UNIT 23 BALANCE OF PAYMENTS

Structure

23.0 OBJECTIVES

This unit carries the discussion of India's foreign trade started in the previous unit further. This unit goes beyond balance of trade to balance of payments, and explains its meaning. It then describes trends in India's Balance of Payments and discusses the measures that have been taken to promote exports. After you have read the unit you should be able to:

- Distinguish between balance of trade and balance of payments;
- Explain the difference between current account and capital account;
- Explain the concept of balance of payments and its importance;
- Discuss the need for export promotion;
- Evaluate the export promotion programme of the Government of India;
- Provide suitable suggestions for export promotion; and
- Evaluate various steps taken by the Government to solve the balance of payments difficulties.

23.1 INTRODUCTION

In the last Unit, we have evaluated the changing structure of India's foreign trade since independence. Trade is only one aspect of international economic transaction. A constant flow of men, material and capital takes place between nations.

This flow involves both payments and receipts of foreign exchange. A nation needs keep a systematic record of these transactions. It is only then that an economy's dependence on the rest-of-the-world and its capability to utilise external resources for its own development gets determined. This systematic record of transactions is what we call balance of payments.

23.2 CONCEPT OF BALANCE OF PAYMENTS AND ITS USES

The principal tool for the analysis of the monetary aspects of international trade is the *balance of international payments statement.* This statement is also simply known as the balance of payments (BOP*). BOP is a systematic record of all international economic transactions, visible as well as invisible of a country during a given period, usually a year*. In other words, the BOP statement is a device for recording all the economic transactions within a given period between the residents of a country and the residents of other countries.

23.2.1 Current Account and Capital Account

The analysis of the BOP can be done in terms of its two major sub-divisions viz., (i) Current Account, and (ii) Capital Account.

1) **Current Account**: The current account of the BOP can be broken in two parts. Viz., (a) balance of trade and, (b) balance of trade in services.

   a) **Balance of Trade (BOT):** The BOT deals only with exports and imports of merchandise (or visible items). The net balance in the BOT will show the monetary value of the different in exports and imports of a country. Thus, three types of net BOT can be visualised:

      i) Deficits in BOT; these will occur. When $X < M$;
      ii) Surplus in BOT; these will occur. When $X>M$; and
      iii) Balance of BOT; these will occur. When $X = M$.

   b) **Balance of Trade in Services (BOS):** The BOS shows net receipts on account of trade in services, (or what are also called invisibles). We can broadly classify invisibles into five groups, viz., (i) services, such as banking, insurance, shipping civil aviation, royalty, consultancy services, postal services, etc. (ii) investment income, which includes profits and dividends on direct, portfolio and other investments as well as interest charges on bilateral and multilateral loans. (ii) travel both business and tourist, (iv) government transfers, and (v) private transfers. All of these transactions are two-way transactions; i.e. during any year these services would be provided by Indians to the rest-of-the- world, and foreigners would be providing these services to India. Indians would receive rewards for their services, which are called current receipts. Likewise, India would have to pay for the services rendered to it by the rest-of-the-world. These are known as Current payments (P). The net of current receipts and current payments constitutes balance of trade in services or BOS . During a year BOS make take any of the following three forms:

      i) Deficits in BOS; these will occur. When $R< P$;
      ii) Surplus in BOS; these will occur. When $R>P$; and
      iii) Balance in BOS; these will occur. When $R=P$

Balance on current account is the sum or aggregate of BOT and BOS, i.e.,

Balance on Current Account = BOT + BOS

i.e. , balance on current account is the net of all current foreign exchange earnings of a country during a year and its liabilities in the form of foreign exchange expenditure (ex) during the year. Its foreign exchange earnings come out of the exports of merchandise and the receipts arising out of the services rendered by it. Its foreign exchange expenditure is incurred on its imports of goods and the payments due to foreigners on account of the services rendered by them. Apparently, like BOT and BOS, current account of the balance of payments may show any of the following three results :

i) Current Account Deficits: these will occur. When imports < exports.
ii) Current Account Surplus : these will occur. When imports. > exports.
iii) Current Account Balance: these will occur. When imports. = exports.

a) **Current Account Surplus** means that a country has earned more foreign exchange during a year than what it has contracted to spend. In this situation, the country's foreign exchange reserves may increase. Alternatively, it may decide to pay off its earlier debt with the help of the surplus foreign exchange it has earned during the year. A third alternative may be that it may decide to give loans to other countries out of its own surplus earnings.

