3
1999	24,823.29	618.61
2000	27,608.43	791.27
2001	29,124.44	49.46
2002	51,010.77	51.50
2003	51,276.41	567.25

Contingency Reserve and Asset Development Reserve

15.23 The Reserve Bank maintains a Contingency Reserve (CR) to enable it to absorb unexpected and unforeseen contingencies. The Reserve Bank has set an indicative target of 12 per cent of the Reserve Bank's total assets to be achieved in phases by the year 2005, subject to review, if considered necessary. The balance in CR has gone up from Rs.48,434.17 crore as on June 30, 2002 to Rs.55,249.29 crore as on June 30, 2003. A sum of Rs.81.20 crore representing unresolved items of credit, which was included under Other Liabilities - Miscellaneous was credited to CR during 2002-03. A transfer of Rs.6733.92 crore was made to CR during 2002-03 from Reserve Bank's income. The balance in CR was sufficient to meet the contingent liabilities.

15.24 In order to meet the internal capital expenditure and make investments in its subsidiaries and associate institutions, the Reserve Bank had created, in 1997-98, a separate Asset Development Reserve (ADR) with the aim of reaching one per cent of the Reserve Bank's total assets within the overall target of 12 per cent set for CR. In the year 2002-03, an amount of Rs.890.31 crore was transferred from income to ADR raising its level from Rs.4,700.54 crore as on June 30, 2002 to Rs.5,590.85 crore as on June 30, 2003. CR and ADR together constituted 11.7 per cent of total assets of the Reserve Bank as on June 30, 2003. The balances in CR and ADR as at the close of last five accounting years are given in Table 15.9.

ASSETS

Foreign Currency Assets

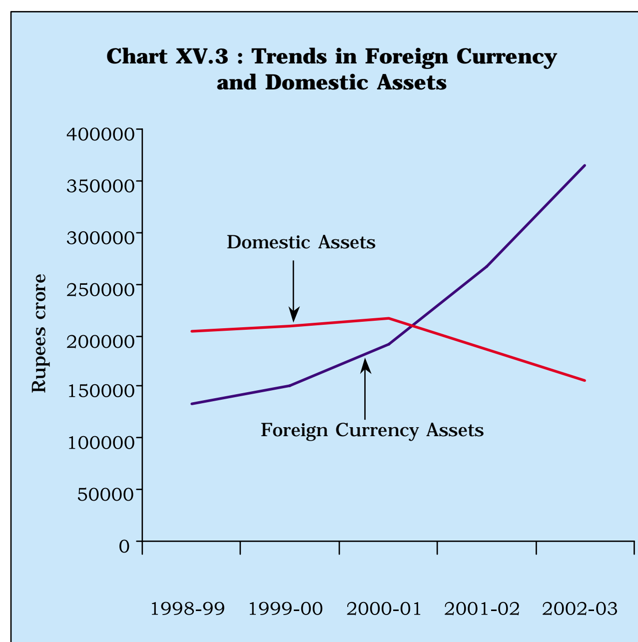
15.25 The foreign currency assets comprise foreign securities held in Issue Department, balances held abroad and investments in foreign securities held in Banking Department. Such assets rose from Rs.2,67,333.18 crore as on June 30, 2002 to Rs.3,65,000.98 crore as on June 30, 2003. The increase in the level of foreign currency assets was mainly on account of market purchases, interest & discount and revaluation gains.

Table 15.9 : Balances in Contingency Reserve and Asset Development Reserve

(Rupees crore)

As on June 30	Balance in CR	Balance in ADR	Total	Percentage to total assets
1	2	3	4	5
1999	23,007.06	2,456.30	25,463.36	7.6
2000	29,911.56	3,167.85	33,079.41	9.2
2001	36,514.13	3,872.63	40,386.76	9.9
2002	48,434.17	4,700.54	53,134.71	11.7
2003	55,249.29	5,590.85	60,840.14	11.7

Chart XV.3 : Trends in Foreign Currency and Domestic Assets



Investment in Government of India Rupee Securities

15.26 Investment in Government of India Rupee Securities which stood at Rs.1,35,067.86 crore as on June 30, 2002 decreased by Rs.29,923.82 crore (22.2 per cent) to Rs.1,05,144.04 crore as on June 30, 2003 mainly on account of substantial open market operations sales during the year.

15.27 The position of foreign currency and domestic assets during the last five years is given in Table 15.10 and Chart XV.3.

Table 15.10 : Position of Foreign Currency and Domestic Assets

(Rupees crore)

As on June 30	Foreign Currency Assets	Domestic Assets
1	2	3
1999	1,32,505.09	2,03,944.77
2000	1,50,901.13	2,09,065.64
2001	1,91,226.06	2,16,246.37
2002	2,67,333.18	1,86,226.62
2003	3,65,000.98	1,54,812.91

Table 15.11 : Investments in Shares of Subsidiaries/Associate Institutions

(Rupees crore)

Institution	Book value of shares held as at	
	30.6.2003	30.6.2002
1	2	3
1. Deposit Insurance and Credit Guarantee Corporation	50.00	50.00
2. National Bank for Agriculture and Rural Development	1,450.00	1,450.00
3. State Bank of India	1,222.73	1,222.73
4. National Housing Bank	450.00	350.00
5. Bharatiya Reserve Bank Note Mudran (P) Ltd.	800.00	800.00
6. Infrastructure Development Finance Co. Ltd.	150.00	150.00
Total	**4,122.73**	**4,022.73**

Investments in Shares of Subsidiaries and Associate Institutions

15.28 The Reserve Bank's investments in the shares of its subsidiaries and associate institutions have increased by Rs.100.00 crore during 2002-03 on account of an additional investment in capital of the National Housing Bank. The details of Reserve Bank's investments in the shares of its subsidiaries and associate institutions are given in Table 15.11.

Other Assets

15.29 'Other Assets' comprise mainly dead stock, gold holdings in the Banking Department, amounts spent on projects pending completion and staff advances. The level of 'Other Assets' has decreased by Rs.290.78 crore (2.3 per cent) from Rs.12,715.34 crore as on June 30, 2002 to Rs.12,424.56 crore as on June 30, 2003.

Auditors

15.30 The accounts of the Reserve Bank for the year 2002-03 were audited by M/s. P.B.Vijayaraghavan & Co., Chennai, M/s. Chandabhoy & Jassoobhoy, Mumbai, M/s. Khimji Kunverji & Co., Mumbai, M/s. P.K.Mitra & Co., Kolkata, M/s. J.L. Sengupta & Co., Kolkata, and M/s. S.N. Nanda & Co., New Delhi appointed by the Central Government.

RESERVE BANK OF INDIA
BALANCE SHEET AS AT 30TH JUNE 2003
ISSUE DEPARTMENT

(Rupees Thousands)

2001- 02	LIABILITIES		2002- 03
	Notes held in the		
11,18,43	**Banking Department**	**28,16,95**	
259072,77,63	**Notes in circulation**	**292509,85,82**	
259083,96,06	**Total Notes issued**		292538,02,77
259083,96,06	**Total Liabilities**		**292538,02,77**

2001- 02	ASSETS		2002- 03
	Gold Coin and Bullion :		
13293,30,60	(a) Held in India	**14036,76,55**	
—	(b) Held outside India	—	
169000,00,00	**Foreign Securities**	**255000,00,00**	
182293,30,60	**Total**		**269036,76,55**
222,78,25	**Rupee Coin**		**228,78,36**
	Government of India		
76567,87,21	**Rupee Securities**		**23272,47,86**
	Internal Bills of Exchange		
—	**and other Commercial Paper**		**—**
259083,96,06	**Total Assets**		**292538,02,77**

BANKING DEPARTMENT

2001- 02	LIABILITIES	2002- 03
5,00,00	**Capital paid-up**	**5,00,00**
6500,00,00	**Reserve Fund**	**6500,00,00**
	National Industrial Credit	
11,00,00	**(Long Term Operations) Fund**	**12,00,00**
	National Housing Credit	
185,00,00	**(Long Term Operations) Fund**	**186,00,00**
	Deposits	
	(a) Government	
100,68,63	(i) Central Government	**100,16,22**
41,12,80	(ii) State Governments	**41,15,13**
	(b) Banks	
55012,21,84	(i) Scheduled Commercial Banks	**78614,08,82**
	(ii) Scheduled State Co-operative	
1687,88,76	Banks	**1643,02,50**
	(iii) Other Scheduled Co-operative	
1651,31,31	Banks	**1548,21,00**
	(iv) Non-Scheduled State	
41,05,74	Co-operative Banks	**47,07,61**
1827,55,07	(v) Other Banks	**2748,21,23**
18126,96,21	**(c) Others**	**17454,27,45**
53,26,57	**Bills Payable**	**48,81,69**
109243,95,11	**Other Liabilities**	**118356,01,11**
194487,02,04	**Total Liabilities**	**227304,02,76**

2001- 02	ASSETS	2002- 03
11,18,43	**Notes**	**28,16,95**
25,80	**Rupee Coin**	**29,02**
20,20	**Small Coin**	**25,25**
	Bills Purchased and Discounted :	
—	(a) Internal	—
—	(b) External	—
—	(c) Government Treasury Bills	—
98168,54,31	**Balances Held Abroad**	**109831,26,17**
63037,35,48	**Investments**	**86514,01,14**
	Loans and Advances to :	
8169,00,00	(i) Central Government	**9783,00,00**
5167,88,65	(ii) State Governments	**3058,92,35**
	Loans and Advances to :	
336,12,00	(i) Scheduled Commercial Banks	**1,05,48**
4,80,90	(ii) Scheduled State Co-operative Banks	**7,06,97**
2,51,00	(iii) Other Scheduled Co-operative Banks	—
—	(iv) Non-Scheduled State Co-operative Banks	—
5654,85,04	(v) NABARD	**4475,64,84**
1043,96,39	(vi) Others	**1004,78,34**
	Loans, Advances and Investments from	
	National Industrial Credit	
	(Long Term Operations) Fund :	
	(a) Loans and Advances to :	
—	(i) Industrial Development Bank of India	—
—	(ii) Export Import Bank of India	—
—	(iii) Industrial Investment Bank of India Ltd.	—
—	(iv) Others	—
	(b) Investments in bonds/debentures issued by :	
—	(i) Industrial Development Bank of India	—
—	(ii) Export Import Bank of India	—
—	(iii) Industrial Investment Bank of India Ltd.	—
—	(iv) Others	—
	Loans, Advances and Investments	
	from National Housing Credit	
	(Long Term Operations) Fund :	
175,00,00	(a) Loans and Advances to National Housing Bank	**175,00,00**
—	(b) Investments in bonds/debentures issued by National Housing Bank	—
12715,33,84	**Other Assets**	**12424,56,25**
194487,02,04	**Total Assets**	**227304,02,76**

Significant Accounting Policies and Notes to the Accounts as per Annexure.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 30TH JUNE 2003

(Rupees Thousands)

2001- 02	INCOME		2002- 03
16866,38,78	**Interest, Discount, Exchange, Commission *etc.*[1]**		**15561,40,98**
16866,38,78	**Total**		**15561,40,98**
	EXPENDITURE		
2334,98,63	**Interest**		**1990,08,87**
1304,35,96	**Establishment**		**1488,85,85**
86,91	**Directors' and Local Board Members' Fees and Expenses**		**55,14**
24,78,54	**Remittance of Treasure**		**28,09,43**
1207,83,63	**Agency Charges**		**1352,40,66**
1304,49,25	**Security Printing (Cheque, Note forms *etc.*)**		**1433,08,53**
27,67,68	**Printing and Stationery**		**26,15,85**
20,96,49	**Postage and Telecommunication Charges**		**17,86,79**
52,48,49	**Rent, Taxes, Insurance, Lighting *etc.***		**59,88,44**
88,02	**Auditors' Fees and Expenses**		**1,00,39**
1,85,37	**Law Charges**		**1,63,67**
125,26,52	**Depreciation and Repairs to Bank's Property**		**125,52,79**
135,93,29	**Miscellaneous Expenses**		**198,24,57**
6542,38,78	**Total**		**6723,40,98**
10324,00,00	**Available Balance** **Less : Contribution to:**		**8838,00,00**
	National Industrial Credit (Long Term Operations) Fund	1,00,00	
	National Rural Credit (Long Term Operations) Fund[2]	1,00,00	
	National Rural Credit (Stabilisation) Fund[2]	1,00,00	
	National Housing Credit (Long Term Operations) Fund	1,00,00	
4,00,00			**4,00,00**
10320,00,00	**Surplus payable to Central Government**		**8834,00,00**

1. After making the usual or necessary provisions in terms of Section 47 of the Reserve Bank of India Act, 1934.
2. These funds are maintained by National Bank for Agriculture and Rural Development (NABARD).

V. S. Das	K. J. Udeshi	Rakesh Mohan	Vepa Kamesam	Bimal Jalan
Chief General Manager	Deputy Governor	Deputy Governor	Deputy Governor	Governor

REPORT OF THE AUDITIORS

TO THE PRESIDENT OF INDIA

We, the undersigned Auditors of the Reserve Bank of India, do hereby report to the Central Government upon the Balance Sheet of the Bank as at 30th June, 2003 and the Profit and Loss Account for the year ended on that date.

We have examined the above Balance Sheet of the Reserve Bank of India as at 30th June, 2003 and the Profit and Loss Account of the Bank for the year ended on that date and report that where we have called for information and explanations from the Bank, such information and explanations have been given and have been satisfactory.

These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in India. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion and according to the best of our information and explanations given to us and as shown by the books of account of the Bank, the Balance Sheet read with Significant Accounting Policies and Notes to the Accounts is a full and fair Balance Sheet containing all necessary particulars and is properly drawn up in accordance with the Reserve Bank of India Act, 1934 and Regulations framed thereunder so as to exhibit a true and correct view of the state of the Bank's affairs, in conformity with the accounting principles generally accepted in India.

M/s. P.B. Vijayaraghavan & Co.	M/s. P.K. Mitra & Co.	M/s. Chandabhoy & Jassoobhoy	M/s. J.L. Sengupta & Co.	M/s. S.N. Nanda & Co.	M/s. Khimji Kunverji & Co.
Auditors	Auditors	Auditors	Auditors	Auditors	Auditors

Dated August 13, 2003

ANNEXURE

RESERVE BANK OF INDIA

SIGNIFICANT ACCOUNTING POLICIES AND NOTES TO THE ACCOUNTS FOR 2002-03

SIGNIFICANT ACCOUNTING POLICIES

1. CONVENTION

The financial statements are prepared in accordance with the Reserve Bank of India Act, 1934 and the notifications issued thereunder and in the form prescribed by the Reserve Bank of India General Regulations, 1949.

Historical cost basis of accounting is used except where it is modified to reflect revaluation.

The accounting practices and policies followed in the statements, unless otherwise stated, are consistent with those followed in the previous year.

2. REVENUE RECOGNITION

Income and expenditure are recognised on accrual basis except penal interest and dividend which are accounted for on receipt basis. Only realised gains are recognised. Provision for outstanding expenditure is made for unpaid bills in each case of Rs. 1 lakh and above.

Balances unclaimed and outstanding for more than three consecutive years in certain transitory accounts including Drafts Payable Account, Payment Orders Account, Sundry Deposits Account, Remittance Clearance Account and Earnest Money Deposit Account are reviewed and written back to the Bank's income. Claims in this respect are considered and charged against Bank's income as and when paid.

Income and expenditure in foreign currency are translated on the basis of exchange rates prevailing on the last business day of the preceding week.

3. GOLD AND FOREIGN CURRENCY ASSETS AND LIABILITIES

(a) Gold

Gold is valued at the end of the month at 90 per cent of the daily average price quoted at London for the month. The rupee equivalent is determined on the basis of the exchange rate prevailing on the last business day of the month. Unrealised gains/losses are adjusted to the Currency and Gold Revaluation Account.

(b) Foreign Currency Assets and Liabilities

All foreign currency assets and liabilities are translated at the exchange rates prevailing on the last business day of the week and also on the last business day of the month.

At the year end, assets and liabilities in foreign currencies are translated at the exchange rates prevailing on the last business day except in cases where rates are contractually fixed. Foreign securities other than Treasury Bills are valued at lower of book value or market price prevailing on the last business day of each month. The depreciation is adjusted against current income. Foreign Treasury Bills are valued at cost.

Forward exchange contracts are evaluated half-yearly and net loss, if any, is provided for.

Profit/loss on sale of foreign currency assets is recognised with respect to the book value. Exchange gains and losses arising from translation of foreign currency assets and liabilities are accounted for in Currency and Gold Revaluation Account and remain adjusted therein.

4. RUPEE SECURITIES

Rupee securities, other than Treasury Bills, held in the Issue and Banking Departments, are valued at lower of book value or market price or rates based on the yield curve prevailing on the last business day of the month where the market price for such securities is not available. The depreciation in the value is adjusted against current income. Treasury Bills are valued at cost.

5. SHARES

Investments in shares are valued at cost.

6. FIXED ASSETS

Fixed Assets are stated at cost less depreciation.

Depreciation on computers, motor vehicles, office equipments, furniture and electrical fittings, *etc.*, is charged on a straight-line basis. Depreciation on other assets including premises and fixtures is charged on written-down value basis.

Depreciation on fixed assets is charged only if held for a period of more than six months as at the year end.

7. RETIREMENT BENEFITS

The liability on account of retirement benefits and leave encashment to employees is estimated based on an actuarial valuation.

8. CONTINGENCY RESERVE AND ASSET DEVELOPMENT RESERVE

Contingency Reserve represents the amount provided on a year-to-year basis for meeting unexpected and unforeseen contingencies including depreciation in value of securities, exchange guarantees and risks arising out of monetary/exchange rate policy compulsions.

In order to meet the internal capital expenditure and make investments in subsidiaries and associate institutions a further specified sum is provided and credited to the Asset Development Reserve.

NOTES TO THE ACCOUNTS

1. SURPLUS TRANSFER TO GOVERNMENT OF INDIA

Surplus transferable to the Government includes an amount of Rs.1717 crore representing interest differential pertaining to the period April 1, 2002 – March 31, 2003 on account of conversion of Special Securities into marketable securities.

2. RESERVE FUND

The Reserve Fund comprises initial contribution of Rs. 5 crore made by the Government of India and appreciation of Rs. 6,495 crore on account of revaluation of gold up to October 1990. Subsequent gains/losses on monthly revaluation of gold are taken to Currency and Gold Revaluation Account.

3. DEPOSITS - OTHERS

(Rupees crore)

Particulars	As at June 30	
	2003	2002
1	2	3
I. Rupee Deposits from Foreign Central Banks and Foreign Financial Institutions	3,311.34	3,646.43
II. Deposits from Indian Financial Institutions	538.73	359.79
III. Accumulated Retirement Benefits	4,447.63	3,631.62
IV. Surplus transferable to Government of India	8,834.00	10,320.00
V. Miscellaneous	322.57	169.12
Total	**17,454.27**	**18,126.96**

4. OTHER LIABILITIES

(Rupees crore)

Particulars	As at June 30	
	2003	2002
1	2	3
I. Contingency Reserve		
Balance at the beginning of the year	48,434.17	36,514.13
Add : Transfer from National Industrial Credit (Long Term Operations) Fund	–	4,224.00
Add: Transfer from National Housing Credit (Long Term Operations) Fund	–	700.00
Add: Transfer from unresolved Items of Credit*	-	81.20
Add : Accretion during the year	6,733.92	6,996.04
Balance at the end of the year	**55,249.29**	**48,434.17**
II. Asset Development Reserve		
Balance at the beginning of the year	4,700.54	3,872.63
Add : Accretion during the year	890.31	827.91
Balance at the end of the year	**5,590.85**	**4,700.54**
III. Currency and Gold Revaluation Account		
Balance at the beginning of the year	51,010.77	29,124.44
Add : Net Accretion during the year	265.64	21,886.33
Balance at the end of the year	**51,276.41**	**51,010.77**
IV. Exchange Equalisation Account		
Balance at the beginning of the year	51.50	49.46
Transfer from Exchange Account	1,123.92	100.00
Add : Net Accretion(+)/ Net Utilisation(-) during the year	(-)608.17	(-)97.96
Balance at the end of the year	**567.25**	**51.50**
V. Provision for net debit entries in RBI General Account	**63.15**	**63.15**
VI. Provision for Outstanding Expenses	**1,239.12**	**1,367.14**
VII. Miscellaneous (See note 5)	**4,369.94**	**3,616.68**
Total (I to VII)	**1,18,356.01**	**1,09,243.95**

* The amount of Rs.81.20 crore represents unresolved items of credit included under Other Liabilities - Miscellaneous in the previous year, transferred to Contingency Reserve during 2002-03.

5. RBI GENERAL ACCOUNT

Miscellaneous under “Other Liabilities” includes Rs. 179.40 crore in respect of inter-office transactions and balances under reconciliation. Reconciliation of entries is in progress and necessary adjustments are being effected as and when ascertained.

6. RUPEE INVESTMENTS

Securities sold under LAF-REPO have been reduced from ‘*Investments*’. Accordingly, the Bank has

absorbed the liquidity in the market to the tune of Rs.21,455.00 crore as on June 30, 2003 for which securities amounting to Rs.22,527.75 crore were provided as collateral. These securities were repurchased on July 1, 2003.

7. FOREIGN CURRENCY ASSETS

(Rupees crore)

Particulars	As at June 30, 2003	As at June 30, 2002
1	2	3
I. Held in Issue Department	2,55,000.00	1,69,000.00
II. Held in Banking Department -		
a) Included in Investments	169.72	164.64
b) Balances Held Abroad	1,09,831.26	98,168.54
Total	**3,65,000.98**	**2,67,333.18**

Notes: 1. There were outstanding forward exchange contracts as at June 30, 2003 under which the Reserve Bank has to buy US dollar equivalent to Rs.18,634.03 crore as against Rs.4,816.86 crore as at June 30, 2002. There were no outstanding forward sale contracts as at June 30, 2003 as against US dollar equivalent to Rs.6,882.44 crore as at June 30, 2002.

2. Uncalled amount on partly paid shares of the Bank for International Settlement as at June 30, 2003 - Rs. 73.24 crore.

8. OTHER ASSETS

(Rupees crore)

Particulars	As at June 30, 2003	As at June 30, 2002
1	2	3
I. Fixed Assets (net of accumulated depreciation)	550.74	478.56
II. Gold	3,145.63	2,979.07
III. Income accrued but not received	6,621.92	6,928.99
IV. Miscellaneous	2,106.27	2,328.72
Total	**12,424.56**	**12,715.34**

9. INTEREST, DISCOUNT, EXCHANGE, COMMISSION, *ETC.*

Interest, Discount, Exchange, Commission, *etc.* include the following items.

(Rupees crore)

Particulars	Year ended	
	June 30, 2003	June 30, 2002
1	2	3
(i) Profit on sale of Foreign and Rupee Securities	6,127.32	4,395.19
(ii) Rent realised	11.98	10.01
(iii) Net profit on sale of Bank's property	2.65	1.22

10. RETIREMENT BENEFITS

The Bank has made a provision of Rs. 616.67 crore towards pension and gratuity funds during the year based on actuarial valuation.

ANNEXURE

CHRONOLOGY OF MAJOR POLICY ANNOUNCEMENTS: APRIL 2002 – JULY 2003

Date of Announcement		POLICY ANNOUNCEMENTS
		I. MONETARY POLICY MEASURES
2002		
April	**29**	• Cash reserve ratio (CRR) to be reduced from 5.5 per cent to 5.0 per cent effective fortnight beginning June 15, 2002. • A reduction in Bank Rate by 50 basis points to be considered by the Reserve Bank as and when necessary. • Collateralised lending facility (CLF) to be phased out with effect from the fortnight beginning October 5, 2002. CLF could be reintroduced for a temporary period in future, if considered necessary in the light of changes in monetary conditions. • All banks were encouraged to put a flexible interest rate system on deposits (with a fixed rate option for depositors) in practice as early as possible. Banks to consider paying the depositors at the contracted rate for the period of deposit already run and waive the penalty for premature withdrawal if the same deposit is renewed at the variable rate. • Banks to provide information to depositors and the Reserve Bank on: a) deposit rates for various maturities and effective annualised return to the depositors, and b) maximum and minimum interest rates charged to their borrowers. The Reserve Bank to place the above information in public domain. • Banks to report to the Reserve Bank the minimum and maximum lending rates to exporters, with effect from fortnight beginning June 15, 2002, for placing in public domain. • Banks to switch over to 'all cost' concept for borrowers by explicitly declaring the processing charges, service charges, *etc.* charged to borrowers and announcing them publicly. • Co-operative banks free to determine the lending rates with the withdrawal of MLR concept. Co-operative banks to publish the minimum and maximum lending rates and display the same in every branch. • Ceiling interest rates on FCNR (B) deposits revised downwards from LIBOR/SWAP rates of corresponding maturities to LIBOR/ SWAP minus 25 basis points. • Ceiling interest rate on export credit in foreign currency reduced to LIBOR plus 0.75 percentage point from the existing LIBOR plus 1.0 percentage point. • The daily borrowings of State Co-operative Banks and District Central Co-operative Banks in the call/notice money market not to exceed 2.0 per cent of their aggregate deposits as at the end of March of the previous financial year. • The limit on banks to borrow and invest from/in overseas market increased from 15 per cent to 25 per cent of their unimpaired Tier I capital within the banks' Open Position Limit and maturity mismatch limits (Gap Limits).
May	**18**	• The CRR reduction by 0.5 percentage point from the then existing level of 5.5 per cent, initially proposed to be effective fortnight beginning June 15, 2002, advanced to reporting fortnight beginning June 1, 2002.
June	**27**	• The repo rate was cut by 25 basis points to 5.75 per cent from 6.00 per cent. • Prudential limit stipulated on the exposure of sheduled commercial banks (SCBs) in call money market in two stages: i) In the first stage, effective October 5, 2002, SCBs daily lending in the call/notice money market, on a fortnightly average basis, not to exceed 50 per cent of their owned funds as at the end of March of the previous financial year; their fortnightly average borrowing not to exceed 150 per cent of their owned funds or 2.0 per cent of aggregate deposits as at the end of March of the previous financial year, whichever is higher. However, they will be allowed to lend and borrow a maximum of 100 per cent and 250 per cent, respectively, of their owned funds on any day during a fortnight. ii) In the second stage, effective fortnight beginning December 14, 2002, SCBs fortnightly average lending in the call/ notice money market not to exceed 25 per cent of their owned funds; fortnightly average borrowings not to exceed 100 per cent of their owned funds or 2.0 per cent of aggregate deposits as at the end of March of the previous financial year, whichever is higher. They will be allowed to lend and borrow a maximum of 50 per cent and 125 per cent, respectively, of their owned funds on any day during a fortnight. iii) An increased access may be allowed for a temporary period in case of mismatches in liquidity position. If the bank has a fully functional Asset Liability Management (ALM) system to the satisfaction of the Reserve Bank, an increased access over the stipulated norm may be permitted for a longer period.

Date of Announce-ment		POLICY ANNOUNCEMENTS
2002		**I. MONETARY POLICY MEASURES** *(Contd.)*
July	**31**	• Following the recommendations of the Working Group constituted to suggest the criteria for fixing limits for transactions of primary dealers (PDs) in call/notice money market as also to suggest a roadmap for phasing them out from call/ notice money market, it was decided: i) With effect from October 5, 2002, PDs will be permitted to lend in call/notice money market up to 25 per cent of their net owned funds (NOF). ii) Access of PDs to borrow in call/notice money market would be gradually reduced in two stages: In Stage I, PDs would be allowed to borrow up to 200 per cent of their NOF as at end-March of the preceding financial year. In Stage II, PDs would be allowed to borrow up to 100 per cent of their NOF. The limits under both the stages would not be applicable for the days on which Government dated securities are issued to the market. The date of implementation of the Stage I, to be notified later, would be operational upon the finalisation of uniform accounting and documentation procedures for repos, allowing rollover of repos, introduction of tripartite repos or collateralised borrowing and lending obligations and permitting repos out of 'available for sale' category. Stage II will commence one month after permitting sale of repoed securities. iii) On implementation of the real-time gross settlement (RTGS) system, the above exemptions would be reviewed.
Oct.	**29**	• Bank Rate was reduced by 25 basis points to 6.25 per cent with effect from close of business on October 29,2002. • Repo rate under the LAF was reduced by 25 basis points to 5.25 per cent. • CRR to be reduced by 25 basis points to 4.75 per cent, effective fortnight beginning November 16,2002. • Apportionment of normal and back-stop facilities changed to one-half each (50:50) from the existing ratio of two-thirds to one-third, effective from the fortnight beginning November 16,2002. • To enable clearing corporation of India ltd. (CCIL) to commence forex clearing operations in early November and to collateralise the facility, all the participants were advised to contribute to the Settlement Guarantee Fund (SGF).
Dec.	**26**	• With a view to providing flexibility to banks in choosing an optimum strategy of holding reserves depending upon their intra-period cash flows, the requirement of daily maintenance of minimum 80 per cent of the CRR balances was reduced to 70 per cent with effect from the fortnight beginning December 28, 2002.
2003		
Feb.	**28**	• The interest rate on savings account offered by banks was reduced to 3.5 per cent per annum from 4.0 per cent per annum with effect from March 1, 2003. • The LAF repo rate was reduced to 5.0 per cent from 5.5 per cent effective March 3, 2003.
April	**29**	• Bank Rate was reduced by 0.25 percentage point from 6.25 per cent to 6.0 per cent with effect from close of business on April 29,2003 with a policy bias to keep it stable until the Mid-term Review of October 2003. • CRR to be reduced by 0.25 percentage point from 4.75 per cent to 4.50 per cent, with effect from fortnight beginning June 14, 2003. • Interest on eligible CRR balances maintained by banks with the Reserve Bank to be paid on a monthly basis (as against the existing practice of quarterly basis) starting from April 2003. • Export credit refinance facility to continue for eligible export credit remaining outstanding under post-shipment credit beyond 90 days and up to 180 days. The measure to be reviewed in October 2003. • The multiplicity of rates at which liquidity is absorbed/injected under back-stop facility rationalised as under: i) the back-stop interest rate will be at the reverse repo cut-off rate at the regular LAF auctions on that day; ii) in case of no reverse repo in the LAF auctions, back-stop will be 2.0 percentage point above the repo cut-off rate; and, iii) on days when no repo/reverse repo bids are received/accepted, back-stop rate will be decided by the Reserve Bank on an *ad-hoc* basis. • In order to enhance transparency in banks' pricing of their loan products as also to ensure that the prime lending rate (PLR) truly reflects the actual costs, banks were advised to take into account their (i) actual cost of funds, (ii) operating expenses and (iii) a minimum margin to cover regulatory requirement of provisioning/capital charge and profit margin, while arriving at the benchmark PLR. • The benchmark PLR to continue to be the ceiling rate for credit limit up to Rs.2 lakh. The system of determination of benchmark PLR by banks and the actual prevailing spreads around the benchmark PLR to be reviewed in September 2003. • The minimum maturity period of fresh NRE deposits raised to one year in line with FCNR (B) deposits. The maturity period of fresh NRE deposits will normally be one year to three years. In case a particular bank, from its ALM point of view, wishes to accept deposits with maturity of more than 3 years, it may do so provided the interest rate on such long term deposits is not higher than that applicable to 3 year NRE deposits.

Date of Announcement		POLICY ANNOUNCEMENTS
2003		**I. MONETARY POLICY MEASURES** *(Concld.)*
April	**29**	• Stage II of the transition to a pure inter-bank call/notice money market would be effective from the fortnight beginning June 14, 2003, wherein non-bank participants would be allowed to lend, on average in a reporting fortnight, up to 75 per cent of their average daily lending in call/notice money market during 2000-01.
		• With effect from fortnight beginning May 3, 2003, reporting of all call/notice money market deals on Negotiated Dealing System (NDS) would be mandatory for all NDS members. Deals done outside NDS should also be reported within 15 minutes on NDS, irrespective of the size of the deal or whether the counterparty is a member of the NDS or not. Full compliance with the reporting requirement to NDS will be reviewed in September 2003. In case there is repeated non-reporting of deals by an NDS member, it will be considered whether non-reported deals by that member should be treated as invalid with effect from a future date.
		• Less complex Over the Counter (OTC) interest rate rupee options to be permitted. Detailed guidelines to be issued in consultation with market participants.
July	**17**	• Banks were advised that until further notice, the interest rates on fresh repatriable NRE deposits for one to three years contracted effective July 17, 2003 should not exceed 250 basis points above the LIBOR/SWAP rates for US dollar of corresponding maturity. The LIBOR/SWAP rates as on the last working day of the preceding month would form the base for fixing ceiling rates for the interest rates that would be offered effective from the following month.
		II. INTERNAL DEBT MANAGEMENT POLICIES
2002		
April	**1**	• WMA limits for State Governments revised. The normal total WMA limit increased by Rs.752 crore to Rs.6,035 crore.
		• Calendar for issuance of dated securities announced for the first six months of the fiscal year 2002-03.
	3	• Notified amount of 364-day Treasury Bills raised from Rs.750 crore to Rs.1,000 crore in the auctions effective April 3, 2002.
	17	• WMA limit to the Government of India for the fiscal 2002-03 retained at Rs.10,000 crore for the first half of the year (April to September) and Rs.6,000 crore for the second half of the year (October to March). The interest rate on WMA is fixed at Bank Rate and on Overdraft at Bank Rate plus two percentage points.
May	**20**	• RBI regulated entities were instructed to transact and hold their investments in Government securities in demat form only either in SGL/CSGL (Gilt) account or in a demat account with depositories.
	31	• Satellite Dealers (SDs) scheme discontinued effective May 31, 2002.
June	**5**	• PDs brought under the purview of Board for Financial Supervision (BFS).
July	**17**	• For the first time, as part of Central Government's market borrowing programme, a bond (10-year Government of India stock) with call and put option issued.
	26	• PDs were required to publish their audited annual results in leading financial newspapers and on their website in the prescribed format.
Oct.	**29**	• Anonymous screen based order driven trading in Government securities on the stock exchanges to be introduced in consultation with SEBI.
		• To move in the direction of categorisation and valuation of banks' investments in consonance with best international practices, the Reserve Bank issued guidelines for uniform accounting norms for repo and reverse repo transactions in consultation with market participants.
		• For deepening and making the repo market more liquid, the Reserve Bank proposed i) extension of repos to all regulated entities with gilt/CSGL accounts as long as all transactions are mandatorily reported and settled through the Delivery *versus* Payment (DvP) System; and ii) to allow rollover of repo contracts using the same securities between the same counterparties.
		• For improving the pricing of bonds in the secondary market and enhancing their liquidity i) fresh issues of floating rate bonds (FRBs) will provide for annual reset of base rate instead of existing practice of semi-annual reset, and ii) the base rate will be determined on the basis of the average cut-off yields of 364-day Treasury Bills in the preceding three auctions as against preceding six auctions as applicable for existing FRBs.
2003		
Jan.	**16**	• Buying and selling of Government securities through the stock exchanges commenced in NSE, BSE and OTCEI.
	20	• Collateralised borrowing and lending obligation (CBLO) was operationalised as a money market instrument through the CCIL.

Date of Announcement		POLICY ANNOUNCEMENTS
2003		**II. INTERNAL DEBT MANAGEMENT POLICIES** *(Concld.)*
Feb.	**21**	• Guidelines were issued to extend eligibility for ready forward (repo) contracts to select categories of gilt account holders, with adequate safeguards to ensure DvP and transparency. The guidelines came into effect from March 3, 2003.
March	**3**	• Based on the recommendations of the Ramachandran Committee, the WMA limit for States was enhanced by Rs. 1,135 crores to Rs. 7,170 crore with effect from March 03, 2003.
	24	• Guidelines were issued for uniform accounting of repo transactions.
		• Guidelines were issued for availment of FCNR (B) loans by PDs.
	31	• An indicative calendar for issuance of dated securities announced for the first six months of the fiscal year 2003-04.
April	**1**	• WMA limit to the Government of India for the fiscal year 2003-04 was retained at Rs. 10,000 crore for the first half of the year (April to September) and Rs. 6,000 crore for the second half of the year (October to March). The interest rate on WMA was fixed at Bank Rate and on Overdraft at Bank Rate plus two percentage points.
		• Overdraft Regulation for the State Governments was made more stringent. The States cannot remain in Overdraft for more than 36 working days in a quarter.
	3	• Operational guidelines were issued to CCIL for operationalisation of Government securities lending scheme. The CCIL was permitted to enter into an arrangement with any of its members for borrowing Government securities for the purpose of handling securities shortage in the settlement of transactions.
	10	• Operational guidelines were issued to PDs for Portfolio Management Services (PMS). PDs, with prior approval of the Reserve Bank and registration with SEBI, were permitted to offer PMS services only to entities not regulated by the Reserve Bank.
	29	• CBLO exempted from CRR subject to the bank maintaining the statutory minimum CRR of 3.0 per cent. Securities lodged in the gilt account of the bank maintained with CCIL under CSGL facility for CBLO remaining unencumbered at the end of any day reckoned for SLR purposes by the concerned bank.
May	**19**	• FRBs 2014 was issued for Rs.5,000 crore incorporating modified features for the first time.
June	**3**	• With a view to enabling PDs to manage their exposure to interest rate risk, they were allowed to deal in exchange traded Interest Rate Derivatives (IRDs) in a phased manner. In the first phase, such entities were permitted to transact only in interest rate futures on notional bonds and Treasury Bills for limited purpose of hedging the risk in their underlying investment portfolio subject to prudential guidelines and appropriate disclosures.
	11	• Based on the feedback from the PDs, they were further permitted to hold trading positions in interest rate futures.
		III. FINANCIAL SECTOR MEASURES
2002		
April	**1**	• In respect of urban co-operative banks (UCBs), it was decided that accretion to or reduction in the share capital after the balance sheet date may be taken into account for determining exposure ceiling at half yearly intervals and the bank may, if they so desire, fix a fresh exposure limit taking into account the amount of share capital available as on 30 September. However, accretions to capital funds other than to share capital would not be eligible for re-fixing the exposure ceiling. Banks should also ensure that they do not take exposures in excess of the ceiling prescribed, in anticipation of infusion of capital on a future date.
	4	• Instances of frauds in UCBs involving large amounts of frauds of serious nature should be reported to the Registrar of Co-operative Societies through a D.O. letter which may cover the various categories of specified frauds.
	5	• The Consultative Group of Directors of Banks and Financial Institutions (Chairman: Dr. A.S. Ganguly), which was constituted to look into the role of Board of Directors of banks/FIs and make recommendations, for consideration by the Government/the Reserve Bank, for making it more effective with a view to minimising risks and over-exposure, submitted its report to the Reserve Bank. The major recommendations of the Group pertain to: appointment of one more whole-time director on the Boards of large-sized nationalised banks; establishment of appropriate due diligence procedures for appointment of directors on the Boards of private sector banks; setting up of nomination committees of Boards of banks to recommend appointment of independent/non-executive directors; building and creation of a pool of professional and talented people for Board level appointments in banks.
		• The recommendation of the High Power Committee on UCBs regarding the appointment of at least two directors with suitable banking experience or with relevant professional, on the Boards of newly constituted UCBs, was extended to all the existing UCBs. All UCBs were advised to amend their by-laws to incorporate the above recommendation and initiate steps for compliance.

Date of Announcement		POLICY ANNOUNCEMENTS
2002		**III. FINANCIAL SECTOR MEASURES** *(Contd.)*
April	**6**	• UCBs were advised that the investment limit in plant and machinery in respect of the industrial undertakings, manufacturing specified hosiery and hand tool items has been enhanced from 'not exceeding Rs.1 crore' to 'not exceeding Rs.5 crore'. Advances to such units may be classified as SSI advances under priority sector.
	15	• Scheduled UCBs were advised to put in place an effective ALM System by June 30, 2002. To begin with, the banks have to ensure coverage of at least 60 per cent of their liabilities and assets; for the remaining 40 per cent, banks may include the position based on their estimates. Internal Asset-Liability Committee (ALCO) is to be set up in each bank, headed by the CEO.
	18	• Banks were advised that while reckoning the quantum of unsecured advances and guarantees for applying the norms relating to unsecured advances and guarantees, outstanding credit card dues should be excluded from the total of unsecured advances.
	19	• Banks were advised that products of aluminium, petroleum products, sugar and foodgrains were to be included in the products eligible for special financial package for large value exports.
	20	• As some banks had not followed the Reserve Bank guidelines on investment transactions and had undertaken transactions which might have exposed the banks to significant risks, UCBs were advised to strictly follow the extant guidelines. Some of the important instructions are as follows: (i) UCBs should not undertake any purchase/sale transactions with broking firms or other intermediaries on a principal to principal basis. (ii) UCBs should seek a SCB, PD or FI as a counter party. Preference should be for direct deals with such counter parties. It will be desirable to check prices from the banks or PDs with whom UCBs may be maintaining Constituent SGL Account (CSGL). (iii) If a deal is put through with the help of broker, the role of the broker should be restricted to that of bringing the two parties to the deal together. Under no circumstances should bank give power of attorney or any other authorisation to brokers/ intermediaries to deal on their behalf in the money and securities markets. (iv) Only brokers registered with NSE or BSE or OTCEI should be utilised for acting as intermediary. A limit of 5 per cent of total transactions (both purchases and sales) should be treated as the aggregate upper contract limit for each of the approved brokers. (v) All investment transactions should be perused by the Board at least once a month.
	22	• The Reserve Bank announced that the past due period of 30 days for identification of NPAs by NBFCs would be done away with, effective March 31, 2003.
		• The Reserve Bank prescribed guidelines for objective identification of loss assets by NBFCs including instances therein which could threaten the recovery of the assets so that the NPAs are promptly classified and adequate provisions are made against such assets.
		• It was decided to take action progressively against NBFCs for non-submission of returns. Such action may include imposing penalties as provided in the Reserve Bank of India Act, 1934 as also launching court proceedings against the errant companies, besides considering rejection/cancellation of the Certificate of Registration. To start with, cases of NBFCs having public deposits of Rs.50 crore and above and defaulting in submission of returns are being taken up. This discipline will be extended to other NBFCs in due course.
	26	• The Reserve Bank approved the merger of ICICI Ltd. with ICICI Bank Ltd., subject to certain conditions.
		• Scheduled UCBs were advised to conduct a special audit of their securities transactions by a Chartered Accountant and to place a report of the audit before the Board.
	29	• Issue of certificate of deposits (CDs) by banks and FIs only in the dematerialised form effective June 30, 2002. Conversion of existing outstandings of CDs into the demat form by October 2002.
		• The RRBs were advised to maintain their entire SLR holdings in Government and other approved securities by converting existing deposits with sponsor banks into approved securities by March 31, 2003.
		• Funds provided to RRBs by sponsor banks for on-lending to priority sector to be excluded from the calculation of priority sector target achievements.
		• All SCBs were advised that they may, on the basis of good track record of the SSI units and the financial position of the units, increase the limit of dispensation of collateral requirement from Rs.5 lakh to Rs.15 lakh.
		• Increase in limit from Rs.15 lakh to Rs.25 lakh for financing of distribution of inputs for allied activities under priority sector.
		• Increase in credit limits from Rs.1 lakh to Rs.5 lakh for marketing of crops (pledge financing) under priority sector. Repayment schedules of such credit enhanced to 12 months from 6 months.
		• Banks were advised that, effective March 31, 2005, an asset would be classified as doubtful if it remained in the sub-standard category for 12 months. Banks were permitted to phase the additional provisioning consequent upon the reduction in the transition period from substandard to doubtful asset from 18 months to 12 months, over a four- year period, commencing from the year ending March 31, 2005, with a minimum of 20 per cent each year.

Date of Announce-ment		POLICY ANNOUNCEMENTS
2002		**III. FINANCIAL SECTOR MEASURES** *(Contd.)*
April	**29**	• Investments by banks in Mortgage Backed Securities (MBS) issued by HFCs and supervised by NHB to be included in the prescribed housing finance allocation of 3 per cent.
May	**3**	• Banks were advised to compute Investment Fluctuation Reserve (IFR) with reference to investments in two categories, *viz.*, “Held for Trading” and “Available for Sale” and for the purpose of computation of IFR, it is not necessary to include investments under “Held to Maturity” category.
		• As an interim measure, the Reserve Bank would grant permission for CDR on the basis of specific recommendations of CDR “Core Group”, if a minimum of 75 per cent by value of the lenders consent for CDR, irrespective of differences in asset classification status in banks/FIs.
		• Banks to constitute an expert internal team to study the methodology of the new Basel proposals and its likely impact.
	14	• With the operationalisation of the CCIL, modified instructions were issued to FIs, which *inter alia*, state that ready forward contracts shall be settled through the SGL accounts of the participants with the Reserve Bank or through the SGL accounts of the CCIL with the Reserve Bank.
	20	• Commercial banks, co-operative banks, PDs, FIs, local area banks, RRBs and NBFCs were advised to hold Government securities in dematerialised form.
	21	• The existing norm of two harvest seasons not exceeding two half years for reckoning NPAs which is applicable only in respect of short-term agricultural crop loans for production and marketing of seasonal agricultural crops and not for other activities like horticulture, floriculture or other allied activities was reviewed and it was decided that the norm of two harvest seasons, not exceeding two half years, be made applicable to all specified direct agricultural advances.
	23	• Parabanking facilities such as lending and hire-purchase extended by banks at select branches departmentally were made eligible for classification as priority sector advances, provided the beneficiary satisfies the criteria laid down by the Reserve Bank for treating such advances as priority sector advances.
	24	• Banks were advised that housing loans to individuals against the mortgage of residential housing properties may be assigned a risk weight of 50 per cent instead of the existing 100 per cent for the purpose of capital adequacy. Loans against mortgage of commercial real estate would continue to attract 100 per cent risk weight as hitherto. Banks’ investment in MBS of residential assets of Housing Finance Companies (HFCs) which are supervised by the National Housing Bank (NHB) would be eligible for risk weight of 50 per cent for the purpose of capital adequacy.
	28	• To ensure that the loan assets relating to projects under implementation were appropriately classified and asset quality correctly reflected, the norms on income recognition, asset classification and provisioning with respect to industrial projects under implementation, which involve time overrun, earlier applicable to FIs only, were made applicable to banks also.
	29	• Keeping in view the nature of operations of banks and the need to ensure uniformity in regulatory requirements, it was decided that compliance with the following Accounting Standards be made optional for banks only for the financial year ended March 31,2002: AS 17 on Segment Reporting, AS 18 on Related Party Disclosure, AS 21 on Consolidated Financial Statements and AS 22 on Taxes on Income. Banks would be required to conform to the above Accounting Standards by March 31, 2003 in accordance with the detailed guidelines to be issued shortly on the basis of the recommendations of a Working Group on the issue.
	30	• Based on the recommendations of the Working Group on Wilful Defaulters, the term ‘Wilful Default’ was redefined and widened so as to cover the aspects of diversion of/siphoning off funds therein. The banks and FIs are required to initiate penal measures against wilful defaulters as advised.
June	**4**	• The banks, all-India notified FIs and State Financial Corporations were advised to submit the list of suit filed accounts of Rs.1 crore and above as on March 31, 2002 and quarterly updates thereof till December 2002 and suit filed accounts of wilful defaulters of Rs.25 lakh and above as at end-March, June, September and December 2002 to the Reserve Bank as well as to Credit Information Bureau (India) Ltd. (CIBIL) for a period of one year till March 31, 2003 and thereafter to CIBIL only.
	6	• UCBs were advised that, in addition to the existing permitted entities, they can also seek insurance companies, mutual funds and provident funds as counter parties for their transactions in securities.
		• The prudential norms for NBFCs relating to (i) removal of the concept of the “past due”, (ii) definition of NPAs and (iii) maintenance of capital adequacy on an ongoing basis and with the certification from the Auditors were amended.
	7	• To ensure uniformity in interpretation of the term ‘financial closure’ for the green field projects, a standard definition was introduced for the purpose of asset classification for FIs.
		• It was decided that, with immediate effect, all transactions in Government securities by UCBs should necessarily be through SGL or constituent SGL account or dematerialised account with depositories.

