CHAPTER: 2

External Sector Policies
2.1: India’s Trade policy: Pre and Post reforms:

2.1.1 Pre Reform scenario:

When India started its economic planning in 1951, the foreign exchange position was comfortable. This was mainly due to the reserve accumulation of Starling balances in London accumulated during the Second World War. Moreover since the plan targets were modest, the need was not felt. But the difficulties started at the end of the First Five Year Plan and became acute at the beginning of the Second Five Year Plan.

In the second Five Year Plan, India adopted the policy of Import- Substitution and Export promotion. Under this policy, India made efforts in two directions. First, people will use goods manufactured in India, instead of importing from abroad. And second, India will also produce those commodities, which were being imported. But this policy created scarcity of consumer goods in the country. And this led to more increase in imports while export increased only marginally due to composition of Indian exports constituted of only primary articles that have an inelastic market.

Despite all these happenings nothing much was done to improve the import situation of the country.

The Import- Export policies were issued every year. It was made a Three Year Export – Import (EXIM) Policy from 1985. But only the first Three Year (1985-88) policy could complete its term. The second one was finally replaced by five-Year EXIM Policy.

In the pre-reform period, import and export was restricted by adopting various policies. The main instruments to control import were: (1) Tariff and (2) Non tariff Barriers (NTBs).

Tariff Barriers were in the form of customs duties and other taxes and charges to influence the imports from a particular country/countries.

NTBs were imposed indirectly to ban, prohibit or slowdown the quantum of imports. NTBs are in the form of:
1) **Quantitative restrictions (QRs):** Govt. can adopt quota system under which it fixes the quantity of imports to be made.

2) **Foreign exchange regulations:** A country can specify the procedures for allocating the foreign exchanges for specific imports.

3) **Technical or administrative regulations:** Here, the importer has to fulfil certain conditions such as labelling, packaging, or description of goods etc.

4) **Consular formalities:** This condition requires the invoices to be certified by their consulates in the exporting country or require import certificates in the language of the importing country.

5) **Miscellaneous Arrangements:** Govt. can import themselves or designate public sector enterprise to effect imports.

Exports was also restricted by imposing various taxes at different levels on the export of commodities.

Various import-export regulations were:

1) **Restrictions on import of capital goods:** 153 items of capital goods, plants, machinery and equipments were not allowed to import. In 1991, about 1400 items of machinery and equipment were on OGL list, allowing only the actual users to import.

    All other imports could be made against a certificate which will be issued by DGTD/Director of Industries, indigenous clearance through advertisement procedure and approval by Capital Goods Committee, on the essential conditions.

    Some capital goods like fertilisers, drugs, power generation etc were allowed to import on global tendering basis.

    For second hand capital goods, all 1400 items were on OGL list. Others were not allowed to import.

2) **Canalised Goods:** According to this scheme, imports could be made through Govt. agencies. There were 53 items, out of which 43 were raw material and 10 were other specified products like drugs, petroleum, fertilizer etc.
3) **High Tariff Duty:** A very high rate of customs duty was imposed to restrict imports. It was as high as 330% in 1990/91.

4) **Restrictions on import of production Goods:** More than 900 items of production goods allowed to import on OGL under actual user and various other conditions. Other production imports like raw materials, components, intermediate goods etc were also imported under several conditions such as Exim scrip, Additional replenishment license etc. Besides this, 800 items of Gems and jewellery, equipment, life saving equipment, drugs etc were importable under OGL.

5) **Administrative measures:** To avoid default in international obligations RBI restricted imports by increasing cash margin requirements and cost of import finance and reducing bank credit.

6) **Input-output norm:** There were about 571 items under input-output norm in 1991-92 policy.

7) **Export incentives:** Various export promotion schemes like replenishment license, Exim-scrips, Special replenishment Licenses, Cash compensatory support, Duty Drawback Scheme etc were introduced from time to time.

2.1.2: **Post-Reform Policies:**

The trend towards liberal trade policy had found its full expression with the announcement of series of trade and industrial policy reforms from 1991. The trade reforms cover the measures that make the trade policy regime more liberal (by reducing govt. control over imports and exports) and incentive framework more neutral (between exportable and importable, between sales to domestic market and sales to import market and between tradable and non tradable), (Nash, Gupta and Purseel, 1994).
The main steps towards trade liberalisation are:
1) Removal of quantitative Restriction on Imports and their replacement by Tariff.
2) Reduction of general level of nominal tariff.
3) Move towards a more uniform tariff structure.

Also, a move towards a more appropriate exchange rate policy is an integral part of trade Policy reforms.

The Main contents of trade policy reforms are:

2.1.2.1 Foreign Exchange Rate Policy:

The exchange rate is a very important macro-economic determinant of a country. In very simple words, exchange rate can be defined as the ratio of prices or values of currencies between two or more countries.