Likewise, a **Current Account Deficit** implies that a country has committed to spend a larger amount of foreign exchange than what it has earned during the year. There may be two alternatives before it now. One, it may draw upon its foreign exchange reserves, and thus settle its liabilities. Two, it may borrow abroad to settle its current liabilities; but in this case it is creating future liabilities for itself in the form of external debt.

If the current account is in balance, i.e., if a country's foreign exchange earnings during a year balance its foreign exchange expenditure, there is nothing much a country has to do in this area.

2) **Capital Account:** The other component of the BOP statement of a country is the capital account. The capital account of the BOP presents transfers of money and other capital items and changes in the country's foreign assets and liabilities resulting from the transactions in the current account.

As seen earlier if a country is having a deficit on its current account BOP it need borrow from the rest of the world to square of its current excess liabilities. Likewise, if it has a surplus, it can lend to the rest-of-the world. These transactions are recorded on its capital account. All the borrowings of a country constitute the credits (cr.) in the capital account, while all lendings by it constitute its debits (dr.) in the capital account. Likewise, all repayments of old debts constitute debits, while receipts from the rest-of-the-world constitute its credits. Thus, if a country has been borrowing over a long period of time, during a particular year it would be contracting new loans (cr.) as well as paying of earlier debts (dr.) . The net of these debits and credits constitutes the capital account of the BOP.

It would be observed that the capital account transactions are designed to provide the balance of current account deficits (or surpluses). It means that if a country is having current borrowing, so that it is left with a sufficient surplus to meet its current excess liabilities, after meeting its repayments obligations of the past debt that fall due in the year. In other words, during a year,

Net capital transfers from		Current Account
	will equal	deficit **plus**
rest-of-the-world		Net repayments of past debt.

Apparently, a country will be obliged to borrow more if either its current account deficit is high or its commitments towards repayment of debt are high or both.

In any case, if a country has a deficit on its current account BOP it will need to have a surplus on its capital account BOP, the surplus on capital account will be used to finance the deficit on current account.

23.2.2 Balance of Payments

The term 'balance of payments is the' sum or aggregate of its current account and capital account. Current account and capital account will always move in the opposite directions; a deficit on current account will always meet with a matching surplus on capital account, and conversely a surplus on current account will match with a deficit on current account. And in the ultimate analysis, an economy's BOP will be in balance i.e., there will be no deficits and surpluses in aggregate BOP.

The above equality in the two sides of the BOP account is of course only an accounting equality. It would be observed that if a country continuously incurs current account deficits and finances such deficits with capital account surpluses, all that it is doing is that it is postponing its current liabilities to the future. The external debt burden will keep on increasing as new debt is further contracted.

The BOP accounts provide a link between the increase in gross external debt and the imports and spending decisions of the economy. Thus,

$$\text{Increase in Gross external debt} = \left\{ \begin{array}{l} \text{Current Account Deficit} \\ - \text{ direct and long-term portfolio} \\ \quad \text{capital inflow} \\ + \text{ official reserve increases} \\ + \text{ other private capital outflow} \end{array} \right.$$

From the above relationship it would be clear that in the process of economic development a small deficit on current account is required to take advantage of the foreign savings and build up physical investments domestically.

Check Your Progress 1

1) What is balance of payments?

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2) Distinguish between visible items and invisible items of trade. Give three examples of each.

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3) Distinguish between balance of trade and balance of payments.

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4) When will a country need to have a surplus on its capital account?

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23.3 BALANCE OF PAYMENTS AND DEVELOPING ECONOMIES

It is well known in development economics that UDCs invariably start as debt or economies. In the process of development itself, these economies have to import a great deal of capital goods, consumer goods, food and raw materials and spares and components. They also have to import some new technologies and, hence, the total exchange outgo cannot be matched by export earnings. But, it is expected that in a decade or two, as the new capital goods and technologies begin to become effective and their products are directed towards exports, export goods and services become competitive in cost and quality. In that case, the volume of exports expands and, in due course, begins to overtake imports. A developing economy then moves on from being a debt or economy to a balanced one in terms of balance of payments and, finally, becomes a credit or economy, exporting more than it imports and giving credit to buyers. Thus, from being a net debt or in the beginning, it becomes a net credit or in the end and, in fact, begins to invest abroad rather than have others lending to and investing in it.