Date of Announcement		POLICY ANNOUNCEMENTS
2002		**III. FINANCIAL SECTOR MEASURES** *(Contd.)*
June	**11**	• In the light of developments involving securities transactions of certain UCBs, it was decided that concurrent auditors shall also certify that investments held by the bank as on the last reporting Friday of each quarter and as reported to the Reserve Bank, are actually owned/held by it as evidenced by physical securities or the custodians' statement. Those banks not having the system of concurrent audit may have the above certification furnished by an auditor appointed by the Registrar of Co-operative Societies.
	15	• To increase the investor base, the minimum size of CDs issued by FIs to single investor was reduced from the existing level of Rs.5 lakh to Rs.1 lakh and in multiples of Rs.1 lakh thereafter.
	20	• UCBs were advised to initiate steps to enhance/augment flow of credit under priority sector to artisans, craftsmen, *etc.* belonging to the minority communities namely, Sikhs, Muslims, Christians, Zoroastrians and Buddhists.
	26	• The Reserve Bank introduced the supervisory rating system based on "CAMELS" model for the FIs, on lines similar to banks.
July	**26**	• In supercession of the earlier instructions on system of charging interest on advances at monthly rests with effect from April 1, 2002, banks were advised that : i) they have option to compound interest at monthly rests effective either from April 1, 2002 or July 1, 2002 or April 1, 2003; ii) with effect from quarter beginning July 1, 2002, banks should ensure that the effective rate does not go up merely on account of the switchover to the system of charging/ compounding interest at monthly rests and increase the burden on the borrowers; iii) instructions on charging interest at monthly rests shall not be applicable to agricultural advances and banks shall continue to follow the existing practice of charging/ compounding of interest on agricultural advances linked to crop seasons. In case of other agricultural advances, banks may take into consideration due dates fixed on the basis of fluidity with borrower for charging of interest.
	31	• FIs were advised to ensure rotation of the partner of the audit firm conducting audit, if the firm continues for more than 4 years, so as to ensure that the audit is not conducted by the same partner for a continuous period of more than four years.
Aug.	**3**	• In view of the drought and floods damaging crops and property in several parts of the country, banks were advised to take immediate action in terms of the standing guidelines in providing appropriate relief to the persons affected by the natural calamities.
	8	• Loans extended by an FI to infrastructure projects against the guarantee of a bank would attract a risk weight of 20 per cent for computation of CRAR of the lending FI. The risk weight of 20 per cent would apply to only that part of the loan which is covered by the bank's guarantee and the remaining amount of loan, if any, would normally attract 100 per cent risk weight. For the purpose of exposure norms, however, the entire loan transaction should be reckoned as an exposure on the borrowing entity and not on the bank guaranteeing the loan. In case the funded facility is by way of term loan, the level of exposure should be reckoned as per the Reserve Bank's extant guidelines.
	16	• The stipulation regarding the promoters' contribution towards the equity capital of a company should come from their own resources and the bank should not normally grant advances to take up shares of other companies was relaxed in the case of bank finance to successful bidders under the PSU disinvestments programme of the Government subject to the conditions specified.
		• In view of the recent developments, both domestic and international, extant instructions and guidelines on 'know your customer' (KYC) norms and cash transactions were reissued reinforcing earlier instructions on the subject with a view to safeguarding banks from being unwittingly used for the transfer or deposit of funds derived from criminal activity or for financing of terrorism. The guidelines are also applicable to foreign currency accounts/transactions.
	19	• Banks were advised to refrain from offering low/zero per cent interest rates on consumer durable advances to borrowers through adjustment of discount available from manufactures/dealers of consumer goods as such loan schemes lack transparency in operations and distort pricing mechanism of loan products. They were also advised to refrain from linking their names in any form/manner with any incentive-based advertisement where clarity regarding interest rate is absent.
	23	• On the basis of recommendation of the Indian Banks' Association (IBA), it was decided to enhance the ceiling for immediate credit of outstation/local cheques from Rs.7,500 to Rs.15,000, subject to the guidelines issued by the Reserve Bank.
	31	• FIs were advised that, with immediate effect, (i) housing loans extended by FIs to individuals against the mortgage of residential housing properties would attract a risk weight of 50 per cent (as against the existing 100 per cent); and (ii) investments by the FIs in the Mortgage Backed Securities (MBS) would attract a risk weight of 50 per cent (in addition to the 2.5 per cent risk weight for market risk) provided that the assets underlying the MBS are the residential loan assets of the Housing Finance Companies (HFC) which are recognised and supervised by NHB; and that the MBS satisfy certain other terms and conditions.

Date of Announcement		POLICY ANNOUNCEMENTS
2002		**III. FINANCIAL SECTOR MEASURES** *(Contd.)*
Aug.	31	• SCBs were advised to classify advances for financing Agriclinics and Agribusiness centres as "Direct Finance under Agriculture."
Sep.	2	• FIs were issued a set of draft guidelines relating to proposed supervisory framework for consolidated supervision which envisages the following three components (a) consolidated financial statements (CFS), (b) consolidated prudential returns (CPR), and (c) application of prudential regulations like capital adequacy, large exposures and liquidity gaps on group-wide basis. Final guidelines on the subject matter were issued on August 1, 2003.
	14	• As per the extant norms the asset classification of the projects under implementation falling under Category II (projects with original cost of Rs.100 crore or more), is required to be decided with reference to the 'deemed date of completion' of such projects as determined by the Independent Group. Henceforth, as a prudential measure, the provisions held by the FIs in respect of accounts should not be reversed even in cases where, as per the deemed date of completion of the Category II projects certain accounts might become eligible for upgradation to the standard category.
Oct.	1	• NBFCs were required to necessarily hold their investments in Government securities either in CSGL with SCB/SHCIL or in a dematerialised account with depositories (NSDL/CDSL) through a depository participant registered with SEBI and dematerialise Government securities held in physical form by October 31, 2002. All further transactions of purchase and sale of Government securities have to be compulsorily through CSGL /demat account. The NBFCs need not seek prior approval of the Reserve Bank for opening a demat/SGL account with any of the organisations mentioned above, but must inform the concerned Regional Office of the Reserve Bank on the details of the account within one week of doing so.
		• As a depositor protection measure, NBFCs were advised to include in their advertisements or statements *in lieu of* advertisement the fact that the deposits collected by them are not insured.
		• All NBFCs holding public deposits of Rs.50 crore and above and RNBCs having aggregate liabilities to the depositors of Rs.50 crore and above as on March 31, 2002 or thereafter were advised to furnish the information regarding their exposure to the capital market to the Reserve Bank in a quarterly return within one month of the close of the respective quarter.
	12	• Banks were advised to use the revised Guidance Notes on Management of Credit Risk and Market Risk for updating their risk management systems. The design of risk management framework should be dictated by banks' own size, complexity of business, risk philosophy, market perception and the expected level of capital and should be adaptable to changes in business size, the market dynamics and future product innovation.
	18	• In order to have uniformity in reporting, frauds were classified mainly on the provisions of the Indian Penal Code like (a) misappropriation and criminal breach of trust, (b) fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property, (c) unauthorised credit facilities extended for reward or for illegal gratification, (d) negligence and cash shortages, (e) cheating and forgery and (f) irregularities in foreign exchange transactions.
	21	• Banks were advised that Boards of each bank may fix a suitable cut off limit with reference to the borrowing entity's overall exposure on the banking system, over which audit of accounts of borrowers by Chartered Accountants would be mandatory.
	29	• The Reserve Bank constituted a group of seven banks (three public sector banks, two new private banks and two old private banks) to participate in the Quantitative Impact Study (QIS 3) being conducted by the Basel Committee to assess the impact of the New Capital Accord.
		• SLR holdings of RRBs in the form of deposits with sponsor banks maturing beyond March 31, 2003 were allowed to be retained till maturity. These deposits may be converted into Government securities, on maturity, in case the concerned RRBs have not achieved the 25 percent minimum level of SLR in Government securities by that time.
		• Banks were permitted to undertake referral business through their network of branches with prior permission from IRDA and the Reserve Bank.
		• RRBs/LABs and co-operative banks were encouraged not to pay any additional interest on the savings banks accounts over and above what is payable by commercial banks. Co-operative banks were encouraged not to pay interest on current accounts.
		• Unsecured advances given by banks to SHGs against group guarantees under the SHG-bank linkage programme would be excluded from the total of unsecured advances for the purpose of computation of prudential norms on unsecured guarantees and advances. The facility will be reviewed after a year.

Date of Announce-ment		POLICY ANNOUNCEMENTS
2002		**III. FINANCIAL SECTOR MEASURES** *(Contd.)*
Oct.	29	• The CAMELS based supervisory rating system to be implemented on trial basis for scheduled UCBs from March 2003.
		• Extension of 90 days norms for recognition of loan impairment to state co-operative banks (SCBs) and District central co-operatives banks (DCCBs) from the year ending March 31, 2006. SCBs and DCCBs to move over to charging of interest at monthly rests effective April 1, 2004.
		• Consolidated instructions were issued clarifying the methodology of charging of interest rate at monthly rest for different types of advances.
		• All SCBs (including RRBs) and local area banks were advised that the limit on advances granted to dealers in drip irrigation/sprinker irrigation system/agricultural machinery located in rural/semi-urban areas was increased from Rs. 10 lakh to Rs. 20 lakh under priority sector lending for agriculture. The individual credit limit to artisans, village and cottage industries for reckoning under advances to 'weaker sections' was increased from Rs. 25,000 to Rs. 50,000.
Nov.	**11**	• The Reserve Bank formulated a scheme for the setting up of Off-shore Banking Units (OBUs) in Special Economic Zones (SEZs) by banks.
	15	• All SCBs were advised not to recover principal or interest during current financial year on *kharif* crop loans; to convert principal in to term loan and defer interest. No interest should be charged on deffered interest.
	25	• Banks and FIs can issue CDs on floating rate basis provided the methodology of computing the floating rate is objective, transparent and market-based.
Dec.	**4**	• The overall ceiling for loans and advances to directors of UCBs, their relatives and concerns in which they are interested was brought down from 10 per cent to 5 per cent of the demand and time liabilities (DTL). Banks whose outstandings of such loans on September 30, 2002 or thereafter, were more than 5 per cent of their DTL were directed not to sanction any fresh loans/renew the existing facilities and to bring these within the prescribed limit of 5 per cent by March 31, 2003.
	13	• All foreign banks operating in India were advised that their unsecured advances which are backed by the guarantees of their overseas branches may not be taken into account for the purpose of computing the limit on unsecured guarantees and advances.
	14	• Banks were allowed to open savings bank accounts in the names of State Government departments/bodies/agencies in respect of grants/subsidies released for implementation of various programmes/schemes sponsored by State Governments.
	19	• Based on the recommendation of the Committee on Computer Audit, the possible areas of audit interest in the Information System (IS) environment have been identified as 15 broad categories and a 'standardised checklists' under each category to facilitate the conduct of computer audit has been prepared and sent to FIs. The issues elaborated in the checklists gives a fair idea about areas that need to be controlled. These checklists, however, are only in the nature of guidelines and FIs are free to develop more elaborate checklists to conduct IS Audit suitable to the IT environment in which they operate and propose to operate.
	20	• All SCBs (excluding RRBs) were advised that no service charge or inspection charge should be levied by them on priority sector loans upto Rs. 25,000.
	21	• In consultation with the Government of India, guidelines were issued to the FIs in regard to the connected lending.
		• Implementation of the Prompt Corrective Action (PCA) scheme was initiated initially for a period of one year. It will be reviewed in December 2003. All scheduled commercial banks were directed to place the scheme before their respective Board of Directors to ensure that their bank does not come within the PCA framework. The PCA framework does not preclude the Reserve Bank from taking any other action as it deems fit in addition to the corrective actions prescribed in the framework.
	27	• All SCBs were advised to waive first year's deffered interest liability (20 per cent) on *kharif* loans, as one time measure.
		• Banks were directed to form a Task Force comprising senior executives for chalking out an action plan for switching over to risk-based internal audit. A quarterly progress report on the implementation of risk-based internal audit should be submitted to the Reserve Bank from the quarter ending March 31, 2003.
2003		
Jan.	**20**	• With effect from April 1, 2003, of the two methods for measuring the credit risk exposure inherent in derivatives for determining individual/group borrower exposures, *viz.* the Original Exposure Method and the Current Exposure Method, banks were encouraged to follow the Current Exposure Method.
	24	• Banks were given freedom to decide their own guidelines for assessing/sanctioning working capital limits of borrowers while purchasing/ discounting/ negotiating/ rediscounting genuine commercial/trade bills. They were allowed to sanction

Date of Announcement		POLICY ANNOUNCEMENTS
2003		**III. FINANCIAL SECTOR MEASURES** *(Contd.)*
		working capital limit as well as bills limit to borrowers after proper appraisal of their credit needs and in accordance with the loan policy as approved by their Board of Directors.
Jan.	**24**	• In supercession of earlier instructions, the detailed guidelines were issued to the banks laying down revised guidelines for purchasing/discounting/negotiating/rediscounting of genuine commercial bills.
	29	• Fresh guidelines to provide a simplified, non-discretionary and non-discriminatory mechanism for compromise settlement of chronic NPAs below Rs.10 crore were issued. All public sector banks were directed to uniformly implement the guidelines to ensure maximum realisation of dues within the stipulated time. The guidelines do not cover cases of wilful default, fraud and malfeasance.
Feb.	**4**	• Revised guidelines were issued for financing of infrastructure projects. The guidelines define infrastructure lending; specify criteria for financing, types of financing by banks, methodology of project appraisal and administrative management; and provide prudential credit exposure limits, risk weight for capital adequacy purposes and asset liability management.
	5	• As announced in the Union Budget 2002-03, revised guidelines on Corporate Debt Restructuring (CDR) were issued to make CDR mechanism more efficient. The revised guidelines provide two categories of debt restructuring under the CDR system – one for 'standard' and 'sub-standard' accounts (Category 1) and the other for 'doubtful' accounts (Category 2).
	19	• Detailed guidelines were issued on country risk management and provisioning therefor. The guidelines are applicable only in respect of countries where a bank's net funded exposure is of two per cent or more of its total assets. The guidelines shall be reviewed after one year, taking into account the experience of banks in implementing the guidelines.
	23	• Final guidelines on Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 were issued. The guidelines and directions relate to registration, owned fund, permissible business, operational structure, deployment of surplus funds, internal control system, prudential norms and disclosure requirements for Securitisation and Reconstruction Companies. The Reserve Bank also issued guidance notes of recommendatory nature on acquisition of assets, issue of security receipts *etc.* A set of standard guidelines in the matter of takeover of the management, sale or lease of whole or part of the business of the borrower is being formulated.
	25	• Final guidelines on consolidated accounting and other quantitative methods to facilitate consolidated supervision were issued to banks. Banks were advised to place the guidelines before the Board of Directors and ensure strict compliance with the same commencing from the year ended March 31, 2003.
	26	• The time period allowed to banks for making provision against the net debit balance in the inter-branch account is to be reduced from one year to six months from the year ending March 31, 2004.
	27	• Banks were advised to recognise income on accrual basis in respect of the three categories of projects under implementation which are classified as 'standard' in terms of the guidelines issued in May 2002.
March	**3**	• The ceiling on interest rates payable on deposits by NBFCs (including Chit Fund companies and Nidhi companies) was revised downwards from 12.5 per cent per annum to 11.0 per cent per annum effective from March 4, 2003. The new rate is applicable to fresh public deposits and renewals of matured public deposits. Other conditions relating to rests at which interest can be compounded, rate of brokerage, *etc.* remain unchanged.
	21	• Guidelines on bank finance for PSU disinvestments were reviewed in consultation with the Government of India and new guidelines were issued in respect of lock-in period for shares relating to such disinvestments.
	29	• To facilitate informed decision making by regulators, depositors and other users of balance sheets, NBFCs (irrespective of whether they hold public deposits or not) were directed to attach a schedule to the balance sheet containing additional particulars as per the format prescribed by the Reserve Bank effective from the balance sheet as on March 31, 2003 and onwards.
	31	• Payment of the minimum rate of return by Residuary Non-Banking Companies (RNBCs) to their depositors was revised to 3.5 per cent on daily deposits and to 5.0 per cent on other deposits effective from April 1, 2003.
April	**8**	• The ceiling for banks to offer credit/non-credit facilities to Indian Joint Ventures / Wholly Owned Subsidiaries abroad was increased from 5 per cent of the unimpaired Tier - I capital to 10 per cent of banks' unimpaired capital funds (Tier I and Tier II capital).
	23	• The Reserve Bank issued guidelines and directions to the Securitisation Companies and Reconstruction Companies seeking registration from the Bank under section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
	29	• While Investment Fluctuation Reserve (IFR) would continue to be treated as Tier II capital, it would not be subject to the ceiling of 1.25 per cent of the total risk-weighted assets. However, for the purpose of compliance with the capital

Date of Announcement		POLICY ANNOUNCEMENTS
2003		**III. FINANCIAL SECTOR MEASURES** *(Contd.)*
		adequacy norms, Tier II capital including IFR, would be considered up to a maximum of 100 per cent of total Tier I capital. The above treatment would be effective from March 31, 2003.
April	**29**	• The Reserve Bank would consider favourably any proposal for transfer of branches in rural and semi-urban centres from one commercial bank to another by mutual agreement. Banks will be expected to ensure that such mutually agreed transfers do not adversely affect the available banking services in that area.
		• Banks were advised to build up provisions, significantly above the minimum regulatory requirements, for their NPAs particularly for those assets which they propose to sell to securitisation/ reconstruction companies.
		• Dealers in drip irrigation/sprinkler irrigation system/ agricultural machinery, irrespective of their location, would be eligible for advances, under priority sector lending for agriculture.
		• Banks with their Board's approval would be free to extend direct finance to the housing sector up to Rs.10 lakh in rural and semi-urban areas as part of priority sector lending.
		• UCBs permitted to exempt both gold loans and small loans up to Rs.1 lakh from the 90 days norm for recognition of loan impairment. These loans would, therefore, continue to be governed by the 180 days norm for classification as NPAs even after March 31, 2004.
		• UCBs permitted to place deposits with strong scheduled UCBs (other than banks classified as weak or sick) with certain conditions.
		• The ceiling on the unsecured advances by the UCBs was revised except in the case of weak/sick UCBs. The aggregate of unsecured advances granted by a UCB to its members as a whole, would continue to be within the overall ceiling of 33 1/3 per cent of the bank's DTL.
		• UCBs were given a maximum period of six months from the date of the inspection report to remove the irregularities pointed out in the inspection report in all respects, failing which the Reserve Bank will invoke the penal provisions.
		• All UCBs are to introduce concurrent audit with immediate effect.
		• UCBs were directed not to grant loans and advances (both secured and unsecured) to directors, their relatives and firms/concerns/companies in which they are interested. Existing advances extended prior to April 29, 2003 should not be renewed or extended further.
	30	• Non-bank entities including corporates were allowed to provide unconditional and irrevocable guarantee for credit enhancement for issuance of CP. Furthermore, banks are allowed to invest in CPs guaranteed by non-bank entities provided their exposure remains within the regulatory ceiling as prescribed by the Reserve Bank for unsecured exposures.
May	**5**	• Banks/All India Financial Institutions were advised to adopt the broad guidelines and frame the Fair Practices Code regarding applications for loans and their processing, loan appraisal and terms/conditions, disbursement of loans including changes in terms and conditions, and post disbursement supervision, duly approved by their Board of Directors.
	14	• Advances up to Rs.20 lakh per dealer, granted by urban co-operative banks to dealers in drip irrigation / sprinkler irrigation systems and agricultural machinery, may be classified under 'Indirect Finance to Agriculture' as a part of priority sector lending. As part of priority sector lending, banks are free to extend direct housing loans up to Rs.10 lakh in rural and semi-urban areas also.
	30	• Revised guidelines were issued for compromise settlement of chronic NPAs. In consultation with the Government of India, the last date for receipt of the applications under the revised One Time Settlement (OTS) Scheme was extended from April 30, 2003 to September 30, 2003 and the date of processing of the applications by banks from October 31, 2003 to December 31, 2003.
June	**3**	• Banks/FIs were allowed to deal in exchange traded interest rate derivatives in a phased manner, with a view to enabling them to manage their exposure to interest rate risks.
	20	• The major irregularities observed in the concurrent audit report of the treasury transactions as also the position of compliance therewith should be incorporated in the half-yearly reviews of the investment protfolio to be submitted to the Regional Offices of the DBS.
	26	• In order to streamline the procedure followed by banks in dealing with the dishonour of cheques, additional instructions were given to banks covering all cheques dishonoured on account of insufficient funds. The instructions also require banks to deal severely with frequent dishonour of cheques. Further, banks are also required to create a database of all dishonoured cheques of Rs.1 crore and above which should form part of their MIS.
July	**8**	• Primary (urban) co-operative banks which are not members of NDS/CCIL system were directed to undertake their transactions in Government securities through gilt account/demat account maintained with NDS members.

Date of Announcement		POLICY ANNOUNCEMENTS
2003		**III. FINANCIAL SECTOR MEASURES** *(Concld.)*
July	**8**	• Banks were exempted from the requirement of approprating the profit on sale of securities from Held to Maturity (HTM) category to 'Capital Reserve Account', as a one-time measure, only in respect of the identified securities that are sold to the Government of India under the scheme of Government of India's Debt Buyback Programme.
	19	• With a view to reducing the level of long pending outstanding entries in the Clearing Adjustment Account of banks, they were allowed, as one time measure, to net off the entries representing clearing differences 'receivable' against entries representing clearing differences 'payable' up to Rs. 500 which are outstanding for more than three years as on March 31, 2003.
	31	• Regulatory framework of NBFCs was amended to permit ready forward contracts in dated securities and Treasury Bills issued by the Government of India and dated securities issued by the State Governments.
		IV. CAPITAL MARKET POLICIES
		(i) Securities and Exchange Board of India (SEBI)
2002		
May	**9**	• SEBI issued guidelines for valuation of unlisted equity shares to bring uniformity in calculation of NAVs of mutual fund (MF) schemes.
	10	• SEBI amended Clause 41 of the Listing Agreement to require that the companies which opt to publish audited results for the entire year within 3 months (instead of publishing un-audited results for the last quarter within 30 days) to publish annual audited results in a specified format. Companies would also be required to disclose audit qualifications in the unaudited/audited financial results along with their impact on the profit or loss together with explanations and the date by which these are expected to be removed.
June	**19**	• SEBI clarified that the service charge of five per cent on the management fees of asset management companies imposed in the Union Budget 2002-03 can be charged to the schemes as an item of general expenditure without imposing an additional burden on unit holders.
	20	• SEBI prescribed all MFs to enter into transactions relating to Government securities only in dematerialised form.
		• SEBI advised MFs that the non-performing or illiquid assets at the time of maturity/closure of schemes but realised within two years after the winding up of the scheme, should be distributed to the old investors if the amount is substantial. In case the amount is not substantial or it is realised after two years, it may be transferred to the Investor Education Fund maintained by each MF.
		• SEBI clarified that the SEBI (Insider Trading) (Amendment) Regulations, 2002 should be followed strictly by the trustee companies, asset management companies and their employees and directors.
		• SEBI advised the stock exchanges to amend the Listing Agreement requiring the companies to furnish specified information on the Electronic Data Information Filing and Retrieval (EDIFAR) website maintained by SEBI.
	26	• SEBI clarified that the investors who have dealt with the member broker through the registered sub-broker are also clients of member broker. Thus, in case of default of the member broker, the clients of the registered sub-brokers would also be eligible for the claims against the defaulting member broker for compensation from the Investor Protection Fund (IPF)/Customer Protection Fund (CPF).
July	**4**	• In order to ensure easy tracking of the underlying shares released on the conversion of the "depository receipts", it was decided that all such shares shall mandatorily be credited to a separate Depository Receipts (DRs) account of the respective investor.
	22	• SEBI decided that a uniform method shall be used by all MFs to calculate the sale and repurchase price of mutual funds' units.
	30	• SEBI notified the SEBI (Mutual Funds) (Third Amendment) Regulations, 2002 requiring the Trust Deed to state that a meeting of the trustees shall be held at least once in every two calendar months and at least six such meetings shall be held in every year. SEBI also laid down the modalities for payment to and recovery from investors in case of discrepancy in calculation of NAV due to non-recording of transactions.
Aug.	**22**	• Following the representation from FIIs about the leakage of trade data, SEBI directed all stock exchanges to reiterate to their employees that they are bound by the code of conduct and to maintain confidentiality of deals and trade data.
	28	• SEBI directed the stock exchanges to amend their bye-laws to expedite arbitral award within three months from the date of entering the reference, *i.e.,* the date on which the arbitral tribunal has held the first meeting. The time taken to make the award shall not be extended beyond three times and any further adjournments shall be granted only in exceptional cases.

Date of Announcement		POLICY ANNOUNCEMENTS
2002		**IV. CAPITAL MARKET POLICIES** *(Contd.)*
Aug.	**29**	• With a view to improve corporate governance standards in MFs, SEBI clarified that the persons providing any type of professional service to the MFs, AMC, trustee company and the sponsors shall be considered as associate directors of AMC or trustee company and the persons having any material pecuniary relationship with these entities, which in the judgement of the trustees may affect independence of directors, shall also be treated as associate directors. All MFs were accordingly directed to classify existing directors of AMC and trustee company as "associates" or "independent" and comply with the requirement of 50 per cent or 2/3rd independent directors of AMC or trustee company.
Sep.	**9**	• SEBI amended the (Substantial Acquisition of Shares and Takeover) Regulations, 1997. The amendments include, *inter alia,* relaxation in norms for disinvestments by state PSUs, removal of automatic exemption in respect of acquisition through preferential allotment, additional disclosure requirements, change of control through special resolution instead of ordinary resolution, additional parameters for determination of offer price, minimum offer size of 20 per cent in all cases, reduction in creeping acquisition limit from 10 per cent to 5 per cent with effect from October 1, 2002.
	24	• SEBI (Issue of Sweat Equity) Regulations, 2002 were issued. The regulations specified the norms for issuance, pricing, accounting treatment, certification of auditors, lock-in period, listing eligibility, applicability of takeover guidelines and general obligations of the company and intermediaries associated with issuance of sweat equity.
		• SEBI issued an operating manual for risk management system, aimed at ensuring a minimum standard of due diligence or risk management system for all the MFs in various areas of their operations like fund management, operations, customer service, marketing and distribution, disaster recovery and business continuity, *etc.* Under each of the risk area, the Manual gives the existing industry practices, practices to be followed on mandatory basis and best practices to be followed by all MFs.
Oct.	**10**	• In order to ensure wider dissemination of information to the shareholders about the post offer details in terms of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, SEBI made it mandatory for the acquirer to make a public announcement in the prescribed format through the merchant banker in all the newspapers in which the original public announcement was made.
	11	• The SEBI issued the SEBI (Portfolio Managers) (Amendment) Regulations to strengthen corporate governance in terms of qualifications of principal officers and investment of money and management of security portfolio of clients.
Nov.	**1**	• SEBI decided to make the admission of debt instruments mandatory on both the depositories.
	7	• SEBI increased the investment limit on foreign securities to 10 per cent of net assets of each MF as on March 31, 2002 from 4 per cent. However, a minimum of US $ 5 million and maximum of US $ 50 million is permissible to each MF irrespective of the size of assets.
Dec.	**2**	• Recommendations of the committee appointed by SEBI on Straight Through Processing (STP) were accepted. Accordingly, Indian capital markets transited to STP from December 2, 2002.
	18	• In line with the recommendations of the Advisory Committee on Derivatives, SEBI allowed stock exchanges to determine the manner of adjustment in derivative contracts at the time of corporate actions in conformity with certain principles.
		• Based on the recommendations of the Advisory Committee on Derivatives, the stock exchanges were advised to separate the cash and derivative segment of the stock exchanges in terms of legal framework governing trading, clearing and settlement of the derivative segment, establishment of separate trade/settlement guarantee funds, separate membership and Governing Council/Clearing Council/Executive Committees.
		• SEBI prescribed a broader eligibility criteria for stocks on which stock options and stock futures would be allowed and also modified the risk containment measures in view of the changed criteria.
2003		
Jan.	**30**	• SEBI clarified the requirements to be fulfilled at the time of conversion of close-ended schemes to open ended schemes including the requirement of filing an offer document with SEBI with updated disclosures and providing a minimum exit period of 30 days to unit holders. They would also be required to communicate to the unit holders the information concerning latest portfolio of the scheme, details of financial performance since inception and the addendum to the offer document detailing the modification made to the scheme.
		• SEBI approved the recommendations of the Group on Corporatisation and Demutualisation of Stock Exchanges (Chairman: Shri M.H. Kania) which included, *inter alia*, a uniform model of corporatisation and demutualisation to be adopted for all stock exchanges and one-time tax concession to stock exchanges which would be demutualised.
Feb.	**13**	• SEBI (Central Listing Authority) Regulations, 2003 were issued. The regulations provided for constitution of a Central Listing Authority (CLA) by SEBI. Besides, the regulations provided for mandatory recommendation from CLA before listing in any stock exchange and appeal to SEBI and Securities Appellate Tribunal in case of refusal of issuance of letter of recommendations from CLA. The CLA was constituted on April 9, 2003.

Date of Announcement		POLICY ANNOUNCEMENTS
2003		**IV. CAPITAL MARKET POLICIES** *(Contd.)*
March	**12**	• SEBI rationalised the risk management structure for T+2 rolling settlement. The exchanges would collect VaR-based margins and Mark to Market margins. The VaR-based margins would differ depending upon the volatility and liquidity of the scrip.
	31	• The settlement cycle on Indian equity markets was shortened to T+2 with effect from April 1, 2003 with a view to reduce risks in the market and protect the interest of the investors.
April	**4**	• SEBI allowed MFs to invest in equity of listed overseas companies which have shareholding of at least 10 per cent in an Indian company listed on a recognised stock exchange in India. The overall ceiling for the entire mutual fund industry to invest in ADRs/GDRs issued by Indian companies and foreign equity and debt securities would be US $ 1 billion. Each MF can invest up to 10 per cent of its net assets in these securities as on January 31, 2003 subject to a maximum of US $ 50 million.
	10	• SEBI framed a uniform policy applicable to all stock exchanges regarding the maintenance/disposal of arbitration records.
	19	• SEBI, in consultation with the Government of India and the Reserve Bank decided to introduce Exchange Traded Interest Rate Derivative Contracts on a notional Government security with a 10-year maturity and a notional Treasury Bill with a maturity of 91 days or three months. Accordingly, SEBI put in place the risk containment measures for the Interest Rate Futures contracts.
	29	• SEBI clarified that contract notes can be issued by the brokers in electronic form authenticated by means of digital signatures.
May	**23**	• SEBI laid down the guidelines for consolidation of schemes by MFs requiring the proposal and modalities of the merger/ consolidation to be approved by the Boards of AMCs and Trustees, filing of the proposal with SEBI, disclosure of all relevant information in the letter to the unit-holders and providing option to exit at prevailing NAVs without exit load.
June	**2**	• SEBI directed the stock exchanges to make necessary provisions in their rules to ensure that the subsidiaries of the company would register only the members of the parent stock exchanges as sub-brokers of the subsidiary company and no other client/sub-broker can be entertained by the subsidiary company.
		• Following representations from some stock exchanges expressing their inability to compute the mean impact cost calculations at their exchanges, SEBI allowed such stock exchanges to use the impact cost of BSE or NSE provided that those stock exchanges have entered into a formal legal arrangement with the relevant stock exchanges (BSE or NSE) for liquidating the positions of their members, if necessary, on that stock exchange.
	5	• SEBI had earlier stipulated that in cases where shortages are in excess of the base minimum capital, the trading facility of the member shall be withdrawn and on recovery of the complete shortage, the member shall be permitted to trade on a reduced exposure for four settlements. In view of the introduction of rolling settlement, SEBI decided that the earlier provisions should apply to at least ten rolling settlements instead of the four specified earlier.
	11	• SEBI revised the composition of additional capital and margins and the eligibility criterion for securities. Accordingly, the minimum cash component of the additional capital and margins was increased from the existing level of 30 per cent to 50 per cent.
	18	• SEBI reviewed the capital requirements of exchanges having average daily turnover of less than Rs.1 crore for three consecutive months. Such exchanges were allowed to maintain base minimum capital (BMC) at Rs.1 lakh. The excess of the BMC may be refunded to the member subject to certain conditions.
	19	• SEBI allowed the stock exchanges to give freedom to charge listing fees without seeking the approval of SEBI.
	25	• SEBI decided that close out mark up of 5 per cent would be applicable in case of debentures and bonds which are assigned a credit rating of triple A and above. However, for other debentures and bonds without the triple A credit rating, the existing close out mark up of 20 per cent shall be applicable as in the case of equities.
		(ii) Reserve Bank of India
2002		
Oct.	**16**	• The Reserve Bank clarified the operational guidelines on ADR/GDR issues. The custodians would be required to submit certificate regarding non-breaching of sectoral caps to the Reserve Bank/SEBI on a monthly basis. Monthly report about the ADR/GDR transactions shall also be submitted by the custodians to the Reserve Bank/SEBI in the prescribed format.
		(iii) Government of India
2002		
June	**19**	• The Income Tax (Eighth Amendment) Rules, 2002 reduced the threshold for quoting PAN for the sale and purchase of securities from Rs.10 lakh to Rs.1 lakh.

Date of Announcement		POLICY ANNOUNCEMENTS
2002		**IV. CAPITAL MARKET POLICIES** *(Concld.)*
Oct.	**30**	• The Government issued an ordinance to restructure the UTI by splitting it into two parts – UTI-I comprising US-64 and assured return schemes and UTI-II comprising NAV-based schemes. The scheme was effected in January 2003.
		• The Government issued the ordinance to grant search and seizure powers to SEBI with the approval of the Court. The monetary penalties on minor offences would be Rs.1 crore and on major offences the penalty would be three times the amount involved in the offence or Rs.25 crore, whichever is higher.
2003		
Jan.	**3**	• The Companies (Second Amendment) Act, 2002 was enacted. The Act seeks to provide for a new, modern, efficient and time-bound Insolvency Law to provide for both rehabilitation and winding up of sick companies within a maximum time frame of two years. It envisages setting up of a National Company Law Tribunal with several Benches to be notified by the Government all over the country.
Feb.	**28**	• The Union Budget proposed that dividends be tax free in the hands of shareholders. Correspondingly, there is a 12.5 per cent dividend distribution tax on domestic companies. While MFs, including UTI-II, are also to pay the dividend distribution tax, equity-oriented schemes are exempted from the purview of this tax for one year. UTI-I is also exempted from the dividend distribution tax.
		• With a view to give a fillip to the capital markets, the Union Budget proposed that all listed equities that are acquired on or after March 1, 2003 and sold after the lapse of a year or more are exempted from the incidence of capital gains tax.
		• Capital gains on buybacks were exempted from tax for one year.
		• Stock exchanges were exempted from payment of capital gains tax on corporatisation.
		(iv) Insurance Regulatory and Development Authority (IRDA)
2002		
Oct.	**16**	• Consequent upon the Central Government's notification enforcing the provisions of Insurance Amendment Act 2002 effective September 23, 2002, the Authority issued fresh regulations pertaining to Insurance Brokers, obligations of insurers to rural and social sectors, licencing of corporate agents, licencing of insurance agents, protection of policyholders' interest and manner of receipt of premium.
2003		
Jan.	**30**	• Consequent to the Reserve Bank permitting banks to undertake referral business through their network of branches for selling insurance products with prior permission of IRDA and the Reserve Bank, guidelines were issued restricting the referral fee to the ceilings on agency commission prescribed under the Insurance Act, 1938 and the IRDA Regulations and forbidding linkage either direct or indirect between the provision of banking services by the bank to its customers and use of the insurance products. Insurers were later advised not to enter into a referral arrangement with any bank, which has been licensed by the Authority to act as an agent or an insurance intermediary.
Feb.	**26**	• The IRDA advised insurance companies to restrict their investments in schemes of mutual funds comprising liquid funds, gilt or debt funds to temporary surpluses and also ensure that investment funds are suitably diversified among MFs duly registered with SEBI. If the schemes of mutual funds in which such investment is made is managed by an investment manager who is under the direct or indirect management or control of the insurer or its promoter, the same shall not exceed 20 per cent of the amount of investments falling under "other than approved investments (OTAI)" subject to group limits. The insurer should not make any investment in shares or debentures of any private limited company in which investment, if any, is made by the MF.
March	**2**	• The IRDA laid down detailed guidelines for investments in MFs. The guidelines include a ceiling of 50 per cent (20 per cent for PSU insurers) of investments falling under the OTAI category for the life and general insurance companies and prescription of a diversified portfolio strategy.
		V. EXTERNAL SECTOR POLICIES
		a) Trade Policy
2002		
April	**26**	• The following modifications to the Union Budget 2002-03 were announced:
		i) 100 per cent deduction of export profits under Section 10A to all SEZ units commencing production on or after April 1, 2002, for a period of five years, and thereafter at 50 per cent for the next two years.

Date of Announce-ment		POLICY ANNOUNCEMENTS
2002		**V. EXTERNAL SECTOR POLICIES** *(Contd.)*
		ii) Supplies to SEZs from DTA to be treated as physical exports instead of deemed exports for the purposes of duties, tariffs and central sales tax.
		iii) Customs duty on dairy products will be at the WTO-bound rate of 40 per cent as against 30 per cent.
June	**3**	• The Directorate General of Foreign Trade (DGFT) notified additional standard input-output norms (SION) for 16 new export items and amendments/corrections/deletions in the SION for 38 existing export items. Of the 16 new items, 10 items relate to the chemicals & allied products, 5 relate to engineering products, and one relates to food products.
July	**23**	• The Government approved setting up of 28 Agri Export Zones (AEZs) in 14 different states with a likely total investment of Rs.780 crore.
Sep.	**13**	• In case of EPCG licences issued to units in the agri-export zones, a period of 12 years reckoned from the date of issuance of the license was permitted for the fulfilment of export obligation.
2003		
Jan.	**3**	• The DGFT notified additional SION for 37 new export items and amendments/corrections/deletions in the SION for 37 existing export items.
	9	• The Government announced that new or second hand capital goods, equipments, components, parts and accessories, containers meant for packing of goods for exports, jigs, fixtures, dies and moulds may be imported for export without a licence/certificate/permission on execution of Legal Undertaking/Bank Guarantee with the Customs Authorities provided that the item is freely exportable without any conditionality/requirement of licence/permission as may be required under ITC (HS) Schedule II.
	17	• The Government decided to remove Quantitative Restrictions (QRs) on import of Garlic.
	22	• The DGFT allowed incidence of special additional duty (SAD) on the inputs to be taken into account for calculation of Duty Entitlement Pass Book (DEPB) rates.
Feb.	**3**	• The DGFT notified additional SION for 17 new export items and amendments/corrections/deletions in the SION for 33 existing export items.
	7	• In a major move to facilitate exports, the Government decided to extend the working hours of the Customs, Custodians and Banks at Delhi, Mumbai, Chennai, Kolkata, Bangalore and Hyderabad Air Cargo Complexes.
	24	• A separate export promotion council for Export Oriented Units (EOUs) and Units of Special Economic Zones (SEZs) has been set up to enhance exports by these entities. It would function as an approved trade body like other export promotion councils and would facilitate the functioning of the concerned units.
	28	• The Union Budget 2003-04 announced, *inter alia,* the following measures relating to custom duty: (i) the peak rate of customs duty to be brought down from 30 per cent to 25 per cent excluding agriculture and diary products, (ii) the duty on conch shells and seed lac (handicraft items) to be reduced from 30 percent to 5 per cent, (iii) import duty on oleo pine resin to be reduced from 15 per cent to 10 per cent, (iv) custom duty on passenger baggage to be reduced from 60 per cent to 50 per cent, (v) proposal to exempt rock phosphate and crude sulphur, inputs for phosphoric acid from Special Additional Duty (SAD), (vi) the basic customs duty on alcoholic liquor to be reduced to 166 per cent in conformity with WTO commitments besides rationalisation of the countervailing duty in respect of imported alcoholic beverages, including wines and, (vii) value limit for full customs duty exemption for bonafide commercial samples and gifts to be raised from Rs.5,000 to Rs.10,000.
		• Reduction in custom duties was also proposed for various items under different sectors like capital goods and infrastructure, textiles, pharmaceuticals, information and technology, biotechnology, tourism, gems and jewellery, power, animal husbandry and veterinary medicine.
		• Other measures announced in the Union Budget 2003-04 include Trade Facilitation Measures, strengthening the ECGC, simplification of custom procedures, modernisation of seaports, improvement in availability of credit and measures to provide bank guarantee facilities to health sector.
March	**4**	• The DGFT notified additional SION for 25 new export items and amendments/corrections/deletions in the SION for 43 existing export items.
	20	• The Government constituted an Inter-Ministerial Committee for the Development of Land Customs Stations (IMC-LCS), which would facilitate trade with neighbouring countries and would contribute significantly to the economic development of the North Eastern region.
	31	• The modified EXIM Policy for 2003-04 was announced by the Government of India. The salient features of the modified EXIM Policy 2003-04 are as follows: (i) measures to boost exports of non-traditional service areas such as health care,

Date of Announce-ment		POLICY ANNOUNCEMENTS
2003		**V. EXTERNAL SECTOR POLICIES** *(Contd.)*
		entertainment and professional services as well as traditional areas like tourism; (ii) major initiatives on agro-exports with the basic aim of reaching the benefits of globalisation to farmers and rural sectors including facilitating association of corporates in the implementation of Agri Export Zones (AEZs); (iii) a more flexible and attractive Export Promotion Capital Goods (EPCG) Scheme in order to expand the manufacturing base for India's exports including the small scale sector; (iv) incentives to Status Holders with premium on high growth; (v) removal of restrictions on exports; (vi) measures to facilitate investments in Special Economic Zones (SEZs); (vii) reoriented export cluster development scheme and procedural simplification aimed at reduction of transaction costs in order to make India globally competitive.
March	**31**	• The Duty Entitlement Pass Book Scheme (DEPB) is being continued and a facility for provisional DEPB rate has been introduced to encourage diversification as also promote exports of new products. The Policy also removed quantitative restrictions on export of five items, namely, paddy (except basmati), cotton linters, rare earth, silk cocoons and certain family planning devices. Along with promotion of agro and service exports, special focus would be given to certain sectors having potential for accelerated export growth, such as textiles (especially garments), auto components, gems & jewellery, chemicals, drugs & pharmaceuticals and electronic hardware. The sector-specific initiatives, such as, Diamond & Jewellery Account for exporters dealing in purchase/sale of diamonds and diamond-studded jewellery and a package to boost electronic hardware/software sector were also announced. Certain procedural simplifications measures announced to provide online approvals to exporters where exports had been effected from 23 EDI ports in the country.
		• The Ministry of Commerce and Industry announced the launching of the 'Focus: CIS' Programme with effect from April 1, 2003, which aims to focus on the major product groups, technology and service sectors for enhancing India's exports to and bilateral trade and cooperation with countries of the Commonwealth of Independent States (CIS) Region.
May	**22**	• The Government amended the Diamond and Jewellery Dollar Accounts Scheme. Firms and companies dealing in the purchase/sale of rough or cut and polished diamonds/precious metal jewellery plain, minakari and/or studded with/ without diamond and/or other stones with a track record of at least 3 years in import or export of diamonds/coloured gemstones/diamond and coloured gemstones studded jewellery/plain gold jewellery and having an average annual turnover of Rs.5 crore or above during preceding three licensing years may also carry out their business through designated Diamond Dollar Accounts.
	30	• The Preferential Trade Agreement signed on March 6, 2003 between the Transitional Islamic State of Afghanistan and Republic of India was operationalised. Export Inspection Council is the sole agency to issue the Certificate of Origin under the Agreement.
		b) Foreign Exchange Market
2002		
April	**1**	• Exporters with proven track record who have been certified as 'Status Holder' in terms of EXIM policy were permitted: i) to credit up to 100 per cent of their eligible receipts of foreign exchange to their EEFC Account; ii) to despatch the export documents direct to the consignees outside India subject to the conditions that the export proceeds are repatriated through the AD named in the GR form and the duplicate copy of the GR form is submitted to the AD for monitoring purposes, by the exporters within 21 days from the date of shipment of export; iii) to realise and repatriate the full value of export proceeds within a period of twelve months from the date of shipment in respect of shipments made on or after April 1, 2002.
	2	• Insurance companies registered with IRDA were permitted to issue general insurance policies denominated in foreign currency and receive premium in foreign currency without prior approval of the Reserve Bank in the following type of cases: i) marine insurance policies in respect of vessels (a) owned by foreign shipping companies but managed by Indian companies as technical operators for the vessels and (b) mortgaged to foreign financiers/bank as per the loan agreement and assignment of the same in favour of the foreign financiers/bank; ii) aviation insurance for aircrafts imported from outside India on lease/ hire basis for the purpose of air taxi operations; iii) marine-cum-erection all risks insurance policies to Indian companies in connection with a project to be set up in India with collaboration of foreign companies for supply of the equipment; iv) and, marine-cum-erection all risks policies favouring Indian companies for execution of projects in India being financed by ECB or awarded to local companies under global tender requiring insurance in foreign currency. Furthermore, ADs have been advised to allow remittance towards the settlement of claims in the above cases subject to compliance of certain conditions.
	12	• ADs were permitted to consider requests for reduction up to 10 per cent in invoice value of export bills in respect of export of gold/silver jewellery or articles made out of cut and polished diamonds also.
	29	• To provide greater freedom and flexibility to banks in their fund management, permission was granted to banks to crystallise their foreign exchange liability in rupees, in select cases, where circumstances so warrant, keeping in view the status of the account of the borrower who had raised ECBs. ADs desirous of crystallising their foreign exchange liability, arising out of guarantees provided for ECBs raised by corporates in India, into rupees have been advised to apply to Exchange Control Department, giving all the required details in the matter.

