External Sector

6.1 The external sector management posed a major challenge in recent years, in particular, since September 1997. In 1998-99, the East Asian crisis, which in recent months has shown some signs of abatement, continued to cast its shadow. In addition, the crises which affected Russia in August 1998 and Brazil in the early part of this year had some repercussions on the global economic outlook. The economic prospects of Japan as well as of the economies of Europe were uncertain. In addition to the unfavourable external situation, India was confronted during the year with certain other developments, *viz*., the economic sanctions imposed by several industrial countries, the suspension of fresh multilateral lending (except for some sectors), the downgrading by international rating agencies and the reduction in investment by foreign institutional investors. Faced with these challenges, the Reserve Bank had to take recourse to monetary policy measures from time to time to bring about orderliness in the foreign exchange market. As a consequence, the developments in respect of both the exchange rate of the rupee and movements in foreign exchange reserves have turned out to be reasonably favourable. Foreign currency assets have increased significantly in both absolute and in net terms. The successful launching of Resurgent India Bonds (RIBs) resulted in accretion to foreign currency assets of US $ 3,547 million over the end-March level of 1998. Moreover, the level of foreign exchange reserves after excluding forward liabilities at the end of March 1999 exceeded the total stock of short-term and portfolio flows.

6.2 Overall, the current account deficit was contained way below the acceptable limit, at 1.0 per cent of GDP and net capital flows were more than adequate to meet the current account deficit. Exports, however, recorded a decline of 3.9 per cent over the previous year. Imports also slowed down, *inter alia*, due to the softening of international oil prices and sluggish domestic industrial activity. With sufficient increase in exports of software and robust accretion through invisibles, the current receipts showed impressive growth and financed 93.3 per cent of current payments.

Balance of Payments

6.3 During 1998-99, the balance of payments remained fairly stable. The moderation in merchandise imports, reflecting in particular, the slackening of industrial activity and the softening of international PoL prices translated into a sizeable reduction in import payments in US dollar terms. This helped to partially mitigate the erosion in export receipts. The net invisible surplus remained buoyant, notwithstanding the depressed international environment, containing the current account deficit. The reduction in capital inflows, foreign portfolio investment in particular, was more than offset by an accrual of US $ 4.2 billion under the RIB Scheme. The balance of payments, consequently, recorded an overall surplus of US $ 4,222 million for the third year in succession (Table 6.1, Table 6.2 and Appendix Table VI.1).

Table 6.1 : India's Overall Balance of Payments

(US $ million)

	Item	1998-99	1997-98
	1	2	3
1.	Current Account		
	i) Exports, fob	34,298	35,680
	ii) Imports, cif	47,544	51,187
	iii) Trade Balance	-13,246	-15,507
	iv) Invisibles, net	9,208	10,007
	v) Current Account Balance	-4,038	-5,500
2.	Total Capital Account	8,565	9,844
	of which:		
	i) External Assistance, net	820	907
	ii) Commercial Borrowings, net	4,362	3,999
	iii) NRI Deposits, net	1,742	1,125
	iv) Foreign Investment, net	2,412	5,390
3.	Overall Balance	4,222	4,511
4.	Monetary Movements	-4,222	-4,511
5.	IMF, net	-393	-618
6.	Reserves and Monetary Gold (Increase - , Decrease +)	-3,829	-3,893

Merchandise Trade

6.4 According to the provisional data released by the Directorate General of Commercial Intelligence and Statistics (DGCI&S), India's exports at US $ 33.7 billion declined by 3.9 per cent during 1998-99, as against an increase of 4.6 per cent recorded during 1997-98, driven by the decline in exports of both primary products (10.4 per cent) and manufactured goods (2.8 per cent) (Appendix Table VI.2 and Table VI.3). This, *inter alia*, reflects the persistence of the domestic industrial slowdown, on the one hand and adverse external conditions, such as, the decline in world trade prices and contraction in import demand of the crisis-affected SouthEast Asian countries, on the other.

6.5 Imports at US $ 41.9 billion decelerated to 0.9 per cent during 1998-99 from 6.0 per cent during 1997-98. Oil imports declined by 21.2 per cent during 1998-99, over and above the fall of 18.7 per cent during the previous year, mainly on account of the decline in international oil prices. Growth in non-oil imports decelerated to 6.3 per cent from 14.5 per cent recorded during the previous year.

6.6 Reflecting the impact of policy changes, the imports of gold and silver through the 'OGL/SIL' route increased by US $ 1.7 billion to US $ 4.9 billion during 1998-99 from US $ 3.2 billion during 1997-98. Gold prices at Mumbai and the spread between the domestic and international prices of gold declined during 1998-99 (Box VI.1). Capital goods imports declined by 6.4 per cent during 1998-99 on top of the decline of 1.3 per cent in the previous year (Appendix Table VI.4).

6.7 Essentially on account of the poor performance of exports, the trade deficit widened by a margin of US $ 1.7 billion to US $ 8.2 billion during 1998-99, even though the deficit on the 'oil' account was reduced by about US $ 1.5 billion (Appendix Table VI.2).

Table 6.2 : India's Balance of Payments : Key Indicators

(Per cent)

Item	1998-99	1997-98	1996-97	1995-96	1990-91
1	2	3	4	5	6
1. Trade					
i) Exports/GDP	8.2	8.5	8.6	8.9	6.2
ii) Imports/GDP	11.4	12.2	12.3	12.0	9.4
iii) Income Terms of Trade (Base: 1978-79=100)	..	562.8	519.7	530.0	212.2
Annual Growth Rate	..	8.3	-1.9	18.8	0.2
iv) Exports Volume Growth	..	-6.3	7.2	31.3	11.0
2. Invisibles Account					
i) Invisible Receipts/GDP	6.2	5.5	5.4	4.9	2.5
ii) Invisible Payments/GDP	4.0	3.2	2.8	3.4	2.6
iii) Invisibles (Net)/GDP	2.2	2.3	2.6	1.5	-0.1
3. Current Account					
i) Current Receipts @ / GDP	14.3	13.9	13.9	13.7	8.5
ii) Current Receipts Growth @	2.1	6.2	11.1	18.2	6.6
iii) Current Receipts @ /Current Payments	93.3	90.7	91.7	88.9	71.5
iv) CAD/GDP	-1.0	-1.3	-1.2	-1.6	-3.2
4. Capital Account					
i) Foreign Investment / GDP	0.6	1.3	1.5	1.3	0.03
ii) Foreign Investment / Exports	7.0	15.0	18.0	15.0	0.6
5. Others					
i) Debt-GDP Ratio	23.7	23.8	23.8	26.3	30.4
ii) Debt-Service Ratio	18.0	19.1	21.2	24.3	35.3
iii) Liability Service Ratio	19.1	20.1	21.7	24.7	35.6
iv) Import Cover of Reserves (in months)	8.3	7.3	6.6	6.1	2.7

@ Excluding official transfers. .. Not Available.

Note : Based on data given in Appendix Table VI.1 and Table VI.5.

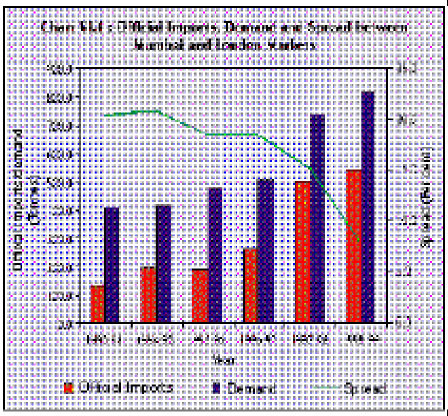
Box VI.1
Non-Monetary Gold

India is the largest consumer of gold in the world. According to the World Gold Council estimates, total demand for gold (including the recycled gold) increased by 11 per cent to 815 tonnes in 1998 from 737 tonnes in 1997, reflecting the continued importance of gold as a means of asset diversification and lower international prices.