23.4 TRENDS IN INDIA'S BALANCE OF PAYMENTS

India has faced pressures on BOP from time to time either due to certain domestic compulsions or due to external factors. The whole period, covering nearly the four and a half decades, can be divided into four sub-periods depending on (i) the nature of BOP problem, (ii) the overall macro-economic environment, and (iii) the external aid situation. The four sub-periods are as follows:

1) upto 1975-76 (Period I),
2) 1976-77 to 1979-80 (Period II),
3) 1980-81 to 1989-90 (Period III), and
4) the recent phase of 1990-98 (period IV).

23.4.1 Period I (Up to 1975-76)

The entire period was very difficult for India's BOP, partly because of slow growth of exports in relation to import requirements and partly because of adverse external factors. Despite tight import controls (through quantitative restrictions) and foreign exchange regulations the current account deficit was 1.8 per cent of the GDP. Foreign exchange reserves were at low levels, generally less than necessary to cover three months imports. Almost the entire current account deficit (92 per cent) was financed by inflows of external assistance on highly concessional terms. There was hardly any commercial deficit.

23.4.2 Period II (1976-77 to 1979-80)

These few years stand out as the golden years for India's BOP. India had a small current account surplus (0.6 per cent of the GDP on an average) and foreign exchange reserves equivalent to about seven months' imports. Export growth was good but the primary reason for the sharp improvement in BOP was the dramatic improvement in net invisibles. Net invisibles increased from a paltry Rs.193 crore in 1974-75 to Rs.2,486 crore in 1979-80.

23.4.3 Period III (1980-81 to 1989-90)

The period broadly corresponds to the period of the Sixth Plan and Seventh Plan. The Sixth Plan was launched when the economy was faced with severe BOP difficulties. In 1981, India entered into an arrangement with the International Monetary Fund for a loan for SDR 5 billion under the Extended Fund Facility. The amount was to be disbursed over a three-year period.

The BOP deficits were particularly acute during the Seventh Plan period. The current account deficit during the whole plan period was as high as 2.2 per cent of the GDP as against 1.3 per cent of the GDP during the Sixth Plan Period.

23.4.4 Period IV (1990-91 onwards)

The BOP crisis reached its climax during 1990-91; current account deficits reached a maximum of 3.26 per cent of the GDP, as would be seen from table-1 below:

Table-1: Key Indicators of India's Balance of Payments

(As percent of GDP)

Year	Exports (a)	Imports (b)	Trade Balance (c)	Net invisibles (d= b-c)	Current A/c deficit (f = d+e)
Average of					
1985-90	5.1	8.3	-3.2	0.9	-2.3
1990-91	6.2	9.4	-3.2	-0.1	-3.2
1991-92	7.3	8.3	-1.1	0.7	-0.4
1992-93	7.8	9.8	-2.0	0.2	-1.8
1993-94	8.8	9.7	-0.9	0.5	-0.4
1994-95	8.8	10.5	-1.6	0.8	-0.8
1995-96	8.9	12.0	-3.1	1.5	-1.6
1996-97	8.6	12.3	-3.7	2.6	-1.2
1997-98	8.5	12.2	-3.7	2.3	-1.3
1998-99	8.2	11.4	-3.2	2.2	-1.0

India was faced with a serious BOP crisis. In view of this, a comprehensive strategy to deal with it was put in place.

Although the BOP continued to be under pressure during 1992-93, there was a distinct improvement compared to the crisis situation prevailing in the middle of 1991. Since then the BOP situation has continued to register improvement, although we have not come out of the shadows completely.

23.5 CAUSES OF BOP DEFICITS

The BOP deficits have come to stay with us for long. We will take an overall view of the causes responsible for these deficits, and would like to identify them more particularly in light of receipt happening.

1) **Balance of Trade Deficits**: The first and the foremost cause of balance of payments deficit in India has been the trade deficits that India has had to encounter right since the beginning of the growth process. The import needs of the economy went on increasing without a corresponding increase in exports, resulting in mounting trade deficits.

Even in more recent times there is sufficient evidence to indicate that the import intensity of Indian industry is rising under pressure of global competition, and with search for advanced technology this trend is certain to continue. Thus, there is apprehension that unless it is matched by high export growth there may be some risk of a substantial drain of foreign exchange reserves.

2) **Declining Surpluses on Account of Invisibles**: A marked feature of India's BOP has been that it has been earning a net surplus on account of trade in invisibles. Large earnings on account of invisibles have been due to remittances form Indians working abroad and surplus earnings on travel services. In the long run, the net position on invisibles would depend on the outcome of two opposing sets of forces-one being the surplus earnings on travel services, government transfers and private transfers and the other being the deficit on investment income. Interaction of these two sets of opposing forces would not, however, change the trend in the immediate future and invisible trade would generate surplus for some more time to come. But there exists a strong possibility that in the long run the negative forces of investment income would outweigh the positive impact of the rest of the items, leading to a deficit in invisible trade thereby creating further complications in the BOP.