Date of Announcement		POLICY ANNOUNCEMENTS
2002		**V. EXTERNAL SECTOR POLICIES** *(Contd.)*
May	**14**	• ADs were advised to obtain, before making any remittances for advertisement on foreign television, a certificate from a Chartered Accountant certifying that the applicant satisfies the criteria of having export earning of more than Rs.10 lakhs during each of the preceding two years and the advertisement for which foreign exchange is being remitted will be broadcast by foreign television company in foreign countries and not in India alone.
		• ADs were permitted to allow repatriation of current income like rent, dividend, pension, interest of NRIs who do not maintain an NRO account in India based on an appropriate certification by a Chartered Accountant, certifying that the amount proposed to be remitted is eligible for remittance and that applicable taxes have been paid/provided for.
	17	• ADs are free to allow remittances towards premium for general insurance policies taken by units located in SEZs from insurers outside India provided the premium is paid by the units out of their foreign exchange balances.
June	**4**	• The Reserve Bank reiterated instructions about the prohibition on remittance in any form towards participation in lottery schemes or lottery like schemes, functioning under different names like money circulation scheme, or remittances for the purpose of securing prize money/awards under FEMA, 1999.
	24	• To further streamline the procedure for reporting overseas direct investments in JV/WOS, the requirement of forwarding of 'Form ODA' along with the prescribed documents to the Reserve Bank for investments made under the automatic route by Indian parties was dispensed with. The report on remittances required to be submitted by ADs was also revised. All remittances/guarantees issued/ capitalisation of exports *etc.*, under the automatic route as well as under the Reserve Bank approval, are henceforth required to be reported in the revised form ODR. However, no change in the procedures relating to the receipt/scrutiny of the form ODA submitted by the Indian parties to the AD has been made.
	27	• On the use of international credit cards, it was clarified that : i) these can be used on internet for any purpose for which exchange can be purchased from an AD in India; ii) these cannot be used on internet or otherwise for purchase of prohibited items, like lottery tickets, banned or proscribed magazines, participation in sweepstakes, payment for call-back services since no drawal of foreign exchange is permitted for such items/activities, and, iii) there is no aggregate monetary ceiling separately prescribed for use of International Credit Cards through internet. Furthermore, debit Cards and ATM Cards can be used for any purpose for which foreign exchange can be purchased from an AD in India.
		• ADs were permitted to receive payment for exports made out of India by debit to the credit card of an importer, where the reimbursement from the card issuing bank/organisation will be received in foreign exchange.
	29	• ADs were permitted to allow remittances for the purpose of normal business operations of the office (trading/non-trading)/branch or representative outside India of Indian entities subject to the following terms and conditions: i)The overseas office (trading/ non-trading)/branch/ representative should not (a) create any financial liabilities contingent or otherwise for Head Office in India (b) invest surplus funds abroad without prior approval of the Reserve Bank. Any funds rendered surplus should be repatriated to India. ii) The overseas office/branch of software exporter company/firm, may repatriate to India 100 per cent of the contract value of each 'off-site' contract as also at least 30 per cent of the contract value of each 'on-site' contract and may utilise the balance amount (70 per cent) of the contract value of 'on-site' contracts for contract related expenses including office/branch expenses abroad. A duly audited yearly statement showing receipts under 'off-site' and 'on-site' contracts undertaken by the overseas office, expenses and repatriation thereon may be sent to the AD. iii) The details of bank account opened in the overseas country should be promptly reported to AD.
		• Indian entities were permitted to open, hold and maintain in the name of its office/branch set up outside India, a foreign currency account with a bank outside India by making remittance for the purpose of normal business operations of the said office/branch or representative, subject to specified conditions.
July	**2**	• ADs were permitted to allow the facility of repatriation of funds out of balances held by Non-Resident Indians/Persons of Indian Origin (NRIs/PIOs) in their Non-resident Ordinary Rupee (NRO) Accounts, for certain purposes as indicated below: i) Up to US $ 30,000 per academic year, to meet expenses in connection with education of their children; ii) Up to US $ 1,00,000 to meet the medical expenses abroad of the account holder or his family members; and iii) Up to US $ 1,00,000 per year, representing sale proceeds of immovable property, held by them for a period of not less than 10 years subject to payment of applicable taxes.
	4	• Products of aluminium/petroleum, sugar and foodgrains also included in the list of products eligible for export with extended period for realisation and repatriation of full export value up to 365 days from the date of shipment. The said facility hitherto restricted only to manufacturer exporters would also be available to merchant exporters/traders.
	6	• ADs were permitted to open term deposit accounts for a period not exceeding 6 months in favour of branch/office of person resident outside India provided the AD is satisfied that the term deposit is out of temporary surplus funds and the concerned branch/office furnishes an undertaking that the maturity proceeds of the term deposit will be utilised for their business in India within 3 months of maturity. The facility is, however, not applicable to branches/offices of shipping and airline companies.

Date of Announcement		POLICY ANNOUNCEMENTS
2002		**V. EXTERNAL SECTOR POLICIES** *(Contd.)*
July	**15**	• It was clarified to the ADs that they would credit the current income like rent, dividend, pension, interest of NRIs to their Non-Resident (External) Rupee Accounts after satisfying themselves that such credits represent current income of the non-resident account holder and income tax thereon was deducted/paid/provided for, as the case may be.
Aug.	**5**	• An 'Automatic Route' for prepayment of External Commercial Borrowings (ECBs), without prior permission of the Reserve Bank, was introduced for a limited period up to March 31, 2003, subject to fulfilment of certain conditions.
	14	• ADs were allowed to permit units in Special Economic Zones (SEZs) to despatch export documents direct to the consignees outside India provided (a) the export proceeds are repatriated through the AD named in the GR/SDF/PP/SOFTEX form and (b) the duplicate copy of the respective declaration form is submitted to the authorised dealer for monitoring purposes by the exporters within 21 days from the date of shipment.
		• It was clarified that inward remittances received through normal banking channels for meeting specific obligations by the account holders were not eligible for credit to their EEFC accounts.
	28	• The facility of realisation and repatriation of full value of export made to certain specified countries within a period of 360 days from the date of shipment was extended for a further period of one year from September 1, 2002.
Sep.	**9**	• Submission of forms A1 and A2, relating to payments below the equivalent to Rs.5,00,000 for all types of transactions in foreign exchange, to the Reserve Bank with R-Returns has been dispensed with and ADs have been advised to audit these forms.
		• In respect of all imports, except import through courier, where value of foreign exchange remitted/paid for import into India exceeded US $ 5,000 or its equivalent, it is obligatory on the part of the ADs to ensure that the importer submits the documentary evidence prescribed therein. This limit was enhanced to US $ 25,000.
		• Where the amount of foreign exchange remitted for import is less than US $ 1,00,000 or its equivalent, ADs were permitted to accept, either Exchange Control copy of Bill of Entry for home consumption or a certificate from the Chief Executive Officer (CEO) or Auditor of the Company that the goods for which remittance was made had actually been imported into India, provided : i) the importer is a company listed on a stock exchange in India and whose net worth is not less than Rs.100 crore as on date of last audited balance sheet, or ii) the importer is a Public Sector Company or an Undertaking of the Government of India or its Departments.
	12	• With a view to provide hassle free release of foreign exchange to the resident individuals for various purposes, ADs were permitted to release an amount up to US $ 500 or its equivalent for all permissible transactions on the basis of a simple letter from the applicant containing the basic information, *viz*., name and the address of the applicant, name and address of the beneficiary, amount to be remitted and purpose of remittance without insisting upon A2 Form or any documents so long as the payment is made by a cheque drawn on the applicant's bank account or by a demand draft.
		• With a view to enable residents to avail of foreign exchange for medical treatment outside India without any hassle and any loss of time, ADs were permitted to release foreign exchange up to US $ 50,000 or its equivalent, on the basis of a declaration, provided the payment of purchase of foreign exchange was being made by a cheque or debit to the applicant's account or by demand draft.
		• ADs were permitted to allow remittance by an NRI and PIO an amount not exceeding US $ 1,00,000 per calendar year, out of the assets in India acquired by way of inheritance/legacy subject to Indian taxes and production of documentary evidence to establish that the assets were acquired by way of inheritance/legacy.
	16	• ADs were permitted to allow remittance up to Rs.20 lakhs per calendar year, out of the assets in India to foreign nationals, including retired employees or non-resident widows of Indian citizens. This limit of Rs.20 lakhs was enhanced to US $ 1,00,000 per calendar year, subject to production of documentary evidence and Indian taxes.
		• ADs were hitherto required to submit, on realisation of export proceeds the duplicate of the GR/SDF/PP/SOFTEX forms, after due certification, to the nearest office of the Reserve Bank. ADs were advised that, henceforth, such duplicate copies of export declaration form *viz*., GR, PP and SOFTEX and Exchange Control copies of the shipping bills together with related Statutory Declaration Forms (SDF) should not be submitted to the Reserve Bank along with the R-Returns. Instead, these should be retained by the ADs who should, however, ensure random checks to confirm that non-realisation or short realisation allowed, if any, is within the powers delegated to them or has been duly approved by the Reserve Bank, wherever necessary.
	17	• In order to permit the corporates to take advantage of low international interest rates, the Reserve Bank permitted prepayment of the outstanding ECBs up to an amount of US $ 100 million without prior permission. This liberalised automatic route was available to all categories of borrowers up to March 31, 2003. Proposals involving prepayment exceeding US $ 100 million would also be considered by the Reserve Bank expeditiously. Individuals, trusts and non-profit making organisations were not eligible under the Automatic Route.

Date of Announcement		POLICY ANNOUNCEMENTS
2002		**V. EXTERNAL SECTOR POLICIES** *(Contd.)*
Sept.	**25**	• ADs were permitted to grant foreign currency loans by their branches in India also against the security of funds held in FCNR(B) Deposit Accounts to the account holders only, subject to specified guidelines.
	27	• With a view to simplifying the procedure for imports into India, uniform regulations and procedures were made applicable to the categories of the short-term credit, *i.e.,* suppliers' credit as well as buyers' credit. Accordingly, ADs were empowered to approve the proposals for short-term credit for financing by way of either Suppliers' Credit or Buyers' Credit, of import of goods into India, provided: i) The credit is being extended for a period of less than three years; ii) The amount of credit does not exceed US $ 20 million, per import transaction; and, iii) The 'all-in-cost' per annum payable for the credit does not exceed LIBOR + 50 basis points for credit up to one year and LIBOR + 125 basis points for credits for periods beyond one year but less than three years, for the currency of credit.
	28	• NRI/PIOs who do not maintain NRO account and have no taxable income need not submit a Chartered Accountant's certificate for remitting their current income like dividend, rent, pension interest. In such cases, ADs have been advised to obtain a simple declaration, in duplicate, from the concerned NRI/PIO to the effect that he/she is not a tax-payer in India.
	29	• For allowing remittance in foreign exchange, ADs were permitted to accept an undertaking tendered by the remitter in the format prescribed by Central Board of Direct Taxes in their Notification F.No.500/152/96-FID dated November 18, 1997 in lieu of an 'Income-Tax Clearance Certificate' or a 'No Objection Certificate' prescribed in the respective Notifications.
Oct.	**3**	• Units located in Special Economic Zone have been allowed to open, hold and maintain Foreign Currency Account with an authorised dealer in India subject to certain conditions, in lieu of the special provision for EEFC Accounts for units in the Special Economic Zones given earlier.
	23	• The facility allowing manufacturer exporters/merchant exporters/traders of certain products having export contracts of Rs.100 crore and above in value terms in one year to realise and repatriate full value of the export of the specified products within a period of 365 days from the date of shipment was extended for one more year up to September 30, 2003.
Nov.	**1**	• The lock-in period for repatriation of the sale proceeds of immovable property (other than agricultural land/farm house/ plantation property) purchased in India by NRIs/PIOs was removed. The sale proceeds allowed to be repatriated should, however, not exceed the foreign exchange brought in to acquire the property.
		• Persons resident in India were allowed to open, hold and maintain with ADs in India Foreign Currency Accounts to be known as Resident Foreign Currency (Domestic) Account, out of foreign exchange acquired in the form of currency notes, bank notes and travellers' cheques. This facility is in addition to the existing RFC facility and the facility of retention of foreign exchange in cash and/or travellers cheques up to US $ 2,000 or its equivalent. The accounts will be maintained in the form of current accounts and there will be no ceiling on the balances held in them. Resident Foreign Currency (Domestic) Accounts can also be credited with/ opened out of foreign exchange earned/or gifts received from close relatives (as defined in the Company Act) and repatriated to India through normal banking channels by resident individuals. Foreign exchange earnings could be through export of goods and/or services, royalty, honorarium, *etc.*
	5	• It was clarified that ADs may issue ICCs to NRIs/PIOs, without prior approval of the Reserve Bank, subject to the condition that charges on the use of ICCs should be settled by the concerned NRIs/PIOs either out of inward remittances or balances held in their Non-Resident External (NRE)Accounts/Foreign Currency Non-Resident(FCNR) Accounts. Subsequently, ADs were permitted to settle credit card charges out of funds held in the card holders' Non-Resident (Ordinary) Rupee Account (NRO) as well to the extent of card limit for use of credit cards issued by banks in India.
	8	• Exporters desirous of submitting bids for execution of projects abroad, including service contract, have been allowed to issue Corporate Guarantee in lieu of Bid Bond Guarantee subject to the condition that the amount of such guarantee shall not exceed 5 per cent of the contract value and the exporters have complied with the provisions contained in Memorandum PEM and other instructions issued by the Reserve Bank from time to time in this regard.
	12	• Entities in the SEZs were granted general permission to undertake hedging transactions in the international commodity exchanges/markets to hedge their commodity price risk on import/export, provided such transactions are undertaken on "stand-alone" basis.
		• ADs were permitted to allow NRIs/PIOs to credit to their NRE/FCNR accounts, refund of application/earnest money/ purchase consideration made by the house building agencies/seller on account of non-allotment of flat/plot/cancellation of bookings/deals for purchase of residential, commercial property, together with interest, if any, but net of income tax payable thereon subject to specified conditions.
	16	• With a view to accord further flexibility in their funds management, banks in India were allowed to invest up to 50 per cent of their unimpaired Tier I Capital or US $ 25 million whichever is higher, in overseas money market instruments and/ or debt instruments.
		• With a view to simplifying and liberalising the procedure for import, the limit for advance remittance without bank guarantee by ADs was raised from US $ 25,000 to US $ 1,00,000 or its equivalent for import of goods into India subject to specified conditions.

Date of Announce-ment		POLICY ANNOUNCEMENTS
2002		**V. EXTERNAL SECTOR POLICIES** *(Contd.)*
Nov.	**16**	• With a view to further liberalise and simplify the facility, the FIIs were permitted to hedge the market value of their entire investment in equity as on a particular date without any reference to a cut-off date. If a hedge becomes naked in part or full owing to shrinking of the value of the portfolio, it may be allowed to continue to the original maturity, if so desired.
	18	• As a measure of further liberalisation, the limit of US $ 5,000 or its equivalent to be released by Authorised Persons to resident individuals in one calendar year, for one or more private visits to any country (except Nepal and Bhutan) was enhanced to US $ 10,000 or its equivalent.
	27	• The facility of acceptance of either Exchange Control copy of Bill of Entry for home consumption or a certificate from the Chief Executive Officer (CEO) or Auditor of a limited or public sector Company that the goods for which remittance was made have actually been imported into India in cases of imports into India, where the amount of foreign exchange remitted is less than US $ 1,00,000 or its equivalent, was extended to autonomous bodies, including scientific bodies/ academic institutions, such as Indian Institute of Science/Indian Institute of Technology, whose accounts are audited by the Comptroller and Auditor General of India (CAG).
Dec.	**2**	• As a part of further liberalisation, the existing ceiling for Indian investment in Myanmar and SAARC countries (excluding Pakistan) under the automatic route was enhanced to US $ 150 million or its equivalent, against the earlier limit of US $ 100 million. The earlier limit of Rs.350 crore for rupee investment in Nepal and Bhutan was raised to Rs.700 crore.
	14	• With a view to ensuring that exporters invariably surrender the export incentives in respect of export bills for which they seek “write-offs”, ADs were advised to obtain document/s evidencing surrender of the export incentives availed of by them before permitting the relevant outstanding bills to be written off. The ADs have also been advised to put in place a system under which their internal inspectors or auditors (including external auditors appointed by ADs) carry out random sample check/percentage check of outstanding export bills written off.
	17	• ADs were advised that the payments received in foreign exchange by a unit in Domestic Tariff Area (DTA) for supply of goods to a unit in SEZ out of its foreign currency account are eligible foreign exchange earnings for the purpose of credit to the EEFC Account.
	21	• The limit of US $ 25 million put on the swap allowed by ADs to facilitate their customers to hedge their foreign exchange exposures was removed. ADs are now free to offer such swaps to customers subject to overall prudential and risk management guidelines. The specified limits would, however, continue for swap transactions facilitating customers to assume a foreign exchange liability, thereby resulting in supply in the market. Positions arising out of cancellation of swaps by customers need not be reckoned within the cap.
		• Banks were allowed to invest their unimpaired Tier I Capital in overseas money market or debt instruments without any percentage or absolute limit subject to approval by their Board of Directors.
		• ADs were allowed to permit their customers to book forward contracts up to the eligible limit, subject to the condition that forward contracts outstanding at any point of time shall not exceed 25 per cent of the eligible limit, within the cap of US $ 100 million to be computed separately for import and export transactions.
		• The cap of US $ 100 million per financial year for rebooking of cancelled forward contracts for a customer was withdrawn and ADs were advised that they are free to offer this facility of rebooking of cancelled contracts to all foreign exchange exposures falling due within one year subject to the condition that the customers submit details of exposure to the ADs in the revised format prescribed.
		• Forward contracts booked to cover exposures falling due beyond one year and long-term foreign currency-rupee swaps, once cancelled, cannot be rebooked. ADs were allowed to continue to offer this facility without any restrictions in respect of export transactions.
		• The restriction on the foreign banks in India that the hedge transactions should spread over a period of six month was removed.
		• ADs are now free to offer forward contracts to persons resident outside India subject to verification of their exposure in India. These forward contracts once cancelled are not eligible to be rebooked.
2003		
Jan.	**6**	• The limit for advance remittance by ADs without bank guarantee for all admissible current account transactions without prior approval of the Reserve Bank was enhanced from US $ 25,000 to US $ 1,00,000.
	13	• Subject to certain specified conditions, listed Indian companies were permitted to invest abroad in companies listed on a recognised stock exchange and having the shareholding of at least 10 per cent in an Indian company listed on a recognised stock exchange in India (as on 1st January of the year of the investment). Such investments shall not exceed 25 per cent of the Indian company’s net worth, as on the date of its latest audited balance sheet.
		• MFs were permitted to invest in equity of overseas companies as indicated above subject to certain specified conditions. Accordingly, the overall cap of US $ 500 million fixed earlier for investment abroad in ADRs/GDRs of Indian companies and rated debt instruments in overseas markets was raised to US $ 1 billion.

Date of Announcement		POLICY ANNOUNCEMENTS
2003		**V. EXTERNAL SECTOR POLICIES** *(Contd.)*
Jan.	**13**	• Resident individuals were also permitted to invest in overseas companies as indicated above without any monetary limit, subject to certain specified conditions.
		• The existing dispensation of permitting repatriation of funds out of NRO accounts up to specified limits for each of the different purposes such as education, medical, sale proceeds of immovable property, assets of foreign nationals including retired employees/widows of Indian citizens resident outside India and assets in India acquired by NRIs/PIOs by way of inheritance/legacy, was removed and ADs were permitted to allow remittance/s up to US $ 1 million in a year out of balances held in NRO accounts/sale proceeds of assets. All other conditions required to be fulfilled in this regard including liability towards Indian taxes, however, remain unchanged.
		• The monetary restriction of US $ 20,000 on remittance by resident individual who is an employee or a director of an Indian office or branch of a foreign company or of a subsidiary of a foreign company or of an Indian company, for acquisition of foreign securities under Employees Stock Option (ESOP) Scheme was removed. All other conditions to be fulfilled for allowing remittance under the scheme have, however, been retained.
		• Indian companies were permitted to retain abroad funds raised through ADRs/GDRs for any period to meet their future forex requirements. Pending repatriation or utilisation of such foreign currency funds, they have also been allowed to invest them in certain specified categories of deposits/monetary instruments.
		• Corporates were allowed to retain the funds raised by them by way of External Commercial Borrowings (ECBs) in bank accounts abroad, for their future forex requirements, subject to fulfilment of certain specified conditions.
		• Indian corporates, who have set up overseas offices, were allowed to acquire immovable property outside India for their business and staff's residential purposes with prior permission from the Reserve Bank.
		All these facilities are available till further notice.
	24	• NRIs/PIOs were required to settle charges on the use of International Credit Cards (ICCs), only out of inward remittances or balances held in their NRE/FCNR(B) accounts. On a review, such card holders holding credit cards issued by banks in India, have been permitted to settle credit card charges out of funds held in their NRO accounts to the extent of the card limit. The debits shall be subject to the same conditions as in the case of residents.
		• With a view to providing hassle free service to customers, the use of ICCs by residents while on tour abroad has been made free from all restrictions, including any item-wise limits within the overall ceiling of the credit card itself. The restrictions on use of ICCs for purchase of prohibited items, *e.g.* lottery tickets, banned or proscribed magazines, participation in sweepstakes, payment of call-back services *etc.,* will remain.
Feb.	**3**	• As a measure of further liberalisation and in order to encourage Indian companies to list ADRs/GDRs on the overseas exchanges, through the scheme of sponsored ADRs/GDRs, resident shareholders of Indian companies, who offer their shares for conversion to ADRs/GDRs, were allowed to receive the sale proceeds in foreign currency subject to condition that the conversion to such ADRs/GDRs should have the approval of Foreign Investment Promotion Board (FIPB). Further, the sale proceeds, so received by residents, are also permitted to be credited to their Exchange Earners' Foreign Currency/Resident Foreign Currency (Domestic) [EEFC/RFC(D)] accounts or to their Rupee accounts in India at their option. Disinvestment proceeds under the scheme, receivable by residents, who have since become non-residents, would also be eligible for credit to their foreign currency accounts abroad or any of their accounts in India at their option.
	10	• With a view to simplifying the procedure for remittances for advertisement on foreign television, ADs were advised to do away with the insistence on furnishing of Chartered Accountant's certificate by the exporters if the stipulated export earnings during the preceding 2 years have been realised through them only.
	14	• As a measure of relaxation of the EEFC Account Scheme, ADs were empowered to permit their exporter constituents to extend trade related loans/advances to overseas importers out of their EEFC balances without any monetary ceiling. This relaxation, which was effective up to June 30, 2003, was subsequently extended till further notice.
March	**1**	• The ceiling of US $ 100 million stipulated earlier for repayment of ECBs under the automatic route was removed. ADs have accordingly been empowered to allow remittances towards prepayment of outstanding ECBs without any limit out of local resources/market purchases, subject to fulfilment of the other conditions prescribed by the Reserve Bank. This relaxation is available till further notice.
		• The automatic route for overseas direct investment was further liberalised: i) The limit of 50 per cent of net worth for market purchases of foreign exchange for investment in JV/WOS abroad was enhanced to 100 per cent of the net worth of the investing company; and, ii) An Indian company with a proven track record would now be eligible to invest up to 100 per cent of its net worth within the overall limit of US $ 100 million by way of market purchases for investment in a foreign entity engaged in any bonafide business activity.
	3	• ADs were empowered to open Stand-by Letters of Credit on behalf of their importer constituents for import of permissible goods into India.

Date of Announce-ment		POLICY ANNOUNCEMENTS
2003		**V. EXTERNAL SECTOR POLICIES** *(Concld.)*
March	**20**	• ADs have been permitted to consider proposals received from organisers of International Seminars/Conferences/ Conventions for opening of temporary foreign currency accounts in India, subject to fulfilment of certain specified conditions including obtaining of prior approval from the concerned Administrative Ministry of Government of India for the conduct of the relevant event.
	27	• ADs were permitted to allow Indian companies to prepay the existing FCCBs subject to the conditions stipulated in terms of Government of India Press Note dated 5th February 2003.
April	**1**	• A number of incentives/facilities for Special Economic Zones (SEZs) were announced: i) The stipulation of twelve months or extended period thereof for realisation of export proceeds removed in respect of SEZs, ii) Units in SEZs have been permitted to undertake job work abroad and export goods from that country itself, subject to certain conditions, iii) Gem and Jewellery units in SEZs and EOUs were allowed to receive payment for exports in the form of precious metals *i.e.* Gold/Silver/Platinum equivalent to the value of jewellery exported, subject to certain conditions, iv) 'Netting off' of export receivables against import payments as well as capitalisation of import payables was permitted, subject to stipulated conditions for SEZ units.
	26	• It was clarified that ADs/NHB approved housing finance institutions in India could grant loans to NRIs/PIOs for purpose of repairs/renovation/improvement of residential accommodation owned by them in India.
	29	• Indian corporates and resident individuals were permitted to invest in rated bonds/fixed income securities of listed eligible companies abroad subject to certain conditions.
		• The requirement of obtaining separate permission from RBI by the Mutual Funds (MFs) for investing overseas in debt/ equity/ADRs/GDRs under the existing regulations was waived. Accordingly, MFs having the requisite approval from SEBI, may proceed to invest overseas.
		• Overseas investors making long-term investments allowed to hedge their forex exposures in India, pending investment, by entering into forward sale contracts with banks in India.
		• Entities having transactions denominated in foreign currency but settled in rupees permitted to book forward contracts which should be held till maturity and on which cash settlement would be made on the maturity date.
		• NRIs/OCBs allowed to book cross currency forward contracts to hedge the balances held in their FCNR (B) accounts. However, contracts once cancelled cannot be rebooked.
May	**5**	• Repatriation of sale proceeds of residential accommodation purchased by NRIs/PIOs out of funds raised by them by way of loans from the ADs/housing finance institutions was allowed to be made by ADs to the extent of such loans repaid by them out of foreign inward remittances.
	21	• As a step towards further liberalisation, resident individuals maintaining a foreign currency account with an AD in India or a bank abroad, as permissible under extant regulations, have been extended the facility of obtaining International Credit Cards issued by overseas banks and other reputed agencies. The charges incurred against the card either in India or abroad, were allowed to be met out of funds held in such foreign currency accounts of the card holder or through remittances from India only through a bank where the card-holder has a current or savings account. Restrictions on purchase of prohibited items continue to apply to such cards.
June	**16**	• Units in Domestic Tariff Areas (DTA) have been permitted to purchase foreign exchange from ADs to pay for goods supplied to them by units in SEZs.
	21	• For developing the derivative market in India and widening the spectrum of hedge products available to residents and non-residents for hedging currency exposures, foreign currency rupee options have been permitted with effect from July 7, 2003. ADs having a minimum CRAR of 9 per cent will be permitted to offer the product on a back-to-back basis. Further, ADs having adequate internal control, risk monitoring/management systems, mark to market mechanism along with fulfilling of certain specified criteria will be allowed to run an option book after obtaining a one time approval from the Reserve Bank.
July	**17**	• The existing limits on remittances in respect of items like employment, emigration, maintenance of close relatives and education abroad were enhanced uniformly to US $ 1,00,000. ADs were permitted to release foreign exchange up to US $1,00,000 or its equivalent (against the existing limit of US $ 50,000 or its equivalent), to resident Indians for medical treatment abroad, without insisting on any estimate from a hospital/doctor in India/abroad, subject to the existing conditions. The limit for remittance towards consultancy services procured from outside India was enhanced to US $ 1 million per project, as against the existing limit of US $ 1,00,000.
	19	• It was clarified that short term credit either by way of suppliers' credit or buyers' credit would not be available for merchanting trade or intermediary trade transactions.
	21	• All companies entering into foreign technology collaboration agreements under the automatic approval route, irrespective of the extent of foreign equity in the shareholding, were permitted to make royalty payments at 8 per cent on export and 5 per cent on domestic sales without any restriction on the duration of royalty payments. All cases of payment of royalty under the automatic route will continue to require prior registration with the Reserve Bank.

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APPENDIX TABLE I.1 : SELECT MACROECONOMIC AND FINANCIAL INDICATORS

Item	2002-03	2001-02	2000-01	1999-2000	1998-99	Average	
						1993-94 to 2002-03 (10 years)	1980-81 to 1989-90 (10 years)
1	2	3	4	5	6	7	8
1. Real GDP (% change)	4.3 (R.E.)	5.6 (Q.E.)	4.4 (P)	6.1	6.5	6.0	5.8
2. Industrial Production (% change)	5.8	2.7	5.0	6.7	4.1	6.5	7.4
3. Agricultural Production (% change)	-12.6	7.0	-6.3	-1.3	7.6	0.4	5.2
4. Foodgrains Production (Million tonnes)	182.6	212.0	196.8	209.8	203.6	203.23	146.5
5. Gross Domestic Saving Rate (% of GDP)	..	24.0	23.4	24.1	21.5	23.5 *	19.4
6. Gross Domestic Investment Rate (% of GDP)	..	23.7	24.0	25.2	22.6	24.5 *	21.2
7. Central Government Finances (% of GDP)							
a) Total Revenue Receipts	9.6 (R.E.)	8.8	9.2	9.4	8.6	9.1	9.8
b) Total Expenditure	16.3 (R.E.)	15.8	15.5	15.4	16.0	15.6	17.7
c) Revenue Deficit	4.2 (R.E.)	4.4	4.1	3.5	3.8	3.5	1.7
d) Fiscal Deficit	5.9 (R.E.)	6.1	5.6	5.4	6.5	5.8	6.8
e) Net RBI Credit to Centre	-1.1	-0.2	0.3	-0.3	0.7	0.2	2.1
f) Interest Payments	4.7 (R.E.)	4.7	4.7	4.7	4.5	4.5	2.6
g) Domestic Debt	60.9 (R.E.)	56.4	52.4	49.7	47.9	50.5	41.7
8. Monetary Aggregates (% change)							
a) Broad Money (M_3)	13.2 @	14.1	16.8	14.6	19.4	16.7	17.2
b) Narrow Money (M_1)	11.8	11.4	11.0	10.6	15.4	14.4	15.1
c) Reserve Money	9.2	11.4	8.1	8.2	14.5	13.0	16.8
9. Scheduled Commercial Banks (% change)							
a) Aggregate Deposits	13.4 @	14.6	18.4	13.9	19.3	16.7	18.1
b) Bank Credit	16.1 @	15.3	17.3	18.2	13.8	16.4	16.8
c) Non-Food Credit	18.6 @	13.6	14.9	16.5	13.0	16.1	17.8
d) Investments in Government Securities	27.3	20.9	22.1	24.7	19.4	21.4	19.4
10. Wholesale Price Index (% change)							
a) Point-to-Point	6.5	1.6	4.9	6.5	5.3	6.7	7.5
b) Average	3.4	3.6	7.2	3.3	5.9	6.1	8.0
11. Consumer Price Index - Industrial Workers (% change)							
a) Point-to-Point	4.1	5.2	2.5	4.8	8.9	7.2	8.9
b) Average	4.0	4.3	3.8	3.4	13.1	7.3	9.1
12. Average BSE Sensitive Index (% change)	-3.8	-22.0	-8.4	41.4	-13.6	2.9	22.3
13. Trade and Balance of Payments							
a) Exports in US $ (% change)	19.2	-1.6	21.0	10.8	-5.1	11.3	8.1
b) Imports in US $ (% change)	19.2	1.7	1.7	17.2	2.2	11.2	7.2
c) Current Account (% of GDP)	0.7	0.2	-0.8	-1.1	-1.0	-0.8	-1.8
d) Capital Account (% of GDP)	2.5	2.2	2.2	2.3	2.1	2.4	1.6
14. Foreign Exchange Reserves* (US $ Million)	75,428	54,106	42,281	38,036	32,490	–	..
15. External Debt* (US $ Million)	104,236	98,761	101,132	98,263	96,886	–	..
a) Debt-GDP Ratio	20.0	21.0	22.4	22.1	23.6	25.0	..
b) Debt-Service Ratio	14.7	13.9	17.2	16.2	17.8	19.6	..
16. Exchange Rate (Rs. / US$)							
a) High	47.51	46.56	43.61	42.44	39.48	31.21	7.73
b) Low	49.06	48.85	46.89	43.64	43.42	49.06	17.13

P Provisional. .. Not available. * Average for nine years from 1993-94 to 2001-02. Q.E. Quick Estimates.
B.E. Budget Estimates. R.E. Revised Estimates. @ Adjusted for mergers.

APPENDIX TABLE I.2 : INTEREST RATE STRUCTURE OF SCHEDULED COMMERCIAL BANKS

(Per cent per annum)

Item	Rates as on																
	July 11, 2003	Mar 1, 2003	Feb 21, 2003	Jan 24, 2003	Jan 17 2003	Jan 10, 2003	Jan 03, 2003	Dec 27, 2002	Dec 20, 2002	Dec. 13, 2002	Nov 22, 2002	Nov 15, 2002	Nov 08, 2002	Nov 01, 2002	Sept 27, 2002	Sept 13, 2002	Aug 23, 2002
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
A. Lending Rates Size of Credit Limit																	
1. Up to Rs. 2 lakh #	≤ PLR	≤ PLR	≤ PLR	≤ PLR	≤ PLR	≤ PLR	≤ PLR	≤ PLR	≤ PLR	≤ PLR	≤ PLR	≤ PLR	≤ PLR	≤ PLR	≤ PLR	≤ PLR	≤ PLR
2. Over Rs. 2 lakh : (Prime Lending Rate)*	10.5-11.50	10.75-11.50	10.75-11.50	10.75-11.50	10.75-11.50	10.75-11.50	10.75-11.50	10.75-11.50	10.75-11.50	10.75-11.50	10.75-11.50	10.75-11.50	10.75-11.50	11.00-12.00	11.00-12.00	11.00-12.00	11.00-12.00
a. Maximum Spread over PLR	2.50-4.00	2.50-4.00	2.50-4.00	2.50-4.00	2.50-4.00	2.50-4.00	2.50-4.00	2.50-4.00	2.50-4.00	2.50-4.00	2.50-4.00	2.50-4.00	2.50-4.00	2.50-4.00	3.35-4.00	3.50-4.00	3.50-4.00
B. Deposit Rates Category of Account																	
1. Current	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
2. Savings	3.50	3.50	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
3. Term Deposits @																	
a) Up to and including one year	4.00-5.25	4.25-5.75	4.25-5.75	4.25-5.50	4.25-5.75	4.25-6.00	4.25-6.00	4.25-6.00	4.25-6.00	4.25-6.00	4.25-6.00	4.25-6.00	4.25-6.00	4.25-6.50	4.25-6.50	4.25-6.00	4.75-6.50
b) 1-2 years	5.00-5.75	5.50-6.00	5.50-6.00	5.50-6.00	5.50-5.75	5.50-6.25	5.50-6.25	5.50-6.50	6.00-6.50	6.00-6.50	6.00-6.50	6.25-6.50	6.25-6.50	6.50-7.00	6.50-7.00	5.50-6.25	7.00-7.25
c) 2-3 years	5.00-5.75	5.50-6.00	5.50-6.00	5.50-6.00	5.50-6.25	5.50-6.25	5.50-6.25	6.00-6.50	6.25-6.50	6.25-6.50	6.25-6.50	6.25-6.50	6.25-6.75	6.75-7.25	6.75-7.25	5.50-6.25	7.25-7.50
d) > 3 years	5.25-6.00	5.75-6.25	5.75-6.25	5.75-6.25	5.50-6.25	5.50-6.25	5.50-6.50	6.25-6.75	6.25-6.75	6.25-6.75	6.50-6.75	6.50-6.75	6.50-7.00	7.00-7.50	7.00-7.50	5.50-6.25	7.50-8.00
Memo Item :																	
Bank Rate ##	6.00 (April 29, 2003)	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25 (October 29, 2002)	6.50	6.50	6.50

* Data relate to major public sector banks.

\# Effective April 1998, credit limits of over Rs. 25,000 and up to Rs. 2 lakh have been merged and are specified as up to Rs. 2 lakh.

@ The minimum maturity period of term deposits is 15 days, effective April 29, 1998. Data relate to major public sector banks.

\## The change in the Bank Rate was made effective from the close of business of respective dates indicated in the bracket.

≤ Not Exceeding

APPENDIX TABLE I.3 : INTEREST RATES ON EXPORT CREDIT

(Per cent per annum)

	Rates Effective									
Export Credit	Effective from May 1, 2003 to October 31, 2003	September 26, 2001#	May 5, 2001#	January 6, 2001	May 26, 2000	October, 29 1999	April 1, 1999	Augst 6, 1998	Apirl 30, 1998	January 1, 1998
1			3		4	5	6	7	8	9
1. Pre-shipment Credit										
i) Up to 180 days	≤PLR-2.5 PP	≤PLR-2.5 PP	≤PLR-1.5 PP	10.00	10.00	10.00	10.00	9.00	11.00	12.00
ii) Beyond 180 days and up to 270 days	Free	≤PLR+0.5 PP	≤PLR+1.5 PP	13.00	13.00	13.00	13.00	12.00	14.00	14.00
iii) Against incentives receivable from Government covered by ECGC Guarantee up to 90 days	≤PLR-2.5 PP	≤PLR-2.5 PP	≤PLR-1.5 PP	10.00	10.00	10.00	10.00	9.00	11.00	12.00
2. Post-shipment Credit										
i) Demand Bills for transit period (as specified by FEDAI)	≤PLR-2.5 PP	≤PLR-2.5 PP	≤PLR-1.5 PP	≤10.00	≤10.00	≤10.00	≤10.00	9.00	≤11.00	≤11.00
ii) Usance Bills*										
a) Up to 90 days	≤PLR-2.5 PP	≤PLR-2.5 PP	≤PLR-1.5 PP	≤10.00	≤10.00	≤10.00	≤10.00	9.00	≤11.00	≤11.00
b) Beyond 90 days and up to six months from the date of shipment	Free	≤PLR+0.5 PP	≤PLR+1.5 PP	12.00	12.00	12.00	12.00	11.00	13.00	13.00
c) Beyond six months from the date of shipment	–	–	–	–	–	–	–	–	–	20.00$ (Min.)
iii) Against incentives receivable from Government covered by ECGC Guarantee (up to 90 days)	≤PLR-2.5 PP	≤PLR-2.5 PP	≤PLR-1.5 PP	≤10.00	≤10.00	≤10.00	≤10.00	9.00	≤11.00	≤11.00
iv) Against undrawn balance (up to 90 days)	≤PLR-2.5 PP	≤PLR-2.5 PP	≤PLR-1.5 PP	≤10.00	≤10.00	≤10.00	≤10.00	9.00	≤11.00	≤11.00
v) Against retention money (for supplies portion only) payable within one year from the date of shipment (up to 90 days)	≤PLR-2.5 PP	≤PLR-2.5 PP	≤PLR-1.5 PP	≤10.00	≤10.00	≤10.00	≤10.00	9.00	≤11.00	≤11.00
3. Deferred Credit										
Deferred credit for the period beyond 180 days	Free	Free	Free	Free	Free	Free	Free	Free	Free (FDA)	Free (FDA)
4. Export Credit, not otherwise specified										
a) Pre-shipment credit	Free	Free	Free	Free	Free	Free	Free	Free	Free	
b) Post-shipment credit	Free	Free	Free	Free	25.00 (Min.)	Free	20.00 (Min.)	20.00 (Min.)	20.00 (Min.)	20.00 (Min.)

FDA From the date of advance. ≤ Not Exceeding Min. Minimum – Not Applicable

$ Chronic cases, *i.e.*, overdues as on July 1, 1997 are exempted. PP Percentage Points

These are ceiling rates, banks would be free to charge any rate below the ceiliing rate.

Note : 'Free' means banks are free to charge interest rates decided by them keeping in view the PLR and spread guidelines.

APPENDIX TABLE II.1 : GROWTH RATES AND SECTORAL COMPOSITION OF REAL GROSS DOMESTIC PRODUCT (AT 1993-94 PRICES)

(Per cent)

Sector	Growth Rate			Share in GDP		
	2002-03#	2001-02*	2000-01@	2002-03#	2001-02*	2000-01@
1	2	3	4	5	6	7
1. Agriculture and Allied Activities	**-3.2**	**5.7**	**-0.4**	**22.1**	**23.9**	**23.8**
of which :						
1.1 Agriculture	..	5.7	-0.6	..	21.9	21.8
2. Industry	**5.7**	**3.2**	**6.5**	**21.8**	**21.5**	**22.0**
of which :						
2.1 Manufacturing	6.1	3.4	7.3	17.1	16.8	17.2
2.2 Mining and Quarrying	5.0	1.0	2.4	2.2	2.2	2.3
2.3 Electricity, Gas and Water Supply	3.9	4.3	5.0	2.4	2.5	2.5
3. Services	**7.1**	**6.5**	**5.7**	**56.1**	**54.6**	**54.1**
of which :						
3.1 Trade, Hotels, Restaurants, Transport and Communication	7.8	8.7	6.9	24.3	23.5	22.8
3.2 Financing, Insurance, Real Estate and Business Services	6.1	4.5	3.5	12.7	12.5	12.6
3.3 Community, Social and Personal Services	6.8	5.6	5.6	13.8	13.5	13.5
3.4 Construction	7.2	3.7	6.9	5.3	5.1	5.2
4. Gross Domestic Product at Factor Cost	**4.3**	**5.6**	**4.4**	**100.0**	**100.0**	**100.0**

Revised Estimates. * Quick Estimates. @ Provisional.

.. Not Separately Available.

Source : Central Statistical Organisation.

APPENDIX TABLE II.2 : QUARTERLY GROWTH RATES AND SECTORAL COMPOSITION OF REAL GROSS DOMESTIC PRODUCT (AT 1993-94 PRICES)

(Per cent)

Sector	2002-03				2001-02				2000-01			
	Q_1	Q_2	Q_3	Q_4	Q_1	Q_2	Q_3	Q_4	Q_1	Q_2	Q_3	Q_4
1	2	3	4	5	6	7	8	9	10	11	12	13
1. Agriculture and Allied Activities	**2.7**	**-3.5**	**-7.6**	**-2.8**	**2.6**	**5.6**	**5.9**	**8.3**	**-1.1**	**4.5**	**-1.5**	**-5.3**
	(23.3)	**(17.8)**	**(25.8)**	**(21.1)**	**(23.9)**	**(19.4)**	**(28.6)**	**(22.8)**	**(24.3)**	**(19.3)**	**(28.7)**	**(22.4)**
2. Industry	**4.3**	**6.2**	**6.2**	**6.2**	**2.4**	**3.0**	**3.5**	**4.0**	**7.7**	**6.5**	**7.2**	**4.3**
	(21.9)	**(23.5)**	**(20.8)**	**(21.3)**	**(22.1)**	**(23.3)**	**(20.0)**	**(21.1)**	**(22.5)**	**(23.8)**	**(20.6)**	**(21.5)**
of which :												
a) Manufacturing	3.8	6.5	6.7	7.1	2.9	3.1	3.4	4.1	8.5	7.5	7.6	5.1
	(17.1)	(18.5)	(16.2)	(16.8)	(17.4)	(18.2)	(15.6)	(16.5)	(17.6)	(18.6)	(16.0)	(16.8)
b) Mining and Quarrying	7.6	6.0	3.8	3.2	-2.5	-0.2	3.6	2.7	5.5	4.2	4.7	1.3
	(2.2)	(2.3)	(2.2)	(2.2)	(2.5)	(2.3)	(2.1)	(2.3)	(2.3)	(2.5)	(2.2)	(2.3)
c) Electricity, Gas and Water Supply	4.4	4.0	5.0	2.4	3.5	5.0	3.4	5.0	5.0	2.4	7.2	2.0
	(2.5)	(2.7)	(2.3)	(2.3)	(2.6)	(2.7)	(2.3)	(2.3)	(2.6)	(2.7)	(2.3)	(2.3)
3. Services	**6.8**	**7.8**	**6.4**	**7.5**	**6.0**	**5.8**	**7.7**	**6.3**	**6.8**	**8.0**	**6.5**	**4.2**
	(54.8)	**(58.7)**	**(53.4)**	**(57.6)**	**(54.0)**	**(57.3)**	**(51.4)**	**(56.2)**	**(53.2)**	**(56.9)**	**(50.7)**	**(56.1)**
of which :												
a) Trade, Hotels, Restaurants, Transport	6.9	8.1	7.2	8.8	7.7	9.0	8.4	9.7	9.7	8.4	7.5	6.1
and Communication	(23.9)	(25.0)	(23.7)	(24.5)	(23.5)	(24.4)	(22.6)	(23.6)	(22.8)	(23.5)	(22.2)	(22.9)
b) Financing, Insurance, Real Estate	6.7	7.0	6.3	4.4	4.5	5.0	4.8	3.8	4.5	3.8	3.1	2.5
and Business Services	(13.0)	(13.7)	(12.0)	(12.1)	(12.8)	(13.5)	(11.6)	(12.2)	(12.8)	(13.5)	(11.8)	(12.5)
c) Community, Social and Personal Services	6.9	7.8	4.6	7.7	6.8	3.1	10.3	3.1	1.8	10.7	8.0	4.6
	(12.5)	(14.3)	(12.6)	(15.8)	(12.3)	(14.0)	(12.3)	(15.3)	(12.0)	(14.3)	(11.9)	(15.8)
d) Construction	6.2	8.5	6.7	7.5	0.3	1.3	5.5	7.5	12.5	9.9	7.1	-1.0
	(5.4)	(5.6)	(5.0)	(5.2)	(5.4)	(5.4)	(4.8)	(5.1)	(5.6)	(5.6)	(4.8)	(5.0)
4. Gross Domestic Product at Factor Cost	**5.3**	**5.2**	**2.3**	**4.9**	**4.4**	**5.1**	**6.3**	**6.3**	**5.0**	**7.0**	**4.2**	**1.9**
	(100.0)	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**

Notes : 1. Figures in brackets are percentage shares to GDP.