The domestic gold demand is met mainly from imports, since gold production in India is negligible. The 1963 Gold Control Order, which sought to conserve foreign exchange reserves for essential imports, gradually led to excess domestic gold demand. This, in turn, widened the spread between domestic and international gold prices and led to a sharp increase in the imports through unofficial channels, resulting in substantial revenue loss. The repeal of the Gold Control Order in 1991, was followed by a series of measures liberalising gold imports. Returning or non-resident Indians are now permitted to bring up to 10 kgs of gold. Gold may also be imported under Special Import Licence Scheme. Thirteen authorised agencies and three state owned agencies have also been permitted to import gold under OGL for sales to specified categories of jewellers and to domestic consumers. These measures have had the desired threefold impact of meeting domestic demand, narrowing the spread between domestic and international prices and reducing unofficial gold imports. Consequently, there was an unprecedented increase in official gold imports from 193.3 tonnes in 1993-94 to 540.3 tonnes in 1998-99 (Chart VI.1).

In view of the rising gold imports, the Government has proposed a new Gold Deposit Scheme in the Union Budget, 1999-2000 in order to mobilise idle gold and also to reduce dependence on imports. Under the proposed scheme, selected commercial banks are to be permitted to accept gold deposits and issue interest-bearing certificates or bonds, which can be reclaimed in gold and are exempted from income, wealth and capital gains taxes.

Indian gold prices are essentially governed by domestic demand and international prices adjusted for exchange rate movements. The average spread between domestic and international average prices of gold, the critical measure of the integration of the Indian and international gold markets, has narrowed from 59.5 per cent in 1990-91 to 15.1 per cent in 1997-98 further to 8.0 per cent in 1998-99 in response to various liberalisation measures.



The average domestic price of gold in the Mumbai market declined by 1.8 per cent to Rs.4,268 per 10 grams in 1998-99 from Rs.4,347 per 10 grams in 1997-98 in sympathy with international prices, partly moderated by rupee depreciation and the imposition of duty at Rs.250 per 10 grams on January 5, 1999. Average gold prices declined to $ 292.15 per oz. in 1998-99 from $ 316.94 per oz. in 1997-98 in the London market, especially with financial markets in developed countries offering better returns. The spread between domestic and international gold prices which had narrowed down to 6.3 per cent in March 1998, widened to 7.3 per cent in August 1998, reflecting depreciation of the Indian rupee and further jumped to 10.9 per cent in January 1999 as a result of the imposition of duty.

6.8 Data on direction of India's foreign trade throws up some interesting features. Exports to the North American countries increased by 7.9 per cent, improving their share in India's export basket to 23.2 per cent during 1998-99 from 20.7 per cent in the previous year. Their share in India's total imports, however, dropped to 9.6 per cent in 1998-99 from 10.0 per cent in the previous year. The exports to the developing countries in Africa grew by 8.6 per cent, and the relative share of these countries moved up to 5.3 per cent during 1998-99 from 4.7 per cent in the previous year. Their share in India's import basket also increased by around three percentage points to 7.1 per cent in 1998-99, reflecting an import growth of 69.6 per cent. Prominent among the country-groups to which the exports declined sharply were the OECD members of Asia and Oceania (13.0 per cent), Eastern Europe (16.6 per cent) and developing countries of Asia (13.9 per cent). Exports to the four crisis-affected South-East Asian countries, *viz.*, Indonesia, Korea, Malaysia, and Thailand declined by 36.8 per cent, with a further deterioration of their combined share in India's export basket to 3.3 per cent in 1998-99 from 5.0 per cent in 1997-98.

Invisibles

6.9 Invisibles transactions continued to be robust at US $ 9,208 million during 1998-99 as compared with US $ 10,007 million in 1997-98 (Appendix Table VI. 5). The contribution of private transfers, in net terms, continued to account for a large share of net invisibles receipts followed by non-factor services. The decline in private transfers during 1998-99 could be attributed to the fall in imports of gold and silver as baggage by returning Indians following the liberalisation of the gold import policy. In fact, private transfer receipts, excluding baggage gold and silver, increased from US $ 9,127 million in 1997-98 to US $ 10,114 million in 1998-99. Non-factor services further strengthened their position in balance of payments during 1998-99. Net earnings in non-factor services enlarged to US $ 2,165 million in 1998-99 as compared with a surplus of US $ 1,319 in 1997-98 mainly due to surge in software exports estimated at US $ 2,615 million in 1998-99. Software exports kept up their momentum with a rise of 49 per cent on top of increases of about 55 per cent in 1997-98 and of 46 per cent in 1996-97. In this context, mention may be made of the initiative being taken by the Government to strengthen the infrastructure for electronic data interchange and electronic commerce in view of the changing mode of trade transactions (Box VI.2). Net investment income payments went up marginally in 1998-99 due to higher interest payments on external borrowings, off-setting higher earnings on the deployment of foreign exchange reserves. Official transfers, especially from Japan, weakened during 1998-99.

Box VI.2
Electronic Commerce

Electronic commerce (EC), in a general sense, refers to all forms of commercial transactions that are based on electronic processing and data transmission. EC is likely to emerge as the major mode of commerce in view of lower information and transaction costs.

EC, which spurted in the mid-'nineties essentially through non-proprietary networks such as the Internet, is expected to expand rapidly in the coming years. Estimates of EC turnover for the period 2000-02 range from US $ 10 billion to US $ 1,522 billion (OECD (1998)). Currently, about 80 per cent of the EC transactions are intra- or inter-organisation type with about 80 per cent of the global EC transactions taking place in the United States. India remains one of the forerunners in EC development among the emerging markets with the Union Ministry of Commerce designated as the nodal agency for implementation of Electronic Data Interchange (EDI) and EC in India. The United Nations' standard (UN/EDIFACT) has been accepted as the national standard for EDI while four bodies - EDI/ EC Council, India EDIFACT Committee, EDI Working Group and Message Development Group - have been formed in order to facilitate the development of EDI/EC in India. Special steps have been taken to introduce EDI/EC in areas such as ports, airlines, banks, tax administration, information exchange between organisations and interface of the authorities with the private sector. Electronic trading of financial instruments such as equity shares has been implemented by the National Stock Exchange.

The global nature of EC results in cross-border transactions often in intangibles with EC based payment mechanisms which pose new challenges for tax administration. The present taxation laws, based either on business connection or permanent establishment, are difficult to apply as the physical location of given transactions loses its importance, making it difficult to determine their revenue jurisdiction. Furthermore, e-commerce through internet, by and large, results in a distinct change in the pattern of intermediation by banks and other institutions limiting the ability of authorities to rely on them to collect withholding tax. Taxes could be source-based or destination-based. While source-based taxes applied to electronic commerce have clear compliance and administrative cost advantages over their destination-based counterparts, problems of evasion still remain. Special types of taxation such as the "bit tax" on data transmission have been proposed. However, tax administration would need to strike a balance between maximising the potential "efficiency gains" out of technology and protecting the revenue base.

Revenue implications of EC for India are limited at this stage as it is possible to identify most forms of cross-border EC transactions (including those involving intangibles) from the banking channel due to the existing reporting norms relating to foreign currency transactions.

References

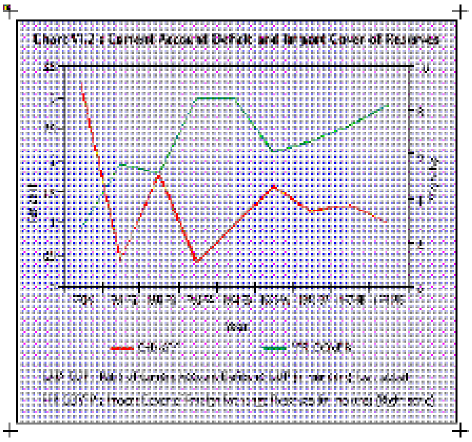
1. Government of India, *Annual Report*, Ministry of Commerce, various issues, New Delhi.

2. OECD, (1997), *The Report of the Group of High-level Private Sector Experts on Electronic Commerce* (Sacher Group Report), Paris.

3. ______, (1998), *The Economic and Social Impact of Electronic Commerce*, Paris.