3) **Mounting Burden of External Debt Servicing**: Another factor behind the increasing pressure on the BOP has been steadily mounting burden of external debt servicing. This is estimated to have increased from about $ 7.6 billion in 1989-90 to about 10.73 billion in 1998-99. Not only has the total volume of external debt been increasing rapidly, the share of short-term commercial borrowing-at market rates of interest as against concessional official development assistance (ODA)- and NRI deposits designated in foreign currencies has been increasing rapidly. With the hardening of interest rates abroad, this newly evolving pattern of external liabilities has steadily pushed up the debt service liability. Indeed, it is the increasing payment of interest on external debt – payment on current account arising from the increasing total debt liability, which has added to the need for external borrowing.

4) **Dim Prospects of Getting Concessional Aid** : During the earlier course of economic development, current account deficits could easily be founded by concessional aid both from bilateral and multilateral sources. But towards the end of eighties the various sources of concessional assistance were drying up, whereas current account deficits were mounting up. The prospects for getting concessional aid on an increasing scale appear to be bleak under the given economic circumstances, mainly because of the following four factors: (a) the generally worsening climate for official development Assistance (ODA)- most developed nations have been unwilling to increase and, in some cases, even maintain the size of their contribution, (b) the view that the Indian economy is now will equipped to tap commercial sources of foreign exchange finance; (c) the entry of new claimants

on the pool, such as China and other nations of East Europe, (d) and emergence of new independent nations, like Estonia, Lithuania, Latvia, Ukraine etc. Since commercial borrowings are quite a costly proposition there is a limit, beyond which it may not be possible for the Government to borrow. Even in case of such loans care must be taken that they should be raised for projects, which are carefully selected, speedily executed and which have direct impact on increasing our exports or reducing the magnitude of imports.

Check Your Progress 2

1) What has been the most difficult period from the point of view of balance of payments of India ?

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2) Mention four important causes of balance of payments difficulties in India?

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23.6 MEASURES ADOPTED TO SOLVE THE PROBLEM

From the point of view of the measures adopted by the government to solve the problem of BOP deficits the whole period since 1950-51 can be divided in two parts, viz. (1) 1951-91 and (2) since 1991.

1) ***Till 1991***, BOP deficits were sought to be controlled by measures like (i) promoting the growth of import substitution type of industries, (ii) putting physical restrictions on imports, (iii) extending assistance for export promotion, (iv) providing incentives for increasing foreign exchange earnings on account of invisibles. The fact that these measures could only moderately be successful is brought out clearly by the fact that the country was faced with BOP crisis of unprecedented dimensions.

2) Since 1991 India has put in practice a comprehensive strategy to overcome BOP deficits. The main elements of this strategy can be identified as follows:

a) ***Fiscal and Monetary Discipline:*** Strict fiscal and monetary discipline has been sought to be adopted to control aggregate demand. The central fiscal deficit stands reduced from 8.4 per cent of GDP in 1990-91 budget to 4.5 per cent in 1999-2000.

Monetary policy has aimed at slowing down the growth of money supply. The rate of growth of money supply has been brought down from 18.5 per cent in 1991-92 to 13.2 per cent in1995-96, and 17.8 per cent in 1998-99.

b) ***Exchange Rate Policy and Foreign Trade Policy Reforms:*** Till 1993, the exchange rate of the Indian rupee was fixed by Government. Since March 1, 1993, a new system of exchange rate determination has been introduced. This is known as the unified exchange rate system or UERS. Under this system, all payments and receipts of foreign exchange are converted in rupees at market rate of exchange. Further, Union Budget for 1994-95 introduced full convertibility on current account that makes many trade transactions relatively free of controls. As a part of foreign trade policy reforms, imports restrictions on capital goods, raw materials and components have been virtually eliminated. Thus, excess import demand will be reflected in a higher market exchange rate and self-correcting mechanism will operate to keep trade deficit in check. Along with this considerable reductions in peak tariffs, especially tariffs on capital goods, have been affected. Cash margins and interest surcharge on import credit have been abolished. Harmonised system of customs classification has been introduced.