2. Quarters Q_1, Q_2 , Q_3 and Q_4 denote April-June, July-September, October-December and January-March, respectively.

Source : Central Statistical Organisation.

APPENDIX TABLE II. 3 : AGRICULTURAL PRODUCTION

(Million tonnes)

Crop	2002-03 A	2001-02	2000-01	1999-2000	1998-99
1	2	3	4	5	6
1. All Crops: Annual Growth Rate (Per cent) $	**-12.6**	**7.0**	**-6.3**	**-1.3**	**7.6**
i) Foodgrains	-14.6	8.4	-6.7	2.7	6.1
ii) Non-foodgrains	-9.5	4.8	-5.7	-6.8	9.8
2. Foodgrains (a+b)	**182.6**	**212.0**	**196.8**	**209.8**	**203.6**
i) Rice	75.7	93.1	85.0	89.7	86.1
ii) Wheat	69.3	71.8	69.7	76.4	71.3
iii) Coarse cereals	26.2	33.9	31.1	30.3	31.3
iv) Pulses	11.3	13.2	11.1	13.4	14.9
a) Kharif	**90.5**	**111.6**	**102.1**	**105.5**	**102.9**
i) Rice	66.5	79.8	72.8	77.5	72.7
ii) Coarse cereals	20.1	26.9	24.9	23.2	25.1
iii) Pulses	3.8	4.9	4.5	4.8	5.1
b) Rabi	**92.1**	**100.5**	**94.7**	**104.3**	**100.7**
i) Rice	9.2	13.3	12.2	12.2	13.4
ii) Wheat	69.3	71.8	69.7	76.4	71.3
iii) Coarse cereals	6.1	7.0	6.2	7.1	6.3
iv) Pulses	7.5	8.3	6.6	8.6	9.8
3. Non-foodgrains					
i) Oilseeds + +	15.8	20.8	18.4	20.7	24.8
ii) Sugarcane	278.6	300.1	296.0	299.3	288.7
iii) Cotton @	9.3	10.1	9.5	11.5	12.3
iv) Jute and Mesta +	10.8	11.6	10.6	10.6	9.8
v) Tea *	..	847.3	848.4	835.4	854.8
vi) Coffee *	275.3	300.6	301.2	292.0	265.0

A Advance estimates as on July 1, 2003.

$ Based on Index of Agricultural Production with base triennium ending 1981-82 = 100.

++ For nine oilseeds out of eleven in all.

@ Million bales of 170 kg. each.

* Million kilograms and data for tea on a calendar year basis.

+ Million bales of 180 kg. each.

.. Not Available

Source : Ministry of Agriculture, Government of India; Tea Board and Coffee Board.

APPENDIX TABLE II.4 : PROCUREMENT, OFF-TAKE AND STOCKS OF FOODGRAINS

(Million tonnes)

Fiscal year	Procurement			Off-take			Stocks *		
	Rice	Wheat	Total	Rice	Wheat	Total	Rice	Wheat	Total @
1	2	3	4	5	6	7	8	9	10
1995-96	9.91	12.33	22.24	11.63	12.72	24.35	13.06	7.76	20.82
1996-97	11.87	8.16	20.04	12.31	13.32	25.63	13.17	3.24	16.41
1997-98	14.51	9.30	23.82	11.27	7.76	18.96	13.05	5.08	18.12
1998-99	11.56	12.65	24.21	11.83	8.90	20.73	12.16	9.66	21.82
1999-2000	17.28	14.14	31.43	12.42	10.63	23.05	15.72	13.19	28.91
2000-01	20.10	16.35	36.46	10.42	7.79	18.21	23.19	21.50	44.98
2001-02	20.88	20.63	41.51	15.32	15.99	31.31	24.91	26.04	51.02
2002-03	18.82	19.02	37.84	24.60	24.99	49.59	17.16	15.65	32.81
First Quarter (April-June)									
2002-03	3.95	18.94	22.89	6.48	3.93	10.41	21.94	41.07	63.05
2003-2004	1.93	15.78	17.71	6.60	5.82	12.43	10.97	24.19	35.17

* Stocks are as at end-March.

@ Includes coarse grains.

Source : Ministry of Food, Consumer Affairs and Public Distribution, Government of India.

APPENDIX TABLE II.5 : TRENDS IN INDEX OF INDUSTRIAL PRODUCTION (BASE : 1993-94=100)

Sector	Mining & Quarrying		Manufacturing		Electricity		General	
Weight	10.47		79.36		10.17		100.00	
Period	Index	Growth Rate (per cent)	Index	Growth Rate (per cent)	Index	Growth Rate (per cent)	Index	Growth Rate (per cent)
1	2	3	4	5	6	7	8	9
1998-99	125.4	-0.8	148.8	4.4	138.4	6.5	145.2	4.1
		(-1.8)		(86.9)		(14.9)		(100.0)
1999-2000	126.7	1.0	159.4	7.1	148.5	7.3	154.9	6.7
		(1.4)		(87.9)		(10.7)		(100.0)
2000-01	130.3	2.8	167.9	5.3	154.4	4.0	162.6	5.0
		(4.9)		(87.3)		(7.7)		(100.0)
2001-02	131.9	1.2	172.7	2.9	159.2	3.1	167.0	2.7
		(3.8)		(85.3)		(10.9)		(100.0)
2002-03 P	139.6	5.8	183.1	6.0	164.3	3.2	176.6	5.8
		(8.4)		(86.2)		(5.4)		(100.0)
2001-02								
April-June	123.0	-1.5	166.3	2.6	154.8	2.2	160.6	2.2
July-September	126.4	0.8	166.5	2.5	158.3	4.0	161.4	2.5
October-December	137.2	3.0	173.9	2.9	160.6	2.1	168.8	2.9
January-March	141.1	2.6	184.1	3.3	163.1	4.1	177.1	3.5
April-September	124.7	-0.4	166.4	2.6	156.6	3.1	161.0	2.4
October-March	139.1	2.8	179.0	3.1	161.9	3.1	173.0	3.2
2002-03 P								
April-June	131.4	6.8	173.1	3.7	160.6	3.7	167.5	4.3
July-September	134.2	6.2	178.0	6.9	163.5	3.3	171.9	6.5
October-December	143.6	4.7	184.5	6.1	167.8	4.5	178.5	5.8
January-March	149.1	5.7	196.8	6.9	165.5	1.5	188.7	6.5
April-September	132.8	6.5	175.6	5.5	162.0	3.5	169.7	5.4
October-March	146.3	5.2	190.7	6.5	166.7	3.0	183.6	6.1
2003-04 P								
April-June	138.3	5.3	182.6	4.7	166.9	4.0	176.4	5.3

P Provisional

Note : Figures in brackets are relative contributions, computed as the ratios (in percentage terms) of the change in the index of the respective industry group to the change in the overall index adjusted for the weight of the relative industry group.

Source : Central Statistical Organisation.

APPENDIX TABLE II.6 : GROWTH IN INDEX OF SEVENTEEN MAJOR INDUSTRY GROUPS OF MANUFACTURING SECTOR (BASE : 1993-94 = 100)

Industry Group	Weight	Index		Percentage Variation		Relative Contribution (Per cent)	
		2002-03P	2001-02	2002-03	2001-02	2002-03	2001-02
1	2	3	4	5	6	7	8
I. Acceleration	**45.45**						
1. Beverages, tobacco and related products	2.38	287.6	224.8	27.9	12.2	18.1	15.3
2. Transport equipment and parts	3.98	232.9	203.3	14.6	6.8	14.3	13.6
3. Textile products (including wearing apparel)	2.54	190.3	166.3	14.4	2.4	7.4	2.6
4. Food products	9.08	168.7	152.0	11.0	-1.6	18.4	-6.0
5. Basic metal and alloy industries	7.45	170.4	156.0	9.2	4.3	13.0	12.5
6. Jute and other vegetable fibre textiles (except cotton)	0.59	107.9	99.6	8.3	-5.9	0.6	-1.0
7. Paper & paper products and printing, publishing & allied industries	2.65	180.5	169.0	6.8	3.0	3.7	3.5
8. Metal products and parts except machinery and equipment	2.81	151.7	142.6	6.4	-10.0	3.1	-11.7
9. Non-metallic mineral products	4.40	232.0	220.7	5.1	1.1	6.0	2.9
10. Machinery and equipment other than transport equipment	9.57	201.4	198.3	1.6	1.3	3.6	6.3
II. Deceleration	**24.55**						
11. Rubber, plastic, petroleum and coal products	5.73	179.8	170.4	5.5	11.1	6.5	25.6
12. Basic chemicals & chemical products (except products of petroleum and coal)	14.00	191.9	185.0	3.7	4.8	11.5	30.9
13. Wool, silk and man-made fibre textiles	2.26	225.1	218.5	3.0	4.4	1.8	5.5
14. Other manufacturing industries	2.56	173.3	173.2	0.1	8.9	0.0	9.5
III. Negative	**9.36**						
15. Cotton textiles	5.52	121.2	124.5	-2.7	-2.2	-2.2	-4.1
16. Leather and leather & fur products	1.14	152.9	158.0	-3.2	5.3	-0.7	2.4
17. Wood and wood products; furniture & fixtures	2.70	76.5	92.8	-17.6	-11.0	-5.3	-8.2
Manufacturing (Total)	**79.36**	**183.1**	**172.7**	**6.0**	**2.9**	**100.0**	**100.0**

P Provisional.

Note : The relative contribution is computed as the ratio (in percentage terms) of the change in the index of the respective industry group to the change in the overall index adjusted for the weight of the relevant industry group.

Source : Central Statistical Organisation.

APPENDIX TABLE II.7 : FREQUENCY DISTRIBUTION OF GROWTH RATES OF SEVENTEEN MAJOR INDUSTRY GROUPS OF MANUFACTURING SECTOR - 1998-99 to 2002-03

(Number of years)

Industry Group	Weight	Negative	0-5 %	5-10 %	10-15 %	15+ %	5+ % (Col. 5+6+7)
1	2	3	4	5	6	7	8
1. Food products	9.08	1	2	0	2	0	2
2. Beverages, tobaco and related products	2.38	0	1	1	2	1	4
3. Cotton textiles	5.52	3	1	1	0	0	1
4. Wool, silk and man-made fibre textiles	2.26	0	3	1	1	0	2
5. Jute and other vegetables fibre textiles (except cotton)	0.59	3	1	1	0	0	1
6. Textile products (including wearing apparel)	2.54	1	3	0	1	0	1
7. Wood and wood products; furniture and fixtures	2.70	4	1	0	0	0	0
8. Paper and paper products and printing, publishing and allied activities	2.65	1	1	2	0	1	3
9. Leather and leather & fur products	1.14	1	0	2	2	0	4
10. Basic chemicals and chemical products (except products of petroleum and coal)	14.00	0	2	3	0	0	3
11. Rubber, plastic, petroleum and coal products	5.73	1	0	1	3	0	4
12. Non-metallic mineral products	4.40	1	1	2	0	1	3
13. Basic metal and alloy industries	7.45	1	2	2	0	0	2
14. Metal products and parts, except machinery and equipment	2.81	2	0	1	0	2	3
15. Machinery and equipment other than transport equipment	9.57	0	3	1	0	1	2
16. Transport equipment and parts	3.98	1	0	2	1	1	4
17. Other manufacturing industries	2.56	1	2	1	1	0	2

Source : Central Statistical Organisation.

APPENDIX TABLE II.8 : USE-BASED CLASSIFICATION OF INDUSTRIAL PRODUCTION (BASE : 1993-94=100)

Industry Group	Weight	Index		Growth Rate (Per cent)				
		2002-03 P	2001-02	2002-03 P	2001-02 P	2000-01	1999-00	1998-99
1	2	3	4	5	6	7	8	9
1. Basic Goods	35.57	159.8	152.5	4.9 (27.4)	2.6 (31.9)	3.6 (24.0)	5.5 (27.7)	1.6 (13.9)
2. Capital Goods	9.26	177.4	160.6	10.5 (16.2)	-3.4 (-11.6)	1.8 (3.5)	6.9 (10.2)	12.6 (28.1)
3. Intermediate Goods	26.51	187.1	180.1	3.9 (19.3)	1.5 (16.1)	4.7 (27.2)	8.8 (37.7)	6.1 (42.3)
4. Consumer Goods (a+b)	28.66	187.5	175.1	7.1 (37.0)	6.0 (63.7)	8.0 (45.4)	5.7 (24.4)	2.2 (15.8)
a) Consumer durables	5.36	237.8	253.7	-6.3 (-8.9)	11.5 (31.4)	14.5 (20.1)	14.1 (13.7)	5.6 (8.7)
b) Consumer non-durables	23.30	175.9	157.0	12.0 (45.9)	4.1 (32.4)	5.8 (25.1)	3.2 (10.6)	1.2 (6.6)
IIP - General	**100.00**	**176.6**	**167.0**	**5.7 (100.0)**	**2.7 (100.0)**	**5.0 (100.0)**	**6.7 (100.0)**	**4.1 (100.0)**

P Provisional.

Note : Figures in brackets are relative contributions, computed as the ratios (in percentage terms) of the change in the index of the respective industry group to the change in the overall index adjusted for the weight of relative industry group.

Source : Central Statistical Organisation.

APPENDIX TABLE II.9 : GROWTH OF SIX INFRASTRUCTURE INDUSTRIES (BASE : 1993-94=100)

Industry	Weight	Index		Growth Rate (Per cent)				
		2002-03 P	2001-02	2002-03	2001-02	2000-01	1999-2000	1998-99
1	2	3	4	5	6	7	8	9
1. Electricity	10.17	164.1	159.3	3.0 (23.3)	3.1 (34.2)	3.9 (28.9)	7.2 (30.3)	6.6 (85.6)
2. Coal	3.22	136.8	131.2	4.3 (8.6)	4.2 (11.7)	3.6 (6.8)	3.2 (3.6)	-2.1 (-7.9)
3. Steel	5.13	222.5	208.1	6.9 (35.2)	4.4 (31.0)	6.4 (30.1)	15.0 (37.4)	1.3 (10.9)
4. Cement	1.99	203.0	186.5	8.8 (15.7)	7.4 (17.6)	-0.9 (-1.6)	14.3 (12.9)	5.7 (16.2)
5. Crude Petroleum	4.17	122.4	118.5	3.3 (7.8)	-1.2 (-4.3)	1.5 (3.7)	-2.4 (-3.6)	-3.4 (-17.1)
6. Petroleum Refinery Products	2.00	210.9	201.0	4.9 (9.4)	3.7 (9.9)	20.3 (32.1)	25.4 (19.4)	5.2 (12.3)
Composite Index of Infrastructure Industries #	**26.68**	**171.9**	**164.1**	**4.8** (100.0)	**3.5** (100.0)	**5.1** (100.0)	**9.1** (100.0)	**2.8** (100.0)

P Provisional. # Estimate based on weighted industry-wise index.

Note : Figures in brackets are relative contributions. The relative contribution is computed as the ratio (in percentage terms) of the change in the index of the respective industry group to the change in the overall index adjusted for the weight of the relative industry group.

Source : Ministry of Commerce and Industry, Government of India.

APPENDIX TABLE II.10 : GROSS DOMESTIC SAVING AND INVESTMENT

Item	Per cent of GDP (at current market prices)				Amount in Rupees crore		
	2001-02*	2000-01@	1999-00	1995-96 to 1998-99 (Average)	2001-02*	2000-01@	1999-00
1	2	3	4	5	6	7	8
1. Household Saving	22.5	21.6	20.8	17.9	5,15,565	4,53,641	4,02,360
of which :							
a) Financial assets	11.2	10.4	10.5	9.8	2,56,647	2,17,841	2,03,702
b) Physical assets	11.3	11.2	10.3	8.1	2,58,918	2,35,800	1,98,658
2. Private Corporate Sector	4.0	4.1	4.4	4.3	92,060	86,142	84,329
3. Public Sector	-2.5	-2.3	-1.0	1.0	-57,662	-48,022	-20,049
4. Gross Domestic Saving	**24.0**	**23.4**	**24.1**	**23.3**	**5,49,963**	**4,91,761**	**4,66,640**
5. Net Capital Inflow	-0.2	0.6	1.1	1.4	-4,872	12,977	21,988
6. Gross Domestic Capital Formation	**23.7**	**24.0**	**25.2**	**24.7**	**5,45,091**	**5,04,738**	**4,88,628**
7. Errors and Omissions	1.3	1.5	1.6	1.6	30,003	31,117	30,366
8. Gross Capital Formation	**22.4**	**22.5**	**23.7**	**23.1**	**5,15,088**	**4,73,621**	**4,58,262**
of which :							
a) Public Sector	6.3	6.4	6.9	7.0	1,45,082	1,34,025	1,34,484
b) Private Corporate Sector	4.8	4.9	6.5	8.0	1,11,088	1,03,796	1,25,120
c) Household Sector	11.3	11.2	10.3	8.1	2,58,918	2,35,800	1,98,658

* Quick Estimates. @ Provisional.

Source: Central Statistical Organisation.

APPENDIX TABLE II.11 : FINANCIAL SAVING OF THE HOUSEHOLD SECTOR (GROSS) (PERCENTAGE DISTRIBUTION)

Item	2001-02*	2000-01@	1999-00	1998-99	1997-98	1996-97	1995-96	1994-95	1993-94
1	2	3	4	5	6	7	8	9	10
Financial Saving (Gross)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
	(12.9)	**(11.9)**	**(12.3)**	**(11.9)**	**(11.3)**	**(11.6)**	**(10.5)**	**(14.4)**	**(12.8)**
a) Currency	9.5	7.1	8.7	10.5	7.4	8.6	13.3	10.9	12.2
	(1.2)	(0.8)	(1.1)	(1.3)	(0.8)	(1.0)	(1.4)	(1.6)	(1.6)
b) Deposits	37.9	42.0	37.5	38.8	46.6	48.1	42.5	45.5	42.6
	(4.9)	(5.0)	(4.6)	(4.6)	(5.3)	(5.6)	(4.5)	(6.5)	(5.4)
i) with banks	31.1	32.4	30.5	33.7	37.8	25.7	26.3	35.3	27.9
ii) with non-banking companies	2.8	4.9	3.7	3.8	3.9	16.4	10.6	7.9	10.6
iii) with co-operative banks and societies	6.1	5.5	4.2	4.6	5.3	6.4	5.8	3.0	5.2
iv) trade debt (net)	-2.1	-0.7	-0.8	-3.3	-0.4	-0.4	-0.2	-0.8	-1.1
c) Shares and debentures	2.3	2.5	7.1	3.4	2.9	6.6	7.3	11.9	13.5
	(0.3)	(0.3)	(0.9)	(0.4)	(0.3)	(0.8)	(0.8)	(1.7)	(1.7)
i) private corporate business	1.1	1.1	3.4	1.5	1.3	3.6	6.6	8.0	7.5
ii) co-operative banks and societies	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
iii) units of UTI	-0.6	-0.4	0.8	0.9	0.3	2.4	0.2	2.7	4.3
iv) bonds of PSUs	0.0	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.5
v) mutual funds (other than UTI)	1.7	1.6	2.9	0.8	1.1	0.3	0.3	1.1	1.2
d) Claims on Government	16.8	15.6	12.1	13.6	12.9	7.4	7.7	9.1	6.3
	(2.2)	(1.9)	(1.5)	(1.6)	(1.5)	(0.9)	(0.8)	(1.3)	(0.8)
i) investment in Government securities	5.7	1.7	0.9	0.7	1.6	0.4	0.4	0.1	0.4
ii) investment in small savings, *etc.*	11.1	13.9	11.2	13.0	11.3	7.0	7.4	9.0	5.9
e) Insurance funds	14.4	13.5	12.0	11.3	11.3	10.2	11.2	7.8	8.7
	(1.9)	(1.6)	(1.5)	(1.3)	(1.3)	(1.2)	(1.2)	(1.1)	(1.1)
i) life insurance funds	13.9	12.9	11.3	10.6	10.6	9.5	10.4	7.2	8.0
ii) postal insurance	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2
iii) State insurance	0.4	0.4	0.5	0.5	0.4	0.4	0.5	0.5	0.5
f) Provident and pension funds	19.0	19.3	22.5	22.4	18.8	19.2	18.0	14.7	16.7
	(2.5)	(2.3)	(2.8)	(2.7)	(2.1)	(2.2)	(1.9)	(2.1)	(2.1)

* Quick Estimates. @ Provisional.

Note : Figures in brackets are percentages to GDP at current market prices.

Source : Central Statistical Organisation.

APPENDIX TABLE III.1 : VARIATIONS IN RESERVE MONEY

(Amount in rupees crore)

Item	Outstanding as on March 31, 2003	Variations							
		Financial year				April-June			
		2002-03		2001-02		2003-04		2002-03	
		Absolute	Per cent	Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8	9	10
Reserve Money									
(C.1+C.2+C.3 = S.1+S.2+S.3+S.4+S.5-S.6)	**3,69,061**	**31,091**	**9.2**	**34,659**	**11.4**	**17,116**	**4.6**	**-8,850**	**-2.6**
Components									
C.1. Currency in Circulation	2,82,473	31,499	12.6	32,769	15.0	17,800	6.3	14,633	5.8
C.2. Bankers' Deposits with the RBI	83,346	-801	-1.0	2,670	3.3	-1,606	-1.9	-23,873	-28.4
of which:									
Scheduled Commercial Banks	77,043	-1,964	-2.5	1,211	1.6	-1,078	-1.4	-23,938	-30.3
C.3. 'Other' Deposits with the RBI	3,242	393	13.8	-780	-21.5	921	28.4	389	13.6
Sources									
S.1. Net RBI Credit to Government (a+b)	1,20,679	-31,499	-20.7	-1,699	-1.1	-4,451	-3.7	-4,212	-2.8
a) Net RBI credit to Central									
Government (i-ii)	**1,12,985**	**-28,399**	**-20.1**	**-5,150**	**-3.5**	**434**	**0.4**	**1,455**	**1.0**
i) Claims on Central Government	1,16,515	-30,013	-20.5	-2,824	-1.9	-2,996	-2.6	-3,589	-2.4
ii) Deposits of Central Government	3,531	-1,614	-31.4	2,326	82.5	-3,430	-97.1	-5,044	-98.1
b) Net RBI Credit to State									
Governments (i-ii)	7,695	-3,100	-28.7	3,451	47.0	-4,885	-63.5	-5,668	-52.5
i) Claims on State Governments	7,695	-3,100	-28.7	3,451	47.0	-4,844	-62.9	-5,627	-52.1
ii) Deposits of State Governments	0	0	–	0	–	41	–	41	–
S.2. RBI's Claims on Commercial and	7,160	-3,588	-33.4	-2,217	-17.1	-1,491	-20.8	-3,527	-32.8
Co-operative Banks									
of which:									
Loans and Advances to									
Scheduled Commercial Banks	102	-2,821	-96.5	-2,119	-42.0	-101	-99.0	-2,587	-88.5
S.3. RBI's Credit to Commercial Sector	3,048	-2,880	-48.6	-7,358	-55.4	-73	-2.4	-3,010	-50.8
S.4. Net Foreign Exchange Assets									
of the RBI	**3,58,244**	**94,275**	**35.7**	**66,794**	**33.9**	**22,710**	**6.3**	**19,279**	**7.3**
S.5. Government's Currency Liabilities	7,071	705	11.1	1,013	18.9	1	0.0	168	2.6
to the Public									
S.6. Net Non-Monetary Liabilities									
of the RBI	1,27,141	25,922	25.6	21,874	27.6	-419	-0.3	17,548	17.3
S.7. Net Domestic Assets of the RBI									
(S.1+S.2+S.3+S.5-S.6)	**10,818**	**-63,184**	**-85.4**	**-32,135**	**-30.3**	**-5,594**	**-51.7**	**-28,129**	**-38.0**

Data provisional. – Not applicable.

APPENDIX TABLE III.2 : RESERVE BANK OF INDIA (RBI) SURVEY

(Amount in rupees crore)

Item		Outstanding as on March 31, 2003	Variations							
			Financial year				April-June			
			2002-03		2001-02		2003-04		2002-03	
			Absolute	Per cent	Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1		2	3	4	5	6	7	8	9	10
Components										
C.I	Currency in Circulation	2,82,473	31,499	12.6	32,769	15.0	17,800	6.3	14,633	5.8
C.II	Bankers' Deposits with the RBI	83,346	-801	-1.0	2,670	3.3	-1,606	-1.9	-23,872	-28.4
C.II.1	Scheduled Commercial Banks	77,043	-1,964	-2.5	1,211	1.6	-1,078	-1.4	-23,938	-30.3
C.III	'Other' Deposits with the RBI	3,242	392	13.8	-780	-21.5	921	28.4	388	13.6
Reserve Money (C.I+C.II+C.III = S.I + S.II + S.III - S.IV - S.V)		**3,69,061**	**31,091**	**9.2**	**34,659**	**11.4**	**17,116**	**4.6**	**-8,850**	**-2.6**
Sources										
S.I	**RBI's Domestic Credit (S.I.1+S.I.2+S.I.3)**	**1,30,888**	**-37,967**	**-22.5**	**-11,273**	**-6.3**	**-6,015**	**-4.6**	**-10,749**	**-6.4**
S.I.1	Net RBI Credit to the Government (S.I.1.1+S.I.1.2)	1,20,679	-31,499	-20.7	-1,699	-1.1	-4,450	-3.7	-4,212	-2.8
S.I.1.1	Net RBI Credit to the Central Government (S.I.1.1.1 + S.I.1.1.2 + S.I.1.1.3 + S.I.1.1.4 - S.I.1.1.5)	1,12,985	-28,399	-20.1	-5,150	-3.5	434	0.4	1,455	1.0
S.I.1.1.1	Loans and Advances to the Central Government	0	-5,176	-100.0	-219	-4.1	8,145	–	2,472	47.8
S.I.1.1.2	Investments in Treasury Bills	3	-15	-83.6	-464	-96.3	-3	-100.0	-18	-100.0
S.I.1.1.3	Investments in Dated Government Securities	1,16,444	-24,731	-17.5	-2,223	-1.6	-11,300	-9.7	-6,107	-4.3
S.I.1.1.3.1	Central Government Securities	52,546	15,270	41.0	-3,022	-7.5	8,700	16.6	3,893	10.4
S.I.1.1.4	Rupee Coins	68	-92	-57.2	83	106.6	162	237.4	64	39.8
S.I.1.1.5	Deposits of the Central Government	3,531	-1,614	-31.4	2,326	82.5	-3,430	-97.1	-5,045	-98.1
S.I.1.2	Net RBI Credit to State Governments	7,695	-3,099	-28.7	3,451	47.0	-4,885	-63.5	-5,667	-52.5
S.I.2	RBI's Claims on Banks	1,368	-2,880	-67.8	-2,117	-33.3	-137	-10.0	-2,682	-63.1
S.I.2.1	Loans and Advances to Scheduled Commercial Banks	102	-2,821	-96.5	-2,119	-42.0	-101	-99.0	-2,587	-88.5
S.I.3	RBI's Credit to Commercial Sector	8,840	-3,589	-28.9	-7,458	-37.5	-1,426	-16.1	-3,855	-31.0
S.I.3.1	Loans and Advances to Primary Dealers	34	-2,849	-98.8	-2,127	-42.5	-34	-100.0	-2,883	-100.0
S.I.3.2	Loans and Advances to NABARD	5,792	-708	-10.9	-100	-1.5	-1,354	-23.4	-845	-13.0
S.II	**Government's Currency Liabilities to the Public**	**7,071**	**705**	**11.1**	**1,012**	**18.9**	**2**	**0.0**	**168**	**2.6**
S.III	**Net Foreign Exchange Assets of the RBI**	**3,58,244**	**94,275**	**35.7**	**66,794**	**33.9**	**22,710**	**6.3**	**19,279**	**7.3**
S.III.1	Gold	16,785	1,917	12.9	2,157	17.0	491	2.9	1,064	7.2
S.III.2	Foreign Currency Assets	3,41,476	92,358	37.1	64,636	35.0	22,219	6.5	18,216	7.3
S.IV	**Capital Account**	**1,11,644**	**20,002**	**21.8**	**17,878**	**24.2**	**-1,086**	**-1.0**	**11,089**	**12.1**
S.V	**Other Items (net)**	**15,497**	**5,919**	**61.8**	**3,996**	**71.6**	**668**	**4.3**	**6,458**	**67.4**

Data provisional. – Not applicable.

APPENDIX TABLE III.3 : VARIATIONS IN MONEY STOCK

(Amount in rupees crore)

Item	Outstanding as on March 31, 2003	Variations							
		2002-03		2001-02		April-June			
						2003-04		2002-03	
		Absolute	Per cent	Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8	9	10
Broad Money (M_3)	**17,25,222**	**2,26,868**	**15.1**	**1,85,135**	**14.1**	**80,736**	**4.7**	**1,11,121**	**7.4**
(C.1+C.2+C.3 = S.1+S.2+S.3+S.4-S.5)	**(16,95,551)**	**(1,97,196)**	**(13.2)**					**(71,416)**	**(4.8)**
Components									
C.1. Currency with the Public	2,70,983	30,188	12.5	31,244	14.9	16,895	6.2	14,490	6.0
C.2. Aggregate Deposits with Banks (a+b)	14,50,997	1,96,286	15.6	1,54,670	14.1	62,921	4.3	96,242	7.7
	(14,21,326)	(1,66,615)	(13.3)					(56,537)	(4.5)
a) Demand Deposits	1,98,602	19,403	10.8	12,929	7.8	9,498	4.8	3,594	2.0
b) Time Deposits	12,52,396	1,76,884	16.4	1,41,741	15.2	53,423	4.3	92,648	8.6
	(12,22,725)	(1,47,213)	(13.7)					(52,943)	(4.9)
C.3. 'Other' Deposits with the RBI	3,242	393	13.8	-780	-21.5	921	28.4	389	13.6
Narrow Money (M_1)(C.1+C.2(a)+C.3)	**4,72,827**	**49,984**	**11.8**	**43,393**	**11.4**	**27,314**	**5.8**	**18,473**	**4.4**
Sources									
S.1. Net Bank Credit to Government (A+B)	**6,78,059**	**88,494**	**15.0**	**77,610**	**15.2**	**35,001**	**5.2**	**45,290**	**7.7**
A. Net RBI Credit to Government (a+b)	1,20,679	-31,499	-20.7	-1,699	-1.1	-4,451	-3.7	-4,212	-2.8
a. Net RBI Credit to Central Government	1,12,985	-28,399	-20.1	-5,150	-3.5	434	0.4	1,455	1.0
b. Net RBI Credit to State Governments	7,695	-3,100	-28.7	3,451	47.0	-4,885	-63.5	-5,668	-52.5
B. Other Banks' Credit to Government	5,57,379	1,19,993	27.4	79,308	22.1	39,452	7.1	49,503	11.3
S.2. Bank Credit to Commercial Sector (a+b)	9,06,612	1,46,965	19.3	80,429	11.8	7,880	0.9	56,100	7.4
a) RBI's Credit to Commercial Sector	3,048	-2,880	-48.6	-7,358	-55.4	-73	-2.4	-3,010	-50.8
b) Other Banks' Credit to Commercial Sector	9,03,564	1,49,845	19.9	87,786	13.2	7,953	0.9	59,110	7.8
S.3. Net Foreign Exchange Assets of Banking Sector (a+b)	3,93,715	82,680	26.6	61,215	24.5	22,710	5.8	23,406	7.5
a) RBI's Net Foreign Exchange Assets	3,58,244	94,275	35.7	66,794	33.9	22,710	6.3	19,279	7.3
b) Other Banks' Net Foreign Exchange Assets	35,471	-11,595	-24.6	-5,579	-10.6	0	0.0	4,127	8.8
S.4. Government's Currency Liabilities to the Public	7,071	705	11.1	1,013	18.9	1	0.0	168	2.6
S.5. Banking Sector's Net Non-Monetary Liabilities (a+b)	2,60,234	91,976	54.7	35,131	26.4	-15,143	-5.8	13,844	8.2
a) Net Non-Monetary Liabilities of RBI	1,27,141	25,922	25.6	21,875	27.6	-419	-0.3	17,548	17.3
b) Net Non-Monetary Liabilities of Other Banks (residual)	1,33,093	66,055	98.5	13,257	24.6	-14,724	-11.1	-3,704	-5.5
Memo Items : Select Monetary Ratios									
1. M_3 Multiplier	4.7								
2. Bankers' Reserves to Aggregate Deposits Ratio	6.5								
3. Currency to Aggregate Deposits Ratio	18.7								

Note : 1. Data provisional.
2. Time deposits and broad money include Resurgent India Bonds worth Rs. 17,945 crore since August 28, 1998 and India Millenniun Deposits worth Rs.25,662 crore since November 17, 2000.
3. Revised in line with the new accounting standards and consistent with the methodology suggested by the Working Group on Money Supply : Analytics and Methodology of Compilation (June 1998). The revision is in respect of pension and provident funds with commercial banks which are classified as other demand and time liabilities and includes those banks which have reported such changes so far.
4. Figures in brackets exclude the impact of mergers since May 3, 2002.

APPENDIX TABLE III.4 : NEW MONETARY AGGREGATES

(Amount in rupees crore)

Item		Outstanding as on March 31, 2003	Variations							
			Financial year				April-June			
			2002-03		2001-02		2003-04		2002-03	
			Absolute	Per cent	Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1		2	3	4	5	6	7	8	9	10
Monetary Aggregates										
M_1 (C.I+C.II.1+C.III)		4,72,771	47,875	11.3	45,736	12.1	27,463	5.8	17,507	4.1
NM_2 (M_1+C.II.2.1)		9,94,545	1,23,287	14.2	1,11,565	14.7	50,766	5.1	55,917	6.4
NM_3 (NM_2+C.II.2.2+C.IV = S.I+S.II+S.III-S.IV-S.V)		**16,44,907**	**2,25,067**	**15.9**	**1,92,484**	**15.7**	**81,766**	**5.0**	**1,09,310**	**7.7**
		(16,15,236)	**(1,95,396)**	**(13.8)**					**(69,605)**	**(4.9)**
Components										
C.I	**Currency with the Public**	**2,71,109**	**30,455**	**12.7**	**31,178**	**14.9**	**16,643**	**6.1**	**14,477**	**6.0**
C.II	**Aggregate Deposits of Residents (C.II.1+C.II.2)**	**13,57,918**	**1,84,610**	**15.7**	**1,61,624**	**16.0**	**61,682**	**4.5**	**87,996**	**7.5**
		(13,28,247)	**(1,54,939)**	**(13.2)**					**(48,291)**	**(4.1)**
C.II.1	Demand Deposits	1,98,420	17,027	9.4	15,339	9.2	9,899	5.0	2,640	1.5
C.II.2	Time Deposits of Residents (C.II.2.1+C.II.2.2)	11,59,499	1,67,583	16.9	1,46,287	17.3	51,782	4.5	85,355	8.6
		(11,29,828)	(1,37,912)	(13.9)					(45,650)	(4.6)
C.II.2.1	Short-term Time Deposits	5,21,774	75,412	16.9	65,829	17.3	23,303	4.5	38,410	8.6
C.II.2.1.1	Certificates of Deposits (CDs)	722	-1,511	-67.7	1,221	120.7	493	68.3	-482	-21.6
C.II.2.2	Long-term Time Deposits	6,37,724	92,170	16.9	80,458	17.3	28,481	4.5	46,945	8.6
C.III	**'Other' Deposits with RBI**	**3,242**	**392**	**13.8**	**-780**	**-21.5**	**921**	**28.4**	**388**	**13.6**
C.IV	**Call/Term Funding from Financial Institutions**	**12,638**	**9,609**	**317.2**	**463**	**18.0**	**2,520**	**19.9**	**6,448**	**212.9**
Sources										
S.I	**Domestic Credit (S.I.1+S.I.2)**	**17,35,917**	**2,46,611**	**16.6**	**1,74,283**	**13.3**	**43,824**	**2.5**	**1,06,807**	**7.2**
S.I.1	Net Bank Credit to the Government (S.I.1.1+S.I.1.2)	6,77,787	87,885	14.9	77,738	15.2	31,549	4.7	46,420	7.9
S.I.1.1	Net RBI Credit to the Government	1,20,679	-31,499	-20.7	-1,699	-1.1	-4,450	-3.7	-4,212	-2.8
S.I.1.2	Credit to the Government by the Banking System	5,57,108	1,19,384	27.3	79,437	22.2	35,999	6.5	50,633	11.6
S.I.2	Bank Credit to the Commercial Sector (S.I.2.1+S.I.2.2)	10,58,129	1,58,725	17.6	96,545	12.0	12,277	1.2	60,387	6.7
S.I.2.1	RBI Credit to the Commercial Sector	8,840	-3,589	-28.9	-7,458	-37.5	-1,426	-16.1	-3,855	-31.0
S.I.2.2	Credit to the Commercial Sector by the Banking System	10,49,289	1,62,314	18.3	1,04,003	13.3	13,703	1.3	64,242	7.2
S.I.2.2.1	Other Investments (Non-SLR Securities)	1,43,202	14,299	11.1	9,857	8.3	1,342	0.9	6,664	5.2
S.II	**Government's Currency Liabilities to the Public**	**7,071**	**705**	**11.1**	**1,012**	**18.9**	**1**	**0.0**	**168**	**2.6**
S.III	**Net Foreign Exchange Assets of the Banking Sector (S.III.1+S.III.2)**	**2,89,877**	**64,039**	**28.4**	**64,592**	**40.1**	**23,609**	**8.1**	**22,027**	**9.8**
S.III.1	Net Foreign Exchange Assets of the RBI	3,58,244	94,275	35.7	66,794	33.9	22,710	6.3	19,279	7.3
S.III.2	Net Foreign Currency Assets of the Banking System	-68,366	-30,235	79.3	-2,202	6.1	898	-1.3	2,748	-7.2
S.IV	**Capital Account**	**2,21,586**	**37,259**	**20.2**	**30,084**	**19.5**	**14,878**	**6.7**	**26,477**	**14.4**
S.V	**Other Items (net)**	**1,66,372**	**49,030**	**41.8**	**17,318**	**17.3**	**-29,210**	**-17.6**	**-6,785**	**-5.8**

Note : 1. Data provisional

2. Figures in brackets exclude the impact of mergers since May 3, 2002.

APPENDIX TABLE III.5 : LIQUIDITY AGGREGATES (OUTSTANDING AMOUNTS)

(Rupees crore)

Month	NM_3	Postal Deposits	**L_1 (2+3)**	Liabilities of Financial Institutions					Public Deposits with NBFCs	**L_3 (9+10)**
				Term Money Borrowings	CDs	Term Deposits	Total (5+6+7)	**L_2 (4+8)**		
1	2	3	**4**	5	6	7	8	**9**	10	**11**
2001-02										
April	12,64,796	34,765	**12,99,561**	1,464	1,384	8,584	11,432	**13,10,993**		
May	12,83,781	35,435	**13,19,216**	1,775	1,040	8,289	11,104	**13,30,320**		
June	12,97,861	36,255	**13,34,116**	1,791	1,018	8,439	11,248	**13,45,364**	17,910	**13,63,273**
July	13,02,217	37,156	**13,39,373**	234	986	7,997	9,217	**13,48,590**		
August	13,10,319	38,204	**13,48,523**	243	997	7,910	9,150	**13,57,673**		
September	13,24,205	38,765	**13,62,970**	359	918	7,949	9,226	**13,72,196**	17,990	**13,90,186**
October	13,39,757	39,625	**13,79,382**	1,291	777	8,309	10,377	**13,89,760**		
November	13,57,067	40,203	**13,97,270**	1,737	621	8,132	10,490	**14,07,760**		
December	13,67,886	41,040	**14,08,926**	1,915	569	7,861	10,345	**14,19,271**	17,623	**14,36,894**
January	13,75,388	41,689	**14,17,077**	2,132	561	7,261	9,954	**14,27,031**		
February	13,97,287	42,268	**14,39,555**	2,163	546	7,003	9,712	**14,49,267**		
March	14,19,840	43,926	**14,63,766**	2,252	602	2,287	5,141	**14,68,907**	19,425	**14,88,332**
2002-03										
April	14,50,542	44,332	**14,94,874**	3,083	602	1,701	5,386	**15,00,260**		
May	15,24,013	45,061	**15,69,074**	2,668	579	2,391	5,638	**15,74,712**		
June	15,29,150	45,868	**15,75,018**	2,470	531	2,536	5,537	**15,80,555**	19,764	**16,00,319**
July	15,37,093	46,893	**15,83,986**	2,920	460	2,628	6,008	**15,89,994**		
August	15,44,126	47,658	**15,91,784**	2,950	404	2,775	6,129	**15,97,913**		
September	15,58,323	48,453	**16,06,776**	3,139	409	3,370	6,918	**16,13,694**	18,662	**16,32,356**
October	15,76,693	49,230	**16,25,923**	2,221	403	3,369	5,993	**16,31,916**		
November	15,96,734	50,073	**16,46,807**	1,583	406	3,659	5,648	**16,52,455**		
December	16,03,894	51,105	**16,54,999**	1,594	448	3,749	5,791	**16,60,790**	19,264	**16,80,054**
January	16,15,015	51,899	**16,66,914**	1,581	449	3,753	5,783	**16,72,697**		
February	16,29,011	53,609	**16,82,620**	1,563	405	3,723	5,691	**16,88,311**		
March	16,44,907	55,047	**16,99,954**	2,128	355	3,724	6,207	**17,06,161**	19,573	**17,25,734**

CDs: Certificates of Deposit; L_1, L_2 and L_3: Liquidity Aggregates; NBFCs: Non-Banking Financial Companies.

Note :
1. Figures are provisional.
2. The methodology of compilation of the liquidity aggregates is available in the"New Monetary and Liquidity Aggregates" RBI Bulletin,November 2000,which also presented the Liquidity Series from April 1993 onwards.The acronym NM_3 is used to distinguish the new monetary aggregate as proposed by the Working Group from the existing monetary aggregates.
3. Postal Deposits comprise post office savings bank deposits, post office time deposits, post office recurring deposits, other deposits and post office cumulative time deposits.
4. Financial Institutions (FIs), here, comprise IDBI, IFCI, ICICI, EXIM Bank, IIBI, SIDBI, NABARD, NHB, TFCI and IDFC.Since March 2002, however, following the erstwhile ICICI's merger with ICICI Bank, the former is not being treated as a financial institution.
5. Since July 2001, the term money borrowings of the FIs comprise borrowings from corporate and others.
6. Since August 2002,Term Deposits include CP & Others.
7. Estimates of public deposits are generated on the basis of returns received from all NBFCs with public deposits of Rs. 20 crore and more as had been recommended by the Working Group.
8. While L_1 and L_2 are compiled on a monthly basis, L_3 is compiled on a quarterly basis.
9. Wherever data are not available, the estimates for the last available month have been repeated.

APPENDIX TABLE III.6 : IMPORTANT BANKING INDICATORS - SCHEDULED COMMERCIAL BANKS

(Amount in rupees crore)

Item	Outstanding as on March 21, 2003	Variations							
		Financial year				First Quarter			
		2002-03		2001-02		2003-04 P		2002-03	
		Absolute	Per cent	Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8	9	10
1. Gross Demand and Time Liabilites (2+3+4+6)	**14,85,643**	**2,13,470**	**16.8**	**1,38,694**	**12.2**	**61,345**	**4.1**	**1,04,079**	**8.2**
2. Aggregate Deposits (a+b)	**12,80,853**	**1,77,493**	**16.1**	**1,40,742**	**14.6**	**62,321**	**4.9**	**94,034**	**8.5**
		(1,47,822)	(13.4)					(54,329)	(4.9)
a. Demand deposits	1,70,289	17,241	11.3	10,496	7.4	9,976	5.9	4,717	3.1
b. Time deposits	11,10,564	1,60,252	16.9	1,30,246	15.9	52,345	4.7	89,317	9.4
		(1,30,581)	(13.7)					(49,612)	(5.2)
3. Other Borrowings #	12,638	9,609	317.3	462	18.0	2,520	19.9	6,448	212.9
4. Other Demand and Time Liabilities	1,29,806	17,923	16.0	20,676	22.7	-1,006	-0.8	-1,002	-0.9
5. Borrowings from the RBI	79	-3,537	-97.8	-280	-7.2	-78	-98.7	-3,280	-90.7
6. Inter-bank Liabilities	62,346	8,444	15.7	-23,186	-30.1	-2,490	-4.0	4,599	8.5
7. Bank Credit (a+b)	**7,29,215**	**1,39,493**	**23.7**	**78,289**	**15.3**	**3,602**	**0.5**	**59,096**	**10.0**
a. Food Credit	49,479	-4,499	-8.3	13,987	35.0	586	1.2	7,030	13.0
b. Non-food Credit	6,79,736	1,43,992	26.9	64,302	13.6	3,015	0.4	52,066	9.7
8. Investments (a+b)	**5,47,546**	**1,09,276**	**24.9**	**68,110**	**18.4**	**36,456**	**6.7**	**45,813**	**10.5**
a. Government Securities	5,23,417	1,12,241	27.3	71,142	20.9	33,158	6.3	47,047	11.4
b. Other Approved Securities	24,129	-2,964	-10.9	-3,032	-10.1	3,298	13.7	-1,233	-4.6
9. Cash in hand	7,567	1,322	21.2	587	10.4	1,459	19.3	1,110	17.8
10. Balances with the RBI	58,335	-4,068	-6.5	2,858	4.8	17,630	30.2	-7,334	-11.8
11. Inter-Bank Assets	59,019	6,156	11.6	-9,491	-15.2	-7,283	-12.3	386	0.7
12. Credit-Deposit Ratio (%)	56.9	–	78.6	–	55.6	–	5.8	–	62.8
13. Non-food Credit-Deposit Ratio (%)	53.1	–	81.1	–	45.7	–	4.8	–	55.4
14. Investment-Deposit Ratio (%)	42.7	–	61.6	–	48.4	–	58.5	–	48.7

P Provisional. – Not applicable.