Current Account

6.10 The buoyancy in the surplus under the invisibles account coupled with decline in imports payments resulted in the current account deficit narrowing to US $ 4,038 million (1.0 per cent of GDP) in 1998-99 from US $ 5,500 million (1.3 per cent of GDP) in 1997-98 (Tables 6.1 and Table 6.2, Chart VI.2 and Appendix Table VI.1). The improvement in the balance of payments reflects strong growth in current receipts which increased to 14.3 per cent of GDP as against an average of 13.2 per cent during the period 1993-94 to 1997-98. Furthermore, current receipts financed 93.3 per cent of current payments in 1998-99. The debt-service ratio declined from 19.1 per cent in 1997-98 to 18.0 per cent in 1998-99 on account of reduction in amortisation (Chart VI.3). Notwithstanding these improvements, the performance of merchandise exports has been a major area of concern. The impact of the reduction in exports was to some extent muted by the fact that import payments were contained mainly because of softening of international PoL prices. Besides, the continuing buoyancy in the invisible receipts, in particular the surge in software exports, technology related services and workers' remittances compensated for the sluggishness in merchandise export growth. While the channel for gold and silver imports for Indians returning from abroad received a lukewarm response, imports of gold and silver through the nominated agencies registered a significant growth in 1998-99. However, total imports of gold and silver are estimated to decline from US $ 5,872 million in 1997-98 to US $ 5,042 million in 1998-99.

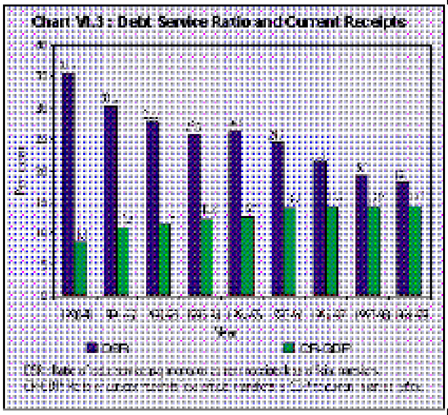


Capital Account

6.11 The turbulence in the international financial markets continued to impinge on developments in the capital account as reflected by quantum, composition and degree of volatility in capital flows during 1998-99. Net capital inflows fell to US $ 8.6 billion as against US $ 9.8 billion during 1997-98. Inflows under foreign direct investment, external assistance and deposits under various non-resident schemes were relatively stable as against a steep fall in the portfolio investment by foreign institutional investors (FIIs). External commercial borrowing through traditional channels showed a sharp decline but it was more than compensated by the successful mobilisation of funds through the issue of RIBs. It may be noted that the proportion of relatively stable flows to total capital flows has also increased significantly in 1998-99 for the third successive year (Appendix Table VI.6).

Foreign Investment

6.12 Financial turmoil in the world economy, imposition of economic sanctions and sluggishness in domestic activity had some bearing on foreign investment during the year. Foreign investment flows declined from US $ 5,385 million in 1997-98 to US $ 2,401 million during 1998-99 mainly on account of net outflows under investment by FIIs and lower offerings of GDRs. Investments by FIIs during 1998-99 recorded net outflows of US $ 390 million in contrast to net inflows of US $ 979 million in 1997-98. The amount raised under GDRs was lower at US $ 270 million during 1998-99 as against US $ 645 million in 1997-98 partly due to the bearish sentiments in domestic stock markets and slackened industrial activity. Inflows under foreign direct investment at US $ 2,462 million in 1998-99 were also lower than that of US $ 3,557 million in 1997-98 (Table 6.3).



6.13 The Union Budget, 1999-2000 announced the establishment of a Foreign Investment Implementation Authority in order to rationalise and simplify approval and implementation procedures of foreign investment proposals. With a view to further facilitating inflows of foreign direct investment, expansion of automatic list of approvals and a more dynamic role for Foreign Investment Promotion Board were also announced.

6.14 There was a discernible consistency in the source and direction of foreign direct investment flows. During 1998-99, inflows from Mauritius and the US continued to dominate followed by Japan while Italy emerged as the fourth major investor. While 'engineering', 'chemicals and allied products' and 'services' were the most favoured industries, 'finance' and computer related industries also gained in importance (Table 6.4 and Table 6.5).

Table 6.3 : Foreign Investment Flows by Category

(US $ million)

Item	1998-99P	1997-98	1996-97
1	2	3	4

A)	Direct Investment	2,462	3,557	2,821
	a) Government (SIA/FIPB)	1,821	2,754	1,922
	b) RBI	179	202	135
	c) NRI	62	241	639
	d) Acquisition of Shares*	400	360	125
B)	Portfolio Investment	-61	1,828	3,312
	a) GDRs #	270	645	1,366
	b) FIIs @	-390	979	1,926
	c) Offshore Funds and Others	59	204	20
C)	**Total (A+B)**	**2,401**	**5,385**	**6,133**

P Provisional.

* Relates to acquisition of shares of Indian companies by non-residents under Section 29 of FERA. Data on such acquisitions have been included as part of FDI since January 1996.

\# Represent the amount raised by Indian corporates through Global Depository Receipts (GDRs).

@ Represent fresh inflow of funds by Foreign Institutional Investors (FIIs).

Note: Data on foreign investment presented here represent gross inflows into the country and may not tally with data presented in other tables which include direct imports against foreign investment, Indian investment abroad as well as disinvestment.

Table 6.4 : Foreign Investment - Country-wise Inflows*

Source	(Rupees crore)			(US $ million)		
	1998-99	1997-98	1996-97	1998-99	1997-98	1996-97
1	2	3	4	5	6	7
Mauritius	2,482.2	3,346.3	3,004.7	590.0	900.4	846.4
U.S.A.	1,904.9	2,554.7	857.6	452.8	687.4	241.6
Japan	989.0	607.5	343.3	235.1	163.5	96.7
Italy	486.3	159.6	98.4	115.6	42.9	27.7
Germany	477.7	562.7	589.9	113.5	151.4	166.2
South Korea	358.7	1,238.0	22.2	85.3	333.1	6.3
Netherlands	224.2	590.5	439.3	53.3	158.9	123.7
Others	1,491.3	1,926.6	1,956.6	354.4	518.4	548.4
Total	**8,414.3**	**10,985.9**	**7,312.0**	**2,000.0**	**2,956.0**	**2,057.0**

* Exclude inflows under the NRI direct investments route through the RBI and inflows due to acquisition of shares under Section 29 of FERA.

Table 6.5 : Foreign Investment - Industry-wise Inflows*

Sector	(Rupees crore)			(US $ million)		
	1998-99	1997-98	1996-97	1998-99	1997-98	1996-97
1	2	3	4	5	6	7
Engineering	1,799.1	2,155.1	2,592.2	427.6	579.9	730.2
Chemicals and Allied Products	1,579.7	956.2	1,078.5	375.5	257.3	303.8
Services	1,550.3	1,194.1	53.9	368.5	321.3	15.2
Electronics and Electrical Equipment	960.4	2,395.6	545.4	228.3	644.6	153.6
Finance	777.6	549.7	770.4	184.8	147.9	217.0
Computers	446.7	517.2	208.4	106.2	139.2	58.7
Pharmaceuticals	119.6	125.6	169.0	28.4	33.8	47.6
Food and Dairy Products	78.1	417.8	843.2	18.6	112.3	237.5
Others	1,102.8	2,674.6	1,051.0	262.1	719.7	293.4
Total	**8,414.3**	**10,985.9**	**7,312.0**	**2,000.0**	**2,956.0**	**2,057.0**

* Exclude inflows under the NRI direct investments route through the RBI and inflows due to acquisition of shares under Section 29 of FERA.

Non-Resident Deposits

6.15 Net inflows under non-resident depositschemes amounted to US $ 1,776 million in 1998-99 as against US $ 1,119 million during 1997-98 (Table 6.6). Net inflows under nonresident external rupee account [NR(E)RA] scheme and non-resident non-repatriable rupee deposit [NR(NR)RD] scheme during the year signalled confidence in rupee denominated assets while the share of foreign currency denominated FCNR(B) deposits fell to 39.1 per cent at end-March 1999 from 41.6 per cent at end-March 1998. A new deposit scheme, nonresident special rupee account [NR(S)RA], with similar facilities as applicable to domestic resident accounts, was introduced in mid-April 1999.