c) ***Structural Reforms***: Among these we may briefly mention as follows: (i) substantial deregulation of trade and industry; (ii) delicensing of many industries; (iii) promotion of competition by the opening up of many areas previously reserved for the public sector to private and foreign investment; (iv) policies put in place of attract foreign direct and port-folio investment; (v) amendment of SICA to permit public enterprises to be examined by BIFR ; (vi) financial sector reformers including deregulation of interest rates, dismantling of directed credit, reforming the banking system, improving the functioning of the capital market including the government securities market, etc.

d) ***Mobilisation of Exceptional Financing*** : Steps have been taken to mobilise exceptional finance from multilateral agencies and bilateral donors. (Exceptional financing need is defined as the requirement felt over and above the inflows of official project aid, commercial borrowings, and NRI deposits). Among other related measures are: stand-by arrangement with the IMF, structural adjustment and social safety net loans negotiated with Asian Development Bank, etc.

Results: The present strategy to overcome BOP crisis is all comprehensive and well coordinated. The results of this type of strategy have been quick to appear. The pressures of BOP have considerably eased as is brought out by the fact that the foreign exchange reserves, which touched a low of # 30,000 million presently as shown in table 2 below:

Table –2 : India's Foreign Exchange Reserves

End of March	Amount # million	Import cover (no. of months)	Current Payments cover (no. of month)
1951	1914	16.8	14.6
1961	390	2.0	1.7
1971	584	2.9	2.2
1981	5850	4.5	4.0
1991	2236	1.0	0.8
1995	20708	8.2	5.9
1996	16018	5.44	3.8
1997	21261	7.00	4.0
1998	25975	7.50	4.5
1999	29522	7.50	4.5

It would be seen that whereas in 1991 we were left with meagre reserves sufficient to cover only one month's imports and 0.8 month's current payments, now we have accumulated reserves that cover about 7 months of imports and 4 months of current payments. This order of reserves is a good cushion and provides big flexibility to policy makers.

To conclude, India has formulated a successful strategy to overcome BOP limitations on growth. But, all the same, it need be remembered that a lasting solution to the BOP problem still eludes us. Our current account deficits are still large and are once again set to rise. Large current account deficits imply that we have to take resort to external borrowings, which in turn put further pressure on BOP deficits. A lasting solution to the BOP deficits is to be found only in generation of large current account surpluses. Generation of current account surpluses, at the present stage of economic development, by and large, means that we should go in a big way to expand our exports. Rapid expansion in exports is the only way to find a permanent solution to our balance of payment problem.

23.7 EXPORT PROMOTION IN INDIA

"Export or Perish" has never been so relevant during the last four and a half decades as now.

23.7.1 Rationale of Export Promotion

Among the factors that make it almost compulsive that we increase the level of our exports, the following may be mentioned .

First, the import needs of the economy are likely to increase in future unless, as already stated, we are ready to slow down our process of growth; specifically the bill on account of direct oil imports and the investment-induced imports of foreign technology and capital put together, is likely to assume an enormous magnitude in the future. It will also be necessary to reckon with the additional deficits on account of non-oil imports.

Secondly, in the context of our past experience it may no longer sound proper to depend upon external assistance to finance essential imports. As long as such assistance is available it should be made use of, but in the process, we should not burn our own sails. Instead efforts should be on to take control of the situation whenever the external pipelines get choked up .

Thirdly, our debt-servicing burden has already assumed serious proportions and is projected to grow more serious. It may not be possible or advisable any more to contract new loans to pay off the old ones.

Fourthly, given the types of technology available, which favours large production units by bringing in economies of scale, our production structure, at least in a few important sectors, may become necessary to widen the market base by exploring new market abroad.

Fifthly, exports may also be needed to raise the earnings capacity for import of essential consumer goods like edible oil food grains (if required, at any time in future), sugar etc., whose domestic shortages have very often in the past, created serious instabilities in the economy.

Finally, the existence of a highly diversified industry, with a large entrepreneurial base experienced in assimilating technology, is providing the on-going reform process with the opportunity to generate rapid expansion in manufactured exports. Such rapid expansion of manufactured exports would not only increase the growth rate, insulate the economy from the dangers of another round of austerity necessitated by a BOP crisis, and more importantly, provide the most direct and powerful means for eradicating poverty. As the exports basket is widened to cover a greater range of labour-intensive manufactured goods and these experience similar if not higher, rate of growth, the impact on India's poor would be as dramatic as it has been in miracle East Asian economies.

In short, the export sector is being regarded 'second only to defence' . This expresses the need for a vigorous export drive.