\# Other than from RBI/IDBI/NABARD/EXIM Bank.

Note : 1. Figures in brackets exclude the impact of mergers since May 3, 2002.

2. Revised in line with the new accounting standards and consistent with the methodology suggested by the Working Group on Money Supply : Analytics and Methodology of Compilation (June 1998). The revision is in respect of pension and provident funds with commercial banks which are classified as other demand and time liabilities and includes those banks which have reported such changes so far.

APPENDIX TABLE III.7 : COMMERCIAL BANK SURVEY

(Amount in rupees crore)

	Variable	Outstanding as on March 21, 2003	Variations							
			Financial year				April-June			
			2002-03		2001-02		2003-04		2002-03	
			Absolute	Per cent	Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
	1	2	3	4	5	6	7	8	9	10
Components										
C.I	**Aggregate Deposits of Residents (C.I.1+C.I.2)**	**11,88,613**	**1,76,103**	**17.4**	**1,35,989**	**15.5**	**64,088**	**5.4**	**92,380**	**9.1**
		(11,58,942)	**(1,46,432)**	**(14.5)**					**(52,675)**	**(5.2)**
C.I.1	Demand Deposits	1,70,289	17,241	11.3	10,496	7.4	9,977	5.9	4,717	3.1
C.I.2	Time Deposits of Residents (C.I.2.1+C.I.2.2)	10,18,324	1,58,862	18.5	1,25,493	17.1	54,111	5.3	87,663	10.2
		(9,88,653)	(1,29,191)	(15.0)					(47,958)	(5.6)
C.I.2.1	Short-term Time Deposits	4,58,246	71,488	18.5	56,472	17.1	24,350	5.3	39,448	10.2
C.I.2.1.1	Certificates of Deposits (CDs)	722	-1,511	-67.7	1,221	120.7	493	68.3	-482	-21.6
C.I.2.2	Long-term Time Deposits	5,60,078	87,374	18.5	69,021	17.1	29,761	5.3	48,215	10.2
C.II	**Call/Term Funding from Financial Institutions**	**12,638**	**9,609**	**317.2**	**463**	**18.0**	**2,520**	**19.9**	**6,448**	**212.9**
Sources										
S.I	**Domestic Credit (S.I.1+S.I.2)**	**14,14,455**	**2,67,294**	**23.3**	**1,56,703**	**15.8**	**46,793**	**3.3**	**1,14,417**	**10.0**
S.I.1	Credit to the Government	5,23,417	1,12,241	27.3	71,141	20.9	33,158	6.3	47,047	11.4
S.I.2	Credit to the Commercial Sector (S.I.2.1+S.I.2.2+S.I.2.3+S.I.2.4)	8,91,038	1,55,053	21.1	85,561	13.2	13,635	1.5	67,370	9.2
S.I.2.1	Bank Credit	7,29,215	1,39,492	23.7	78,289	15.3	3,602	0.5	59,095	10.0
S.I.2.1.1	Non-food Credit	6,79,736	1,43,991	26.9	64,302	13.6	3,015	0.4	52,066	9.7
S.I.2.2	Net Credit to Primary Dealers	4,093	3,765	1148.9	461	-346.4	5,557	135.8	2,874	877.1
S.I.2.3	Investments in Other Approved Securities	24,129	-2,964	-10.9	-3,032	-10.1	3,298	13.7	-1,233	-4.6
S.I.2.4	Other Investments (in non-SLR Securities)	1,33,601	14,759	12.4	9,844	9.0	1,178	0.9	6,633	5.6
S.II	**Net Foreign Currency Assets of Commercial Banks (S.II.1-S.II.2-S.II.3)**	**-68,366**	**-30,235**	**79.3**	**-2,202**	**6.1**	**898**	**-1.3**	**2,748**	**-7.2**
S.II.1	Foreign Currency Assets	31,082	-22,994	-42.5	2,430	4.7	-377	-1.2	4,718	8.7
S.II.2	Non-resident Foreign Currency Repatriable Fixed Deposits	92,240	1,390	1.5	4,753	5.5	-1,766	-1.9	1,654	1.8
S.II.3	Overseas Foreign Currency Borrowings	7,208	5,851	431.2	-121	-8.2	491	6.8	316	23.2
S.III	**Net Bank Reserves (S.III.1+S.III.2-S.III.3)**	**65,823**	**792**	**1.2**	**3,725**	**6.1**	**19,167**	**29.1**	**-2,943**	**-4.5**
S.III.1	Balances with the RBI	58,335	-4,067	-6.5	2,858	4.8	17,630	30.2	-7,333	-11.8
S.III.2	Cash in Hand	7,567	1,322	21.2	587	10.4	1,459	19.3	1,110	17.8
S.III.3	Loans and Advances from the RBI	79	-3,537	-97.8	-280	-7.2	-78	-98.7	-3,280	-90.7
S.IV	**Capital Account**	**86,541**	**14,221**	**19.7**	**8,807**	**13.9**	**15,349**	**17.7**	**15,152**	**21.0**
S.V.	**Other items (net) (S.I+S.II+S.III-S.IV-C.I-C.II)**	**1,24,120**	**37,918**	**44.0**	**12,967**	**17.7**	**-15,099**	**-12.2**	**241**	**0.3**
S.V.1	Other Demand & Time Liabilities (net of S.II.3)	1,22,598	12,072	10.9	20,796	23.2	-1,496	-1.2	-1,318	-1.2
S.V.2	Net Inter-Bank Liabilities (other than to PDs)	7,420	6,054	443.2	-13,235	-90.6	10,349	139.5	7,087	518.8

Note : 1. Data provisional.
2. Figures in brackets exclude the impact of mergers since May 3, 2002.

APPENDIX TABLE III.8 : SECTORAL DEPLOYMENT OF GROSS BANK CREDIT

(Amount in Rupees crore)

Sector	Outstanding as on			Variations	
	March 21, 2003 *	March 22, 2002	March 23, 2001	2002-03	2001-02
1	2	3	4	5	6
I. Gross Bank Credit (1+2)	**6,16,906**	**5,36,727**	**4,69,153**	**80,179**	**67,574**
1. Public Food Procurement Credit	49,479	53,978	39,991	-4,499	13,987
2. Non-food Gross Bank Credit	5,67,427	4,82,749	4,29,162	84,678	53,587
				(100.0)	(100.0)
A. Priority Sectors ##	2,03,799	1,75,259	1,54,414	28,540	20,845
				(33.7)	(38.9)
a) Agriculture	71,609	60,761	51,922	10,848	8,839
				(12.8)	(16.5)
b) Small Scale Industries	60,486	57,199	56,002	3,287	1,197
				(3.9)	(2.2)
c) Other Priority Sectors	71,704	57,299	46,490	14,405	10,809
				(17.0)	(20.2)
B. Industry (Medium and Large)	2,00,335	172,324	1,62,837	28,011	9,487
				(33.1)	(17.7)
C. Wholesale Trade (other than food procurement)	22,398	20,459	17,845	1,939	2,614
				(2.3)	(4.9)
D. Other Sectors	1,40,895	1,14,707	94,066	26,188	20,641
				(30.9)	(38.5)
of which :					
a) Housing	34,654	22,346	16,143	12,308	6,203
b) Consumer Durables	6,904	7,015	5,566	-111	1,449
c) Non-Banking Financial Companies	14,052	9,653	7,810	4,399	1,843
d) Loans to Individuals against Shares and Debentures/Bonds	1,762	1,520	1,697	242	-177
e) Real Estate Loans	3,098	2,596	1,766	502	830
f) Other Non-Priority Sector Personal Loans	26,089	23,402	18,064	2,687	5,338
g) Advances against Fixed Deposits	22,701	21,243	19,942	1,458	1,301
h) Tourism and Tourism related Hotels	1,806	1,540	996	266	544
II. Export Credit [included under item I(2)]	**49,402**	**42,978**	**43,321**	**6,424**	**-343**
				(7.6)	(-0.6)
III. Net Bank Credit (including inter-bank participations)	**6,16,085**	**5,35,063**	**4,67,206**	**81,022**	**67,857**

The data in this statement may not agree with those quoted elsewhere in the report as the data base are different.

* Excluding the impact of the merger of ICICI with ICICI Bank.

Note : 1. Data are provisional and relate to 49 selected scheduled commercial banks (48 SCBs in March 2003) which account for about 90 per cent of bank credit of all scheduled commercial banks. Gross bank credit data include bills rediscounted with RBI, IDBI, EXIM Bank, other approved financial institutions and inter-bank participations. Net bank credit data are exclusive of bills rediscounted with RBI, IDBI, EXIM Bank and other approved financial institutions.

2. Figures in brackets are proportions to incremental non-food gross bank credit.

APPENDIX TABLE III.9 : INDUSTRY-WISE DEPLOYMENT OF GROSS BANK CREDIT

(Amount in rupees crore)

Industry	Outstanding as on March 21, 2003	Variations	
		2002-03	2001-02
1	2	3	4
Industry (Small, Medium and Large)	**2,60,821**	**31,298**	**10,684**
1. Coal	1,325	-84	375
2. Mining	1,776	183	290
3. Iron and Steel	21,425	1,383	636
4. Other Metals and Metal Products	7,513	1,017	145
5. All Engineering	23,414	-785	802
of which : Electronics	6,237	296	650
6. Electricity	11,300	1,957	753
7. Cotton Textiles	13,863	2,119	-1,500
8. Jute Textiles	786	49	-107
9. Other Textiles	14,058	603	1,443
10. Sugar	5,024	-4	346
11. Tea	1,053	67	-72
12. Food Processing	8,360	1,075	931
13. Vegetable Oils (including *vanaspati)*	2,853	124	-147
14. Tobacco and Tobacco Products	756	-105	-102
15. Paper and Paper Products	4,326	585	273
16. Rubber and Rubber Products	2,498	252	51
17. Chemicals, Dyes, Paints *etc.*	27,831	1,843	1,923
of which :			
a) Fertilisers	6,293	830	230
b) Petro-Chemicals	7,007	344	548
c) Drugs and Pharmaceuticals	7,492	1,099	1,004
18. Cement	5,180	956	382
19. Leather and Leather Products	2,927	75	88
20. Gems and Jewellery	7,542	1,086	-125
21. Construction	4,551	551	825
22. Petroleum	12,021	701	-252
23. Automobiles including trucks	4,707	253	45
24. Computer Software	2,531	866	442
25. Infrastructure	20,033	5,224	3,460
a) Power	10,752	3,379	2,127
b) Telecommunications	4,110	138	328
c) Roads and Ports	5,171	1,707	1,005
26. Other Industries	53,168	11,307	-221

Note : Data are provisional and relate to select scheduled commercial banks.

APPENDIX TABLE III.10 : RESERVE BANK'S ACCOMMODATION TO SCHEDULED COMMERCIAL BANKS

(Amount in rupees crore)

Item	2003-04	2002-03				2001-02
	July	March	December	September	June	March
1	2	3	4	5	6	7
1. Export Credit Refinance						
A) Limit	4,827	5,048	5,072	5,198	5,800	9,086
a) Normal	2,413.5	2,524	2,536	3,467	3,869	6,060
b) Backstop	2,413.5	2,524	2,536	1,731	1,931	3,026
B) Outstanding	3	85	34	12	336	3,194
a) Normal	3	62	34	12	264	3,144
b) Backstop	0	23	0	0	72	50
2. Collateralised Lending Facility (CLF)						
A) Limit	–	–	–	328	657	657
a) Normal	–	–	–	219	438	438
b) Backstop	–	–	–	109	219	219
B) Outstanding	–	–	–	0	0	23
a) Normal	–	–	–	0	0	23
b) Backstop	–	–	–	0	0	0
Memo Items :						
1. Aggregate Export Credit $	52,654	50,248	45,984	44,804	47,225	43,123
2. Export Credit eligible for Refinance	32,180	33,655	33,817	34,652	38,669	35,461
3. Aggregate Export Credit as percentage of Net Bank Credit	7.13	6.8	6.7	6.8	7.3	7.4

$ Inclusive of Rupee export credit, pre-shipment credit in foreign currency (PCFC), rediscounting of export bills abroad (EBR) and overdue export credit.

Note :
1. Data pertain to the last reporting Friday of the month.
2. Effective April 1, 2002, ECR facility is being provided to the banks to the extent of 15 per cent of the outstanding export credit eligible for refinance as at the end of second precending fortnight. Apportiontment of normal and back-stop under ECR facility has been changed from initial ratio of two-third to one-third (i.e., 67:33) to one half (50:50) each effective from November 16, 2002.
3. CLF was being provided to the extent of 0.125 per cent of a bank's average aggregate deposits during April 1997 - March 1998. Limits for the CLF were reduced by 50 per cent effective from July 27, 2002. CLF withdrawn effective from October 5, 2002.

APPENDIX TABLE III.11 : VARIATIONS IN INDEX NUMBERS OF WHOLESALE PRICES (BASE : 1993-94 = 100)

(Per cent)

Major Group/Sub-group/Commodity	Weight	Variations				End-June	
		Point-to-point basis		Average basis		Point-to-point basis	
		2002-03	2001-02	2002-03	2001-02	2003-04 P	2002-03
1	2	3	4	5	6	7	8
All Commodities	**100.000**	**6.5**	**1.6**	**3.4**	**3.6**	**5.3**	**2.7**
I. Primary Articles	**22.025**	**6.1**	**3.9**	**3.4**	**3.6**	**7.3**	**1.8**
1. Food articles	15.402	0.8	5.2	1.7	3.4	4.0	2.2
a) Cereals	4.406	4.0	0.8	2.0	-1.7	4.5	-1.9
i) Rice	2.449	4.1	-2.3	-0.6	-0.3	4.1	-4.2
ii) Wheat	1.384	0.1	3.1	0.2	-0.7	3.2	-3.1
b) Pulses	0.603	0.3	-3.3	-4.5	5.3	-2.7	-6.3
c) Fruits & vegetables	2.917	-1.2	14.4	0.7	18.3	10.8	5.5
d) Milk	4.367	0.6	4.7	3.4	1.8	1.8	4.4
e) Eggs, fish and meat	2.208	-4.0	9.3	1.5	2.5	-1.0	4.6
f) Condiments and spices	0.662	7.4	-0.2	3.1	-7.0	5.1	2.0
g) Other food articles	0.239	17.9	-25.7	-2.7	-12.2	-2.2	-9.9
i) Tea	0.157	14.2	-21.6	0.5	-8.4	-8.8	-8.2
ii) Coffee	0.082	25.9	-33.1	-9.7	-20.0	16.6	-14.5
2. Non-food articles	6.138	22.1	0.6	8.3	4.4	17.4	0.5
a) Fibres	1.523	26.5	-17.9	-4.7	-3.4	26.7	-17.1
Raw cotton	1.357	34.3	-21.3	-4.2	-5.5	31.2	-17.9
b) Oilseeds	2.666	30.0	6.8	16.3	6.6	19.3	7.2
3. Minerals	0.485	-1.3	1.7	-0.4	5.3	-0.5	2.0
II. Fuel, Power, Light and Lubricants	**14.226**	**10.8**	**3.9**	**5.6**	**9.0**	**4.8**	**5.7**
1. Coking coal	0.241	0.0	0.0	0.0	8.9	0.0	0.0
2. Mineral oils	6.990	18.4	1.2	6.4	6.1	4.3	5.1
3. Electricity	5.484	3.4	9.2	5.8	12.4	6.6	8.0
III. Manufactured Products	**63.749**	**5.1**	**0.0**	**2.8**	**1.8**	**4.8**	**1.9**
1. Sugar, *Khandsari* & *Gur*	3.929	-10.5	-3.2	-7.9	-4.6	-5.3	-5.0
i) Sugar	3.619	-15.0	-3.8	-8.8	-5.0	-9.1	-5.5
ii) *Khandsari*	0.173	-11.9	0.3	-8.3	5.8	-9.7	-6.6
iii) *Gur*	0.060	-9.5	4.5	-6.9	6.9	-14.9	-6.7
2. Edible oils	2.755	27.4	12.5	22.3	9.3	16.0	24.9
3. Cotton textiles	4.215	8.3	-6.7	-1.1	-0.6	7.8	-5.3
4. Chemicals & chemical products	11.931	4.2	2.5	2.9	2.8	3.1	2.7
5. Cement	1.731	1.1	-4.7	-2.2	8.7	1.3	-3.9
6. Iron and steel	3.637	9.2	0.0	5.1	-0.1	18.8	1.3
7. Machinery & tools	8.363	0.5	2.0	0.9	5.0	1.1	1.9
8. Transport equipments & parts	4.295	-0.9	1.3	0.5	2.4	-1.5	2.3

P Provisional.

APPENDIX TABLE III.12 : VARIATIONS IN WHOLESALE PRICES - WEIGHTED CONTRIBUTIONS (BASE : 1993-94 = 100)

(Per cent)

Major Group/Sub-group/Commodity	Weight	Point-to-point basis		Average basis		End-June Point-to-point basis	
		2002-03	2001-02	2002-03	2001-02	2003-04 P	2002-03
1	2	3	4	5	6	7	8
All Commodities	**100.000**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
I. Primary Articles	**22.025**	**21.6**	**53.4**	**22.8**	**23.2**	**31.5**	**15.4**
1. Food articles	15.402	2.2	51.5	8.4	16.0	12.6	13.6
a) Cereals	4.406	2.9	2.4	2.7	-2.3	3.9	-3.4
i) Rice	2.449	1.6	-3.6	-0.4	-0.2	1.9	-4.1
ii) Wheat	1.384	0.0	2.8	0.1	-0.3	0.9	-1.8
b) Pulses	0.603	0.0	-1.4	-0.9	1.0	-0.3	-1.7
c) Fruits & vegetables	2.917	-0.6	26.0	0.7	15.2	7.3	7.1
d) Milk	4.367	0.5	12.9	4.4	2.3	1.5	7.3
e) Eggs, fish and meat	2.208	-1.7	14.3	1.2	1.8	-0.5	4.5
f) Condiments and spices	0.662	0.9	-0.1	0.7	-1.7	0.7	0.6
g) Other food articles	0.239	0.4	-2.8	-0.1	-0.7	-0.1	-0.7
i) Tea	0.157	0.2	-1.5	0.0	-0.3	-0.2	-0.4
ii) Coffee	0.082	0.2	-1.3	-0.1	-0.4	0.1	-0.3
2. Non-food articles	6.138	19.3	2.1	14.2	7.0	19.2	1.1
a) Fibres	1.523	4.9	-16.5	-2.0	-1.4	6.4	-10.1
Raw cotton	1.357	5.4	-17.3	-1.5	-2.1	6.5	-9.3
b) Oilseeds	2.666	10.6	9.0	10.9	4.0	8.9	6.3
3. Minerals	0.485	-0.1	0.4	0.0	0.5	0.0	0.3
II. Fuel, Power, Light and Lubricants	**14.226**	**33.9**	**47.1**	**32.6**	**47.5**	**18.1**	**41.7**
1. Coking coal	0.241	0.0	0.0	0.0	0.6	0.0	0.0
2. Mineral oils	6.990	29.7	7.8	19.6	17.2	8.6	20.0
3. Electricity	5.484	4.2	41.3	13.1	24.3	9.5	21.8
III. Manufactured Products	**63.749**	**44.3**	**0.0**	**46.4**	**28.5**	**50.7**	**41.5**
1. Sugar, *Khandsari* & *Gur*	3.929	-5.7	-7.3	-8.2	-5.0	-3.3	-6.8
i) Sugar	3.619	-7.0	-7.4	-7.8	-4.7	-4.8	-6.3
ii) *Khandsari*	0.173	-0.3	0.0	-0.4	0.2	-0.3	-0.4
iii) *Gur*	0.060	-0.1	0.1	-0.1	0.1	-0.1	-0.1
2. Edible oils	2.755	8.5	14.0	12.6	4.7	6.7	17.1
3. Cotton textiles	4.215	4.8	-16.7	-1.2	-0.7	5.5	-8.0
4. Chemicals & chemical products	11.931	8.2	19.3	10.6	9.8	7.3	12.5
5. Cement	1.731	0.3	-4.7	-1.0	3.7	0.4	-2.4
6. Iron and steel	3.637	4.4	0.0	4.6	-0.1	10.7	1.5
7. Machinery & tools	8.363	0.5	8.0	1.8	9.3	1.3	4.9
8. Transport equipments & parts	4.295	-0.6	3.1	0.5	2.6	-1.1	3.4

P Provisional.

APPENDIX TABLE III.13 : ANNUALISED VARIATIONS IN PRICE INDICES (Point-to-Point Basis)

(Per cent)

Year/ Month	Wholesale Price Index @	CPI for Industrial Workers $	CPI for Urban Non-manual Employees +	CPI for Agricultural Labourers*
1	2	3	4	5
1997-98	4.5	8.3	7.2	3.8
	(4.4)	(6.8)	(6.9)	(3.4)
1998-99	5.3	8.9	9.0	8.8
	(5.9)	(13.1)	(11.3)	(11.0)
1999-00	6.5	4.8	5.0	3.4
	(3.3)	(3.4)	(4.5)	(4.4)
2000-01	4.9	2.5	5.6	-2.0
	(7.2)	(3.8)	(5.6)	(-0.3)
2001-02	1.6	5.2	4.8	3.0
	(3.6)	(4.3)	(5.1)	(1.1)
2002-03	6.5	4.1	3.8	4.9
	(3.4)	(4.0)	(3.8)	(3.2)
2001-02				
April	5.5	2.3	4.7	-2.0
May	5.6	2.5	4.9	-2.3
June	5.2	3.4	5.5	-1.3
July	5.2	4.0	5.7	-0.3
August	5.1	5.2	6.2	1.3
September	3.2	4.7	5.9	1.6
October	2.7	4.2	4.8	2.6
November	2.5	4.9	5.1	2.3
December	1.9	5.2	5.1	3.0
January	1.3	4.9	4.5	2.3
February	1.6	5.2	4.3	3.0
March	1.6	5.2	4.8	3.0
2002-03				
April	1.8	4.7	4.5	2.7
May	1.4	4.7	4.2	2.6
June	2.7	4.2	4.1	2.6
July	3.0	3.9	3.8	2.3
August	3.5	3.9	3.6	2.2
September	3.3	4.3	4.1	3.2
October	3.1	4.1	3.8	2.9
November	3.4	3.6	3.3	3.2
December	3.5	3.2	2.8	2.9
January	4.8	3.4	3.3	3.9
February	5.5	3.9	4.1	4.5
March	6.5	4.1	3.8	4.9
2003-04				
April	6.7	5.1	4.3	5.5
May	5.7	4.7	4.3	5.1
June	5.3 P	4.4	3.7	5.1

P Provisional.

@ Base : 1993-94=100. $ Base : 1982=100.

+ Base : 1984-85=100. * Base : 1986-87=100.

Note : Figures in brackets are on average basis.

APPENDIX TABLE IV.1 : MEASURES OF DEFICIT OF THE CENTRAL GOVERNMENT

(Rupees crore)

Year	Fiscal Deficit		Primary Deficit		Net RBI Credit +	Revenue Deficit
	Gross	Net	Gross	Net		
1	2	3	4	5	6	7
1992-93	40,173 (35,909)	30,232	9,098 (4,834)	11,644	4,257	18,574
1993-94	60,257 (55,257)	45,994	23,516 (18,516)	24,331	260	32,716
1994-95	57,703 (48,030)	40,313	13,643 (3,970)	12,050	2,130	31,029
1995-96	60,243 (50,253)	42,432	10,198 (208)	10,806	19,855	29,731
1996-97	66,733 (56,242)	46,394	7,255 (-3236)	9,022	1,934	32,654
1997-98	88,937 (73,204)	63,062	23,300 (7,567)	22,748	12,914	46,449
1998-99	1,13,349 (89,560)	79,944	35,466 (11,678)	32,138	11,800	66,976
1999-2000	1,04,716	89,910	14,467	33,539	-5,588	67,596
2000-01	1,18,816	1,07,854	19,502	40,904	6,705	85,234
2001-02	1,40,955	1,23,074	33,495	51,129	-5,150	1,00,162
2002-03(RE)	1,45,466	1,31,697	29,803	56,605	-28,399	1,04,712
2003-04(BE)	1,53,637	1,41,375	30,414	57,312	..	1,12,292
As Percentage to GDP at Current Market Prices						
1992-93	5.37 (4.80)	4.04	1.22 (0.65)	1.56	0.57	2.48
1993-94	7.01 (6.43)	5.35	2.74 (2.15)	2.83	0.03	3.81
1994-95	5.70 (4.74)	3.98	1.35 (0.39)	1.19	0.21	3.06
1995-96	5.07 (4.23)	3.57	0.86 (0.02)	0.91	1.67	2.50
1996-97	4.88 (4.11)	3.39	0.53 -(0.24)	0.66	0.14	2.39
1997-98	5.84 (4.81)	4.14	1.53 (0.50)	1.49	0.85	3.05
1998-99	6.51 (5.14)	4.59	2.04 (0.67)	1.85	0.68	3.85
1999-2000	5.41	4.64	0.75	1.73	-0.29	3.49
2000-01	5.65	5.13	0.93	1.94	0.32	4.05
2001-02	6.14	5.36	1.46	2.23	-0.22	4.36
2002-03(RE)	5.88	5.33	1.21	2.29	-1.15	4.24
2003-04(BE)	5.60 #	5.15 @	1.11 @	2.09 @	..	4.09 @
Average						
1992-93 to 2001-02	5.15 *	4.42	0.73 *	1.64	0.40	3.30

RE Revised Estimates. BE Budget Estimates. .. Not Available.
(-) Indicates Surplus.
\+ As per RBI records after closure of Government accounts.
\# As per the Union Budget Speech 2003-2004.
@ Worked out on the basis of the implicit nominal GDP underlying the Budget Estimates of GFD/GDP ratio of 5.6 per cent for 2003-2004.
* Net of States' share in small savings.

Notes : 1. The revenue deficit denotes the difference between revenue receipts and revenue expenditure. The net RBI credit to the Central Government is the sum of the increase in the RBI's holdings of i) Treasury Bills, ii) Government of India dated securities, iii) rupee coins and iv) Loans and Advances from the Reserve Bank to Centre since April 1, 1997 adjusted for changes in Centre's cash balances with the Reserve Bank. The gross fiscal deficit is the excess of total expenditure including loans, net of recoveries over revenue receipts (including external grants) and non-debt capital receipts. The net fiscal deficit is the difference between gross fiscal deficit and net lending. The gross primary deficit is the difference between the gross fiscal deficit and interest payments. The net primary deficit denotes net fiscal deficit *minus* net interest payments.

2. Figures in parentheses are excluding States' share in small savings as per the new system of accounting followed since 1999-2000.

Source : Central Government Budget Documents and Reserve Bank Records.

APPENDIX TABLE IV.2 : MAJOR ITEMS OF RECEIPTS AND EXPENDITURES OF THE CENTRAL GOVERNMENT

(Rupees crore)

Item	2003-04 (BE)	2002-03 (RE)	2002-03 (BE)	2001-02	2000-01	1999-00	1998-99	1997-98	1996-97	1995-96	1994-95	1993-94	1992-93	Average 1992-93 to 2001-02
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1. Total Receipts	4,38,795	4,04,013	4,10,309	3,62,453	3,26,789	2,97,189	2,79,549	2,32,963	1,87,823	1,68,468	1,59,778	1,30,893	1,10,306	
(2+5)	(15.99)	(16.34)	(16.05)	(15.79)	(15.53)	(15.34)	(16.06)	(15.30)	(13.73)	(14.18)	(15.78)	(15.23)	(14.74)	(15.17)
2. Revenue Receipts	2,53,935	2,36,936	2,45,105	2,01,449	1,92,605	1,81,482	1,49,485	1,33,886	1,26,279	1,10,130	91,083	75,453	74,128	
(3+4)	(9.26)	(9.59)	(9.59)	(8.77)	(9.15)	(9.37)	(8.59)	(8.79)	(9.23)	(9.27)	(8.99)	(8.78)	(9.91)	(9.09)
3. Tax Revenue	1,84,169	1,64,177	1,72,965	1,33,662	1,36,658	1,28,271	1,04,652	95,672	93,701	81,939	67,454	53,449	54,044	
(Net to Centre)	(6.71)	(6.64)	(6.76)	(5.82)	(6.49)	(6.62)	(6.01)	(6.28)	(6.85)	(6.90)	(6.66)	(6.22)	(7.22)	(6.51)
4. Non-tax Revenue	69,766	72,759	72,140	67,787	55,947	53,211	44,833	38,214	32,578	28,191	23,629	22,004	20,084	
of which :	(2.54)	(2.94)	(2.82)	(2.95)	(2.66)	(2.75)	(2.58)	(2.51)	(2.38)	(2.37)	(2.33)	(2.56)	(2.68)	(2.58)
i) Interest Receipts	39,160	40,571	41,660	35,515	32,811	33,895	30,076	25,323	22,106	18,419	15,797	15,078	12,487	
	(1.43)	(1.64)	(1.63)	(1.55)	(1.56)	(1.75)	(1.73)	(1.66)	(1.62)	(1.55)	(1.56)	(1.75)	(1.67)	(1.64)
ii) Dividend and Profits	17,861	20,194	18,805	17,289	13,575	9,553	7,584	5,181	3,854	3,248	2,716	2,451	2,493	
	(0.65)	(0.82)	(0.74)	(0.75)	(0.65)	(0.49)	(0.44)	(0.34)	(0.28)	(0.27)	(0.27)	(0.29)	(0.33)	(0.41)
5. Capital Receipts	1,84,860	1,67,077	1,65,204	1,61,004	1,34,184	1,15,707	1,30,064	99,077	61,544	58,338	68,695	55,440	36,178	
	(6.74)	(6.76)	(6.46)	(7.01)	(6.38)	(5.97)	(7.47)	(6.51)	(4.50)	(4.91)	(6.78)	(6.45)	(4.83)	(6.08)
6. Total Expenditure	4,38,795	4,04,013	4,10,309	3,62,453	3,25,592	2,98,053	2,79,340	2,32,053	2,01,007	1,78,275	1,60,739	1,41,853	1,22,618	
(7 + 8)	(15.99)	(16.34)	(16.05)	(15.79)	(15.47)	(15.39)	(16.04)	(15.24)	(14.69)	(15.01)	(15.87)	(16.51)	(16.38)	(15.64)
7. Revenue	3,66,227	3,41,648	3,40,482	3,01,611	2,77,839	2,49,078	2,16,461	1,80,335	1,58,933	1,39,861	1,22,112	1,08,169	92,702	
Expenditure	(13.35)	(13.82)	(13.32)	(13.14)	(13.20)	(12.86)	(12.43)	(11.84)	(11.62)	(11.77)	(12.06)	(12.59)	(12.39)	(12.39)
of which :														
i) Interest	1,23,223	1,15,663	1,17,390	1,07,460	99,314	90,249	77,882	65,637	59,478	50,045	44,060	36,741	31,075	
Payments	(4.49)	(4.68)	(4.59)	(4.68)	(4.72)	(4.66)	(4.47)	(4.31)	(4.35)	(4.21)	(4.35)	(4.28)	(4.15)	(4.42)
ii) Subsidies	49,907	44,618	39,801	31,207	26,838	24,487	23,593	18,540	15,499	12,666	11,854	11,605	10,824	
	(1.82)	(1.81)	(1.56)	(1.36)	(1.28)	(1.26)	(1.36)	(1.22)	(1.13)	(1.07)	(1.17)	(1.35)	(1.45)	(1.26)
iii) Defence	44,347	41,088	43,589	38,059	37,238	35,216	29,861	26,174	20,997	18,841	16,426	14,978	12,109	
	(1.62)	(1.66)	(1.70)	(1.66)	(1.77)	(1.82)	(1.72)	(1.72)	(1.53)	(1.59)	(1.62)	(1.74)	(1.62)	(1.68)
8. Capital	72,568	62,365	69,827	60,842	47,753	48,975	62,879	51,718	42,074	38,414	38,627	33,684	29,916	
Disbursements	(2.65)	(2.52)	(2.73)	(2.65)	(2.27)	(2.53)	(3.61)	(3.40)	(3.08)	(3.23)	(3.81)	(3.92)	(4.00)	(3.25)
of which :														
Capital Outlay	42,283	30,345	40,691	26,558	24,745	24,037	18,841	17,525	14,195	14,099	14,891	13,230	13,619	
	(1.54)	(1.23)	(1.59)	(1.16)	(1.18)	(1.24)	(1.08)	(1.15)	(1.04)	(1.19)	(1.47)	(1.54)	(1.82)	(1.29)
9. Developmental	1,97,174	1,90,630	1,82,686	1,59,364	1,39,386	1,29,151	1,37,257	1,10,994	94,197	84,427	82,803	72,464	65,479	
Expenditure *	(7.19)	(7.71)	(7.14)	(6.94)	(6.62)	(6.67)	(7.88)	(7.29)	(6.88)	(7.11)	(8.18)	(8.43)	(8.75)	(7.48)
of which :														
Social Sector	60,018	57,526	49,712	44,538	34,467	31,913	29,012	24,755	20,209	18,701	15,178	12,020	7,261	
	(2.19)	(2.33)	(1.94)	(1.94)	(1.64)	(1.65)	(1.67)	(1.63)	(1.48)	(1.57)	(1.50)	(1.40)	(0.97)	(1.54)
10. Non-Developmental	2,55,572	2,37,008	2,40,372	2,15,456	1,97,470	1,77,928	1,50,298	1,27,820	1,12,217	98,632	82,402	73,586	60,584	
Expenditure *	(9.32)	(9.59)	(9.40)	(9.38)	(9.38)	(9.19)	(8.63)	(8.40)	(8.20)	(8.30)	(8.14)	(8.56)	(8.10)	(8.63)
Memo Items :														
1. Interest Payments as per cent of Revenue Receipts	48.53	48.82	47.89	53.34	51.56	49.73	52.10	49.02	47.10	45.44	48.37	48.69	41.92	48.73
2. Revenue Deficit as per cent of Gross Fiscal Deficit	73.09	71.98	70.38	71.06	71.74	64.55	59.09	52.23	48.93	49.35	53.77	54.29	46.24	57.12
3. Net RBI Credit to Centre as per cent of Gross Fiscal Deficit	..	-19.52	..	-3.65	5.64	-5.34	10.41	14.52	2.90	32.96	3.69	0.43	10.60	7.22

BE Budget Estimates. RE Revised Estimates. .. Not Available.

* Data on developmental and non-developmental expenditures are inclusive of Commercial Departments.

Note : Figures in brackets are percentages to GDP.

Source : Central Government Budget Documents and Reserve Bank records.

APPENDIX TABLE IV.3 : DIRECT AND INDIRECT TAX REVENUES OF THE CENTRAL AND STATE GOVERNMENTS

(Rupees crore)

Year		Centre (Gross)			States @			Centre and States Combined		
		Direct	Indirect	Total	Direct	Indirect	Total	Direct	Indirect	Total
1		2	3	4	5	6	7	8	9	10
1992-93		18,132	56,434	74,566	4,353	35,573	39,926	22,485	92,007	1,14,492
	(a)	24.3	75.7	100.0	10.9	89.1	100.0	19.6	80.4	100.0
	(b)	2.4	7.5	10.0	0.6	4.8	5.3	3.0	12.3	15.3
1993-94		20,298	55,445	75,743	5,032	41,545	46,577	25,330	96,990	1,22,320
	(a)	26.8	73.2	100.0	10.8	89.2	100.0	20.7	79.3	100.0
	(b)	2.4	6.5	8.8	0.6	4.8	5.4	2.9	11.3	14.2
1994-95		26,966	65,328	92,294	7,014	48,765	55,779	33,980	1,14,093	1,48,073
	(a)	29.2	70.8	100.0	12.6	87.4	100.0	22.9	77.1	100.0
	(b)	2.7	6.5	9.1	0.7	4.8	5.5	3.4	11.3	14.6
1995-96		33,563	77,661	1,11,224	8,040	55,587	63,627	41,603	1,33,248	1,74,851
	(a)	30.2	69.8	100.0	12.6	87.4	100.0	23.8	76.2	100.0
	(b)	2.8	6.5	9.4	0.7	4.7	5.4	3.5	11.2	14.7
1996-97		38,891	89,871	1,28,762	8,403	62,675	71,078	47,294	1,52,546	1,99,840
	(a)	30.2	69.8	100.0	11.8	88.2	100.0	23.7	76.3	100.0
	(b)	2.8	6.6	9.4	0.6	4.6	5.2	3.5	11.1	14.6
1997-98		48,274	90,946	1,39,220	6,469	71,624	78,093	54,743	1,62,570	2,17,313
	(a)	34.7	65.3	100.0	8.3	91.7	100.0	25.2	74.8	100.0
	(b)	3.2	6.0	9.1	0.4	4.7	5.1	3.6	10.7	14.3
1998-99		46,595	97,202	1,43,797	10,804	78,468	89,272	57,399	1,75,670	2,33,069
	(a)	32.4	67.6	100.0	12.1	87.9	100.0	24.6	75.4	100.0
	(b)	2.7	5.6	8.3	0.6	4.5	5.1	3.3	10.1	13.4
1999-00		57,960	1,13,792	1,71,752	12,176	91,109	1,03,285	70,136	2,04,901	2,75,037
	(a)	33.7	66.3	100.0	12.8	87.2	100.0	25.5	74.5	100.0
	(b)	3.0	5.9	8.9	0.6	4.7	5.3	3.6	10.6	14.2
2000-01		68,305	1,20,299	1,88,604	12,204	1,04,823	1,17,027	80,509	2,25,122	3,05,631
	(a)	36.2	63.8	100.0	10.4	89.6	100.0	26.3	73.7	100.0
	(b)	3.2	5.7	9.0	0.6	5.0	5.6	3.8	10.7	14.5
2001-02 *		69,197	1,17,863	1,87,060	14,269	1,13,165	1,27,434	83,466	2,31,028	3,14,494
	(a)	37.0	63.0	100.0	11.2	88.8	100.0	26.5	73.5	100.0
	(b)	3.0	5.1	8.1	0.6	4.9	5.6	3.6	10.1	13.7
2002-03 *		91,585	1,44,215	2,35,800	23,626	1,31,789	1,55,415	1,15,211	2,76,004	3,91,215
BE	(a)	38.8	61.2	100.0	15.2	84.8	100.0	29.4	70.6	100.0
	(b)	3.6	5.6	9.2	0.9	5.2	6.1	4.5	10.8	15.3
2002-03 *		82,445	1,39,473	2,21,918	21,413	1,24,965	1,46,378	1,03,858	2,64,438	3,68,296
RE	(a)	37.2	62.8	100.0	14.6	85.4	100.0	28.2	71.8	100.0
	(b)	3.3	5.6	9.0	0.9	5.1	5.9	4.2	10.7	14.9
2003-04 *		95,714	1,55,813	2,51,527	21,789	1,41,547	1,63,336	1,17,503	2,97,360	4,14,863
BE	(a)	38.1	61.9	100.0	13.3	86.7	100.0	28.3	71.7	100.0
	(b)	3.5	5.7	9.2	0.8	5.2	6.0	4.3	10.8	15.1
Memo Items :										
(Average)										
1992-93 to	(a)	31.5	68.5	100.0	11.4	88.6	100.0	23.9	76.1	100.0
2001-02	(b)	2.8	6.2	9.0	0.6	4.7	5.4	3.4	10.9	14.4

RE Revised Estimates. BE Budget Estimates.

@ Excluding States' share in Central Taxes as reported in Central Government Budget Documents.

* Data regarding State Governments are provisional (See Notes to Appendix Table IV.5 for details)

(a) Represents percentages to total tax revenue.

(b) Represents percentages to GDP.

Source : Budget Documents of Central and State Governments.

APPENDIX TABLE IV.4 : FINANCING OF GROSS FISCAL DEFICIT OF THE CENTRAL GOVERNMENT

(Rupees crore)

Year	Internal Finance				External Finance	Total Finance/ Gross Fiscal Deficit (5+6)
	Market Borrowings #	Other Liabilities @	91-day Treasury Bills /Draw down of Cash balances +	Total (2+3+4)		
1	2	3	4	5	6	7
1980-81	2,679	1,862	2,477	7,018	1,281	8,299
	(32.3)	(22.4)	(29.8)	(84.6)	(15.4)	(100.0)
1985-86	4,884	10,209	5,315	20,408	1,449	21,857
	(22.3)	(46.7)	(24.3)	(93.4)	(6.6)	(100.0)
1990-91	8,001	22,103	11,347	41,451	3,181	44,632
	(17.9)	(49.5)	(25.4)	(92.9)	(7.1)	(100.0)
1995-96	33,087	17,031	9,807	59,925	318	60,243
	(54.9)	(28.3)	(16.3)	(99.5)	(0.5)	(100.0)
1996-97	20,012	30,550	13,184	63,746	2,987	66,733
	(30.0)	(45.8)	(19.8)	(95.5)	(4.5)	(100.0)
1997-98	32,499	56,257	-910	87,846	1,091	88,937
	(36.5)	(63.3)	-(1.0)	(98.8)	(1.2)	(100.0)
1998-99	68,988	42,650	-209	1,11,429	1,920	1,13,349
	(60.9)	(37.6)	-(0.2)	(98.3)	(1.7)	(100.0)
1999-2000	70,277	32,396	864	1,03,537	1,180	1,04,717
	(67.1)	(30.9)	(0.8)	(98.9)	(1.1)	(100.0)
2000-01	72,931	39,577	-1,197	1,11,311	7,505	1,18,816
	(61.4)	(33.3)	-(1.0)	(93.7)	(6.3)	(100.0)
2001-02	87,724	49,126	-1,496	1,35,354	5,601	1,40,955
	(62.2)	(34.9)	-(1.1)	(96.0)	(4.0)	(100.0)
2002-03 (BE)	95,859	38,895	0	1,34,754	770	1,35,524
	(70.7)	(28.7)	(0.0)	(99.4)	(0.6)	(100.0)
2002-03 (RE)	1,12,865	40,799	5,298	1,58,962	-13,496	1,45,466
	(77.6)	(28.0)	(3.6)	(109.3)	-(9.3)	(100.0)
2003-04 (BE)	1,07,194	42,861	0	1,50,055	3,582	1,53,637
	(69.8)	(27.9)	(0.0)	(97.7)	(2.3)	(100.0)

RE Revised Estimates. BE Budget Estimates.

\# Includes Zero Coupon Bonds, Loans in conversion of maturing Treasury Bills, etc.

@ Other liabilities comprise small savings, state provident funds, special deposits, reserve funds, Treasury Bills excluding 364-day Treasury Bills, etc. With effect from 1999-2000, small savings and public provident funds are represented through NSSF's investment in Central government securities.

\+ Variations in 91-day Treasury Bills issued net of changes in cash balances with RBI, up to March 31, 1997. Since April 1, 1997 these figures represent draw down of cash balances.

Note : 1. Figures in brackets represent percentages to total finance (gross fiscal deficit).

2. Since 1999-2000, Gross fiscal deficit excludes the States' share in small savings.

Source : Central Government Budget Documents and Reserve Bank records.