Table 6.6 : Balances under NRI Deposit Schemes

(US $ million)

Item	Balances (March-end)		Variations @	
	1999	1998	1998-99	1997-98
1	2	3	4	5
1. FCNR(A)	0	1	-1	-2,305
2. FCNR(B)	8,323	8,467	-144	971
3. NR(E)RA	6,220	5,637	980	1,197
4. NR(NR)RD	6,758	6,262	941	1,256
Total	**21,301**	**20,367**	**1,776**	**1,119**

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

Note : 1. Variations do not match with the difference between outstanding stocks for rupee deposits on account of the exchange rate fluctuations during the year.

2. Variations presented in this table may differ from data presented in other tables against NRI deposits on account of valuation effects.

External Assistance

6.16 Net inflow of external assistance (drawals *less* repayments) of US $ 853 million during the year 1998-99 was lower as compared with US $ 1,136 million in the previous year reinforcing the recent trend towards reduced reliance on such flows. Transfer of resources (sum of loans and grants *less* repayments of principal and interest) at US $ (-)385 million continued to be negative as in the previous year (Appendix Table VI.7).

External Commercial Borrowings

6.17 Disbursements under normal external commercial borrowings by way of bonds and loans, *etc*., more than halved during the year reflecting the deceleration in industrial growth, the high forward premia over most of the first half of the year and the increase in borrowing costs following sanctions. This necessitated a policy response in the form of floatation of RIBs amounting to US $ 4,230 million (Box I.2). Inclusive of RIBs, drawals under ECBs amounted to US $ 7,226 million in 1998-99, almost the same as in the previous two years. With amortisation being lower than that in the previous year, net drawals amounted to US $ 4,362 million (US $ 3,999 million in 1997-98).

6.18 The ECB policy was modified during the year keeping in view the developments in the international capital markets following the South-East Asian financial crisis and the requirements of different sectors of the domestic economy. Infrastructure and export sectors continued to be thrust areas in regard to ECB allocation. The average maturity of ECBs was, however, reduced to 5 years and the ECBs were permitted to be used for project related rupee expenditure (except for investment in stock markets and real estate) for all sectors. Average maturity for ECBs under the long-term window outside the internal ECB cap was reduced from the existing 10 and 20 years to 8 and 16 years, respectively.

Overall Balance of Payments

6.19 During the year, the overall balance of payments recorded a surplus of US $ 4,222 million (1.0 per cent of GDP) for the third year in succession as against that of US $ 4, 511 million (1.1 per cent of GDP) during 1997-98 and US $ 6,793 million (1.7 per cent of GDP) in 1996-97, as net capital flows at US $ 8,565 million more than offset the current account deficit during the year. The overall surplus in 1998-99 enabled repurchases of US $ 393 million from the IMF and resulted in accretion of US $ 3,829 million, excluding valuation changes, to foreign exchange reserves (Table 6.1 and Appendix Table VI.1). The compilation and dissemination of BoP statistics in India now fully conform to the international best standards (Box VI.3).

Foreign Exchange Reserves

6.20 India's foreign exchange reserves comprising foreign currency assets of the Reserve Bank, gold held by the Reserve Bank and Special Drawing Rights (SDRs) held by the Government increased for the third successive year during 1998-99. The reserves increased by US $ 3,123 million from US $ 29,367 million (Rs.1,15,905 crore) as at end-March 1998 to US $ 32,490 million (Rs.1,38,005 crore) as at end-March 1999; India's foreign exchange reserves had increased by US $ 4,736 million during 1996-97 and US $ 2,944 million during 1997-98 (Table 6.7 and Appendix Table VI.8). Significantly, the forward liabilities of the Reserve Bank declined from US $ 1,792 million at end-March 1998 to US $ 802 million at end- March 1999 and stood at US $ 972 million by end-June 1999. Net of outstanding forward liabilities to the Authorised Dealers (ADs) and use of the IMF credit, the Reserve Bank's foreign exchange reserves recorded a higher expansion of US $ 4,490 million during the year and stood at US $ 31,401 million at end-March 1999 (equivalent to almost 8 months of imports) as against US $ 26,911 million as at end-March 1998.

Box VI.3
Recent Changes in Compilation and Dissemination of BoP Statistics

The balance of payments (BoP) statistics in India is compiled in line with the conceptual framework and guidelines set out by the International Monetary Fund (IMF) in its Balance of Payments Manual (BOPM5) which is now into its 5th edition. The Manual provides standards for concepts, definitions, classifications, conventions and timeliness which are adapted to country specific situations. With the opening up of the economy a number of important changes and innovations have occurred in international transactions prompting changes in the compilation, classification and presentation of India's BoP data.

BoP statistics are now brought out in a timely fashion, with a lag of just one quarter. The timeliness of BoP statistics confirms to the international best practices of Special Data Dissemination Standards (SDDS) of the IMF. This was rendered possible by the Sub-Group on Reporting of Foreign Exchange Transaction by Authorised Dealers (ADs), which recommended, *inter alia*, institution of reporting arrangements for capturing foreign exchange transactions every fortnight in floppy media from the most critical ADs. The quarterly BoP statistics are finalised in due course by incorporating data on retained earnings by foreign collaborators of FDI enterprises culled out from a quinquennial survey with corresponding adjustments in investment income and foreign direct investments leaving the overall BoP position unchanged. The qualitative difference between preliminary and final BoP statistics is modest. Over the years, the format of capital account has changed to incorporate the growing recourse to external commercial borrowing and short-term credit. In accordance with the BOPM5, purchase of gold from the Government has been excluded from the BoP statistics since 1990-91 with suitable adjustments in 'other capital receipts' and 'foreign exchange reserves'. Since 1990-91, the treatment of defence-related imports has been modified with credits financing such imports shown in the capital account. Interest payments on defence debt pertaining to the General Currency Area (GCA) are recorded under investment income payments and principal repayments under commercial borrowings. In the case of Rupee Payment Area (RPA), interest and principal repayments are shown under the item 'Rupee Debt Service' in the capital account. Other major changes are (i) inclusion of import of gold and silver brought in as baggage by returning Indians with *contra* entry under private transfer receipts since 1992-93 and (ii) inclusion of redemptions of both principal and interest under NR(NR)RD scheme as well as local withdrawals under NR(E)RA scheme under private transfer receipts since 1996-97.

Table 6.7 : Foreign Exchange Reserves and Use of IMF Credit

(US $ million)

As at the end of	Gold	SDR	Foreign Currency Assets	**Total (2+3+4)**	Reserve Position in the Fund	Outstanding* use of IMF Credit (Net)
1	2	3	4	**5**	6	7
March 1992	3,499	90	5,631	**9,220**	0	3,451 (2,516)
March 1993	3,380	18	6,434	**9,832**	296	4,799 (3,433)
March 1994	4,078	108	15,068	**19,254**	299	5,040 (3,568)
March 1995	4,370	7	20,809	**25,186**	331	4,300 (2,755)
March 1996	4,561	82	17,044	**21,687**	310	2,374 (1,625)
March 1997	4,054	2	22,367	**26,423**	294	1,313 (947)
March 1998	3,391	1	25,975	**29,367**	283	664 (497)
March 1999	2,960	8	29,522	**32,490**	663	287 (212)
June 1999 P	2,706	0	30,559	**33,265**	653	206 (154)

P. Provisional
* Figures in brackets are in SDR million.

6.21 The increase in reserves during the year 1998-99 was driven by the accretion of US $ 3,547 million in foreign currency assets which in turn was rendered possible due to inflows of US $ 3,713 million under RIBs. Notwithstanding the loss of reserves during the early part of the year, an excess supply position prevailed in the foreign exchange market since the end of August 1998 following the policy initiatives to restore orderly conditions. For the year as a whole, there were net purchases of US $ 1,842 million from the ADs. The other contributory factors to movement of foreign currency assets during 1998-99 were aid receipts of US $ 1,248 million, interest earnings on deployment of foreign reserves of US $ 1,323 million and acquisition of SDRs (through the IMF) equivalent to US $ 842 million to effect various payments to the IMF and maintaining balances in the SDR account.