23.7.2 Measures for Export Promotion

Export promotion is a multi-dimensional activity. As such export promotion measures adopted by the Government have embraced a number of areas like production for export, quality control, packaging export credit and finance, export incentives and assistance, export marketing organisational set-up etc. We shall review the various measures undertaken under these different heads.

A) **Export Production**

The production for export has been given a special treatment by the Government, Industrial units in the priority sector exporting 10 per cent or more of their production are granted preferred sources of supply and facilities for further expansion of their export production.

Special treatment is also being accorded to 10 per cent export-oriented units (EOUs). The EOUs can be located anywhere in the country and are eligible for duty-free imports of capital goods, raw materials and components.

Likewise, Export Processing Zones (EPZs) on the lines of Free Trade Zones (FTZs) of Singapore and Hong-Kong have been sent up to facilitate free imports and exports. Each zone provides basic Infrastrutural facilities like developed land, standard design factory buildings, built up sheds, roads, power, water supply and drainage, in addition to whole range of fiscal incentives.

Quality Control: Intimately connected with the problem of exportable surplus is the problem of quality control. The Government has enforced quality control and pre-shipment inspection through the provision of the Export (Quality Control and Inspection)Act, 1983. Under the provisions of the Act, the Export Inspection Council has been set up to discharge all the functions relating to quality control. There is compulsory export inspection for specified products.

Packaging: Attractive packaging is as important as the quality of a product. In order to promote research in development cheap, sound and attractive packaging, the government has set up the Indian Institute of Packaging.

B) **Export Credit and Finance**

Short-term export credits in the form of pre-shipment and post-shipment finance are provided by the commercial banks, which are authorised dealers in foreign exchange. These credits have been covered by a special refinance scheme of the Reserve Bank of India and are provided at a concessional rate of interest.

Exim Bank: The government has set up the Export-import Bank wide functions to finance, promote and develop foreign trade. It came into being on January 1, 1982.

Exim Bank is the principal financial institution engaged in coordinating the working of institutions engaged in financing and promoting export and import of goods. The Bank provides financial assistance to promote Indian exports through direct financial assistance, overseas investment finance, term finance for production and export development, pre-shipment credit, buyers, credit, line of credit, relending facility, export bill rediscounting, refinance to commercial banks, finance for computer software exports, marketing and bulk import finance for computer software exports, marketing and bulk import finance to commercial banks. The diversified lending programmes of Exim Bank now cover various stages of exports i.e., from the development of exports markets to expansion of production capacity for exports, production for exports and post-shipment financing. Exim Bank's focus is on export of manufactured goods projects.

C) **Export Incentives and Assistance**

Various types of export incentives have been evolved; these have been altered and modified from time to time to meet varying conditions. Broadly, these incentives can be classified into three categories, viz., (i) fiscal incentives, (ii) financial incentives, and (iii) special incentives schemes.

i) ***Fiscal incentives***. Under fiscal incentives the important measures that have been in vogue are income tax concessions, customs drawback, refund of excise duty, exemption from sales tax, provision for export under bond, and facility for manufacture under bond.

ii) ***Financial Incentives***. These incentives refer to the provision of cash assistance for specified export promotional efforts and export facilities.

iii) ***Special Incentives Schemes***. Easy access to imported inputs through instruments like the Open General Licence (OGL), Engineering Products Export Scheme, exemption from income tax for profit from exports lowering of the tariffs, etc. are some of the measures designed as incentives to the exporters.

D) **Organisational Set-Up**

The Government has established several specialized organizations for export promotion like (i) The Central Advisory Board on Trade, (ii) The Trade Development Authority, (iii) The Federation of Indian Export Organisations, (iv) Export Promotion Councils, and (v) Commodity Boards like Rubber Board, Coffee Board, Tea Board, Tobacco Board and Spices Board. Etc.

In addition , for increasing State participation in foreign trade, a number of public sector agencies have been set up, among which the more important are: The State Trading Corporation and the Minerals and Metals Trading Corporation. The STC group now includes, besides the STC, the Cashew Corporation of India, the Handicrafts and Handlooms Export Corporation, the Project and Equipment Corporation, the State Chemicals and Pharmaceuticals corporation and the Central Cottage Industries Export Corporation.

In short, the export promotion programme of the Government covers a very broad spectrum. To an extent these measures have been successful in as much as they have made stagnant Indian exports move, although at a slow rate. A consequence of the slow growth of exports has been that India's share in world exports has been falling gradually; presently, it stands at no more than 0.60 per cent. While , on the one hand, it reflects the poor performance of exports, on the other it also indicates, given proper opportunities, the vast potentialities for growth. Let us identify our basic limitations and suggest remedies for their removal.