APPENDIX TABLE IV.5 : BUDGETARY OPERATIONS OF STATE GOVERNMENTS

A : Measures of Deficit of State Governments

(Rupees crore)

Year	Fiscal Deficit		Primary Deficit		Net RBI Credit*	Conventional Deficit	Revenue Deficit
	Gross	Net	Gross	Net			
1	2	3	4	5	6	7	8
1990-91	18,787	14,532	10,132	8,280	420	-72	5,309
1991-92	18,900	15,746	7,956	10,123	-340	156	5,651
1992-93	20,892	15,770	7,681	6,497	176	-1,829	5,114
1993-94	20,596	16,263	4,795	5,188	591	462	3,812
1994-95	27,697	23,507	8,284	9,459	48	-4,468	6,156
1995-96	31,426	26,695	9,494	10,556	16	-2,849	8,201
1996-97	37,251	33,460	11,675	16,055	898	7,041	16,114
1997-98	44,200	39,135	14,087	16,932	1,543	-2,103	16,333
1998-99	74,254	66,209	38,380	37,814	5,579	3,520	43,642
1999-2000	91,480	79,309	46,309	43,431	1,312	3,113	53,797
2000-01	89,532	84,698	37,830	44,434	-1,092	-2,346	53,569
2001-02P	95,986	91,439	33,497	38,145	3,451	-2,552	59,233
2002-03 (RE)P	116,730	102,902	42,584	37,626	-3,100	5,317	61,302
2003-04 (BE)P	108,861	97,395	26,573	24,399		6,593	49,008
As Percentage to GDP at Current Market Prices Base : 1993-94							
1990-91	3.3	2.6	1.8	1.5	0.1	–	0.9
1991-92	2.9	2.4	1.2	1.5	-0.1	–	0.9
1992-93	2.8	2.1	1.0	0.9	–	-0.2	0.7
1993-94	2.4	1.9	0.6	0.6	0.1	0.1	0.4
1994-95	2.7	2.3	0.8	0.9	–	-0.4	0.6
1995-96	2.6	2.2	0.8	0.9	–	-0.2	0.7
1996-97	2.7	2.4	0.9	1.2	0.1	0.5	1.2
1997-98	2.9	2.6	0.9	1.1	0.1	-0.1	1.1
1998-99	4.3	3.8	2.2	2.2	0.3	0.2	2.5
1999-2000	4.7	4.1	2.4	2.2	0.1	0.2	2.8
2000-01	4.3	4.0	1.8	2.1	-0.1	-0.1	2.5
2001-02P	4.2	4.0	1.5	1.7	0.2	-0.1	2.6
2002-03(RE)P	4.7	4.2	1.7	1.5	-0.1	0.2	2.5
2003-04 (BE)P	4.0	3.5	1.0	0.9	..	0.2	1.8

B : Select Budgetary Variables of State Governments

(Per cent)

Item	2003-04P (BE)	2002-03P (RE)	2001-02P	1990-00 (Average)
1	2	3	4	5
1. GFD/Total Expenditure (excluding recoveries)	24.6	28.4	27.3	21.4
2. Revenue Deficit/Revenue Expenditure	12.8	17.3	18.8	9.3
3. Conventional Deficit/Aggregate Disbursements	1.4	1.2	-0.7	-0.1
4. Revenue Deficit/GFD	45.0	52.5	61.7	34.8
5. Non-Developmental Revenue Expenditure/Revenue Receipts	52.1	53.4	53.5	39.6
6. Interest Payments/Revenue Receipts	24.7	25.2	24.4	16.5
7. Developmental Expenditure/GDP	9.5	10.0	9.4	10.2
of which :				
Social Sector Expenditure/GDP	6.0	6.0	5.8	5.7
8. Non-Developmental Expenditure/GDP	6.5	6.5	6.0	4.6
9. States' Tax Revenue/GDP	6.2	6.0	5.7	5.3
10. States' Non Tax Revenue/GDP	1.4	1.5	1.4	1.7

RE Revised Estimates. BE Budget Estimates. - Negligible. .. Not Available.

GFD Gross Fiscal Deficit.

(-) Indicates surplus.

* Data pertain to State Governments having accounts with the Reserve Bank of India.

P Provisional data relate to the budgets of 28 State Governments and the National Capital Territory of Delhi, of which 3 are Vote- on-Account.

Note : The net RBI credit to State Governments refers to the increase in loans and advances given to them by the RBI net of their incremental deposits with the RBI.

Source : Budget Documents of the State Governments and RBI Records.

APPENDIX TABLE IV.6 : COMBINED RECEIPTS AND DISBURSEMENTS OF THE CENTRAL AND STATE GOVERNMENTS

(Rupees crore)

Item	2003-04 (BE)	2002-03 (RE)	2002-03 (BE)	2001-02 (Accounts)	Percentage Variation	
					Col.2 over Col.3	Col.3 over Col.5
1	2	3	4	5	6	7
I. Total Receipts (A+B)	**8,04,728**	**7,46,600**	**7,36,538**	**6,55,907**	**7.8**	**13.8**
A. Revenue Receipts (1+2)	5,20,320	4,71,599	4,90,665	4,00,229	10.3	17.8
1. Tax Receipts (a+b)	4,11,263	3,66,695	3,88,015	3,13,937	12.2	16.8
a) Direct Taxes	1,17,503	1,03,858	1,15,211	83,466	13.1	24.4
b) Indirect Taxes	2,93,760	2,62,838	2,72,804	2,30,471	11.8	14.0
2. Non-tax receipts	1,09,057	1,04,904	1,02,650	86,292	4.0	21.6
of which:						
Interest receipts	18,428	20,120	23,802	17,131	-8.4	17.4
B. Capital Receipts	2,84,408	2,75,001	2,45,873	2,55,678	3.4	7.6
of which:						
a) State Provident Funds (Net)	16,063	18,156	20,086	14,096	-11.5	28.8
b) Recovery of loans & advances	8,055	11,297	7,726	14,512	-28.7	-22.2
II. Total Disbursements (A+B+C)	**8,11,321**	**7,51,917**	**7,41,724**	**6,53,354**	**7.9**	**15.1**
A. Developmental Expenditure(a+b+c)	3,99,926	3,79,589	3,72,374	3,29,007	5.4	15.4
a) Revenue	3,14,263	3,01,951	2,95,467	2,62,708	4.1	14.9
b) Capital	66,126	54,286	60,186	40,627	21.8	33.6
c) Loans and Advances	19,537	23,352	16,721	25,671	-16.3	-9.0
B. Non-Developmental Expenditure(a+b+c)	3,86,573	3,49,328	3,58,285	3,11,140	10.7	12.3
a) Revenue	3,60,332	3,29,343	3,32,293	2,92,258	9.4	12.7
of which:						
Interest payments	1,75,487	1,60,488	1,62,423	1,42,370	9.3	12.7
b) Capital	24,443	17,659	24,124	18,136	38.4	-2.6
c) Loans and Advances	1,799	2,326	1,868	746	-22.7	212.6
C. Others (a + b) @	24,821	23,001	11,065	13,208	7.9	74.1
a) Revenue	7,025	6,319	6,597	4,658	11.2	35.7
b) Capital	17,796	16,681	4,468	8,550	6.7	95.1
III. Overall Surplus(+)/Deficit(-)	**-6,593**	**-5,317**	**-5,186**	**2,553**	**–**	**–**
Memorandum Items :						
1. Expenditure on Social Sector #	2,24,187	2,05,912	2,02,183	1,76,733	8.9	16.5
	(8.2)	(8.3)	(7.9)	(7.7)		
2. Total Social Services	1,67,108	1,53,692	1,56,351	1,37,872	8.7	11.5
of which :	(6.1)	(6.2)	(6.1)	(6.0)		
(i) Education	81,583	74,759	76,663	68,722	9.1	8.8
	(3.0)	(3.0)	(3.0)	(3.0)		
(ii) Medical, Public Health & Family	36,407	34,179	34,665	29,792	6.5	14.7
Welfare and Water Supply & Sanitation	(1.3)	(1.4)	(1.4)	(1.3)		
3. Combined Domestic Liabilities *	20,49,750	18,08,976	17,61,791	15,60,538	13.3	15.9
	(74.7)	(73.2)	(68.9)	(68.0)		
a) Centre	17,19,133	15,04,226	14,44,248	12,94,863	14.3	16.2
	(62.7)	(60.9)	(56.5)	(56.4)		
b) States	7,90,702	6,94,289	6,83,826	5,89,797	13.9	17.7
	(28.8)	(28.1)	(26.7)	(25.7)		

RE : Revised Estimates. BE : Budget Estimates.

@ Comprise discharge of internal debt, compensation and assignments to local bodies and Panchayati Raj institutions in respect of State governments.

Social Sector expenditure comprises outlay on social services, rural development and food subsidy. Rural development, although forms a part of economic services, is included in social sector expenditure on account of its immense importance for development of social infrastructure in rural areas.

* The domestic liabilities of the Centre and States do not add up to the combined domestic liabilities on account of inter-governmental adjustments.

Note : 1. Figures in brackets are percentages to GDP.
2. Data include Commercial Departments in respect of Central Government's Revenue Account.
3. Data regarding State Governments are provisional (see Notes to Appendix Table IV.5 for details).
4. Tax Receipts are net of surcharge transferred to National Calamity Contingency Fund.

Source : Budget Documents of Central and State Governments.

APPENDIX TABLE IV.7 : OUTSTANDING LIABILITIES OF THE CENTRAL GOVERNMENT

(Rupees crore)

Year	Internal Debt	Small Savings, Deposits, Provident Funds and Other Accounts	Reserve Funds and Deposits	Total Internal Liabilities (2+3+4)	External Liabilities	Total Liabilities (5+6)
1	2	3	4	5	6	7
1990-91	1,54,004	1,07,107	21,922	2,83,033	31,525	3,14,558
	(27.1)	(18.8)	(3.9)	(49.8)	(5.5)	(55.3)
1991-92	1,72,750	1,21,500	23,464	3,17,714	36,948	3,54,662
	(26.4)	(18.6)	(3.6)	(48.6)	(5.7)	(54.3)
1992-93	1,99,100	1,36,802	23,753	3,59,655	42,269	4,01,924
	(26.6)	(18.3)	(3.2)	(48.0)	(5.6)	(53.7)
1993-94	2,45,712	1,60,355	24,556	4,30,623	47,345	4,77,968
	(28.6)	(18.7)	(2.9)	(50.1)	(5.5)	(55.6)
1994-95	2,66,467	1,92,222	28,993	4,87,682	50,929	5,38,611
	(26.3)	(19.0)	(2.9)	(48.2)	(5.0)	(53.2)
1995-96	3,07,868	2,13,435	33,680	5,54,983	51,249	6,06,232
	(25.9)	(18.0)	(2.8)	(46.7)	(4.3)	(51.0)
1996-97	3,44,476	2,39,042	37,919	6,21,437	54,239	6,75,676
	(25.2)	(17.5)	(2.8)	(45.4)	(4.0)	(49.4)
1997-98	3,88,998	2,91,867	42,097	7,22,962	55,332	7,78,294
	(25.5)	(19.2)	(2.8)	(47.5)	(3.6)	(51.1)
1998-99	4,59,696	3,33,261	41,595	8,34,552	57,254	8,91,806
	(26.4)	(19.1)	(2.4)	(47.9)	(3.3)	(51.2)
1999-2000	7,14,254	2,00,830	47,508	9,62,592	58,437	10,21,029
	(36.9)	(10.4)	(2.5)	(49.7)	(3.0)	(52.7)
2000-2001	8,03,698	2,40,364	58,535	11,02,597	65,945	11,68,542
	(38.2)	(11.4)	(2.8)	(52.4)	(3.1)	(55.5)
2001-2002	9,13,061	3,08,668	73,133	12,94,862	71,546	13,66,408
	(39.8)	(13.4)	(3.2)	(56.4)	(3.1)	(59.5)
2002-2003 (RE)	10,37,163	3,81,027	86,035	15,04,225	57,650	15,61,875
	(42.0)	(15.4)	(3.5)	(60.9)	(2.3)	(63.2)
2003-2004 (BE)	11,58,639	4,59,243	1,01,251	17,19,133	60,931	17,80,064
	(42.2)	(16.7)	(3.7)	(62.7)	(2.2)	(64.9)

Note : 1. Figures in brackets represent percentages to GDP.

2. Since 1999-2000, Centre's share in small savings collections is converted into Central Government securities and are part of internal debt.

Source : Budget Documents of Goverment of India.

APPENDIX TABLE IV.8 : FINANCING OF STATE GOVERNMENTS' GROSS FISCAL DEFICIT

(Rupees crore)

Year	Loans from the Central Government (net)	Market Borrow-ings(net)	Others#	Gross Fiscal Deficit (2+3+4)	States' Outstanding Liabilities (end-March)			States' Outstanding Liabilities as per cent of GDP at current market prices
					Total+	Loans & Advances from Centre	Market Loans	
1	2	3	4	5	6	7	8	9
1990-91	9,978 (53.1)	2,556 (13.6)	6,253 (33.3)	18,787 (100.0)	1,10,289	74,117	15,618	19.4
1991-92	9,373 (49.6)	3,305 (17.5)	6,222 (32.9)	18,900 (100.0)	1,26,338	83,491	18,923	19.3
1992-93	8,921 (42.7)	3,500 (16.8)	8,471 (40.5)	20,892 (100.0)	1,42,178	92,412	22,426	19.0
1993-94	9,533 (46.3)	3,620 (17.6)	7,443 (36.1)	20,596 (100.0)	1,60,077	1,01,945	26,058	18.6
1994-95	14,760 (53.3)	4,075 (14.7)	8,862 (32.0)	27,697 (100.0)	1,84,527	1,16,705	30,133	18.2
1995-96	14,801 (47.1)	5,888 (18.7)	10,737 (34.2)	31,426 (100.0)	2,12,225	1,31,505	36,021	17.9
1996-97	17,547 (47.1)	6,515 (17.5)	13,189 (35.4)	37,251 (100.0)	2,43,525	1,49,053	42,536	17.8
1997-98	23,676 (53.6)	7,280 (16.5)	13,244 (30.0)	44,200 (100.0)	2,81,207	1,72,729	49,816	18.5
1998-99	31,057 (41.8)	10,467 (14.1)	32,730 (44.1)	74,254 (100.0)	3,41,978	2,03,786	60,283	19.6
1999-2000	12,408 (13.6)	12,664 (13.8)	66,409 (72.6)	91,480 (100.0)	4,20,133	2,16,195	72,947	21.7
2000-01	8,396 (9.4)	12,519 (14.0)	68,617 (76.6)	89,532 (100.0)	4,98,092	2,24,590	85,466	23.7
2001-02P	9,098 (9.5)	17,017 (17.7)	69,871 (72.8)	95,986 (100.0)	5,89,797	2,33,688	1,02,483	25.7
2002-03 (RE)P	8,138 (7.0)	23,264 (19.9)	85,328 (73.1)	1,16,730 (100.0)	6,94,289	2,41,826	1,25,747	28.1
2003-04 (BE)P	11,638 (10.7)	13,489 (12.4)	83,734 (76.9)	1,08,861 (100.0)	7,90,702	2,53,464	1,39,236	28.8

RE Revised Estimates. BE Budget Estimates.

\# Includes loans from Financial Institutions, Provident Funds, Reserve Funds, Deposits and Advances, Special Securities issued to NSSF, etc. With the change in the system of accounting with effect from 1999-2000, States' share in small savings which was hitherto included under loans from Centre, is included under "others".

\+ Includes internal debt (including Special Securities issued to NSSF), loans and advances from the Central Government and Provident Funds.

P Provisional data based on the budgets of 28 State Governments and the National Capital Territory of Delhi, of which 3 are Vote-on-Account.

Notes : 1. Figures in brackets are percentages to the Gross Fiscal Deficit.
2. Data on outstanding liabilities of the State Governments have been revised taking into account the latest available information.

Source : Budget Documents of State Governments and Combined Finance and Revenue Accounts of the Union and State Governments.

APPENDIX TABLE IV.9 : MARKET BORR0WINGS OF CENTRAL AND STATE GOVERNMENTS AND THEIR SPONSORED INSTITUTIONS

(Rupees crore)

Government/Authority	Gross			Repayments			Net		
	2003-04(BE)	2002-2003+	2001-02	2003-04(BE)	2002-03	2001-02	2003-04(BE)	2002-03	2001-02
1	2	3	4	5	6	7	8	9	10
1. Central Government (a+b)	1,66,230	1,51,126	1,33,801	59,036	47,008	41,499	1,07,194	1,04,118	92,302
a) Dated Securities	1,40,230	1,25,000	1,14,213	32,909	27,420	26,499	1,07,321	97,580	87,714
b) 364-day Treasury Bills	26,000	26,126	19,588	26,127	19,588	15,000	-127	6,538	4,588
2. State Governments	28,145	30,853	18,707	4,145	1,789	1,446	24,000 *	29,064	17,261
3. Institutions Sponsored by State Governments (relate to SFCs and SLDBSs/ SCARDBs)	..	672 (319)	584	341 @	272	184	..	400	400
Grand Total (1+2+3)	**1,94,375**	**1,82,651**	**1,53,092**	**63,522**	**49,069**	**43,129**	**1,31,194**	**1,33,582**	**1,09,963**

.. Not Available BE Budget Estimates.

\+ Actuals as per Reserve Bank records.

* Includes additional borrowings of Rs.4,000 crore and Rs.7,000 crore for debt -swap scheme.

@ Repayments of SCARDBs not included

Figures in brackets indicate actually raised.

Source : Central Government Budget Documents and Reserve Bank records.

APPENDIX TABLE V.1 : REPO / REVERSE REPO AUCTIONS UNDER LIQUIDITY ADJUSTMENT FACILITY

(Amount in Rupees crore)

LAF Date (#)	Repo/ Reverse Repo period (Day (s))	Repo					Reverse Repo					Net injections (+)/ absorption(–) of liquidity [(11) – (6)]	Outstanding Amount@
		Bids received		Bids accepted		Cut-off Rate (%)	Bids received		Bids accepted		Cut-off Rate (%)		
		Number	Amount	Number	Amount		Number	Amount	Number	Amount			
1	2	3	4	5	6	7	8	9	10	11	12	13	14
2002-03													
Apr-02	1	5	10,310	5	5,155	6.00	–	–	–	–	–	-5,155	5,155
Apr-03	1	14	24,150	14	24,150	6.00	–	–	–	–	–	-24,150	24,150
Apr-04	1	18	30,055	18	30,055	6.00	–	–	–	–	–	-30,055	30,055
Apr-05	3	11	16,235	11	16,235	6.00	–	–	–	–	–	-16,235	16,235
Apr-08	1	6	13,790	6	13,790	6.00	–	–	–	–	–	-13,790	13,790
Apr-09	1	6	10,990	6	10,990	6.00	–	–	–	–	–	-10,990	10,990
Apr-10	1	8	12,365	8	12,365	6.00	–	–	–	–	–	-12,365	12,365
Apr-11	1	7	9,480	7	9,480	6.00	–	–	–	–	–	-9,480	9,480
Apr-12	3	6	9,150	6	9,150	6.00	–	–	–	–	–	-9,150	9,150
Apr-15	1	5	5,590	5	5,590	6.00	–	–	–	–	–	-5,590	5,590
Apr-16	1	7	5,875	7	5,875	6.00	5	545	5	545	8.00	-5,330	5,330
Apr-17	1	4	2,510	4	2,510	6.00	–	–	–	–	–	-2,510	2,510
Apr-18	1	3	920	3	920	6.00	–	–	–	–	–	-920	920
Apr-19	3	2	525	2	525	6.00	–	–	–	–	–	-525	525
Apr-22	1	3	5,420	3	2,710	6.00	–	–	–	–	–	-2,710	2,710
Apr-23	1	3	7,850	3	3,925	6.00	–	–	–	–	–	-3,925	3,925
Apr-24	2	1	9,200	1	4,600	6.00	–	–	–	–	–	-4,600	4,600
Apr-26	3	1	9,300	1	4,650	6.00	–	–	–	–	–	-4,650	4,650
Apr-29	1	5	5,430	5	5,430	6.00	–	–	–	–	–	-5,430	5,430
Apr-30	2	3	2,710	3	2,710	6.00	–	–	–	–	–	-2,710	2,710
May-02	1	3	255	3	255	6.00	–	–	–	–	–	-255	255
May-03	3	4	285	–	–	–	–	–			–	–	–
May-08	1	1	5,700	1	2,850	6.00	–	–	–	–	–	-2,850	2,850
May-09	1	1	4,800	1	2,400	6.00	–	–	–	–	–	-2,400	2,400
May-10	3	1	5,000	1	2,500	6.00	–	–	–	–	–	-2,500	2,500
May-15	1	–	–	–	–	–	1	50	–	–	–	–	–
May-21	1	–	–	–	–	–	2	490	2	490	8.00	490	-490
May-23	1	1	6,000	1	1,500	6.00	–	–	–	–	–	-1,500	1,500
May-24	3	1	6,000	1	1,500	6.00	–	–	–	–	–	-1,500	1,500
May-27	1	1	7,500	1	3,750	6.00	–	–	–	–	–	-3,750	3,750
May-28	1	1	9,000	1	4,500	6.00	–	–	–	–	–	-4,500	4,500
May-29	1	2	11,700	2	5,850	6.00	–	–	–	–	–	-5,850	5,850
May-30	1	3	12,820	3	11,538	6.00	–	–	–	–	–	-11,538	11,538
May-31	3	2	12,285	2	12,285	6.00	–	–	–	–	–	-12,285	12,285
Jun-03	1	2	850	2	850	6.00	–	–	–	–	–	-850	850
Jun-04	1	3	10,350	3	7,763	6.00	–	–	–	–	–	-7,763	7,763
Jun-05	1	4	12,725	4	9,544	6.00	–	–	–	–	–	-9,544	9,544
Jun-06	1	2	11,200	2	8,400	6.00	–	–	–	–	–	-8,400	8,400
Jun-07	3	1	11,000	1	5,500	6.00	–	–	–	–	–	-5,500	5,500
Jun-10	1	1	8,000	1	8,000	6.00	–	–	–	–	–	-8,000	8,000
Jun-11	1	3	4,275	3	4,275	6.00	–	–	–	–	–	-4,275	4,275
Jun-12	1	1	5,500	1	5,500	6.00	–	–	–	–	–	-5,500	5,500
Jun-13	1	1	6,500	1	4,875	6.00	–	–	–	–	–	-4,875	4,875
Jun-14	3	3	5,660	3	5,660	6.00	–	–	–	–	–	-5,660	5,660
Jun-17	1	3	5,160	3	5,160	6.00	–	–	–	–	–	-5,160	5,160
Jun-18	1	2	10,110	2	10,110	6.00	–	–	–	–	–	-10,110	10,110
Jun-19	1	3	10,210	3	7,658	6.00	–	–	–	–	–	-7,658	7,658
Jun-20	1	3	13,530	3	8,118	6.00	–	–	–	–	–	-8,118	8,118
Jun-21	3	3	12,880	2	12,380	6.00	–	–	–	–	–	-12,380	12,380
Jun-24	1	6	14,070	6	12,663	6.00	–	–	–	–	–	-12,663	12,663
Jun-25	1	13	19,690	11	15,344	6.00	–	–	–	–	–	-15,344	15,344
Jun-26	1	16	23,250	16	11,626	6.00	–	–	–	–	–	-11,626	11,626
Jun-27	1	22	22,740	1	5	5.75	–	–	–	–	–	-5	5
Jun-28	3	27	24,710	27	24,710	5.75	–	–	–	–	–	-24,710	24,710
Jul-01	1	4	6,000	4	5,400	5.75	–	–	–	–	–	-5,400	5,400
Jul-02	1	3	12,275	3	6,138	5.75	–	–	–	–	–	-6,138	6,138
Jul-03	1	3	15,350	3	11,513	5.75	–	–	–	–	–	-11,513	11,513
Jul-04	1	3	14,330	3	10,748	5.75	–	–	–	–	–	-10,748	10,748
Jul-05	3	6	15,150	6	11,363	5.75	–	–	–	–	–	-11,363	11,363
Jul-08	1	14	19,460	14	9,730	5.75	–	–	–	–	–	-9,730	9,730
Jul-09	1	15	22,860	15	20,574	5.75	–	–	–	–	–	-20,574	20,574
Jul-10	1	18	22,550	18	22,550	5.75	–	–	–	–	–	-22,550	22,550
Jul-11	1	14	13,190	14	13,190	5.75	–	–	–	–	–	-13,190	13,190
Jul-12	3	9	8,200	9	8,200	5.75	–	–	–	–	–	-8,200	8,200
Jul-15	1	14	11,940	14	8,957	5.75	–	–	–	–	–	-8,957	8,957
Jul-16	1	16	23,175	16	17,383	5.75	–	–	–	–	–	-17,383	17,383
Jul-17	1	18	26,940	18	20,208	5.75	–	–	–	–	–	-20,208	20,208
Jul-18	1	16	24,900	16	17,430	5.75	–	–	–	–	–	-17,430	17,430
Jul-19	3	22	26,185	22	23,568	5.75	–	–	–	–	–	-23,568	23,568
Jul-22	1	22	27,850	22	25,067	5.75	–	–	–	–	–	-25,067	25,067
Jul-23	1	21	28,020	21	22,416	5.75	–	–	–	–	–	-22,416	22,416
Jul-24	1	16	22,965	16	16,077	5.75	–	–	–	–	–	-16,077	16,077
Jul-25	1	13	18,110	13	16,299	5.75	–	–	–	–	–	-16,299	16,299
Jul-26	3	5	9,905	5	9,905	5.75	–	–	–	–	–	-9,905	9,905
Jul-29	1	13	17,565	13	14,052	5.75	–	–	–	–	–	-14,052	14,052
Jul-30	1	17	21,495	17	17,196	5.75	–	–	–	–	–	-17,196	17,196
Jul-31	1	19	24,615	19	19,692	5.75	–	–	–	–	–	-19,692	19,692
Aug-01	1	20	19,620	20	15,696	5.75	–	–	–	–	–	-15,696	15,696
Aug-02	3	19	21,795	19	17,436	5.75	–	–	–	–	–	-17,436	17,436
Aug-05	1	18	16,445	18	9,867	5.75	–	–	–	–	–	-9,867	9,867

APPENDIX TABLE V.1 : REPO / REVERSE REPO AUCTIONS UNDER LIQUIDITY ADJUSTMENT FACILITY (Contd.)

LAF Date (#)	Repo/ Reverse Repo period (Day (s))	Repo					Reverse Repo					Net injections (+)/ absorption(–) of liquidity [(11) – (6)]	Outstanding Amount@
		Bids received		Bids accepted		Cut-off Rate (%)	Bids received		Bids accepted		Cut-off Rate (%)		
		Number	Amount	Number	Amount		Number	Amount	Number	Amount			
1	2	3	4	5	6	7	8	9	10	11	12	13	14
Aug-06	1	17	18,660	17	13,062	5.75	–	–	–	–	–	-13,062	13,062
Aug-07	1	16	14,090	16	14,090	5.75	–	–	–	–	–	-14,090	14,090
Aug-08	1	6	4,075	6	2,038	5.75	–	–	–	–	–	-2,038	2,038
Aug-09	3	3	2,970	3	2,970	5.75	–	–	–	–	–	-2,970	2,970
Aug-12	1	9	12,890	9	12,890	5.75	–	–	–	–	–	-12,890	12,890
Aug-13	1	7	14,280	7	9,996	5.75	–	–	–	–	–	-9,996	9,996
Aug-14	2	12	14,685	12	10,280	5.75	–	–	–	–	–	-10,280	10,280
Aug-16	3	10	13,690	10	10,952	5.75	–	–	–	–	–	-10,952	10,952
Aug-19	1	8	11,560	8	8,093	5.75	–	–	–	–	–	-8,093	8,093
Aug-20	1	9	16,030	9	12,824	5.75	–	–	–	–	–	-12,824	12,824
Aug-21	1	15	17,825	15	17,825	5.75	–	–	–	–	–	-17,825	17,825
Aug-22	1	13	13,630	13	13,630	5.75	–	–	–	–	–	-13,630	13,630
Aug-23	3	13	11,185	13	11,185	5.75	–	–	–	–	–	-11,185	11,185
Aug-26	1	10	12,050	10	9,640	5.75	–	–	–	–	–	-9,640	9,640
Aug-27	1	12	20,295	12	14,207	5.75	–	–	–	–	–	-14,207	14,207
Aug-28	1	10	18,560	10	16,704	5.75	–	–	–	–	–	-16,704	16,704
Aug-29	1	8	17,410	8	15,669	5.75	–	–	–	–	–	-15,669	15,669
Aug-30	3	11	16,070	11	16,070	5.75	–	–	–	–	–	-16,070	16,070
Sep-02	1	12	14,375	12	11,500	5.75	–	–	–	–	–	-11,500	11,500
Sep-03	1	13	18,235	13	16,412	5.75	–	–	–	–	–	-16,412	16,412
Sep-04	1	14	19,770	14	19,770	5.75	–	–	–	–	–	-19,770	19,770
Sep-05	1	9	10,010	9	10,010	5.75	–	–	–	–	–	-10,010	10,010
Sep-06	3	9	6,900	9	6,900	5.75	–	–	–	–	–	-6,900	6,900
Sep-09	2	12	16,230	12	16,230	5.75	–	–	–	–	–	-16,230	16,230
Sep-11	1	9	19,640	9	11,784	5.75	–	–	–	–	–	-11,784	11,784
Sep-12	1	8	19,720	8	19,720	5.75	–	–	–	–	–	-19,720	19,720
Sep-13	3	11	17,195	11	15,476	5.75	–	–	–	–	–	-15,476	15,476
Sep-16	1	8	12,960	8	11,664	5.75	–	–	–	–	–	-11,664	11,664
Sep-17	1	7	11,340	7	10,206	5.75	–	–	–	–	–	-10,206	10,206
Sep-18	1	11	14,755	11	14,755	5.75	–	–	–	–	–	-14,755	14,755
Sep-19	1	11	13,220	11	13,220	5.75	–	–	–	–	–	-13,220	13,220
Sep-20	3	13	8,595	13	8,595	5.75	–	–	–	–	–	-8,595	8,595
Sep-23	1	6	8,775	6	8,775	5.75	–	–	–	–	–	-8,775	8,775
Sep-24	1	10	13,175	10	11,858	5.75	–	–	–	–	–	-11,858	11,858
Sep-25	1	10	14,100	10	12,690	5.75	–	–	–	–	–	-12,690	12,690
Sep-26	1	8	11,075	8	11,075	5.75	–	–	–	–	–	-11,075	11,075
Sep-27	3	11	9,680	11	7,744	5.75	–	–	–	–	–	-7,744	7,744
Sep-30	1	17	17,325	17	17,325	5.75	–	–	–	–	–	-17,325	17,325
Oct-01	2	21	17,265	21	17,265	5.75	–	–	–	–	–	-17,265	17,265
Oct-03	1	22	10,840	22	10,840	5.75	–	–	–	–	–	-10,840	10,840
Oct-04	3	27	16,675	27	16,675	5.75	–	–	–	–	–	-16,675	16,675
Oct-07	1	9	14,860	9	11,888	5.75	–	–	–	–	–	-11,888	11,888
Oct-08	1	16	24,030	16	21,628	5.75	–	–	–	–	–	-21,628	21,628
Oct-09	1	15	23,630	15	18,904	5.75	–	–	–	–	–	-18,904	18,904
Oct-10	1	9	18,980	9	18,980	5.75	–	–	–	–	–	-18,980	18,980
Oct-11	3	10	18,105	10	16,295	5.75	–	–	–	–	–	-16,295	16,295
Oct-14	2	8	13,645	8	10,234	5.75	–	–	–	–	–	-10,234	10,234
Oct-16	1	13	16,825	13	10,095	5.75	–	–	–	–	–	-10,095	10,095
Oct-17	1	16	20,060	16	16,048	5.75	–	–	–	–	–	-16,048	16,048
Oct-18	3	18	19,300	18	19,300	5.75	–	–	–	–	–	-19,300	19,300
Oct-21	1	12	13,025	12	9,119	5.75	–	–	–	–	–	-9,119	9,119
Oct-22	1	11	16,150	11	14,536	5.75	–	–	–	–	–	-14,536	14,536
Oct-23	1	11	13,980	11	12,582	5.75	–	–	–	–	–	-12,582	12,582
Oct-24	1	10	12,525	10	10,020	5.75	–	–	–	–	–	-10,020	10,020
Oct-25	3	14	15,450	14	12,360	5.75	–	–	–	–	–	-12,360	12,360
Oct-28	1	14	15,865	14	12,692	5.75	–	–	–	–	–	-12,692	12,692
Oct-29	1	14	17,605	14	14,084	5.75	–	–	–	–	–	-14,084	14,084
Oct-30	1	10	12,345	10	12,345	5.50	–	–	–	–	–	-12,345	12,345
Oct-31	1	10	11,680	10	11,680	5.50	–	–	–	–	–	-11,680	11,680
Nov-01	4	13	5,125	13	5,125	5.50	–	–	–	–	–	-5,125	5,125
Nov-05	1	15	13,225	15	10,580	5.50	–	–	–	–	–	-10,580	10,580
Nov-06	1	18	20,310	18	16,248	5.50	–	–	–	–	–	-16,248	16,248
Nov-07	1	12	8,760	12	7,885	5.50	–	–	–	–	–	-7,885	7,885
Nov-08	3	13	4,650	13	4,650	5.50	–	–	–	–	–	-4,650	4,650
Nov-11	1	9	1,975	9	1,975	5.50	1	50	1	50	7.50	-1,925	1,925
Nov-12	1	3	1,525	–	–	–	–	–	–	–	–	–	–
Nov-13	1	3	1,310	–	–	–	–	–	–	–	–	–	–
Nov-14	1	8	1,980	–	–	–	–	–	–	–	–	–	–
Nov-15	3	24	7,630	24	5,322	5.50	–	–	–	–	–	-5,322	5,322
Nov-18	2	25	18,400	25	14,720	5.50	–	–	–	–	–	-14,720	14,720
Nov-20	1	26	19,325	26	19,325	5.50	–	–	–	–	–	-19,325	19,325
Nov-21	1	25	15,755	25	14,182	5.50	–	–	–	–	–	-14,182	14,182
Nov-22	3	29	7,290	29	7,290	5.50	–	–	–	–	–	-7,290	7,290
Nov-25	1	34	7,705	34	7,705	5.50	–	–	–	–	–	-7,705	7,705
Nov-26	1	42	11,415	42	11,415	5.50	–	–	–	–	–	-11,415	11,415
Nov-27	1	47	13,905	47	13,905	5.50	–	–	–	–	–	-13,905	13,905
Nov-28	1	47	15,705	47	15,705	5.50	–	–	–	–	–	-15,705	15,705
Nov-29	3	31	11,790	31	11,790	5.50	–	–	–	–	–	-11,790	11,790
Dec-02	1	30	16,715	30	16,715	5.50	–	–	–	–	–	-16,715	16,715
Dec-03	1	31	16,295	31	16,295	5.50	–	–	–	–	–	-16,295	16,295
Dec-04	1	36	16,875	36	16,875	5.50	–	–	–	–	–	-16,875	16,875
Dec-05	1	31	15,225	31	15,225	5.50	–	–	–	–	–	-15,225	15,225
Dec-06	3	22	9,750	22	9,750	5.50	–	–	–	–	–	-9,750	9,750
Dec-09	1	20	5,770	20	5,770	5.50	–	–	–	–	–	-5,770	5,770

APPENDIX TABLE V.1 : REPO / REVERSE REPO AUCTIONS UNDER LIQUIDITY ADJUSTMENT FACILITY (Contd.)

LAF Date (#)	Repo/ Reverse Repo period (Day (s))	Repo					Reverse Repo					Net injections (+)/ absorption(–) of liquidity [(11) – (6)]	Outstanding Amount@
		Bids received		Bids accepted		Cut-off Rate (%)	Bids received		Bids accepted		Cut-off Rate (%)		
		Number	Amount	Number	Amount		Number	Amount	Number	Amount			
1	2	3	4	5	6	7	8	9	10	11	12	13	14
Dec-10	1	16	4,120	16	4,120	5.50	–	–	–	–	–	-4,120	4,120
Dec-11	1	15	2,520	15	2,520	5.50	–	–	–	–	–	-2,520	2,520
Dec-12	1	17	4,360	17	4,360	5.50	1	125	–	–	–	-4,360	4,360
Dec-13	3	17	4,950	17	4,950	5.50	–	–	–	–	–	-4,950	4,950
Dec-16	1	15	8,975	15	8,975	5.50	–	–	–	–	–	-8,975	8,975
Dec-17	1	20	10,615	20	10,615	5.50	–	–	–	–	–	-10,615	10,615
Dec-18	1	9	7,770	9	7,770	5.50	–	–	–	–	–	-7,770	7,770
Dec-19	1	12	5,620	12	5,620	5.50	–	–	–	–	–	-5,620	5,620
Dec-20	3	13	6,120	13	6,120	5.50	–	–	–	–	–	-6,120	6,120
Dec-23	1	7	3,580	7	1,790	5.50	–	–	–	–	–	-1,790	1,790
Dec-24	2	5	855	5	855	5.50	–	–	–	–	–	-855	855
Dec-26	1	7	2,525	7	1,895	5.50	–	–	–	–	–	-1,895	1,895
Dec-27	3	13	2,710	13	2,710	5.50	–	–	–	–	–	-2,710	2,710
Dec-30	1	8	1,620	8	1,620	5.50	–	–	–	–	–	-1,620	1,620
Dec-31	1	15	8,235	15	8,235	5.50	–	–	–	–	–	-8,235	8,235
Jan-01	1	18	9,070	18	9,070	5.50	–	–	–	–	–	-9,070	9,070
Jan-02	1	28	11,915	28	11,915	5.50	–	–	–	–	–	-11,915	11,915
Jan-03	3	27	14,635	27	14,635	5.50	–	–	–	–	–	-14,635	14,635
Jan-06	1	27	15,860	27	15,860	5.50	1	350	–	–	–	-15,860	15,860
Jan-07	1	24	9,195	24	9,195	5.50	–	–	–	–	–	-9,195	9,195
Jan-08	1	26	9,305	26	9,305	5.50	–	–	–	–	–	-9,305	9,305
Jan-09	1	16	2,555	16	2,555	5.50	–	–	–	–	–	-2,555	2,555
Jan-10	3	9	1,035	9	1,035	5.50	–	–	–	–	–	-1,035	1,035
Jan-13	1	15	6,750	15	6,750	5.50	–	–	–	–	–	-6,750	6,750
Jan-14	1	21	8,770	21	8,770	5.50	–	–	–	–	–	-8,770	8,770
Jan-15	1	22	9,335	22	9,335	5.50	–	–	–	–	–	-9,335	9,335
Jan-16	1	19	6,645	19	6,645	5.50	–	–	–	–	–	-6,645	6,645
Jan-17	3	5	2,725	5	1,363	5.50	2	130	2	130	7.50	-1,233	1,233
Jan-20	1	3	1,755	3	1,755	5.50	–	–	–	–	–	-1,755	1,755
Jan-21	1	5	1,925	5	963	5.50	–	–	–	–	–	-963	963
Jan-22	1	10	3,105	10	1,554	5.50	–	–	–	–	–	-1,554	1,554
Jan-23	1	8	2,795	8	1,398	5.50	–	–	–	–	–	-1,398	1,398
Jan-24	3	5	815	5	815	5.50	1	50	–	–	–	-815	815
Jan-27	1	7	1,135	7	1,135	5.50	–	–	–	–	–	-1,135	1,135
Jan-28	1	9	2,010	9	2,010	5.50	–	–	–	–	–	-2,010	2,010
Jan-29	1	5	1,060	5	1,060	5.50	–	–	–	–	–	-1,060	1,060
Jan-30	1	7	1,175	7	1,175	5.50	–	–	–	–	–	-1,175	1,175
Jan-31	3	5	1,560	5	1,560	5.50	–	–	–	–	–	-1,560	1,560
Feb-03	1	5	1,475	5	1,475	5.50	–	–	–	–	–	-1,475	1,475
Feb-04	1	16	3,625	16	3,625	5.50	–	–	–	–	–	-3,625	3,625
Feb-05	1	34	11,055	34	11,055	5.50	–	–	–	–	–	-11,055	11,055
Feb-06	1	36	8,160	36	8,160	5.50	–	–	–	–	–	-8,160	8,160
Feb-07	3	22	4,930	22	4,930	5.50	–	–	–	–	–	-4,930	4,930
Feb-10	1	16	2,980	16	2,980	5.50	–	–	–	–	–	-2,980	2,980
Feb-11	1	9	2,215	9	2,215	5.50	–	–	–	–	–	-2,215	2,215
Feb-12	2	10	2,580	10	1,291	5.50	–	–	–	–	–	-1,291	1,291
Feb-14	3	13	1,825	13	458	5.50	–	–	–	–	–	-458	458
Feb-17	1	16	5,240	16	5,240	5.50	–	–	–	–	–	-5,240	5,240
Feb-18	1	18	6,350	18	6,350	5.50	–	–	–	–	–	-6,350	6,350
Feb-19	1	25	7,105	25	7,105	5.50	–	–	–	–	–	-7,105	7,105
Feb-20	1	22	7,585	22	7,585	5.50	–	–	–	–	–	-7,585	7,585
Feb-21	3	26	8,815	26	8,815	5.50	–	–	–	–	–	-8,815	8,815
Feb-24	1	12	1,820	12	1,820	5.50	–	–	–	–	–	-1,820	1,820
Feb-25	1	1	100	1	100	5.50	1	200	1	200	7.50	100	-100
Feb-26	1	–	–	–	–	–	2	800	2	800	7.50	800	-800
Feb-27	1	–	–	–	–	–	1	100	1	100	7.50	100	-100
Feb-28	3	–	–	–	–	5.00	1	150	1	150	7.50	150	-150
Mar-04	1	16	6,125	16	6,125	5.00	–	–	–	–	–	-6,125	6,125
Mar-05	1	22	9,790	22	9,790	5.00	–	–	–	–	–	-9,790	9,790
Mar-06	1	21	11,585	21	11,585	5.00	–	–	–	–	–	-11,585	11,585
Mar-07	3	5	1,875	5	1,875	5.00	1	35	1	35	7.10	-1,840	1,840
Mar-10	1	1	500	1	500	5.00	1	25	–	–	–	-500	500
Mar-11	1	2	1,100	2	1,100	5.00	–	–	–	–	–	-1,100	1,100
Mar-12	1	2	710	2	710	5.00	–	–	–	–	–	-710	710
Mar-13	4	1	500	1	500	5.00	–	–	–	–	–	-500	500
Mar-17	2	4	2,315	4	2,315	5.00	–	–	–	–	–	-2,315	2,315
Mar-19	1	3	5,370	3	5,370	5.00	3	950	3	950	7.00	-4,420	4,420
Mar-20	1	2	3,680	2	1,840	5.00	4	1,520	4	1,520	7.00	-320	320
Mar-21	3	5	3,835	5	3,835	5.00	1	300	1	300	7.00	-3,535	3,535
Mar-24	1	1	150	–	–	5.00	18	3,805	18	3,805	7.00	3,805	-3,805
Mar-25	1	–	–	–	–	5.00	22	5,750	22	5,750	7.00	5,750	-5,750
Mar-26	1	1	350	–	–	5.00	21	5,540	21	5,540	7.00	5,540	-5,540
Mar-27	1	–	–	–	–	5.00	24	6,990	22	6,715	7.00	6,715	-6,715
Mar-28	3	–	–	–	–	5.00	21	6,160	21	6,160	7.00	6,160	-6,160
Mar-31	1	4	7,025	4	7,025	5.00	15	4,635	14	4,610	7.00	-2,415	2,415
2003-04													
Apr-01	2	23	14,010	23	14,010	5.00	6	1,635	6	1,635	7.00	-12,375	12,375
Apr-03	1	30	17,690	30	17,690	5.00	–	–	–	–	–	-17,690	17,690
Apr-04	3	34	27,880	34	27,880	5.00	–	–	–	–	–	-27,880	27,880
Apr-07	1	29	25,040	29	25,040	5.00	–	–	–	–	–	-25,040	25,040
Apr-08	1	35	31,185	35	31,185	5.00	–	–	–	–	–	-31,185	31,185
Apr-09	1	36	26,655	36	21,324	5.00	–	–	–	–	–	-26,655	26,655
Apr-10	6	36	28,645	36	28,645	5.00	–	–	–	–	–	-28,645	28,645

APPENDIX TABLE V.1 : REPO / REVERSE REPO AUCTIONS UNDER LIQUIDITY ADJUSTMENT FACILITY (Concld.)