6.22 As a part of prudent reserve management, the Reserve Bank has kept its forward liabilities within manageable limits. Forward liabilities at end-June 1999 constituted only 3.2 per cent of its total foreign currency assets (Chart VI.4).

6.23 Balances under the Special Drawing Rights (SDRs) held by the Government which amounted to SDR 0.79 million (US $ 1 million) at end-March 1998 increased to SDR 5.94 million (US $ 8 million) at end-March 1999. A total amount of SDR 611.71 million (equivalent to US $ 842 million) was purchased through the IMF using foreign currency assets; of these SDR 330.86 million (equivalent to US $ 451.8 million) were utilised for payments on account of repurchases and various payment charges to the IMF. Moreover, following an increase in the IMF quota to SDR 4,158 million, there was a quota payment to the IMF during 1998-99 equivalent to SDR 1,102.7 million during the year; of this SDR 275.7 million (US $ 384.01 million) was made out of foreign currency assets of the Reserve Bank while the balance payment of SDR 827.0 million (Rs.4,424.79 crore) was made in the form of domestic currency by credit to IMF Account No.1, *i.e.*, the Securities Account.

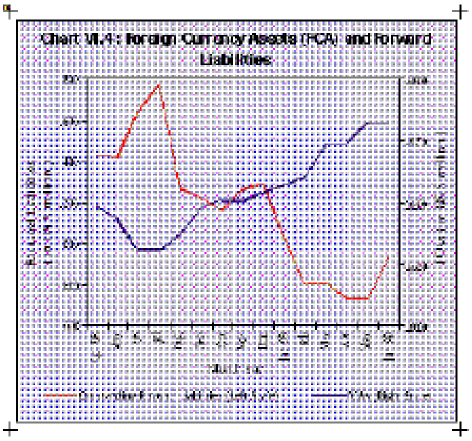


Chart VI.4: Foreign Currency Assets (FCA) and Forward Liabilities

6.24 The value of gold held by the Reserve Bank fell from US $ 3,391 million at end-March 1998 to US $ 2,960 million by end-March 1999. This decline in the value of gold was due to a fall in the quantity of gold held by the Reserve Bank as well as valuation losses on account of decline in international gold prices. The quantity of gold held fell from 396.2 tonnes to 357.3 tonnes during the period on account of redemption obligation under the Gold Bond scheme, thereby, resulting in a decline of US $ 333 million.

6.25 Foreign exchange reserves increased further to US $ 33,265 million (Rs.1,44,238 crore) by end-June 1999 entirely on account of a rise in foreign currency assets to US $ 30,559 million (Rs.1,32,505 crore). This accretion to the RBI's foreign currency assets during the first quarter of 1999-2000 could be attributed to a turnaround in capital inflows. While the trade deficit, on DGCI&S basis, at US $ 2.4 billion during April - June 1999, was broadly the same as in the corresponding period of 1998, foreign investment inflows at US $ 1.3 billion were much higher as compared with US $ 476 million during the corresponding period of 1998. The value of gold held by the Reserve Bank, however, fell to US $ 2,706 million (Rs.11,732 crore) by end-June 1999 due to the continuing slump in international prices.

External Debt

6.26 India's external debt declined from the peak of US $ 99,008 million at end-March 1995 to US $ 94,320 million at end-March 1998 but increased to US $ 98,231 million at end-March 1999 (Table 6.8 and Appendix Table VI.9). The major source of increase during 1998-99 was under commercial borrowings, particularly on account of Resurgent India Bonds. Although the proportion of concessional debt to total debt continued its declining trend falling from 39.2 per cent at end-March 1998 to 37.9 per cent at end-March 1999, there was a significant improvement in the composition of external debt and key indicators of debt sustainability. Short-term debt declined from US $ 5,046 million at end-March 1998 to US $ 4,329 million at end-March 1999 or from 5.3 per cent of total external debt to 4.4 per cent over the same period. While the external debt-GDP ratio declined from 23.8 per cent at end-March 1998 to 23.7 per cent at end-March 1999, the debt service ratio fell from 19.1 per cent in 1997-98 to 18.0 per cent in 1998-99 (Table 6.9). The ratio of short-term debt to foreign currency assets was as low as 14.7 per cent at end-March 1999 as against 19.4 per cent at end-March 1998.

Table 6.8 : India's External Debt

(US $ million)

	Item	At the end of March	
		1999 P	1998
	1	2	3
1.	Multilateral	30,545	29,551
2.	Bilateral	17,486	16,982
3.	IMF	287	664
4.	Commercial Borrowings (including trade credits) #	28,509	24,290
5.	NRI Deposits	12,344	11,913
6.	Rupee Debt	4,731	5,874
7.	Long-term Debt (1 to 6)	93,902	89,274
8.	Short-term Debt *	4,329	5,046
9.	**Total Debt (7+8)**	**98,231**	**94,320**

P Provisional.
Includes net investment by 100% FII debt funds.
* Excludes suppliers credit of up to 180 days for which no estimates are available.

Exchange Rate Management

6.27 The management of the exchange rate during 1998-99, particularly during the early part of the year posed a severe challenge in view of the continuing turbulence in the South-East Asian financial markets and the spread of contagion to other markets such as Russia and Brazil apart from the presence of domestic uncertainties. Concerted policy efforts were, therefore, made in June and August 1998 to reverse the sentiments with a positive impact. The successful raising of funds under RIBs in August 1998, along with certain monetary and other measures taken by the Reserve Bank helped to restore confidence and normalcy in the Indian foreign exchange market. Consequently, during the second half of 1998-99, the exchange rate of the Indian rupee remained broadly stable resulting in a turnaround in the demand-supply mismatch in the foreign exchange market. In contrast to cumulative sales amounting to US $ 2,502 million during May-July 1998, the subsequent period from August 1998-March 1999 witnessed cumulative purchases of US $ 4,143 million resulting in net market purchases at US $ 1,842 million for the year as a whole by the Reserve Bank (Table 6.10).

Table 6.9 : Debt Service Payments

(US $ million)

	Item	1998-99	1997-98	1996-97	1995-96	1994-95	1993-94	1992-93
	1	2	3	4	5	6	7	8
1.	External Assistance @	3,144	3,234	3,319	3,283	2,897	2,753	2,541
2.	External Commercial Borrowing *	4,648	4,725	4,948	4,696	4,715	3,500	2,707
3.	IMF #	419	667	1,061	1,860	1,368	387	614
4.	NRI Deposits (Interest Payments)	1,719	1,807	1,627	1,247	1,046	905	918
5.	Rupee Debt Service	802	767	727	952	983	1,053	878
6.	Total Debt Servicing	10,732	11,200	11,682	12,038	11,009	8,598	7,658
7.	Total Current Receipts **	59,760	58,545	55,115	49,625	41,988	33,629	27,839
8.	Debt Service Ratio (6/7 (%))	18.0	19.1	21.2	24.3	26.2	25.6	27.5
9.	Interest Payments to Current Receipts Ratio	8.0	7.6	7.3	8.8	9.7	10.5	12.5
10.	Debt to Current Receipts Ratio	164.4	161.1	169.6	188.9	235.8	275.6	323.4
11.	Liability Service Ratio (%)	19.1	20.1	21.7	24.7	26.6	25.9	27.9

@ 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 given in this table follow accrual method of accounting consistent with balance of payments (BoP) methodology and may therefore differ from those recorded on cash basis.

2. From the year 1992-93, total current receipts include private transfers on account of *contra* entry against gold and silver imports. The liability service ratio represents debt service payments and remittances of profit and dividend payments taken together as a ratio of current receipts.