23.7.3 Flaws in Export Promotion

i) A major flaw in our export promotion system is that we have been giving undue emphasis to improving price competitiveness of export products and profitability of export operations. Various fiscal, financial and other incentives have been evolved mainly for reducing cost disadvantage of export products and augmenting profitability of export marketing operations. While price plays an important role in influencing the buying decisions, other factors such as quality of the product, ability of the exporters to comply with the delivery schedule etc., also are important factors influencing foreign buyers. Therefore, export promotion measures can be effective only if they are duly co-ordinated to meet the export marketing needs in all respects i.e. distribution channels, quality of the product, etc. (ii) though many export promotion bodies and export services institutions facilitate compilation and dissemination of international marketing information, vital information directly affecting export-marketing opportunities does not get properly compiled, analysed and systematically disseminated. Also, resources constraints inhibit individual firm to effectively act on market information received. (iii) the levy of indirect taxes on export products and later the refund of the same is a wasteful process as the amount to be refunded gets unnecessarily blocked with the national exchequer thereby delaying its productive use. (iv) availing of promotional measures involves various procedural formalities, which are complicated and also time-consuming. As long as the average producer is bitten by the bug “export and perish” nothing really can be achieved.

Check Your Progress 3

1) Mention four corrective measures for balance of payments pursued till 1991.

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2) Discuss the main elements of the present strategy to solve balance of payments problem in India.

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3) Mention five structural changes introduced in Indian economic policy.

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23.8 EXPORT STRATEGY

A sound strategy of export promotion need incorporate the following features:

1) **Building up a Sound Export Production Base**

Till the recent past very little has been done to build up a stable and viable export production base and supportive infrastructural facilities to cope effectively with a growing export demand. Supply constraints and infrastructural bottlenecks have, therefore, become stumbling blocks to export efforts as an integral part of the total production programme in the export oriented sectors. Therefore, it is necessary to make a deliberate production plan and to earmark a part of production for export even if there is a pressure of domestic demand on export supplies . In this connection, D.V. Kapur Committee has suggested: (i) inducing domestic producers through more incentives to export, (ii) building in an advantage in attaining economies of scale, and (iii) further liberalisation of the licensing policies aimed at injecting intense competition.

2) **Supply of Adequate Technology**

It must be realised that a mere expansion of capacity for export production is not enough; it must be based on appropriate technology to enable us produce 6-Sigma quality products (6-Sigma indicates virtually zero defect product) so that products can stand competition in international markets. There is a growing technology gap between the world and us. Our technology may be appropriate to our needs but not for exports where updated technology is necessary. India's success in agricultural, space and nuclear research shows that it has the capacity to develop the most modern technologies if necessary resources of men and material and proper incentives are provided. While talking of technology, we should also keep in mind the need for the upgradation of packaging standards. Packaging is an integral part of the product and an important element of success of exports.

3) **Concessional Supply of Intermediate Goods**

A major hindrance to exports is the high costs of basic industrial inputs-steel, metals, plastics, glass, etc. – in the country. The only way to enable our exporters to compete fairly with their counterparts abroad is to ensure that these basic goods are available to everyone-exporters, potential exporters and non-exporters – international prices.

4) **Selectivity in Exports**

In the past we had a tendency to try and export whatever we could produce in excess of our requirements. In that context and particularly in terms of planned effort it was important that we should produce for whatever could find a market. The principle is still valid; but a glance at the range of goods that figure in world imports is sufficient to show that we cannot possibly produce all the goods for which world markets exist. Some additional criteria are, therefore, required to determine what goods India should try to produce for export. India should avoid, to the maximum extent possible, goods that are capital-intensive, energy-intensive or transport-intensive or which use domestically produced inputs that themselves are capital-intensive, energy-intensive or transport-intensive.

There are many industries where India has an advantage because of relatively lower costs of all forms of manpower— whether it is professional or factory labour. However, while this can given an initial advantage, it should not be taken for an enduring advantage. **One**, as products become more sophisticated, labour as a cost factor becomes less and less important. **Two**, the differences in cost are narrowed down through higher levels of automation. **Three**, in processes that require large number of cheap labour, the industry is bound to shift its operation along the line of the ever-declining scale of poorer countries. So a poorer country than Indian can eventually overtake us with yet cheaper labour. Therefore, when one has established an export market on the basis of cheaper manpower, one has to be vigilant to make sure that one builds up other advantages to compensate for the inevitable loss of this temporary advantage.