LAF Date (#)	Repo/ Reverse Repo period (Day (s))	Repo					Reverse Repo					Net injections (+)/ absorption(–) of liquidity [(11) – (6)]	Outstanding Amount@
		Bids received		Bids accepted		Cut-off Rate (%)	Bids received		Bids accepted		Cut-off Rate (%)		
		Number	Amount	Number	Amount		Number	Amount	Number	Amount			
1	2	3	4	5	6	7	8	9	10	11	12	13	14
Apr-16	1	32	25,285	32	20,228	5.00	–	–	–	–	–	-25,285	25,285
Apr-17	4	46	21,115	46	21,115	5.00	–	–	–	–	–	-21,115	21,115
Apr-21	1	35	25,365	35	25,365	5.00	–	–	–	–	–	-25,365	25,365
Apr-22	1	37	31,995	37	31,995	5.00	–	–	–	–	–	-31,995	31,995
Apr-23	1	40	29,355	40	29,355	5.00	–	–	–	–	–	-29,355	29,355
Apr-24	1	37	27,525	37	27,525	5.00	–	–	–	–	–	-27,525	27,525
Apr-25	3	39	24,610	39	24,610	5.00	–	–	–	–	–	-24,610	24,610
Apr-28	1	44	27,660	44	27,660	5.00	–	–	–	–	–	-27,660	27,660
Apr-29	1	42	30,770	42	30,770	5.00	–	–	–	–	–	-30,770	30,770
Apr-30	2	45	22,960	45	22,960	5.00	–	–	–	–	–	-22,960	22,960
May-02	3	43	13,710	43	13,710	5.00	1	100	1	100	7.00	-13,610	13,610
May-05	1	40	16,115	40	16,115	5.00	–	–	–	–	–	-16,115	16,115
May-06	1	43	25,250	43	25,250	5.00	–	–	–	–	–	-25,250	25,250
May-07	1	40	24,400	40	24,400	5.00	–	–	–	–	–	-24,400	24,400
May-08	1	33	21,735	33	21,735	5.00	–	–	–	–	–	-21,735	21,735
May-09	3	37	20,020	37	20,020	5.00	–	–	–	–	–	-20,020	20,020
May-12	1	28	10,595	28	10,595	5.00	–	–	–	–	–	-10,595	10,595
May-13	1	34	12,540	34	12,540	5.00	–	–	–	–	–	-12,540	12,540
May-14	5	28	8,750	28	8,750	5.00	–	–	–	–	–	-8,750	8,750
May-19	1	36	16,155	36	16,155	5.00	–	–	–	–	–	-16,155	16,155
May-20	1	35	17,945	35	14,356	5.00	–	–	–	–	–	-14,356	14,356
May-21	1	29	12,495	29	12,495	5.00	–	–	–	–	–	-12,495	12,495
May-22	1	37	19,270	37	19,270	5.00	–	–	–	–	–	-19,270	19,270
May-23	3	41	23,125	41	23,125	5.00	–	–	–	–	–	-23,125	23,125
May-26	1	45	25,415	45	25,415	5.00	–	–	–	–	–	-25,415	25,415
May-27	1	43	30,015	43	30,015	5.00	–	–	–	–	–	-30,015	30,015
May-28	1	45	30,085	45	30,085	5.00	–	–	–	–	–	-30,085	30,085
May-29	1	44	30,230	44	30,230	5.00	–	–	–	–	–	-30,230	30,230
May-30	3	28	12,240	28	12,240	5.00	–	–	–	–	–	-12,240	12,240
Jun-02	1	33	20,865	33	20,865	5.00	–	–	–	–	–	-20,865	20,865
Jun-03	1	37	27,375	37	27,375	5.00	–	–	–	–	–	-27,375	27,375
Jun-04	1	32	18,235	32	18,235	5.00	–	–	–	–	–	-18,235	18,235
Jun-05	1	33	18,335	33	18,335	5.00	1	300	–	–	–	-18,335	18,335
Jun-06	3	33	19,275	33	19,275	5.00	–	–	–	–	–	-19,275	19,275
Jun-09	1	33	18,105	33	18,105	5.00	–	–	–	–	–	-18,105	18,105
Jun-10	1	29	15,270	29	10,693	5.00	–	–	–	–	–	-10,693	10,693
Jun-11	1	29	16,500	29	13,200	5.00	–	–	–	–	–	-13,200	13,200
Jun-12	1	19	4,315	19	4,315	5.00	–	–	–	–	–	-4,315	4,315
Jun-13	3	11	2,695	11	2,695	5.00	–	–	–	–	–	-2,695	2,695
Jun-16	1	26	10,350	26	10,350	5.00	–	–	–	–	–	-10,350	10,350
Jun-17	1	31	19,270	31	19,270	5.00	–	–	–	–	–	-19,270	19,270
Jun-18	1	30	19,935	30	19,935	5.00	–	–	–	–	–	-19,935	19,935
Jun-19	1	31	19,385	31	19,385	5.00	–	–	–	–	–	-19,385	19,385
Jun-20	3	27	19,270	27	19,270	5.00	–	–	–	–	–	-19,270	19,270
Jun-23	1	34	23,750	34	23,750	5.00	–	–	–	–	–	-23,750	23,750
Jun-24	1	40	28,305	40	28,305	5.00	–	–	–	–	–	-28,305	28,305
Jun-25	1	39	26,115	39	26,115	5.00	–	–	–	–	–	-26,115	26,115
Jun-26	1	42	26,490	42	26,490	5.00	–	–	–	–	–	-26,490	26,490
Jun-27	4	36	21,455	36	21,455	5.00	–	–	–	–	–	-21,455	21,455
Jul-01	1	33	21,970	32	21,945	5.00	–	–	–	–	–	-21,945	21,945
Jul-02	1	38	20,375	38	20,375	5.00	–	–	–	–	–	-20,375	20,375
Jul-03	1	40	24,155	40	24,155	5.00	–	–	–	–	–	-24,155	24,155
Jul-04	3	43	24,060	43	24,060	5.00	–	–	–	–	–	-24,060	24,060
Jul-07	1	40	27,470	40	27,470	5.00	–	–	–	–	–	-27,470	27,470
Jul-08	1	52	32,795	52	32,795	5.00	–	–	–	–	–	-32,795	32,795
Jul-09	1	49	32,005	49	32,005	5.00	–	–	–	–	–	-32,005	32,005
Jul-10	1	42	31,100	42	31,100	5.00	–	–	–	–	–	-31,100	31,100
Jul-11	3	41	26,960	41	26,960	5.00	–	–	–	–	–	-26,960	26,960
Jul-14	1	40	26,360	40	26,360	5.00	–	–	–	–	–	-26,360	26,360
Jul-15	1	46	29,030	46	29,030	5.00	–	–	–	–	–	-29,030	29,030
Jul-16	1	43	24,735	43	24,735	5.00	–	–	–	–	–	-24,735	24,735
Jul-17	1	48	25,280	48	25,280	5.00	–	–	–	–	–	-25,280	25,280
Jul-18	3	46	23,255	46	23,255	5.00	–	–	–	–	–	-23,255	23,255
Jul-21	1	41	25,400	41	25,400	5.00	–	–	–	–	–	-25,400	25,400
Jul-22	1	50	29,425	50	29,425	5.00	–	–	–	–	–	-29,425	29,425
Jul-23	1	47	29,150	47	29,150	5.00	–	–	–	–	–	-29,150	29,150
Jul-24	1	50	27,050	50	27,050	5.00	–	–	–	–	–	-27,050	27,050
Jul-25	3	48	22,855	48	22,855	5.00	–	–	–	–	–	-22,855	22,855
Jul-28	1	48	33,590	48	33,590	5.00	–	–	–	–	–	-33,590	33,590
Jul-29	1	46	27,905	46	27,905	5.00	–	–	–	–	–	-27,905	27,905
Jul-30	1	37	17,780	37	17,780	5.00	2	1,220	2	1,220	7.00	-16,560	16,560
Jul-31	1	44	25,845	44	25,845	5.00	–	–	–	–	–	-25,845	25,845
Aug-01	3	48	31,130	48	31,130	5.00	–	–	–	–	–	-31,130	31,130
Aug-04	1	51	34,305	51	34,305	5.00	–	–	–	–	–	-34,305	34,305
Aug-05	1	49	34,570	49	34,570	5.00	–	–	–	–	–	-34,570	34,570
Aug-06	1	49	31,890	49	31,890	5.00	–	–	–	–	–	-31,890	31,890

Note : Does not include fortnightly repos.

(@) : Net of reverse repo.

(#) : Working days, on which no bid was received under LAF auction, have been excluded.

APPENDIX TABLE V.2 : ISSUE OF CERTIFICATES OF DEPOSIT BY SCHEDULED COMMERCIAL BANKS

(Amount in rupees crore)

Fortnight ended		Total Outstanding	Rate of Discount (Per cent)@	Fortnight ended		Total Outstanding	Rate of Discount (Per cent)@	Fortnight ended		Total Outstanding	Rate of Discount (Per cent)@
	1	2	3		4	5	6		7	8	9
2001				**2002**				**2003**			
January	12	1,180	7.25-11.00	January	11	775	6.20-9.50	January	10	1,199	4.37-6.61
	26	1,197	7.25-10.75		25	1,008	5.99-9.60		24	1,226	4.60-7.00
February	9	1,153	7.25-11.00	February	8	1,196	6.00-9.50	February	7	1,214	4.75-6.50
	23	1,187	6.75-12.0		22	1,292	5.95-10.15		21	1,125	3.00-7.50
March	9	1,060	7.25-11.00	March	8	1,503	5.95-10.00	March	7	928	5.25-7.10
	23	771	5.50-11.00		22	1,576	5.00-10.03		21	908	5.00-7.10
April	6	1,061	6.50-11.00	April	5	1,474	5.00-10.88	April	4	891	5.25-7.40
	20	905	7.00-11.00		19	1,393	5.00-10.28		18	1,485	5.25-7.40
May	4	1,011	5.00-10.80	May	3	1,247	5.00-10.28	May	2	1,660	5.00-6.26
	18	935	6.30-11.50		17	1,362	5.00-9.50		16	1,947	5.25-6.25
June	1	960	6.80-10.50		31	1,360	6.00-8.90		30	1,996	3.94-7.00
	15	979	5.00-10.00	June	14	1,357	5.00-10.00	June	13	2,227	3.99-7.00
	29	921	6.80-10.25		28	1,359	5.40-9.20		27	2,183	3.74-6.50
July	13	782	5.00-10.50	July	12	1,312	5.21-9.10				
	27	751	6.00-10.00		26	1,303	5.10-8.50				
August	10	786	6.00-10.50	August	9	1,161	4.99-8.50				
	24	757	5.00-10.00		23	1,007	5.03-8.50				
September	7	729	6.00-10.00	September	6	1,249	5.00-8.50				
	21	736	6.33-9.50		20	1,236	5.50-8.75				
October	5	825	6.00-9.50	October	4	1,270	5.20-8.25				
	19	786	6.20-9.75		18	1,394	4.94-8.00				
November	2	766	6.44-9.40	November	1	1,310	6.00-7.50				
	16	791	6.40-9.40		15	1,309	4.69-8.50				
	30	876	6.33-9.30		29	1,219	4.46-7.05				
December	14	798	5.00-9.50	December	13	1,204	4.69-8.50				
	28	839	5.00-9.20		27	1,163	4.71-6.50				

P Provisional.
@ : Effective disount rate range per annum.

APPENDIX TABLE V.3 : COMMERCIAL PAPER*

(Amount in Rupees crore)

Fortnight ended		Total Outstanding	Typical Effective Rates of Discount (Per cent)	Fortnight ended		Total Outstanding	Typical Effective Rates of Discount (Per cent)
1		2	3	4		5	6
2001							
January	15	7,796	10.00 - 11.98	May	15	8,080	7.54 - 10.10
	31	7,188	10.04 - 11.50		31	8,111	7.70 - 10.00
February	15	7,296	10.05 - 10.40	June	15	8,293	7.65 - 10.25
	28	7,246	9.15 - 11.15		30	8,447	7.67 - 9.75
March	15	6,991	9.25 - 11.50	July	15	7,709	6.90 - 9.50
	31	5,847	8.75 - 11.25		31	8,520	6.55 - 9.30
April	15	6,295	9.30 - 12.00	August	15	9,148	6.30 - 8.75
	30	7,034	9.10 - 11.50		31	9,125	5.72 - 8.50
May	15	6,982	9.10 - 10.75	September	15	9,374	6.05 - 9.71
	31	7,314	8.80 - 11.03		30	9,549	6.05 - 8.10
June	15	7,985	8.65 - 10.25	October	15	8,589	6.13 - 8.25
	30	8,566	8.49 - 10.40		31	8,426	6.07 - 8.35
July	15	8,019	8.19 - 9.80	November	15	8,606	5.79 - 8.00
	31	7,275	8.01 - 11.50		30	8,599	5.70 - 8.50
August	15	7,271	7.90 - 10.35	December	15	9,006	5.50 - 8.45
	31	6,982	7.75 - 13.00		31	9,025	5.50 - 8.25
September	15	7,013	7.55 - 9.85				
	30	7,805	7.40 - 10.00	**2003**			
October	15	8,660	7.73 - 10.25	January	15	8,645	5.70 - 7.50
	31	8,807	7.50 - 11.80		31	8,554	5.60 - 8.05
November	15	8,913	7.48 - 9.80	February	15	8,173	5.58 - 9.86
	30	8,507	7.48 - 9.35		28	7,070	5.82 - 9.50
December	15	8,610	7.33 - 9.81	March	15	6,573	5.60 - 8.20
	31	8,384	7.20 - 11.65		31	5,749	6.00 - 7.75
2002				April	15	5,839	5.25 - 8.15
January	15	8,644	7.40 - 9.75		30	5,994	5.05 - 9.85
	31	8,822	7.35 - 9.80	May	15	6,396	5.05 - 8.50
February	15	8,494	7.10 - 9.81		31	6,820	5.00 - 9.88
	28	8,402	7.20 - 10.00	June	15	6,854	5.00 - 8.00
March	15	8,273	7.15 - 10.35		30	7,108	5.20 - 7.40
	31	7,224	7.41 - 10.25	July	15	7,069	5.15 - 6.80
April	15	7,783	7.60 - 11.10		31	7,557	4.99 - 8.25
	30	8,046	7.60 - 9.60				

* Issued at face value by companies

APPENDIX TABLE V.4 : INTER-BANK AND MERCHANT TRANSACTIONS IN THE FOREIGN EXCHANGE MARKET

(US $ million)

Month	Inter-bank							Merchant						
	Spot			Forward/Swap				Spot			Forward			
	Purchases	Sales	Net	Purchases	Sales	Net	Turnover	Purchases	Sales	Net	Purchases	Sales	Net	Turnover
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
2002														
April	12,747	12,322	425	40,984	42,195	-1,211	124,285	7,069	7,063	6	1,554	3,335	-1,781	22,532
May	12,098	11,499	599	31,994	35,124	-3,130	109,248	6,365	7,084	-719	1,971	2,829	-858	22,928
June	11,024	10,921	103	26,882	27,481	-599	96,729	6,193	6,637	-444	2,440	2,689	-249	23,239
July	14,014	15,322	-1,308	28,390	28,817	-427	113,196	7,790	7,165	625	3,247	3,034	213	27,364
August	12,171	13,761	-1,590	23,842	23,761	81	95,838	7,241	6,501	740	3,698	2,753	945	25,418
September	10,873	11,631	-758	19,963	18,712	1,251	84,145	6,849	6,726	123	4,626	2,815	1,811	26,568
October	12,375	12,823	-448	21,971	20,358	1,613	91,434	8,087	7,607	480	2,931	2,986	-55	26,825
November	12,428	14,279	-1,851	25,009	23,974	1,035	96,769	7,182	6,927	255	3,880	2,704	1,176	25,690
December	16,184	18,527	-2,343	26,078	23,742	2,336	106,132	8,388	7,689	699	4,182	2,855	1,327	27,861
2003														
January	18,208	18,944	-736	26,415	24,076	2,339	113,650	8,917	7,666	1,251	3,993	4,487	-494	31,693
February	16,031	16,787	-756	23,205	22,004	1,201	98,885	7,564	6,628	936	3,530	5,295	-1,765	30,092
March	14,874	15,078	-204	25,518	25,696	-178	105,298	9,553	9,529	24	3,382	3,543	-161	34,350
April	11,993	13,001	-1,008	22,073	21,602	471	89,363	6,896	6,384	512	3,402	2,536	866	24,992
May P	15,834	17,688	-1,854	29,125	28,621	504	113,246	7,574	6,752	822	5,187	3,364	1,823	29,067
June P	19,369	19,652	-283	26,133	26,289	-156	121,898	8,948	8,162	786	4,912	3,631	1,281	35,471

P Provisional

Note : 1. Merchant turnover include cross-currency (*i.e.* foreign currency to foreign currency, both spot & forward) transactions and cancellation of forward contracts.

2. Inter-bank turnover include cross-currency (*i.e.* foreign currency to foreign currency, both spot & forward) transactions.

APPENDIX TABLE V.5 : A PROFILE OF CENTRAL GOVERNMENT DATED SECURITIES

(Amount in Rupees crore)

Item	2002-03	2001-02	2000-01
1	2	3	4
1. Gross Borrowing	1,25,000	1,14,213	1,00,183
2. Repayment	27,420	26,499	28,396
3. Net Borrowing	97,580	87,714	71,787
4. Weighted Average Maturity (in years)	13.83	14.26	10.60
5. Weighted Average Yield (per cent)	7.34	9.44	10.95
6. A. Maturity Distribution - Amount			
a) Up to 5 years	–	2,000	12,500
b) Above 5 and up to 10 years	45,500	16,000	35,000
c) Above 10 years	79,500	96,213	52,683
Total	1,25,000	1,14,213	1,00,183
B. Maturity Distribution - Per cent			
a) Up to 5 years	–	1.75	12.48
b) Above 5 and up to 10 years	36.40	14.01	34.94
c) Above 10 years	63.60	84.24	52.58
Total	100.00	100.00	100.00
7. Price-Based Auctions-Amount	56,000	53,000	65,000
8. Yield -Per cent			
Minimum	6.05 (12 years, 8 months)	6.98 (FRB, 8 years)	9.47 (2 years, 11 months)
Maximum	8.62 (24 years, 3 months)	11.00 (19 years, 8 months)	11.70 (11 years, 9 months)
9. Yield - Maturity Distribution-wise			
A. Less than 10 years			
Minimum	6.57 (8 years)	6.98 (FRB, 8 years)	9.47 (2 years, 11 months)
Maximum	7.72 (9 years, 11 months)	9.81 (7 years, 5 months)	11.69 (9 years, 10 months)
B. 10 years			
Minimum	6.72	9.39	11.30
Maximum	8.14	9.39	11.30
C. Above 10 years			
Minimum	6.05 (12 years, 8 months)	7.18 (14 years, 11 months)	10.47 (14 years)
Maximum	8.62 (24 years, 3 months)	11.00 (19 years, 8 months)	11.70 (11 years, 9 months)
Memo Item :			
1. Initial Subscriptions by RBI	36,175	28,892	31,151
2. Open Market Operations by RBI - Net Sales	53,780	30,335	19,218
3. Monetised Deficit*	-28,399	-5,150	6,705
4. Ways and Means Advances to Centre (Outstandings) (as on March 31)	Nil	5,176	5,395

.. Not applicable.
* Financial year variation.

Note : Figures in brackets represent residual maturity in years.

APPENDIX TABLE V.6 : SECONDARY MARKET TRANSACTIONS IN GOVERNMENT SECURITIES

(Amount in Rupees crore)

Item	Transaction in Government Securities															
	2002-03												2003-04 (so far)			
	April	May	June	July	August	September	October	November	December	January	February	March	April	May	June	July
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
I. OUTRIGHT TRANSACTIONS																
1. Central Government Securities	96,545.28	60,086.47	58,422.91	1,17,792.82	1,22,358.49	85,172.37	1,24,018.97	1,67,302.50	1,47,941.26	1,77,910.36	69,844.43	65,973.64	1,13,401.26	1,49,966.30	1,50,251.91	1,52,293.60
	(94.91)	(91.34)	(93.44)	(94.74)	(94.49)	(94.70)	(94.74)	(95.26)	(95.44)	(94.13)	(90.07)	(86.57)	(90.50)	(95.13)	(94.52)	(92.65)
2. State Government Securities	1,031.81	338.86	276.61	408.22	542.95	1,080.59	679.38	985.63	1,031.13	939.61	525.22	1,381.34	555.18	918.83	1,534.97	943.31
	(1.01)	(0.52)	(0.44)	(0.33)	(0.42)	(1.20)	(0.52)	(0.56)	(0.67)	(0.50)	(0.68)	(1.81)	(0.44)	(0.58)	(0.97)	(0.57)
3. Treasury Bills (a+b)	4,148.42	5,360.70	3,826.10	6,132.90	6,596.96	3,690.81	6,207.98	7,336.87	6,040.13	10,150.55	7,172.53	8,851.44	11,353.98	9,756.02	7,182.15	11,146.41
	(4.08)	(8.15)	(6.12)	(4.93)	(5.09)	(4.10)	(4.74)	(4.18)	(3.90)	(5.37)	(9.25)	(11.62)	(9.06)	(4.29)	(4.52)	(6.78)
(a) 91 days	1,119.03	1,949.98	1,854.57	2,212.18	1,830.20	1,053.33	2,321.23	2,750.81	3,423.51	6,789.54	4,567.98	4,210.06	3,666.82	2,012.00	2,861.33	5,322.03
	(1.10)	(2.96)	(2.97)	(1.78)	(1.41)	(1.17)	(1.77)	(1.57)	(2.21)	(3.59)	(5.89)	(5.52)	(2.93)	(1.28)	(1.80)	(3.24)
(b) 364 days	3,029.39	3,410.72	1,971.53	3,920.72	4,766.76	2,637.49	3,886.76	4,586.05	2,616.63	3,361.01	2,604.54	4,641.38	7,687.16	4,744.03	4,320.82	5,824.38
	(2.98)	(5.18)	(3.15)	(3.15)	(3.68)	(2.93)	(2.97)	(2.61)	(1.69)	(1.78)	(3.36)	(6.09)	(6.13)	(3.01)	(2.72)	(3.54)
Total (1+2+3)	1,01,725.51	65,786.03	62,525.62	1,24,333.94	1,29,498.40	89,943.77	1,30,906.33	1,75,625.00	1,55,012.53	1,89,000.51	77,542.18	76,206.42	1,25,310.42	1,57,641.15	1,58,969.03	1,64,383.31
	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)
II. REPO TRANSACTIONS																
1. Central Government Securities	44,018.23	43,590.78	36,451.40	32,833.73	29,116.05	36,194.40	42,268.20	30,013.44	30,377.83	48,048.78	50,319.93	66,571.45	35,101.13	37,623.97	40,807.01	67,382.59
	(93.62)	(98.11)	(96.31)	(96.09)	(87.49)	(86.66)	(90.71)	(86.99)	(80.68)	(72.15)	(76.93)	(89.68)	(83.94)	(86.84)	(83.96)	(89.92)
2. State Government Securities	25.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	20.00	0.00	99.00	0.00	0.00
	(0.05)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	(0.03)	0.00	(0.23)	(0.00)	(0.00)
3. Treasury Bills (a+b)	2,977.24	840.11	1,396.75	1,336.30	4,164.95	5,573.63	4,327.21	4,489.21	7,273.05	18,550.37	15,092.57	7,644.27	6,713.84	5,604.96	7,797.89	7,553.06
	(6.33)	(1.89)	(3.69)	(3.91)	(12.51)	(13.34)	(9.29)	(13.01)	(4.56)	(27.85)	(23.07)	(10.30)	(16.06)	(12.94)	(16.04)	(10.08)
(a) 91 days	43.24	0.00	166.50	32.00	400.00	530.00	200.00	299.00	1,717.52	5,097.17	3,240.26	880.03	241.00	520.10	743.70	1,218.64
	(0.09)	0.00	(0.44)	(0.09)	(1.20)	(1.27)	(0.43)	(0.87)	(4.56)	(7.65)	(4.95)	(1.19)	(0.51)	(1.20)	(1.53)	(1.63)
(b) 364 days	2,934.00	840.11	1,230.25	1,304.30	3,764.95	5,043.63	4,127.21	4,190.21	5,555.53	13,453.20	11,852.31	6,764.24	6,499.84	5,084.86	7,054.19	6,334.42
	(6.24)	(1.89)	(3.25)	(3.82)	(11.31)	(12.08)	(8.86)	(12.14)	(14.76)	(20.20)	(18.12)	(9.11)	(15.54)	(11.74)	(14.51)	(8.45)
Total (1+2+3)	47,020.47	44,430.89	37,848.15	34,170.03	33,281.00	41,768.03	46,595.41	34,502.65	37,650.88	66,599.15	65,412.50	74,235.72	41,814.97	43,327.93	48,604.90	74,935.65
	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)
III. GRAND TOTAL (I+II)	1,48,745.98	1,10,216.92	1,00,373.77	1,58,503.97	1,62,779.40	1,31,711.80	1,77,501.74	2,10,127.65	1,92,663.40	2,55,599.67	1,42,954.68	1,50,442.14	1,67,125.39	2,00,969.08	2,07,573.93	2,39,318.96
I as percentage of III	68.39	59.69	62.29	78.44	79.55	68.29	73.75	83.58	80.46	73.94	54.24	50.65	74.98	78.44	76.58	68.69
II as percentage of III	31.61	40.31	37.71	21.56	20.45	31.71	26.25	16.42	19.54	26.06	45.76	49.35	25.02	21.56	23.42	31.31

Note : 1. Figures in brackets indicate percentages to total outright / repo transactions.
2. Repos transactions exclude second leg of transactions.

APPENDIX TABLE V.7 : ISSUES OF CENTRAL GOVERNMENT DATED SECURITIES

(Amount in Rupees crore)

Issue / Auction Particulars						Bids/Application Received				Bids / Application Accepted							Gross Raised (15+16+17)	Cut-off Price (Rs.) / Yield (%)
Nomenclature of loan	Date of Auction	Date of Issue	Tenor (Years)	Residual Maturity (Years)	Notified Amount	Competitive		Non-Competitive		Competitive		Non- Competitive		Allocation to				
						Number	Face Value	Number +	Face Value	Number	Face Value	Number +	Face Value	Others	PDs (Devlmt.)	RBI (Devlmt./P)		
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
2002-03																		
6.65% GS 2009 # ** u	04-Apr-02	05-Apr-02	7	7.00	3000.00	160	6839.00	21	61.96	73	2938.03	21	61.96	3000.00	–	–	3000.00	6.65
6.85% GS 2012 # ** u	04-Apr-02	05-Apr-02	10	10.00	4000.00	310	13490.45	25	176.53	56	3823.47	25	176.53	4000.00	–	–	4000.00	6.85
7.49% GS 2017 # **	15-Apr-02	16-Apr-02	15	15.00	6000.00	263	8563.25	19	95.49	189	5904.50	19	95.49	6000.00	–	–	6000.00	7.49
9.40% GS 2012 $ P	–	22-Apr-02	11	10.39	6000.00	–	–	–	–	–	–	–	–	–	–	6000.00	6000.00	114.81/7.3357
7.40% GS 2012 # **	02-May-02	03-May-02	10	10.00	6000.00	274	12964.50	15	27.42	94	5972.57	15	27.42	6000.00	–	–	6000.00	7.40
7.55% GS 2010 # **	13-May-02	14-May-02	8	8.00	3000.00	161	3987.00	14	18.16	123	2467.00	14	18.16	2485.16	–	514.83	3000.00	7.55
8.35% GS 2022 # **	13-May-02	14-May-02	20	20.00	3000.00	85	1933.60	14	22.72	46	1474.10	14	22.72	1496.82	–	1503.18	3000.00	8.35
7.40% GS 2012 $ P	–	21-May-02	10	10.00	6000.00	–	–	–	–	–	–	–	–	–	–	6000.00	6000.00	95.00/8.14
7.49% GS 2017 $ P	–	30-May-02	15	14.88	4000.00	–	–	–	–	–	–	–	–	–	–	4000.00	4000.00	96.45/7.8983
10.18% GS 2026 $ P	–	30-May-02	25	24.28	2000.00	–	–	–	–	–	–	–	–	–	–	2000.00	2000.00	115.7/8.6234
7.40% GS 2012 $	05-June-02	06-June-02	10	9.91	4000.00	273	6753.30	–	–	150	2678.30	–	–	2678.30	1321.700	–	4000.00	97.80/7.7202
8.35% GS 2022 $	05-June-02	06-June-02	20	19.94	2000.00	48	1363.51	–	–	1	0.010	–	–	0.010	–	1999.99	2000.00	100/8.35
7.55% GS 2010 $	01-Jul-02	02-Jul-02	8	7.87	4000.00	261	6735.10	–	–	201	4000.00	–	–	4000.00	–	–	4000.00	101.46/7.3005
GOI FRB 2017	01-Jul-02	02-Jul-02	15	15.00	3000.00	41	3685.00	–	–	18	2885.00	–	–	2885.00	115.00	–	3000.00	0.34 @
																		100/6.84% for first 1/2 yr
8.07% GS 2017 $ **	17-Jul-02	18-Jul-02	15	14.49	4000.00	229	6634.6	23	37.31	66	1521.09	23	37.31	1558.40	1285.000	1156.59	4000.00	102.30/7.8021
6.72% GS 2007/12 # ** u	17-Jul-02	18-Jul-02	10	10.00	3000.00	145	5508.00	12	12.40	90	2987.59	12	12.40	3000.00	–	–	3000.00	6.72 @@
9.39% GS 2011 $ **	02-Aug-02	05-Aug-02	10	8.91	5000.00	324	12123.25	13	32.52	105	4967.48	13	32.52	5000.00	–	–	5000.00	113.90/7.2434
10.18% GS 2026 $ **	02-Aug-02	05-Aug-02	25	24.10	2000.00	163	6154.00	9	19.12	34	1980.88	9	19.12	2000.00	–	–	2000.00	124.00/7.9302
7.46% GS 2017# **	27-Aug-02	28-Aug-02	15	15.00	5000.00	260	8840.90	26	108.34	157	4891.65	26	108.34	5000.00	–	–	5000.00	7.46
7.95% GS 2032 # ** u	27-Aug-02	28-Aug-02	30	30.00	2000.00	119	3992.50	15	38.54	67	1961.45	15	38.54	2000.00	–	–	2000.00	7.95
7.46% GS 2017 $ **	09-Sep-02	11-Sep-02	15	14.96	4000.00	261	6546.93	22	106.76	152	3893.23	22	106.76	4000.00	–	–	4000.00	100.15/7.4427
8.35% GS 2022 $ **	09-Sep-02	11-Sep-02	20	19.68	3000.00	131	4288.50	20	55.63	98	2944.36	20	55.63	3000.00	–	–	3000.00	106.50/7.7014
7.27% GS 2013 $ **	08-Oct-02	09-Oct-02	11	10.90	4000.00	361	15269.50	26	78.31	119	3921.68	26	78.31	4000.00	–	–	4000.00	100.93/7.1444
7.95% GS 2032 $ ** u	08-Oct-02	09-Oct-02	30	29.89	3000.00	91	4463.25	15	47.68	39	2952.31	15	47.68	3000.00	–	–	3000.00	100.72/7.8858
7.46% GS 2017 $ **	16-Oct-02	17-Oct-02	15	14.86	4000.00	253	13922.50	18	50.85	18	3949.15	18	50.85	4000.00	–	–	4000.00	100.79/7.3702
10.03% GS 2019 $ **	06-Nov-02	07-Nov-02	18	16.76	4000.00	245	10410.90	14	29.00	20	3971.00	14	29.00	4000.00	–	–	4000.00	126.58/7.2601
10.18% GS 2026 $ **	06-Nov-02	07-Nov-02	25	23.84	3000.00	166	5822.50	11	30.50	49	2969.50	11	30.50	3000.00	–	–	3000.00	129.80/7.4807
8.35% GS 2022 $ **	05-Dec-02	06-Dec-02	20	19.44	5000.00	263	12189.00	23	86.52	39	4913.47	23	86.52	5000.00	–	–	5000.00	115.09/6.9251
7.38% GS 2015 $ **	06-Jan-03	07-Jan-03	13	12.66	5000.00	256	13006.38	22	166.65	112	4833.34	22	166.65	5000.00	–	–	5000.00	111.58/6.0555
6.57% GS 2011 P	–	24-Feb-03	8	8.00	7500.00	–	–	–	–	–	–	–	–	–	–	7500.00	7500.00	6.57
6.72% GS 2014 P	–	24-Feb-03	11	11.00	5500.00	–	–	–	–	–	–	–	–	–	–	5500.00	5500.00	6.72
2003-04																		
7.37% GS 2014 $ **	08-Apr-03	09-Apr-03	12	11.02	5000.00	236	7926.00	24	60.19	201	4939.80	24	60.19	5000.00	–	–	5000.00	111.11/5.9787
6.30% GS 2023 # **	08-Apr-03	09-Apr-03	20	20.00	4000.00	245	10413.00	25	147.31	65	3852.68	25	147.31	4000.00	–	–	4000.00	6.30
6.25% GS 2018 $ **	22-Apr-03	23-Apr-03	15	14.69	5000.00	319	9655.25	26	101.93	134	4898.07	26	101.93	5000.00	–	–	5000.00	101.40/6.1032
7.95% GS 2032 $ **	22-Apr-03	23-Apr-03	30	29.35	2000.00	131	4472.75	19	60.65	9	1939.35	19	60.65	2000.00	–	–	2000.00	121.51/6.3274
6.25% GS 2018 $ P	–	23-Apr-03	15	14.69	3000.00	–	–	–	–	–	–	–	–	–	–	3000.00	3000.00	101.40/6.1032
7.95% GS 2032 $ P	–	23-Apr-03	30	29.35	2000.00	–	–	–	–	–	–	–	–	–	–	2000.00	2000.00	121.51/6.3274
7.27% GS 2013 $ **	03-May-03	05-May-03	11	10.33	6000.00	314	12468.70	14	30.90	98	5969.10	14	30.90	6000.00	–	–	6000.00	109.92/5.9679
6.30% GS 2023 $ **	03-May-03	05-May-03	20	18.93	3000.00	143	4158.75	14	41.55	118	2958.45	14	41.55	3000.00	–	–	3000.00	99.45/6.3485
GOI FRB 2014	19-May-03	20-May-03	11	11.00	5000.00	110	8710.00	2	0.80	55	4999.20	2	0.80	5000.00	–	–	5000.00	0.14 @
																		100/5.09% for first 1 yr
6.85% GS 2012 $ **	03-Jun-03	04-Jun-03	10	8.84	6000.00	378	13026.00	21	91.30	151	5908.70	21	91.30	6000.00	–	–	6000.00	107.48/5.7566
6.13% GS 2028 # **	03-Jun-03	04-Jun-03	25	25.00	3000.00	187	7886.00	19	214.32	15	2850.00	19	150.00	3000.00	–	–	3000.00	6.13
7.37% GS 2014 $ **	01-Jul-03	02-Jul-03	12	10.79	5000.00	298	12800.00	20	95.42	116	4904.58	20	95.42	5000.00	–	–	5000.00	112.80/5.7590
6.05% GS 2019 $ **	01-Jul-03	02-Jul-03	16	15.94	4000.00	279	9055.80	22	178.09	94	3821.91	22	178.09	4000.00	–	–	4000.00	100.90/5.9613
6.13% GS 2028 $ **	01-Jul-03	02-Jul-03	25	24.92	3000.00	114	5379.75	20	136.14	45	2863.85	20	136.14	3000.00	–	–	3000.00	100.39/6.0989
6.35% GS 2020 $ **	15-Jul-03	16-Jul-03	17	16.46	6000.00	371	15722.50	29	309.93	115	5700.00	29	300.00	6000.00	–	–	6000.00	103.92/5.9723
7.95% GS 2032 $ **	15-Jul-03	16-Jul-03	30	29.12	3000.00	134	5234.75	22	68.19	12	2931.81	22	68.190	3000.00	–	–	3000.00	123.38/6.2041
GOI FRB 2011	07-Aug-03	08-Aug-03	8	8.00	6000.00	115	13145.00	10	19.40	54	5980.60	10	19.40	6000.00	–	–	6000.00	0.13@
																		100/5.03% for first 1 yr
6.01% GS 2028 # **	07-Aug-03	08-Aug-03	25	24.63	3000.00	176	7476.26	27	243.32	79	2850.00	27	150.00	3000.00	–	–	3000.00	6.01

Yield Based Auction u Uniform Price Auction P Private Placement with RBI + Number of applicants. ** Allotment to Non-Competitive bidders at wtd.average yield/price of competitive bids.

$ Reissues @ Mark up (spread) over the base rate @@ yield at first call (issuance with put & call options)

APPENDIX TABLE V.8 : PROFILE OF TREASURY BILLS

(Amount in Rupees crore)

Item		2002-03	2001-02	2000-01	1999-2000
1		2	3	4	5
1. Implicit Yield at Cut-off Price (per cent)					
14-day Treasury Bills					
	Minimum	..	6.78	6.26	6.52
	Maximum	..	7.56	10.97	8.87
	Average	..	7.13	8.23	8.23
91-day Treasury Bills					
	Minimum	5.10	6.05	7.91	8.25
	Maximum	7.00	8.50	10.47	9.46
	Average	5.73	6.88	8.98	9.03
182-day Treasury Bills					
	Minimum	..	8.33	8.42	8.96
	Maximum	..	8.57	10.42	9.97
	Average	..	8.44	9.43	9.68
364-day Treasury Bills					
	Minimum	5.35	6.16	8.66	9.31
	Maximum	6.98	8.85	10.91	10.33
	Average	5.93	7.30	9.76	10.09
2. Gross Issues					
14-day Treasury Bills		..	1,100	10,480	16,453
91-day Treasury Bills		26,402	20,216	7,255	8,155
182-day Treasury Bills		..	300	2,600	2,900
364-day Treasury Bills		26,126	19,588	15,000	13,000
3. Net Issues					
14-day Treasury Bills		..	-300	-25	125
91-day Treasury Bills		4,626	3,171	310	20
182-day Treasury Bills		..	-1300	..	1,300
364-day Treasury Bills		6,538	4,588	2,000	2,800
4. Outstanding at Year/Period End					
14-day Treasury Bills		..	..	300	325
91-day Treasury Bills		9,627	5,001	1,830	1,520
182-day Treasury Bills		..	..	1,300	1,300
364-day Treasury Bills		26,126	19,588	15,000	13,000

.. Not applicable.

Note : 1. Non-competitive bids allowed to certain entities like State Governments result in the difference between notified amount and actual amounts issued and outstanding.

2. Auction of 14-day and 182-day Treasury Bills were discontinued from the week beginning May 14, 2001.

APPENDIX TABLE V.9 : ASSISTANCE SANCTIONED AND DISBURSED BY FINANCIAL INSTITUTIONS

(Rs. crore)

Institution	2002-03 P		2001-02 P		2000-2001	
	S	D	S	D	S	D
1	2	3	4	5	6	7
A. All India Development Banks	**17,030.6**	**13,551.4**	**60,840.4**	**45,050.1**	**96,533.4**	**58,673.9**
(1to 5)	**(73.5)**	**(57.6)**	**(461.3)**	**(450.9)**	**(803.8)**	**(775.6)**
1. IDBI	2,889.1	3,924.3	13,505.2	11,151.0	26,414.4	16,984.0
	(–)	(–)	(284.6)	(302.1)	(418.2)	(492.9)
2. IFCI	2,031.4	1,792.8	759.9	1,078.7	1,766.5	2,156.8
3. ICICI*	–	–	36,229.2	25,831.1	55,815.2	31,664.6
4. SIDBI	10,903.6	6,789.4	9,025.5	5,919.3	10,435.0	6,158.7
	(73.5)	(57.6)	(176.7)	(148.8)	(385.6)	(282.7)
5. IIBI	1,206.5	1,044.9	1,320.7	1,070.0	2,102.3	1,709.8
B. Specialised Financial Institutions	**475.1**	**490.2**	**872.7**	**868.9**	**339.1**	**253.5**
(6 to 8)						
6. IVCF	1.5	1.5	3.3	4.1	3.6	3.3
7. ICICI Venture	389.5	394.0	774.0	778.3	229.9	189.6
8. TFCI	84.1	94.7	95.4	86.5	105.6	60.6
C. Investment Institutions	**6,199.9**	**8,111.5**	**9,363.2**	**11,667.5**	**18,684.1**	**12,792.8**
(9 to 11)						
9. LIC	4,332.7	6,205.8	6,741.5	8,914.2	10,867.2	7,095.0
10. UTI #	307.4	414.7	991.0	1,269.6	6,770.1	4,599.9
11. GIC $	1,559.8	1,491.0	1,630.7	1,483.7	1,046.8	1,097.9
D. Total Assistance by All-India Financial Institutions (AIFIs) (A+B+C)	**23,705.6**	**22,153.1**	**71,076.3**	**57,586.5**	**1,15,556.6**	**71,720.2**
E. State-level Institutions	..	..	**3,803.7**	**3,467.3**	**4,991.5**	**3,643.4**
(12 and 13)						
12. SFCs	..	..	2,210.2	1,749.6	2,911.4	1,979.0
13. SIDCs	..	..	1,593.5	1,717.7	2,080.1	1,664.4
F. Total Assistance by All Financial Institutions (AFIs)	..	..	**74,880.0**	**61,053.8**	**1,20,548.1**	**75,363.6**

P Provisional. .. Not available. – Nil/Negligible. S Sanctions. D Disbursements.

* Since ICICI Ltd. was merged with ICICI Bank Ltd. effective March 30, 2002, ICICI Ltd. has ceased to exist. Data for ICICI Ltd. are, therefore, for the year up to 2001-02.

With the repeal of the UTI Act, 1963, UTI has stopped providing long-term finance. Hence, data for 2002-03 relate to the period April-October 2002 only.

$ Data include GIC and its former subsidiaries.

Note : Data in parentheses for IDBI and SIDBI pertain to refinance to SFCs/SIDCs, seed capital as also loans to and subscription to shares and bonds of financial institutions and are excluded from the total.

Source : IDBI for SIDCs and UTI, SIDBI for SFCs and respective financial institutions.

APPENDIX TABLE V.10 : NEW CAPITAL ISSUES BY NON-GOVERNMENT PUBLIC LIMITED COMPANIES

(Amount in Rupees crore)

Security and Type of Issue	2002-03P		2001-02		2000-01	
	No. of Issues	Amount	No. of Issues	Amount	No. of Issues	Amount
1	2	3	4	5	6	7
1) Equity Shares (a+b)	**5**	**460.2**	**6**	**860.4**	**128**	**2,607.6**
	(5)	(391.3)	(3)	(654.3)	(52)	(1,227.3)
a) Prospectus	3	206.7	4	852.7	111	2,312.4
	(3)	(201.0)	(2)	(653.7)	(48)	(1,182.0)
b) Rights	2	253.5	2	7.7	17	295.2
	(2)	(190.3)	(1)	(0.6)	(4)	(45.3)
2) Preference Shares (a+b)	**–**	**–**	**–**	**–**	**2**	**142.2**
a) Prospectus	–	–	–	–	–	–
b) Rights	–	–	–	–	2	142.2
3) Debentures (a+b)	**1**	**217.5**	**4**	**774.0**	**2**	**90.2**
a) Prospectus	–	–	1	69.5	–	–
b) Rights	1	217.5	3	704.5	2	90.2
of which:						
i) Convertible (a+b)	1	217.5	3	518.1	1	36.2
a) Prospectus	–	–	1	69.5	–	–
b) Rights	1	217.5	2	448.6	1	36.2
ii) Non-Convertible (a+b)	–	–	1	255.9	1	54.0
a) Prospectus	–	–	–	–	–	–
b) Rights	–	–	1	255.9	1	54.0
4) Bonds (a+b)	**3**	**1,200.0**	**9**	**4,058.0**	**7**	**2,050.0**
a) Prospectus	3	1,200.0	9	4,058.0	7	2,050.0
b) Rights	–	–	–	–	–	–
5) Total (1+2+3+4)	**9**	**1,877.7**	**19**	**5,692.4**	**139**	**4,890.0**
a) Prospectus	6	1,406.7	14	4,980.2	118	4,362.4
b) Rights	3	471.0	5	712.2	21	527.6

– Nil/Negligible.

Note:
1. Data are provisional.
2. Data exclude bonus shares, offers for sale and private placements.
3. Figures in brackets indicate data in respect of premium on capital issues. These are included in respective totals.
4. Preference shares include cumulative convertible preference shares and equi-preference shares.
5. Convertible debentures include partly convertible debentures.
6. Non-convertible debentures include secured premium notes and secured deep discount bonds.
7. Data are compiled from prospectus /circulars/advertisements issued by companies, replies given by the companies to the Reserve Bank's questionnaires, information received from stock exchanges, press reports, *etc.*

APPENDIX TABLE V.11 : INDICATORS OF EQUITY MARKETS

Year/Month	BSE Sensex (Base : 1978-79=100)				S&P CNX Nifty (Base : 03.11.1995=1000)				The Stock Exchange, Mumbai		National Stock Exchange	
	Average@	High	Low	End of the Year/ Month	Average@	High	Low	End of the Year/ Month	Turnover #	Price/ Earning Ratio $	Turnover #	Price/ Earning Ratio $
1	2	3	4	5	6	7	8	9	10	11	12	13
2000-01	**4270** (-8.4)	**5542**	**3541**	**3604**	**1335** (-2.5)	**1625**	**1125**	**1148**	**10,00,032**	**23.86**	**13,39,510**	**20.35**
2001-02	**3332** (-22.0)	**3742**	**2600**	**3469**	**1077** (-19.3)	**1198**	**854**	**1130**	**3,07,292**	**16.55**	**5,13,167**	**15.72**
2002-03	**3206** (-3.8)	**3513**	**2834**	**3049**	**1037** (-3.7)	**1147**	**923**	**978**	**3,14,073**	**14.51**	**6,17,989**	**15.24**
2002												
April	3435	3513	3301	3338	1121	1147	1074	1085	28,875	16.83	53,320	18.02
May	3303	3462	3114	3126	1080	1128	1027	1029	28,138	16.19	54,979	17.44
June	3257	3362	3161	3245	1066	1097	1040	1058	23,320	15.92	44,241	16.28
July	3215	3359	2988	2988	1035	1082	959	959	26,724	15.34	51,398	16.39
August	3053	3181	2950	3181	978	1011	954	1011	23,780	13.62	46,113	14.54
September	3086	3187	2991	2991	987	1014	963	963	24,410	13.14	46,499	14.69
October	2950	3010	2834	2949	955	974	923	951	27,641	12.68	51,902	14.25
November	3058	3229	2948	3229	992	1050	951	1050	25,981	13.22	51,352	14.55
December	3316	3398	3207	3377	1074	1098	1036	1094	30,582	14.37	61,973	14.57
2003												
January	3328	3390	3220	3250	1073	1100	1035	1042	30,898	14.43	64,762	14.56
February	3279	3322	3223	3284	1056	1070	1036	1063	23,461	14.22	48,289	14.32
March	3156	3277	3049	3049	1016	1059	978	978	20,265	13.74	43,160	13.85
April	3037	3215	2924	2960	965	1032	924	934	20,823	13.21	48,971	13.20
May	3033	3181	2943	3181	963	1007	936	1007	22,510	13.21	54,690	11.15
June	3387	3607	3182	3607	1069	1134	1011	1134	24,933	14.61	61,586	12.20
Memo Item :	**2002-03**	**2001-02**	**2000-01**	**1999-2000**	**2002-03**	**2001-02**	**2000-01**	**1999-2000**				
a) Co-efficient of Variation (%)@	4.8	7.2	8.8	13.2	5.2	6.8	7.5	14.7				
b) Dispersion (Range)@	679	1,142	2,001	2,689	224	344	500	825				
c) Market Capitalisation # *	5,72,198	6,12,224	5,71,553	9,12,842	5,37,133	6,36,861	6,57,847	10,20,426				

@ Based on daily closing indices. # In Rupees crore. $ Based on scrips included in the BSE Sensex and the S&P CNX Nifty, resepectively. * Pertain to BSE and NSE.

Note : Figures in brackets are percentage variations over the previous year.

Source : The Stock Exchange, Mumbai and the National Stock Exchange of India Limited.