Table 6.10 : Purchases and Sales of US Dollar by the Reserve Bank

(US $ million)

Year/Month	Net Sales(-)/* Purchases (+)	Cumulative since April 1998	Outstanding Forward Sales (-)/ Purchases (+)#
1	2	3	4
1998			
April	201	201	-1,427
May	-754	-553	-1,415
June	-1,627	-2,180	-1,634
July	-121	-2,301	-1,774
August	542	-1,758	-1,266
September	760	-998	-1,216
October	95	-903	-1,155
November	75	-828	-1,260
December	-84	-912	-1,294
1999			
January	477	-435	-1,031
February	858	423	-801
March	1,420	1,842	-802
April	38	1,880	-732
May	975	2,855	-732
June	-157	2,698	-972

* Include spot, swap and forward transactions besides transactions under Resurgent India Bonds (RIBs).

Outstanding at the end of the month.

6.28 The strong monetary measures in January 1998 could successfully check the contagion effects of the South-East Asian crisis, thereby stabilising the foreign exchange market with normalcy prevailing by April 1998. This enabled subsequent rolling-back of the monetary measures undertaken in January 1998.

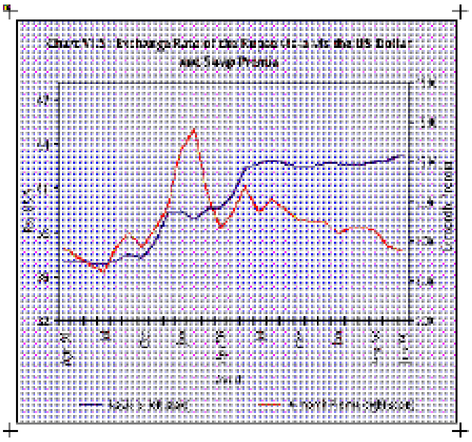
6.29 In May 1998, however, domestic and international developments created uncertainties in market expectations. Excess demand conditions, which had got built up in May 1998, had intensified by June 1998 in both the spot and the forward segments of merchant transactions in the foreign exchange market as the deficit enlarged from US $ 3,082 million to US $ 4,430 million over the same period. The exchange rate of the rupee depreciated from Rs 39.73 per US dollar at the beginning of May 1998 to Rs.42.38 per US dollar on June 11, 1998. Reflecting the uncertainties in the market, both the three-month and the six-month swap premia jumped sharply over their April 1998 level, increasing by 3-5 percentage points to about 10 per cent in June 1998 (Table 6.11 and Chart VI.5).

Table 6.11 : Forward Premia (Monthly Average)

(Per cent per annum)

Year/Month	1-month	3-month	6-month
1	2	3	4
1998			
March	8.81	9.10	9.58
April	3.67	5.31	6.91
May	6.49	7.37	8.20
June	9.59	10.23	10.10
July	5.84	7.34	8.21
August	9.58	8.87	9.16
September	7.42	7.95	8.47
October	5.55	6.80	7.71
November	4.33	6.24	7.39
December	4.96	6.10	7.45
1999			
January	5.08	5.93	6.65
February	5.57	6.69	6.97
March	6.98	6.99	7.06
April	5.67	6.06	6.74
May	4.70	5.09	5.54
June	4.54	4.99	5.23

6.30 The Reserve Bank had to undertake cumulative sales of US $ 2,381 million during May-June 1998 to stem speculative activities and restore orderly market conditions in the foreign exchange market (Table 6.10). The Reserve Bank's operations were supported by a set of measures announced on June 11, 1998, which were detailed in Section I of the Report. These measures contributed to restore normalcy in the foreign exchange market with the rupee ending the month at Rs.42.47 per US dollar after falling to Rs.42.92 per US dollar on June 23, 1998.



6.31 Responding to the June 1998 measures, the foreign exchange market exhibited orderly conditions during most part of the second quarter. The exchange rate hovered around Rs.42.50 per US dollar over this period except for a few days in mid-August 1998 when it traded in a wider range of Rs.42.69-Rs.43.42 per US dollar.

6.32 With the deepening of the Russian financial turmoil and the fear of Chinese renminbi devaluation influencing the foreign exchange market, there appeared excess demand pressures in August 1998 in the spot segment of merchant as well as inter-bank transactions of the foreign exchange market with the deficit recording US $ 1,255 million and US $ 1,608 million, respectively (Table 6.12 and Table 6.13). The Rupee registered its lowest level of Rs.43.42 per US dollar on August 19, 1998. This prompted the Reserve Bank to undertake a fresh package of monetary policy and institutional measures on August 20, 1998 in order to prevent speculative sentiments from building up in the domestic foreign exchange market (Please see Section I for details).

6.33 These measures coupled with the successful raising of US $ 4,230 million under RIBs seemed to have changed the market sentiments and ensured orderly conditions in the foreign exchange market. The Rupee strengthened to Rs.42.55 per US dollar by the end of August 1998 and further to Rs. 42.49 by end-September 1998. As excess supply conditions prevailed, the Reserve Bank recouped a part of the reserve loss over the period prior to August 1998 with net purchases amounting to US $ 1,302 million during August-September 1998.

6.34 The normalcy in the exchange market continued through the third quarter with the exchange rate varying in a range of Rs.42.27-Rs.42.63 per US dollar. The forward premia too declined over the course of the quarter. The Reserve Bank's operations in the market were moderate with net purchases of US $ 86 million during the quarter.

Table 6.12 : Merchant Transactions in the Foreign Exchange Market

(US $ million)

	Spot			Forward			Merchant
Year/Month	Purchases	Sales	Net	Purchases	Sales	Net	Turnover*

1	2	3	4	5	6	7	8
1998							
April	4,807	4,680	127	1,513	2,538	-1,025	17,786
May	4,081	5,071	-990	1,532	3,624	-2,092	18,470
June	4,610	5,634	-1,024	1,367	4,773	-3,406	23,045
July	4,442	4,997	-555	1,489	3,505	-2,016	20,476
August	3,867	5,122	-1,255	1,424	3,649	-2,225	20,085
September	4,207	5,053	-846	1,318	2,266	-948	26,302
October	4,027	4,537	-510	1,187	2,039	-852	23,081
November	4,551	4,744	-193	1,121	2,327	-1,206	19,716
December	5,243	5,430	-187	1,045	2,348	-1,303	19,968
1999							
January	4,486	4,300	186	1,125	1,961	-836	20,331
February	4,596	4,422	174	1,196	1,938	-742	17,387
March	5,420	4,771	649	1,697	2,497	-800	19,439
April	4,522	4,583	-61	1,401	2,869	-1,468	17,862
May	5,086	4,780	306	1,802	2,557	-755	20,211
June	4,469	5,152	-683	1,158	2,444	-1,286	17,651

* Include cross-currency (*i.e.*, foreign currency to foreign currency, both spot and forward) transactions and cancellation/re-booking of forward contracts.

Table 6.13 : Inter-bank Transactions in the Foreign Exchange Market

(US $ million)

	Spot			Forward/Swap			Inter-bank
Year/Month	Purchases	Sales	Net	Purchases	Sales	Net	Turnover*
1	2	3	4	5	6	7	8
1998							
April	7,980	7,719	261	17,777	17,769	8	77,677
May	11,839	10,258	1,581	27,229	26,511	718	1,05,032
June	15,207	13,403	1,804	34,418	33,052	1,366	1,31,006
July	11,357	10,465	892	24,031	23,647	384	1,05,727
August	13,260	11,652	1,608	22,837	21,941	896	1,01,433
September	8,059	7,455	604	15,045	15,370	-325	1,04,535
October	8,391	7,872	519	12,218	11,998	220	83,275
November	8,847	8,335	512	12,421	12,302	119	73,938
December	8,107	7,726	381	12,552	11,725	827	64,376
1999							
January	7,117	7,597	-480	14,462	14,381	81	69,938
February	7,112	7,463	-351	13,597	13,189	408	67,607
March	8,936	9,536	-600	14,899	15,317	-418	72,735
April	9,873	9,636	237	14,234	14,814	-580	67,556

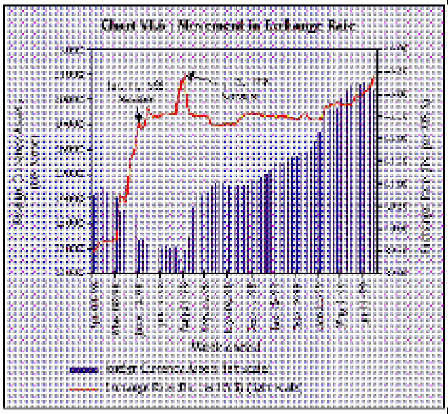
May	10,050	10,651	-601	15,170	14,576	594	75,283
June	11,076	10,510	566	14,487	13,942	545	75,440

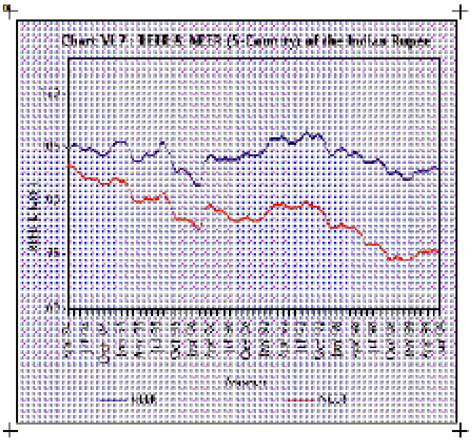
* These data are on gross basis and include cross-currency (*i.e.*, foreign currency to foreign currency, both spot and forward) transactions.