5) **Expansion of Warehousing Facilities**

Warehousing facilities should be expanded in important commercial centres abroad, specially for fast-moving consumer goods. Nowadays, foreign buyers are reluctant to keep a high level of inventories and want the exporters to do so in order to enable them to buy the product in smaller quantities and at short notice. Although warehousing is an expensive operation, it pays good dividends in the long run and helps establish closer and more stable relations with the market.

6) **Supply of Trade Information**

A well directed foreign trade policy should be based on accurate trade information supported by reliable data. We have yet to conceive of a system by which this can be done. At present trade statistics are based on highly loaded information supplied by the Export Promotion Councils to obtain maximum advantage of duty drawbacks and export subsidies.

7) **Efforts to Widen and Diversity the Markets**

Indian entrepreneurs have to constantly bear in mind the fast changing trade trends and reorient their strategies, to aim at deriving higher yield by way of larger shares in the markets and better unit realisation by way of higher levels of quality and value added products. The three pronged thrust on their part would call for: (a) a relentless attempt at recovering the last ground by wresting a larger share in the world markets for sectors of traditional strength like tea, spices, jute, leather, mica and other miscellaneous agro-based products; (b) a concerted move for maintaining and enhancing the momentum gained by commodities like oil meals, basmati rice, marine products, etc; and (c) a sustained focus being kept on the sectors which have lately fared well-chemicals, engineering components, jewellery, fabrices, handicrafts, and software.

Finally, we have to realise that healthy export sector can be built up only on a strong domestic economic structure. A sound domestic economy is a must if we want a self-sustaining buoyant export sector.

In this context it may be stressed that export promotion and import substitution are neither mutually exclusive nor alternative strategies of development. They represent two sides of the same coin. The factors and policies which would be necessary to bring about an acceleration in export growth would also lead to efficient import substitution: Whether it is a better management of the public sector and an alleviation of infrastructural bottlenecks, on the other hand, or an improvement in the performance of the agricultural sector and a revival of industrial growth, on the other. In other words, the economic determinants of the balance of payments must be related to development at a national level rather than the external sector alone, i.e., the balance of payments prospects should not be considered in isolation from the growth prospects of the economy.

Check Your Progress 4

1) Discuss the need for export promotion in India at this stage of economic development.

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2) Mention the three import measures taken by the Government for promoting exports from India.

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3) What steps we need to take to promote our exports?

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23.9 LET US SUM UP

A developing economy needs more of imports to meet the development requirements of the economy. Since the exports fail to keep pace with the import requirements the deficit is met by foreign borrowings. This has created balance of payments difficulties for India. The ultimate solution to the problem lies in promoting exports on a big scale. This needs a well-formulated strategy.

23.10 KEY WORDS

Balance of Payments: A systematic record of all international economic transactions, visible and invisible, of a country during a year.

Balance of Trade: It is an account of exports and imports of goods only of a country.

Capital Account: Presents transfers of money and other capital items and changes in the country's assets and liabilities resulting from the transactions in the current account

Current Account: It is an annual statement of income of a nation from the rest of the world. It states the net amount receivable or payable on account of transactions in goods and services both.

Current Account Deficit: A situation in which a country's total earnings of foreign exchange fall short of its obligations of foreign exchange during a year.

Concessional aid: Borrowing from an external source on easy terms.

Import Intensity: The ratio of imports in total cost of inputs used in the production of a commodity.

Portfolio Investment: Investment in the purchase of equity shares and debentures, etc.

23.11 SOME USEFUL BOOKS

Reserve Bank of India : Balance of Payments Manual

Reserve Bank of India : Report on Currency and Finance (Annual)

Government of India : Economic Survey (Annual)

Joshi, Vijay & I.M.D. Little : India's Economic Reforms 1991-2001.

23.12 ANSWERS/HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See first para of Section 23.2
2) See Sub-section 23.2.1
3) See Sub-section 23.2.1
4) See last part of Sub-section 23.2.1

Check Your Progress 2

1) See Sub-section 23.4.4
2) Thoroughly read Section 23.5

Check Your Progress 3

1) Read Section 23.6
2) Thoroughly read Section 23.6
3) See Section 23.6

Check Your Progress 4

1) See Sub-section 23.7.1
2) See Sub-section 23.7.2
3) Thoroughly study Section 23.8