APPENDIX TABLE V.12 : TURNOVER IN THE EQUITY DERIVATIVES MARKET

(Rupees crore)

Month/Year	The Stock Exchange, Mumbai (BSE)				The National Stock Exchange (NSE)			
	Index Futures	Index Options $	Stock Futures	Stock Options $	Index Futures	Index Options $	Stock Futures	Stock Options $
1	2	3	4	5	6	7	8	9
2000-01	**1,672.62**	–	–	–	**2,365**	–	–	–
2001-02	**1,276.30**	**78.30**	**451.60**	**115.51**	**21,482**	**3,766**	**51,516**	**25,163**
2002-03	**1,810.99**	**1.98**	**644.30**	**21.17**	**43,952**	**9,247**	**2,86,532**	**1,00,133**
2001-02								
April	28.05	–	–	–	292	–	–	–
May	11.78	–	–	–	230	–	–	–
June	38.89	15.74	–	–	590	196	–	
July	40.64	6.03	–	8.19	1,309	326	–	396
August	491.72	52.22	–	52.14	1,305	284	–	1,107
September	359.10	3.73	–	36.04	2,857	412	–	2,012
October	52.20	0.20	–	3.34	2,485	559	–	2,433
November	52.31	0.27	78.99	4.88	2,484	455	2,811	3,010
December	13.51	0.00	69.66	2.48	2,339	405	7,515	2,660
January	28.40	0.07	110.37	6.17	2,660	338	13,261	5,089
February	155.56	0.04	149.54	1.75	2,747	430	13,939	4,499
March	4.14	0.00	43.04	0.52	2,185	360	13,989	3,957
2002-03								
April	1.11	0.61	21.49	0.55	1,656	382	15,065	4,570
May	9.90	0.03	104.70	0.32	2,022	463	15,981	5,133
June	12.31	0.00	90.36	0.43	2,123	389	16,178	4,642
July	0.89	0.00	77.38	0.40	2,513	511	21,205	6,178
August	0.02	0.00	43.93	0.46	2,978	518	17,881	5,562
September	0.09	0.00	18.10	1.99	2,836	583	17,501	6,221
October	0.00	0.00	13.85	0.15	3,145	727	21,213	8,357
November	0.00	0.00	13.15	0.10	3,500	845	25,463	10,028
December	0.00	0.00	15.51	0.45	5,958	1,088	35,532	13,043
January	546.57	0.00	100.26	0.27	5,557	940	38,299	14,353
February	589.42	0.03	89.70	5.68	5,040	946	32,445	10,964
March	650.68	1.31	55.87	10.37	6,624	1,856	29,770	11,082
2003-04								
April	64.77	0.00	20.77	1.80	6,994	1,707	29,749	11,569
May	8.13	0.03	10.46	4.33	6,283	1,617	32,752	12,722
June	0.59	0.00	6.08	2.54	9,348	1,942	46,505	15,042

$ Notional turnover for call and put options. – Not Applicable.

Note : Index futures were introduced in June 2000, index options in June 2001, stock options in July 2001 and stock futures in November 2001 both on BSE and NSE.

Sources : The Stock Exchange, Mumbai and the National Stock Exchange of India Limited.

APPENDIX TABLE VI.1 : SELECT ECONOMIC INDICATORS - WORLD

Item	2004$	2003$	2002	2001	2000	1999	1998	1997
1	2	3	4	5	6	7	8	9
I. World Output (Per Cent Change)	4.1	3.2	3.0	2.3	4.7	3.6	2.8	4.3
i) Advanced economies	2.9	1.9	1.8	0.9	3.8	3.4	2.7	3.4
ii) Developing countries	5.8	5.0	4.6	3.9	5.7	3.9	3.5	5.9
a) Developing Asia	6.5	6.3	6.5	5.7	6.8	6.1	4.0	6.6
b) Africa	5.2	3.9	3.4	3.6	2.8	2.6	3.3	3.0
c) Middle East, Malta and Turkey	4.9	5.1	4.5	1.4	5.8	0.8	3.8	6.6
d) Western Hemisphere	4.2	1.5	-0.1	0.6	4.0	0.2	2.3	5.2
iii) Countries in Transition	4.1	4.0	4.1	5.1	6.6	3.6	-0.8	2.0
II. Inflation- CPI (Per Cent Change)								
i) Advanced economies	1.7	1.9	1.5	2.2	2.3	1.4	1.5	2.1
ii) Developing countries	5.1	5.8	5.4	5.8	5.8	6.6	10.2	9.8
a) Developing Asia	3.3	2.3	1.9	2.7	1.8	2.5	7.7	4.8
III. Fiscal Balance #								
i) Advanced economies	-2.3	-2.6	-2.1	-0.8	0.3	-0.9	-1.3	-1.8
ii) Developing countries	-3.2	-3.4	-3.8	-3.8	-3.2	-3.8	-3.8	-2.6
a) Developing Asia	-3.6	-3.9	-4.0	-4.1	-4.3	-4.2	-3.6	-2.6
IV. Net Capital Flows* (US $ billion)								
Emerging Market Economies**								
i) Net private capital flows (a+b+c)	113.2	90.5	85.9	38.8	51.1	96.0	53.4	75.7
a) Net private direct investment	146.7	147.6	139.2	170.5	149.0	156.8	148.8	136.0
b) Net private portfolio investment	10.3	-3.5	-36.6	-38.5	12.1	41.4	1.7	48.5
c) Net other private capital flows	-43.7	-53.6	-16.7	-93.2	-110.1	-102.2	-97.1	-108.8
ii) Net official flows	-18.0	-1.9	25.8	38.8	-3.8	14.0	83.0	56.3
V. World Trade @	6.1	4.3	2.9	0.1	12.6	5.6	4.4	10.6
Imports								
i) Advanced economies	5.9	4.7	2.1	-1.1	11.9	8.0	6.0	9.4
ii) Developing countries	8.0	4.7	5.4	2.2	15.7	1.7	-0.5	11.8
Exports								
i) Advanced economies	5.8	3.8	2.0	-1.0	12.0	5.5	4.1	10.6
ii) Developing countries	7.6	3.7	5.1	3.3	14.9	4.6	5.2	14.0
Terms of Trade								
i) Advanced economies	0.7	0.6	0.4	0.4	-2.5	-0.3	1.3	-0.5
ii) Developing countries	-2.4	1.7	1.2	-3.1	6.0	4.6	-6.6	-0.3
VI. Current Account Balance (US $ billion)								
i) Advanced economies	-261.9	-270.4	-217.2	-187.3	-224.5	-91.6	49.6	94.5
ii) Developing countries	18.9	73.6	54.9	31.1	67.1	-10.1	-83.2	-56.0
a) Developing Asia	25.8	34.8	51.2	34.5	44.2	46.7	47.9	8.4

$ Projections.

Central Government balance as percentage of GDP.

* Net capital flows comprise net direct investment, net portfolio investment, and other long- and short-term net investment flows, including official and private borrowing.

** Emerging markets include developing countries, countries in transition, Korea, Singapore, Taiwan Province of China, and Israel.

@ Annual percentage change in world trade in volume of goods and services.

Source : World Economic Outlook (IMF), April 2003.

APPENDIX TABLE VI.2 : INDIA'S OVERALL BALANCE OF PAYMENTS

Item	Rupees crore			US $ million		
	2002-03	2001-02	2000-01	2002-03	2001-02	2000-01
1	2	3	4	5	6	7
A. Current Account						
1. Exports, f.o.b.	2,56,352	2,14,351	2,05,287	53,000	44,915	44,894
2. Imports, c.i.f.	3,16,702	2,74,778	2,70,663	65,474	57,618	59,264
3. Trade Balance	-60,350	-60,427	-65,376	-12,474	-12,703	-14,370
4. Invisibles, net	78,275	64,161	48,975	16,182	13,485	10,780
a) 'Non-Factor' Services	29,995	21,960	11,401	6,206	4,577	2,478
of which, Software Exports	*46,427*	*36,036*	*29,014*	*9,600*	*7,556*	*6,341*
b) Income	-23,617	-17,467	-22,384	-4,882	-3,601	-4,832
c) Private Transfers	69,924	57,821	58,412	14,448	12,125	12,798
d) Official Transfers	1,973	1,847	1,546	410	384	336
5. Current Account Balance	17,925	3,734	-16,401	3,708	782	-3,590
B. Capital Account						
1. Foreign Investment, net (a+b)	21,918	31,877	27,245	4,555	6,692	5,862
a. Direct Investment *of which * :*	17,412	22,588	15,413	3,611	4,741	3,272
i. In India	22,575	29,192	18,414	4,660	6,131	4,029
Equity	*13,091*	*18,658*	*10,964*	*2,700*	*4,095*	*2,400*
Re-invested earnings	*7,250*	*8,710*	*6,175*	*1,498*	*1,646*	*1,350*
Other Capital	*2,234*	*1,824*	*1,275*	*462*	*390*	*279*
ii. Abroad	-5,163	-6,604	-3,001	-1,049	-1,390	-757
Equity	*-2,051*	*-2,701*	*-1,586*	*-424*	*-570*	*-344*
Re-invested earnings	*-2,600*	*-3,329*	*-1,076*	*-519*	*-699*	*-339*
Other Capital	*-512*	*-574*	*-339*	*-106*	*-121*	*-74*
b. Portfolio Investment	4,506	9,289	11,832	944	1,951	2,590
In India	*4,679*	*9,617*	*12,609*	*979*	*2,020*	*2,760*
Abroad	*-173*	*-328*	*-777*	*-35*	*-69*	*-170*
2. External Assistance, Net	-11,745	5,418	2,001	-2,460	1,117	410
Disbursements	13,392	16,073	13,528	2,773	3,352	2,942
Amortisation	-25,137	-10,655	-11,527	-5,233	-2,235	-2,532
3. Commercial Borrowings, net	-8,283	-7,476	17,577	-1,698	-1,576	3,737
Disbursements	13,219	12,896	41,845	2,737	2,696	9,052
Amortisation	-21,502	-20,372	-24,268	-4,435	-4,272	-5,315
4. Short Term Credit, net	4,715	-4,236	321	979	-891	105
5. Banking Capital *of which,*	39,800	26,671	3,517	8,243	5,592	811
NRI Deposits, net	*13,602*	*13,127*	*10,567*	*2,808*	*2,754*	*2,317*
6. Rupee Debt Service	-2,303	-2,458	-2,763	-474	-519	-617
7. Other Capital, net @	16,921	793	-1,223	3,493	158	-290
8. Total Capital Account	**61,023**	**50,589**	**46,675**	**12,638**	**10,573**	**10,018**
C. Errors & Omissions	3,068	2,269	-2,612	634	402	-572
D. Overall Balance [A(5)+B(8)+C]	**82,016**	**56,592**	**27,662**	**16,980**	**11,757**	**5,856**
E. Monetary Movements (F+G)	-82,016	-56,592	-27,662	-16,980	-11,757	-5,856
F. IMF, Net	0	0	-115	0	0	-26
G. Reserves and Monetary Gold (Increase-, Decrease +)	**-82,016**	**-56,592**	**-27,547**	**-16,980**	**-11,757**	**-5,830**

* : Data on Foreign Direct Investment (FDI) are revised since 2000-01 with expanded coverage to approach international best practices. FDI data for previous years would not be comparable with these figures.

@ Comprises mainly of leads and lags in export receipts. Other items included are funds held abroad, India's subscription to international institutions, quota payment to IMF, and residual item of other capital transaction not included elsewhere.

Note : 1. Gold and silver brought by returning Indians have been included under imports, with a *contra* entry in private transfer receipts

2. Data on exports and imports differ from those given by DGCI&S on account of differences in coverage, valuation and timing.

APPENDIX TABLE VI.3 : INDIA'S FOREIGN TRADE

Item	Rupees crore			US $ million			SDR million		
	April-March			April-March			April-March		
	2002-03P	2001-02	2000-01	2002-03P	2001-02	2000-01	2002-03P	2001-02	2000-01
1	2	3	4	5	6	7	8	9	10
I. Exports (a+b)	**2,52,790**	**2,09,018**	**2,03,571**	**52,234**	**43,827**	**44,560**	**39,419**	**34,712**	**34,187**
	(20.9)	(2.7)	(27.6)	(19.2)	(-1.6)	(21.0)	(13.6)	(1.5)	(26.3)
a. POL @	11,718	10,107	8,645	2,421	2,119	1,892	1,827	1,678	1,452
	(15.9)	(16.9)	(5032.4)	(14.3)	(12.0)	(4768.2)	(8.9)	(15.6)	(4980.2)
b. Non-oil	2,41,072	1,98,911	1,94,926	49,813	41,708	42,668	37,592	33,034	32,735
	(21.2)	(2.0)	(22.3)	(19.4)	(-2.3)	(16.0)	(13.8)	(0.9)	(21.0)
II. Imports (a+b)	**2,96,597**	**2,45,200**	**2,30,873**	**61,286**	**51,413**	**50,536**	**46,250**	**40,721**	**38,772**
	(21.0)	(6.2)	(7.3)	(19.2)	(1.7)	(1.7)	(13.6)	(5.0)	(6.2)
a. Oil and POL	85,367	66,770	71,497	17,640	14,000	15,650	13,312	11,089	12,007
	(27.9)	(-6.6)	(30.8)	(26.0)	(-10.5)	(24.1)	(20.0)	(-7.6)	(29.5)
b. Non-oil	2,11,230	1,78,430	1,59,376	43,647	37,413	34,886	32,938	29,632	26,765
	(18.4)	(12.0)	(-0.8)	(16.7)	(7.2)	(-5.9)	(11.2)	(10.7)	(-1.8)
III. Trade Balance (I-II)	**-43,807**	**-36,182**	**-27,302**	**-9,052**	**-7,587**	**-5,976**	**-6,831**	**-6,009**	**-4,585**
a. Oil Balance (I.a-II.a)	-73,649	-56,663	-62,851	-15,218	-11,881	-13,758	-11,484	-9,410	-10,555
b. Non-oil Balance (I.b-II.b)	29,842	20,482	35,549	6,166	4,295	7,781	4,653	3,401	5,970

P Provisional.
@ Petroleum, oil and lubricants.

Note : Figures in brackets are percentage variations over the previous year.

Source : DGCI & S.

APPENDIX TABLE VI.4 : INDIA'S EXPORTS OF PRINCIPAL COMMODITIES

Commodity Group	Rupees crore					US $ million				
				Percentage Variation					Percentage Variation	
	2002-03P	2001-02	2000-01	2002-03 over 2001-02	2001-02 over 2000-01	2002-03 P	2001-02	2000-01	2002-03 P over 2001-02	2001-02 over 2000-01
1	2	3	4	5	6	7	8	9	10	11
I. Primary Products	**40,225 (15.9)**	**34,165 (16.3)**	**32,556 (16.0)**	**17.7**	**4.9**	**8,312 (15.9)**	**7,164 (16.3)**	**7,126 (16.0)**	**16.0**	**0.5**
A. Agricultural & Allied Products	**31,030 (12.3)**	**28,144 (13.5)**	**27,288 (13.4)**	**10.3**	**3.1**	**6,412 (12.3)**	**5,901 (13.5)**	**5,973 (13.4)**	**8.7**	**-1.2**
of which :										
1. Tea	1,622	1,719	1,789	-5.7	-3.9	335	360	392	-7.0	-7.9
2. Coffee	974	1,095	1,185	-11.0	-7.6	201	230	259	-12.3	-11.5
3. Rice	5,364	3,174	2,932	69.0	8.3	1,108	666	642	66.5	3.7
4. Oil Meal	1,378	2,263	2,045	-39.1	10.7	285	474	448	-40.0	6.0
5. Marine Products	6,683	5,898	6,367	13.3	-7.4	1,381	1,237	1,394	11.7	-11.3
B. Ores & Minerals	**9,195 (3.6)**	**6,021 (2.9)**	**5,267 (2.6)**	**52.7**	**14.3**	**1,900 (3.6)**	**1,262 (2.9)**	**1,153 (2.6)**	**50.5**	**9.5**
II. Manufactured Goods	**1,85,608 (73.4)**	**1,59,146 (76.1)**	**1,56,858 (77.1)**	**16.6**	**1.5**	**38,353 (73.4)**	**33,370 (76.1)**	**34,335 (77.1)**	**14.9**	**-2.8**
of which :										
A. Leather & Manufactures	**8,648 (3.4)**	**9,110 (4.4)**	**8,883 (4.4)**	**-5.1**	**2.6**	**1,787 (3.4)**	**1,910 (4.4)**	**1,944 (4.4)**	**-6.4**	**-1.8**
B. Chemicals & Related Products	**34,025 (13.5)**	**28,862 (13.8)**	**26,889 (13.2)**	**17.9**	**7.3**	**7,031 (13.5)**	**6,052 (13.8)**	**5,886 (13.2)**	**16.2**	**2.8**
1. Basic Chemicals, Pharmaceuticals & Cosmetics	21,182	17,632	16,739	20.1	5.3	4,377	3,697	3,664	18.4	0.9
2. Plastic & Linoleum	5,523	4,709	4,181	17.3	12.6	1,141	987	915	15.6	7.9
3. Rubber, Glass, Paints & Enamels, *etc.*	5,560	4,695	4,278	18.4	9.7	1,149	984	937	16.7	5.1
4. Residual Chemicals & Allied Products	1,760	1,826	1,691	-3.6	8.0	364	383	370	-5.0	3.4
C. Engineering Goods	**40,618 (16.1)**	**33,183 (15.9)**	**31,150 (15.3)**	**22.4**	**6.5**	**8,393 (16.1)**	**6,958 (15.9)**	**6,819 (15.3)**	**20.6**	**2.0**
D. Textiles	**51,140 (20.2)**	**46,094 (22.1)**	**48,686 (23.9)**	**10.9**	**-5.3**	**10,567 (20.2)**	**9,665 (22.1)**	**10,657 (23.9)**	**9.3**	**-9.3**
of which :										
1. Cotton Yarn, Fabrics, Made-ups, *etc.*	15,831	14,655	15,810	8.0	-7.3	3,271	3,073	3,461	6.5	-11.2
2. Readymade Garments	26,005	23,878	25,441	8.9	-6.1	5,374	5,007	5,569	7.3	-10.1
3. Manmade Yarn, Fabrics, Made-ups, *etc.*	6,366	5,079	4,836	25.3	5.0	1,316	1,065	1,058	23.5	0.6
E. Gems and Jewellery	**42,847 (16.9)**	**34,845 (16.7)**	**33,733 (16.6)**	**23.0**	**3.3**	**8,854 (16.9)**	**7,306 (16.7)**	**7,384 (16.6)**	**21.2**	**-1.1**
F. Handicrafts	**3,488 (1.4)**	**2,618 (1.3)**	**3,022 (1.5)**	**33.2**	**-13.4**	**721 (1.4)**	**549 (1.3)**	**662 (1.5)**	**31.3**	**-17.0**
G. Carpets	**2,405 (1.0)**	**2,433 (1.2)**	**2,657 (1.3)**	**-1.2**	**-8.4**	**497 (1.0)**	**510 (1.2)**	**582 (1.3)**	**-2.6**	**-12.3**
1. Handmade	1,817	1,788	2,042	1.6	-12.4	375	375	447	0.2	-16.1
2. Millmade	500	473	505	5.6	-6.2	103	99	110	4.1	-10.1
3. Silk	88	172	111	-49.1	55.4	18	36	24	-49.9	48.8
III. Petroleum, Crude & Products	**11,718 (4.6)**	**10,107 (4.8)**	**8,645 (4.2)**	**15.9**	**16.9**	**2,421 (4.6)**	**2,119 (4.8)**	**1,892 (4.2)**	**14.3**	**12.0**
IV. Others	**15,238 (6.0)**	**5,600 (2.7)**	**5,512 (2.7)**	**172.1**	**1.6**	**3,149 (6.0)**	**1,174 (2.7)**	**1,206 (2.7)**	**168.1**	**-2.7**
Total Exports (I+II+III+IV)	**2,52,790**	**2,09,018**	**2,03,571**	**20.9**	**2.7**	**52,234**	**43,827**	**44,560**	**19.2**	**-1.6**

P Provisional.

Note : 1. Figures in brackets represent percentage to total exports.
2. Leather and manufactures include finished leather, leather goods, leather garments, footwear of leather and its components and saddlery and harness.
3. Engineering goods comprise ferro alloys, aluminium other than products, non-ferrous metal, manufactures of metals, machine tools, machinery and equipments, transport equipments, residual engineering items, iron and steel bar/rod, *etc.*, primary and semi-finished iron and steel, electronic goods, computer software and project goods.
4. Textiles include readymade garments, cotton yarn, fabric made-ups, *etc.*, manmade textiles made-ups, *etc.*, natural silk textiles, wool and woollen manufactures, coir and coir manufactures and jute manufactures.

Source : DGCI & S.

APPENDIX TABLE VI.5 : INDIA'S IMPORTS OF PRINCIPAL COMMODITIES

Commodity Group	Rupees crore					US $ million				
				Percentage Variation					Percentage Variation	
	2002-03P	2001-02	2000-01	2002-03P over 2001-02	2001-02 over 2000-01	2002-03 P	2001-02	2000-01	2002-03P over 2001-02	2001-02 over 2000-01
1	2	3	4	5	6	7	8	9	10	11
I. Bulk Imports	**1,16,849 (39.4)**	**96,638 (39.4)**	**95,095 (41.2)**	**20.9**	**1.6**	**24,145 (39.4)**	**20,263 (39.4)**	**20,816 (41.2)**	**19.2**	**-2.7**
A. Petroleum, Petroleum Products & Related Material	**85,367 (28.8)**	**66,770 (27.2)**	**71,497 (31.0)**	**27.9**	**-6.6**	**17,640 (28.8)**	**14,000 (27.2)**	**15,650 (31.0)**	**26.0**	**-10.5**
B. Bulk Consumption Goods	**11,459 (3.9)**	**9,745 (4.0)**	**6,593 (2.9)**	**17.6**	**47.8**	**2,368 (3.9)**	**2,043 (4.0)**	**1,443 (2.9)**	**15.9**	**41.6**
1. Cereals & Cereal Preparations	118	87	87	36.5	-0.3	24	18	19	34.5	-4.5
2. Edible Oil	8,745	6,465	5,977	35.3	8.2	1,807	1,356	1,308	33.3	3.6
3. Pulses	2,563	3,160	498	-18.9	534.0	530	663	109	-20.1	507.3
4. Sugar	33	33	31	0.2	4.8	7	7	7	-1.3	0.4
C. Other Bulk Items	**20,023 (6.8)**	**20,124 (8.2)**	**17,005 (7.4)**	**-0.5**	**18.3**	**4,137 (6.8)**	**4,220 (8.2)**	**3,722 (7.4)**	**-1.9**	**13.4**
1. Fertilisers	2,844	3,238	3,435	-12.2	-5.7	588	679	752	-13.5	-9.7
a) Crude	884	796	1,015	11.1	-21.6	183	167	222	9.5	-24.9
b) Sulphur & Unroasted Iron Pyrites	353	274	407	29.0	-32.6	73	57	89	27.1	-35.5
c) Manufactured	1,606	2,169	2,013	-25.9	7.8	332	455	441	-27.0	3.2
2. Non-Ferrous Metals	3,121	3,087	2,439	1.1	26.6	645	647	534	-0.4	21.2
3. Paper, Paperboard & Manufactured including Newsprint	2,129	2,131	2,061	-0.1	3.4	440	447	451	-1.5	-0.9
4. Crude Rubber including Synthetic & Reclaimed	876	831	694	5.3	19.8	181	174	152	3.8	14.8
5. Pulp & Waste Paper	1,647	1,405	1,287	17.2	9.2	340	295	282	15.5	4.6
6. Metalliferrous Ores & Metal Scrap	4,856	5,455	3,537	-11.0	54.2	1,003	1,144	774	-12.3	47.7
7. Iron & Steel	4,550	3,976	3,553	14.4	11.9	940	834	778	12.8	7.2
II. Non-Bulk Imports	**1,79,748 (60.6)**	**1,48,561 (60.6)**	**1,35,778 (58.8)**	**21.0**	**9.4**	**37,142 (60.6)**	**31,150 (60.6)**	**29,721 (58.8)**	**19.2**	**4.8**
A. Capital Goods	**61,685 (20.8)**	**47,130 (19.2)**	**40,847 (17.7)**	**30.9**	**15.4**	**12,746 (20.8)**	**9,882 (19.2)**	**8,941 (17.7)**	**29.0**	**10.5**
1. Manufactures of Metals	2,322	1,941	1,783	19.6	8.9	480	407	390	17.9	4.3
2. Machine Tools	1,126	920	1,001	22.4	-8.0	233	193	219	20.6	-11.9
3. Machinery except Electrical & Electronics	16,653	14,168	12,375	17.5	14.5	3,441	2,971	2,709	15.8	9.7
4. Electrical Machinery except Electronics	3,102	2,835	2,197	9.4	29.0	641	594	481	7.8	23.6
5. Electronic Goods including Computer Software	27,285	19,070	16,878	43.1	13.0	5,638	3,999	3,695	41.0	8.2
6. Transport Equipments	8,682	5,482	3,199	58.4	71.4	1,794	1,149	700	56.1	64.1
7. Project Goods	2,516	2,714	3,414	-7.3	-20.5	520	569	747	-8.6	-23.9
B. Mainly Export Related Items	**49,508 (16.7)**	**39,394 (16.1)**	**36,815 (15.9)**	**25.7**	**7.0**	**10,230 (16.7)**	**8,260 (16.1)**	**8,059 (15.9)**	**23.8**	**2.5**
1. Pearls, Precious & Semi-Precious Stones	29,299	22,046	21,963	32.9	0.4	6,054	4,623	4,808	31.0	-3.8
2. Chemicals, Organic & Inorganic	14,352	13,352	11,165	7.5	19.6	2,966	2,800	2,444	5.9	14.6
3. Textile Yarn, Fabrics, *etc.*	4,627	3,565	2,726	29.8	30.8	956	747	597	27.9	25.3
4. Cashew Nuts, Raw	1,231	431	961	185.4	-55.1	254	90	210	181.3	-57.0
C. Others	**68,555 (23.1)**	**62,037 (25.3)**	**58,115 (25.2)**	**10.5**	**6.7**	**14,166 (23.1)**	**13,008 (25.3)**	**12,721 (25.2)**	**8.9**	**2.3**
of which :										
1. Gold and Silver	20,492	21,854	21,189	-6.2	3.1	4,234	4,582	4,638	-7.6	-1.2
2. Artificial Resins & Plastic Materials	3,717	3,215	2,535	15.6	26.8	768	674	555	13.9	21.5
3. Professional, Scientific & Optical Goods	5,168	4,965	4,015	4.1	23.7	1,068	1,041	879	2.6	18.5
4. Coal, Coke & Briquittes *etc.*	5,915	5,453	5,039	8.5	8.2	1,222	1,143	1,103	6.9	3.6
5. Medicinal & Pharmaceutical Products	2,718	2,027	1,712	34.1	18.4	562	425	375	32.2	13.4
6. Chemical Materials & Products	2,134	2,120	1,528	0.7	38.7	441	444	335	-0.8	32.9
7. Non-Metallic Mineral Manufactures	1,119	1,049	794	6.7	32.2	231	220	174	5.2	26.6
Total Imports (I+II)	**2,96,597**	**2,45,200**	**2,30,873**	**21.0**	**6.2**	**61,286**	**51,413**	**50,536**	**19.2**	**1.7**

P Provisional.

Note : Figures in brackets represent percentage to total imports.

Source : DGCI & S.

APPENDIX TABLE VI.6 : INVISIBLES BY CATEGORY OF TRANSACTIONS

Item	Rupees crore			US $ million		
	2002-03	2001-02	2000-01	2002-03	2001-02	2000-01
1	2	3	4	5	6	7
I. Non Factor Services, net	**29,995**	**21,960**	**11,401**	**6,206**	**4,577**	**2,478**
Receipts	1,20,840	98,559	86,614	24,986	20,665	18,870
Payments	90,845	76,599	75,213	18,780	16,088	16,392
i) Travel, net	-2,120	3,011	1,369	-438	628	294
Receipts	14,641	13,880	14,505	3,029	2,910	3,168
Payments	16,761	10,869	13,136	3,467	2,282	2,874
ii) Transportation, net	-28	-1,936	-5,711	-3	-413	-1,257
Receipts	12,308	9,410	8,751	2,544	1,969	1,913
Payments	12,336	11,346	14,462	2,547	2,382	3,170
iii) Insurance, net	278	71	614	57	13	135
Receipts	1,789	1,279	1,176	371	267	257
Payments	1,511	1,208	562	314	254	122
iv) G.N.I.E., net	378	942	1,455	79	197	316
Receipts	1,486	2,235	3,012	307	469	657
Payments	1,108	1,293	1,557	228	272	341
v) Miscellaneous, net	31,487	19,872	13,674	6,511	4,152	2,990
Receipts	90,616	71,755	59,170	18,735	15,050	12,875
Payments	59,129	51,883	45,496	12,224	10,898	9,885
Of which:						
Software Services, net	42,855	32,834	26,308	8,863	6,884	5,750
Receipts	46,427	36,036	29,014	9,600	7,556	6,341
Payments	3,572	3,202	2,706	737	672	591
II. Income, net	**-23,617**	**-17,467**	**-22,384**	**-4,882**	**-3,601**	**-4,832**
Receipts	13,685	17,316	12,356	2,826	3,448	2,705
Payments	37,302	34,783	34,740	7,708	7,049	7,537
III. Private Transfers, net	**69,924**	**57,821**	**58,412**	**14,448**	**12,125**	**12,798**
Receipts	71,697	58,136	58,756	14,815	12,192	12,873
Payments	1,773	315	344	367	67	75
IV. Official Transfers, net	**1,973**	**1,847**	**1,546**	**410**	**384**	**336**
Receipts	1,977	1,851	1,556	410	385	338
Payments	4	4	10	0	1	2
V. Invisibles, net (I to IV)	**78,275**	**64,161**	**48,975**	**16,182**	**13,485**	**10,780**
Receipts	2,08,199	1,75,862	1,59,282	43,037	36,690	34,786
Payments	1,29,924	1,11,701	1,10,307	26,855	23,205	24,006

GNIE : Government, Not Included Elsewhere.

APPENDIX TABLE VI.7 : COMPOSITION OF CAPITAL INFLOWS

Variable	2002-03	2001-02	2000-01	1999-00	1998-99	1997-98	1996-97	1995-96	1994-95	1993-94	1992-93	1991-92	1990-91
1	2	3	4	5	6	7	8	9	10	11	12	13	14
Total Capital Inflows(Net) US $ Million,	**12,638**	**10,573**	**10,018**	**10,444**	**8,435**	**9,844**	**12,006**	**4,089**	**8,502**	**8,895**	**3,876**	**3,910**	**7,056**
of which : (in per cent)													
1. Non-debt Creating Inflows	**44.6**	**77.1**	**67.8**	**49.7**	**28.6**	**54.8**	**51.3**	**117.5**	**57.9**	**47.6**	**14.3**	**3.4**	**1.5**
a) Foreign Direct Investment	36.9	58.0	40.2	20.7	29.4	36.2	23.7	52.4	15.8	6.6	8.1	3.3	1.4
b) Portfolio Investment	7.7	19.1	27.6	29.0	-0.8	18.6	27.6	65.1	42.1	41.0	6.2	0.1	0.1
2. Debt Creating Inflows	**-6.6**	**9.2**	**59.4**	**23.1**	**54.4**	**52.4**	**61.7**	**57.7**	**25.0**	**21.3**	**39.9**	**77.5**	**83.3**
a) External Assistance	-19.2	11.4	4.3	8.6	9.7	9.2	9.2	21.6	17.9	21.4	48.0	77.7	31.3
b) External Commercial Borrowings #	-13.5	-14.9	37.2	3.0	51.7	40.6	23.7	31.2	12.1	6.8	-9.2	37.2	31.9
c) Short-term Credits	7.7	-8.4	1.0	3.6	-8.9	-1.0	7.0	1.2	4.6	-8.6	-27.8	-13.1	15.2
d) NRI Deposits $	22.2	26.0	23.1	14.7	11.4	11.4	27.9	27.0	2.0	13.5	51.6	7.4	21.8
e) Rupee Debt-Service	-3.8	-4.9	-6.2	-6.8	-9.5	-7.8	-6.1	-23.3	-11.6	-11.8	-22.7	-31.7	-16.9
3. Other Capital @	**62.0**	**13.7**	**-27.2**	**27.2**	**17.0**	**-7.2**	**-13.0**	**-75.2**	**17.1**	**31.1**	**45.8**	**19.1**	**15.2**
4. Total (1 to 3)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Memo Item :													
Stable flows *	**84.5**	**89.3**	**71.4**	**67.4**	**109.7**	**82.4**	**65.4**	**33.7**	**53.3**	**67.6**	**121.6**	**113.0**	**84.7**

Note : Data on FDI have been revised since 2000-01 with expanded coverage to approach international best practices. FDI data for previous years would not be comparable with those figures.

Refers to medium and long-term borrowings

$ Including NR (NR) Rupee Deposits

@ Includes leads and lags in exports (difference between the custom and the banking channel data), banking capital (assets and liabilities of banks excluding NRI deposits), loans to non-residents by residents, India's subscription to international institutions and quota payment to IMF.

* Stable Flows are defined to represent all capital flows excluding portfolio flows and short-term trade credits

APPENDIX TABLE VI.8 : EXTERNAL ASSISTANCE

Item	Rupees crore			US $ million		
	2002-03P	2001-02R	2000-01	2002-03P	2001-02 R	2000-01
1	2	3	4	5	6	7
1. Loans	13,448	16,129	13,527	2,830	3,310	2,967
2. Grants	1,715	1,667	727	361	342	160
3. Gross Utilisation (1+2)	15,163	17,796	14,254	3,191	3,652	3,127
4. Repayments	24,290	10,705	11,662	5,106	2,194	2,505
5. Interest Payments	4,534	5,256	5,429	953	1,077	1,166
6. Net (3-4-5)	-13,661	1,835	-2,837	-2,868	381	-544

P Provisional. R Revised.

Note : 1. Loans are inclusive of non-government loans but exclusive of suppliers' credits and commercial borrowings.
2. Grants are exclusive of PL 480-II grants.
3. Repayments include amortisation of civilian debt owed to Russia and hence do not tally with the data given in Appendix Table VI.2.

Source : Controller of Aid, Accounts and Audit, Government of India.

APPENDIX TABLE VI.9 : INDIA'S FOREIGN EXCHANGE RESERVES

End of Month	Foreign Exchange Reserves (Rupees crore)				Foreign Exchange Reserves (US $ million)				Total Foreign Exchange Reserves (in SDR million)	Movement in Foreign Exchange Reserves (in SDR million) @	Reserve Position in the Fund (in SDR million)+
	SDRs*	Gold $	Foreign Currency Assets	**Total (2+3+4)**	SDRs	Gold	Foreign Currency Assets	**Total (6+7+8)**			
1	2	3	4	5	6	7	8	9	10	11	12
March 1993	55	10,549	20,140	**30,744**	18	3,380	6,434	**9,832**	7,033	317	212
March 1994	339	12,794	47,287	**60,420**	108	4,078	15,068	**19,254**	13,631	6,598	212
									(11,156)	(6,141)	
March 1995	23	13,752	66,005	**79,780**	7	4,370	20,809	**25,186**	16,137	2,506	212
									(13,786)	(2,630)	
March 1996	280	15,658	58,446	**74,384**	82	4,561	17,044	**21,687**	14,841	-1,296	212
									(12,167)	(-1,619)	
March 1997	7	14,557	80,368	**94,932**	2	4,054	22,367	**26,423**	19,052	4,211	212
									(16,576)	(4,409)	
March 1998	4	13,394	1,02,507	**1,15,905**	1	3,391	25,975	**29,367**	21,983	2,931	212
									(19,891)	(3,315)	
March 1999	34	12,559	1,25,412	**1,38,005**	8	2,960	29,522	**32,490**	23,928	1,945	489
									(22,150)	(2,259)	
March 2000	16	12,973	1,52,924	**1,65,913**	4	2,974	35,058	**38,036**	28,240	4,312	489
									(26,435)	(4,285)	
March 2001	11	12,711	1,84,482	**1,97,204**	2	2,725	39,554	**42,281**	33,540	5,300	489
									(31,781)	(5,346)	
June 2001	20	13,163	1,91,226	**2,04,409**	4	2,798	40,652	**43,454**	34,884	1,344	489
									(33,041)	(1,260)	
September 2001	21	13,998	2,00,762	**2,14,781**	4	2,925	41,948	**44,877**	34,815	1,275	489
									(32,949)	(1,168)	
December 2001	25	13,761	2,18,021	**2,31,807**	5	2,856	45,251	**48,112**	38,318	4,778	489
									(36,446)	(4,665)	
March 2002	50	14,868	2,49,118	**2,64,036**	10	3,047	51,049	**54,106**	43,392	9,852	489
									(41,351)	(9,570)	
June 2002	47	16,272	2,67,333	**2,83,652**	10	3,330	54,703	**58,043**	43,626	234	489
									(41,526)	(175)	
September 2002	48	15,964	2,88,648	**3,04,660**	10	3,300	59,663	**62,973**	47,609	4,217	489
									(45,517)	(4,166)	
December 2002	33	16,542	3,21,774	**3,38,349**	7	3,444	66,994	**70,445**	52,005	8,613	489
									(49,865)	(8,514)	
March 2003	19	16,785	3,41,476	**3,58,280**	4	3,534	71,890	**75,428**	54,905	11,513	489
									(52,736)	(11,385)	
June 2003	6	17,182	3,65,001	**3,82,189**	1	3,698	78,546	**82,245**	58,711	3,806	697
									(56,474)	(3,738)	

* At Rupee-SDR exchange rate at the end of the respective month.
$ Gold has been valued close to international market price.
@ Variations over the previous March.
\+ Cover drawal of Reserve Position in the Fund.

Note :

1. Gold holdings include acquisition of gold worth US $ 191million from the Government during 1991-92, US $ 29.4 million during 1992-93, US $ 139.3 million during 1993-94, US $ 315.0 million during 1994-95 and US $ 17.9 million during 1995-96. On the other hand, 1.27 tonnes of gold amounting to Rs 43.55 crore (US $11.97 million), 38.9 tonnes of gold amounting to Rs 1485.22 crore (US $ 376.0 million) and 0.06 tonnes of gold amounting to Rs. 2.13 crore (US $ 0.5 million) were repurchased by the Central Government on November 13, 1997, April 1, 1998 and October 5, 1998, respectively, for meeting its redemption obligation under the Gold Bond Scheme.
2. Conversion of foreign currency assets into US dollar was done at exchange rates supplied by the IMF up to March 1999. Effective April 1, 1999, the conversion is at New York closing exchange rate.
3. Figures in brackets represent reserves adjusted for gold revaluation, pursuant to the practice of valuing gold reserves close to international market price, effective October 17, 1990.

APPENDIX TABLE VI.10 : INDIA'S EXTERNAL DEBT

(As at end March)

Item	Rupees crore			US $ million		
	2003P	2002R	2001R	2003P	2002R	2001R
1	2	3	4	5	6	7
I. Multilateral	**1,42,126**	**1,55,633**	**1,45,105**	**29,919**	**31,898**	**31,105**
A. Government borrowing	1,29,373	1,38,023	1,27,886	27,234	28,289	27,414
i. Concessional	1,02,367	96,178	89,008	21,549	19,713	19,080
a. IDA	1,00,933	94,848	87,753	21,247	19,440	18,811
b. Others #	1,434	1,330	1,255	302	273	269
ii. Non-concessional	27,006	41,845	38,878	5,685	8,576	8,334
a. IBRD	19,010	28,012	26,376	4,002	5,741	5,654
b. Others ##	7,996	13,833	12,502	1,683	2,835	2,680
B. Non-Government borrowing	12,753	17,610	17,219	2,685	3,609	3,691
i. Concessional	0	0	0	0	0	0
ii. Non-concessional	12,753	17,610	17,219	2,685	3,609	3,691
a. Public sector	9,149	12,729	12,386	1,926	2,609	2,655
IBRD	4,380	7,298	7,114	922	1,496	1,525
Others ##	4,769	5,431	5,272	1,004	1,113	1,130
b. Financial institutions	3,088	3,736	3,368	650	766	722
IBRD	585	1,049	1,017	123	215	218
Others ##	2,503	2,687	2,351	527	551	504
c. Private sector	516	1,145	1,465	109	234	314
IBRD	297	929	1,148	63	190	246
Others	219	216	317	46	44	68
II. Bilateral	**79,930**	**74,762**	**74,519**	**16,826**	**15,323**	**15,974**
A. Government borrowing	60,096	56,302	56,802	12,651	11,540	12,176
i. Concessional	59,541	55,418	55,504	12,534	11,359	11,898
ii. Non-concessional	555	884	1,298	117	181	278
B. Non-Government borrowing	19,834	18,460	17,717	4,175	3,783	3,798
i. Concessional	7,965	6,885	5,579	1,677	1,411	1,196
a. Public sector	5,108	4,278	2,962	1,075	877	635
b. Financial institutions	2,857	2,607	2,617	602	534	561
c. Private sector	0	0	0	0	0	0
ii. Non-concessional	11,869	11,575	12,138	2,498	2,372	2,602
a. Public sector	5,350	4,822	3,715	1,126	988	796
b. Financial institutions	3,569	3,708	3,568	751	760	765
c. Private sector	2,950	3,045	4,855	621	624	1,041
III. International Monetary Fund	**0**	**0**	**0**	**0**	**0**	**0**
IV. Trade Credit	**23,766**	**26,110**	**27,625**	**5,003**	**5,351**	**5,923**
A. Buyers' credit	13,591	16,147	17,336	2,861	3,309	3,717
B. Suppliers' credit	4,998	5,144	5,401	1,052	1,054	1,158
C. Export credit component of bilateral credit	5,177	4,819	4,828	1,090	988	1,035
D. Export credit for defence purposes	0	0	60	0	0	13

(Contd...)

APPENDIX TABLE VI.10 : INDIA'S EXTERNAL DEBT *(Concld.)*

(As at end March)

Item	Rupees crore			US $ million		
	2003P	2002R	2001R	2003P	2002R	2001R
1	2	3	4	5	6	7
V. Commercial Borrowing	**1,05,259**	**1,13,451**	**1,12,938**	**22,157**	**23,248**	**24,215**
A. Commercial bank loans	46,450	48,682	46,169	9,778	9,976	9,899
B. Securitized borrowings $ (including FCCBs)	56,405	62,258	63,868	11,873	12,758	13,694
C. Loans/securitized borrowings, etc. with multilateral/bilateral guarantee and IFC(W)	2,404	2,511	2,901	506	514	622
D. Self Liquidating Loans	0	0	0	0	0	0
VI. NRI & FC(B&O) Deposits (above one-year maturity)	**1,11,271**	**83,712**	**77,273**	**23,423**	**17,154**	**16,568**
VII. Rupee Debt *	**13,372**	**14,844**	**17,345**	**2,815**	**3,042**	**3,719**
A. Defence	11,915	13,235	15,573	2,508	2,712	3,339
B. Civilian +	1,457	1,609	1,772	307	330	380
VIII. Total Long-term Debt (I to VII)	**4,75,724**	**4,68,512**	**4,54,805**	**100,143**	**96,016**	**97,504**
IX. Short-term Debt	**19,443**	**13,396**	**16,919**	**4,093**	**2,745**	**3,628**
A. NRI deposits (less than 1 year maturity)	7,059	4,724	4,463	1,486	968	957
B. Others (trade related) @	12,384	8,672	12,456	2,607	1,777	2,671
X. Gross Total	**4,95,167**	**4,81,908**	**4,71,724**	**104,236**	**98,761**	**101,132**
Concessional Debt	1,83,245	1,73,325	1,67,436	38,575	35,525	35,893
As % of Total Debt	37.0	36.0	35.5	37.0	36.0	35.5
Short Term Debt	19,443	13,396	16,919	4,093	2,745	3,628
As % of Total Debt	3.9	2.8	3.6	3.9	2.8	3.6
Memo Items:						
Debt Indicators:						
1. Debt Stock - GDP Ratio (in per cent)	20.0	21.0	22.4	20.0	21.0	22.4
2. Debt Service Ratio(%) (for fiscal year) (Including debt-servicing on non-civilian credits)	14.7	13.9	17.2	14.7	13.9	17.2

P Provisional. R Revised.

\# Refers to Debt outstanding to Institutions like IFAD,OPEC & EEC(SAC).

\## Refers to debt outstanding against loans from ADB.

$ Includes net investment by 100 per cent FII debt funds, Resurgent India Bonds (RIBs) and India Millennium Deposits (IMDs).

* Debt owed to Russia denominated in Rupees and converted at current exchange rates, payable in exports.

\+ Includes Rupee suppliers' credit from end-March 1990 onwards.

@ This does not include suppliers' credit of up to 180 days for which no estimates are available.

Notes : 1. Multilateral loans do not include revaluation of IBRD pooled loans and exchange rate adjustment, under IDA loans for pre-1971 credits.

2. Debt-service ratio from the year 1992-93 includes the revised private transfer contra-entry on account of gold and silver imports.

APPENDIX TABLE VI.11: INDICES OF REAL EFFECTIVE EXCHANGE RATE (REER) AND NOMINAL EFFECTIVE EXCHANGE RATE (NEER) OF THE INDIAN RUPEE

Year/Month	36 - country bilateral trade weights (Base : 1985 = 100)		5 - country bilateral trade weights (Base : 1993-94 = 100)	
	REER	NEER	REER	NEER
1	2	3	4	5
1993-94	61.59	44.69	100.00	100.00
1994-95	66.04	43.37	105.81	96.09
1995-96	63.62	39.73	102.29	87.69
1996-97	63.81	38.97	103.43	86.38
1997-98	67.02	40.01	105.84	86.43
1998-99	63.44	36.34	97.79	76.45
1999-00	63.29	35.46	96.74	74.22
2000-01	66.53	35.52	100.76	73.77
2001-02	68.43	35.75	102.09	73.18
2002-03 (P)	72.82	37.05	97.88	68.78
2002-03 (P)				
April	74.10	38.55	100.09	71.88
May	72.77	37.79	98.27	70.46
June	72.39	37.16	97.78	69.32
July	71.56	36.52	96.18	67.76
August	72.96	36.98	97.87	68.50
September	73.21	37.04	98.18	68.73
October	73.66	37.27	98.78	69.14
November	73.54	37.14	98.23	68.59
December	72.65	36.84	97.46	68.40
January	71.63	36.32	96.29	67.39
February	72.21	36.42	96.89	67.51
March	73.15	36.53	98.07	67.73
2003-04(P)				
April	74.28	36.72	99.66	68.17
May	72.31	35.89	97.33	66.88
June	73.06	36.04	98.29	67.12

P : Provisional.

Note : 1. The 36-country and 5-country REER indices have been recalculated from April 1994 and April 1993 onwards, respectively, using the new Wholesale Price Index (WPI) series (Base : 1993-94=100).

2. The 36-Country REER & NEER have been estimated using the common price index and the exchange rate for the Euro, thus representing 31 countries and the Euro area w.e.f. 01.03.2002.