6.35 Excess market supply conditions prevailed during the fourth quarter, particularly in March 1999. The Reserve Bank's net purchases were significantly higher at US $ 2,755 million over the quarter; in the month of March 1999 alone, the Reserve Bank purchased US $ 1,420 million in the foreign exchange market. The Rupee traded in the narrow range of Rs.42.40-42.56 per US dollar (Chart VI.6).

6.36 The excess supply conditions visible during the fourth quarter of 1998-99 continued into the first two months of 1999-2000. The rupee traded in the range of Rs.42.44 - 42.99 per US dollar. Net purchases by the Reserve Bank amounted to US $ 1,013 million over the two-month period. During June 1999, the foreign exchange market exhibited volatility following border tensions with the rupee depreciating to Rs.43.39 per US dollar on June 25, 1999. The Reserve Bank's operations in foreign exchange market resulted in net sales of US $ 157 million in June 1999. The rupee, however, recovered and ended the month at Rs.43.36 per US dollar as the Reserve Bank reiterated its policy to maintain orderly conditions in the forex market.

6.37 The movements of REER and NEER are shown in Chart VI.7 and Appendix Table VI.10 (Please refer to the RBI Bulletin for details).





International Developments

6.38 The global slowdown, which began in mid-1997, persisted during 1998 with world output decelerating to 2.5 per cent during 1998 from 4.2 per cent in 1997. The weakening of world economic growth can be attributed to crises-induced contraction in many South-East Asian economies, the Russian default on government debt and the consequent devaluation of the Rouble in August 1998, the collapse of the crawling peg based exchange rate regime in Brazil in early 1999 followed by the devaluation of the Brazilian Real and the continued recession in Japan.

6.39 Advanced economies fared relatively well in the face of the recurrent bouts of instability suffered by the global financial markets during 1998, with the exception of Japan. In fact, the continued resilience of the US economy represented the main driving force of the world economy accounting for more than one half of the overall growth of world output during 1998. However, growth in advanced countries decelerated to 2.2 per cent during 1998 from 3.2 per cent in 1997.

6.40 Growth in developing countries slackened to 3.3 per cent during 1998 from 5.7 per cent during 1997, with output growth in the Asian region decelerating to 3.8 per cent in 1998 from 6.6 per cent in 1997 (Appendix Table VI.11). The deceleration in the Asian region, which began in 1996 with export contraction, worsened with the currency crises of 1997 and ultimately culminated in a regional contraction in 1998. South-East Asian economies remained at the centre of the crises, with Indonesia, Malaysia, Thailand and South Korea recording substantial contractions in 1998. However, Korea and Thailand have shown signs of economic downturn bottoming out. On the other hand, Hong Kong, Singapore, Taiwan and most notably China weathered the crisis with limited damage.

6.41 The reduction in global demand led to a substantial contraction in world trade. In terms of volume, both the exports as well as imports of advanced economies fell, respectively, to 3.2 per cent and 4.7 per cent in 1998 from 10.3 per cent and 9.1 per cent in 1997. Exports from developing countries decelerated to 2.2 per cent from 11.4 per cent in 1997. Imports of developing countries contracted by 0.7 per cent in 1998 in sharp contrast to the robust growth of 11.2 per cent in 1997. The economic contraction in the South-East Asian countries caused a significant contraction in import demand, which in turn led to a positive current account balance of these countries. As a result, the current account balance of the Asian developing countries improved significantly to a surplus of US $ 35.0 billion in 1998 from a deficit of US $ 4.0 billion in 1997.

6.42 Net long-term resource flows to developing countries declined to US $ 275.0 billion in 1998 from US $ 338.1 billion in 1997, with much of the contraction occurring after the Russian default and devaluation in August 1998 (Appendix Table VI.11). While net official development finance picked up to an aggregate US $ 47.9 billion in 1998 (US $ 39.1 billion in 1997), net private capital flows to developing countries, which had increased spectacularly in the early 1990s, declined from US $ 299.0 billion in 1997 to US $ 227.1 billion in 1998. Foreign direct investment flows reversed their upward trend since 1991 and declined to US $ 155.0 billion in 1998 as compared with US $ 163.4 billion in 1997. Similarly, international capital market flows, including bonds, loans and portfolio equity flows, also declined substantially to US $ 72.1 billion in 1998 as compared with US $ 135.5 billion in 1997.

6.43 The US dollar appreciated *vis-a-vis* most other major international currencies reflecting, in part, the relative buoyancy of the US economy as compared to the other developed countries and the associated widening of interest differentials in favour of dollar denominated assets. Since August 1998, the Yen rose to a peak of 109 per US dollar in mid-January 1999 - about 25 per cent above its August trough before falling back to about 120 per US dollar by early March 1999 -mainly on account of the easing of monetary policy with a marginal depreciation in May and June before recovering to its March 1999 level. The Euro, which was launched on January 1, 1999, initially strengthened against the US dollar but subsequently depreciated by nearly 12 per cent as compared to its initial value in terms of dollars by early July 1999 (Box VI.4). On the other hand, the Pound Sterling depreciated moderately against the US dollar between end-1998 and July 1999 on account of the weakening of growth and the consequent easing of monetary policy in United Kingdom.

6.44 The recent financial crises in East Asia, Russia and Brazil highlighted the need to address problems of capital flight and growing private debt of a number of emerging economies. It is in this context a need has been felt for reviewing and restructuring the international monetary system with a view to instituting responsive crisis prevention and management measures (Box VI.5). The G-22 countries set up three Working Groups on i) Transparency and Accountability, ii) Strengthening Financial System and iii) International Financial Crises. The G-7 countries also committed themselves to strengthening the architecture of the international monetary system in October 1998. Pursuant to this, Professor Hans Teitmeyer submitted a report on international co-operation and co-ordination in the area of financial market supervision and surveillance which recommended the formation of Financial Stability Forum with participation from the G-7, the IMF, IBRD, BIS, OECD, and other international regulatory groups. Subsequently, meetings at Bonn (March 1999) and Washington DC (April 1999), held at the initiative of the G-33 countries endorsed the measures taken by the member countries and multilateral institutions and also addressed the steps to be initiated in this regard. India had participated actively in these meetings.

Box VI.4
Euro and India

The Euro was introduced on January 1, 1999 in line with the schedule set out by the Maastricht Treaty. Eleven[1] out of fifteen member countries in the European Economic and Monetary Union (EMU) which have achieved the Maastricht convergence criteria irrevocably linked their domestic currencies to Euro on December 31, 1998.

The Euro is issued and administered by an European System of Central Banks (ESCB) which comprises of the European Central Bank (ECB) and 11 national central banks (NCBs) which will set the monetary policy and can alone authorise the issuance of Euro notes. The Euro is, presently, transacted in the form of electronic currency but Euro notes and coins will be put in circulation on January 1, 2002 and would replace entirely the national currencies of the eleven member Euro countries on July 1, 2002.

The Euro is yet to prove its strength in the international market. The Euro, on an average, depreciated from 0.8608 per US dollar during January 1999 to 0.9181 during March 1999 and further to 0.9655 per US dollar during July 1999. The continued strength of the U.S. economy and low U.S. unemployment in contrast to the sluggish trend and high unemployment in Euro-zone countries has put considerable pressure on the Euro. Besides, the upheavals in the European Commission, tensions between ECB and national governments and outbreak of war in Yugoslavia have added pressure on Euro.

The Reserve Bank had set up the Working Group on Euro (Chairman: Shri V.Subhramanyam) in order to identify the measures required to be undertaken to ensure smooth transition to the new currency. The Bank has notified the Euro as a permissible currency under FERA. The financial sector has started dealing in Euro with the monthly average exchange rate of Rupee against Euro steadily appreciating from 49.3819 in January, to 44.8315 in July 1999. The introduction of the Euro is not likely to alter the configuration of the dominant currency position of the US dollar in India's foreign exchange operations till the Euro gains a stronger position as a leading invoicing currency in the world. It is, however, too early to fully gauge the multi-dimensional implications of the Euro for the Indian economy.

There may not be any direct immediate impact of introduction of Euro on India's trade with Euro countries especially as Indian companies dealing in EMU currencies, in view of the "no compulsion no prohibition" principle, are not required to invoice in or use Euro till 2001. Potential benefits in terms of greater sales and procurement possibilities may be expected with the phasing out of currency related obstacles to the mobility of goods, services and factors within the EMU region. Despite India's large share of trade with EMU countries, the EU currencies account for only 7.1 per cent in case of exports and 8.1 per cent in case of imports of trade invoicing and about 3.0 per cent of trade finance (buyers and suppliers credit) under short-term credit (less than three years window) with the bulk of the transactions in the US dollar.

The Euro area has a long record of current account surpluses with India and this has the ability to finance foreign investment. The EMU could open financing opportunities for Indian corporates who have been largely tapping the markets abroad in US dollars in the forms of bonds, syndicated loans and GDRs. There will not be any change in interest on fixed rate loans till maturity unless the agreement provides otherwise. In case of floating rate loans, it will have to be linked to Euro LIBOR if it is LIBOR based loan. In case of new loans, the reference rate could be either Euro LIBOR or EURIBOR.

Indian banks will have opportunities for diversifying their borrowing sources by tapping the vast liquid and diversified financial market with an array of financial instruments *via* the single currency. In case of interest on FCNR deposits and LIBOR linked loans, banks may be advised to adopt Euro LIBOR. For new loans, banks may be allowed to use either Euro LIBOR or EURIBOR as reference rate for loans denominated in the Eurozone currencies. The most significant impact for the Indian bank branches operating abroad is the elimination of exchange rate risk across the EMU region, which will encourage branches to buy/sell securities across borders on a larger scale. In India, the costs of transition to Euro relate mostly to the need for staff training, upgradation of information technology, marketing and legal issues, audit and security, stationery *etc*.

1. The conversion rates between Euro and the currencies of the member states opting the Euro which came into effect since January 1, 1999 are as follows: 1 Euro = 40.3399 Belgian francs; 1.95583 German marks; 166.386 Spanish pesetas; 6.55957 French francs; 0.787564 Irish pounds; 1936.27 Italian lire; 40.3399 Luxembourg francs; 2.20371 Dutch guilders; 13.7603 Austrian schillings; 200.482 Portuguese escudos; 5.94573 Finnish markkas.

References

1. Reddy, Y.V., (1999), 'Key Note Address', Seminar on *Eurocurrency and its Implications for India*, ASSOCHAM, New Delhi, February.

2. Reserve Bank of India, (1998), *Report of the Working Group on the Euro,* (Chairman: Shri V.Subhramanyam).

3. Subrahmanyam, G., Dixit, S.V.S. and Roy, A., (1998), *'EMU, Euro and India'*, Development Research Group, Study No. 15, Reserve Bank of India, Mumbai.

Box VI.5
International Financial Architecture

The recent financial crises in many parts of the globe have underscored the need for fresh initiatives to strengthen the global financial system in terms of crises prevention measures (which reduce the recognition lag) and crises management measures (which shorten the policy lag).

Crisis prevention measures aim at enhancing transparency and accountability, strengthening of the national financial system and ensuring orderly liberalisation of capital movements and good governance.

The International Monetary Fund (IMF) has launched a major initiative in order to instil transparency in member country economies by developing international standards against agreed benchmarks of good practices which minimise costs of asymmetry of information. For example, the IMF has decided to release member country-specific assessments in the form of Public Information Notices (PINs), and staff reports following Article IV consultations as well as encourage members to issue letter of intents (LOIs), memorandum of economic and financial policies (MEFPs), and policy framework papers (PFPs). Besides, the Dissemination Standards Bulletin Board (DSBB) at the IMF website would publish macroeconomic data through the detailed Special Data Dissemination Standard (SDDS) in respect of countries which access international financial markets and a less comprehensive General Data Dissemination System (GDDS) for all member countries. The Fund is also preparing a "Code of Good Practices on Fiscal Transparency" and a "Draft Code of Good Practices on Transparency in Monetary and Financial Policies".

With a view to promoting greater transparency in the IMF, there has been a proposal for external evaluation of the effectiveness of IMF's surveillance over member's policies under Article IV of the Articles of Agreement. Further, the IMF has initiated actions for strengthening and/or transforming the Interim Committee to broaden its scope to prevent crises.

Several international institutions have also adopted/ developed transparency standards in order to minimise information costs. The Basle Committee on Banking Supervision has set up a committee to review the Core Principles for Effective Banking Supervision which includes, data related issues, dealing with weak banks, safety nets, licensing, governance and legal and judicial issues. The International Organisation of Securities Commission has developed Objectives and Principles of Securities Regulation and Disclosure Standards to facilitate cross-border offering and initial listing by multilateral issuers. The International Association of Insurance Supervisors has issued a compendium of principles, standards and guidance paper for insurance supervision. The International Accounting Standard Committee (IASC) has promulgated a comprehensive set of International Accounting Standards. The International Federation of Accountants (IFAC) has formulated International Standards on Auditing and Audit Practice Statements. The Committee on the Global Financial System (CGFS) analyses global financial system conditions and makes recommendations for improving market functioning. The United Nations Commission on International Trade Law adopted a model law for cross-border insolvency. The Committee on Payment and Settlement Systems is working to improve the robustness of the payment system. The OECD, on its part, set up a Task Force which has circulated draft "Principles of Corporate Governance".

The recent South-East Asian crisis has highlighted the need for instituting crisis management mechanisms that allow co-ordinated action by national authorities and international institutions which limit contagion effects. Given the limited resources at the disposal of the international agencies including the IMF, and increasing default on private debt, a crucial role has been assigned to the private sector in forestalling and resolving financial crises. For example, the IMF has now allowed provisioning for Contingent Credit Lines (CCL) from commercial banks. In response to the crises management, certain countries, particularly Japan have committed to bilateral support under the international framework of the IMF, the World Bank, the Asian Development Bank, *etc.*, and have provided massive assistance to crisis-affected countries. There were efforts to create regional funds for immediate assistance to manage the crises in an effective manner. Besides, proposals to involve the private sector and to have orderly debt workouts are being actively considered.

References

1. Bundesbank, (1999), '*International Co-operation and Co-ordination in the Area of Financial Market Supervision and Surveillance'* (Chairman : Hans Tietmeyer).

2. Eichengreen, Barry (1999), *Towards a New International Financial Architecture - A Practical Post-Asia Agenda*, Institute for International Economics, Washington.

3. Fischer, Stanley, (1999), "On the Need for an International Lender of Last Resort", *Paper delivered at the American Economic Association and American Finance Association*, New York, January.

4. G-22, (1998), *Reports on the International Financial Architecture*, (Willard Group), October.

5. International Monetary Fund, (1999), *Report of the Managing Director to the Interim Committee on Progress in Strengthening the Architecture of the International Financial System*, Washington D.C., April.

6. United Nations, (1998), *Towards a New International Financial Architecture,* New York.