I. Pre Reform Policies:

India’s foreign exchange rate policies have been changing over time. Before 1972, except in the year 1971, Rupee was pegged to Pound Sterling. In 1971, rupee was pegged to dollar for a brief period of time. In 1972, pound sterling itself began to float against other currencies. As a result, rupee also started to float automatically. In 1975, Government of India decided to peg rupee to a basket of currencies which will be adjustable within a band of ±2.25% to the base of Rs 18,3084 per pound. In 1979, the band was broadened to ± 5%. This was made to insulate the economy from short-term fluctuations and allow the government to change the value of nominal exchange rate whenever necessary. Moreover, this system provided some degree of independence to the authority. But, during 1980s, depreciation of rupees started to be used by the government as a tool of trade policy. This resulted in decline of REER. Since, export also declined due to adverse domestic as well as international condition, and import increased, depreciation of REER worsened the trade balance and BOP situation and India headed for BOP crises in 1991.
II. Policy Change Since 1991:

In the year 1991, the first move towards trade policy liberalisation was taken with the devaluation of Indian rupee in two stages on 1\textsuperscript{st} and 3\textsuperscript{rd} July 1991 by about 18% against the basket of 5 major currencies. Simultaneously Exim- Scrip policy was introduced under which certain imports were permitted only against export entitlements. However, exim-scrip scheme was abolished due to operational difficulties and LERMS (Liberalised Exchange Rate Management System) was introduced in 1992. With LERMS, partial convertibility of rupee in the current account was introduced. According to this scheme, all foreign exchange earnings on current account transactions will have to be surrendered to Authorised Dealers (ADs). ADs, in turn, will surrender 40% of foreign exchange earnings to the RBI at official rate and remaining 60% will be converted at market determined rate. After adopting this dual exchange rate policy, due to overall stability of market conditions, government decided to unify the exchange rate. According to market determined unified exchange rate policy, full convertibility of rupee at the trade account was introduced on March 1\textsuperscript{st}, 1993. Now, all the exporters and all other earners can convert their 100% of their earnings at market determined rate. However, there were a number of restrictions existed on the trade of invisible goods. In 1994, the RBI announced full convertibility of rupees on current account with the liberalisation of invisible account and accepted obligations under Article VIII of the IMF, according to which, India committed to forsake the use of exchange rate restrictions on current international transactions as an instrument of managing BOP.

III. Capital Account Convertibility:

In India, though the current account is almost fully convertible, various cautious steps have been taken regarding capital account convertibility. The RBI appointed Capital Account Convertibility Committee under the chairmanship of S.S. Tarapore in 1997. It recommended a phased liberalization of capital account with a $\pm 5\%$ band centred around REER. Such a crawling peg will have the advantage in the form of anchoring expectations,
identification of neutral base and enact lag structure indicating the response of trade flows to REER movements (A. Karmarkar, 2000).

Liberalisation of capital account enables capital account transactions to function independently according to market forces. As a result, financial market of the economy gets integrated with foreign financial markets. Availability of external resources becomes easy. This stimulates growth.

Rupee was already made convertible for investment purposes by NRIs and FIIs. But, we do not have currency convertibility for resident Indians. That is, transfer of capital for overseas assets still needs permission.

In 1997, RBI identified 3 broad areas for taking steps regarding CAC—(1) Money market—reduce minimum period of term deposits, reduce lock-in period for mutual funds, expand Repo market, reduce CRR and SLR and introduce intermediaries in money market. (2) increase the number of primary dealers, enhance their underwriting power, allow FIIs to participate in TBs, impose interest futures in TBs and dated government securities, (3) permit foreign currency denominated bonds to resident Indians, allow FIIs to hedge risks in forward market, introduce derivatives, allow FIIs to act as ADs.

However, CAC movement slowed down due to South East Asian crises in 1997. It was learnt from the crises that certain pre-conditions are necessary for CAC. These are:

1. Macro-economic stability- fiscal deficit should hover around 3-3.5% of GDP and inflation should be reduced to the levels of trading partners.

2. Sustainable foreign exchange reserve of at least $30 million. Current account should be financed by fully long-term capital inflows. Reliance on short-term capital flows should be reduced.

3. Supervising authority should have necessary infrastructure to monitor the liberalisation of financial system more efficiently.

Tarapore committee recommendations regarding CAC and actual attainments can be found out from table 2.1.
Table: 2.1  
Macro-economic Variables influencing CAC decision

<table>
<thead>
<tr>
<th>Macro-economic variables</th>
<th>Actuals: 1998/99</th>
<th>Tarapore norms 1997/00</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Gross Fiscal deficit of the centre and the stated during 1998/99 as % of GDP</td>
<td>8.5</td>
<td>3.5 or less by 1999/00</td>
</tr>
<tr>
<td>2) Inflation rate at the end of March 1999</td>
<td>4.8</td>
<td>3-5%</td>
</tr>
<tr>
<td>3) NPAs as a % of bank’s net advances</td>
<td>7.5</td>
<td>5.0 or less</td>
</tr>
<tr>
<td>4) Foreign currency assets/ currency ratio at the end of March 1999</td>
<td>74%</td>
<td>70% or above</td>
</tr>
<tr>
<td>5) Foreign exchange reserves to cover imports during 1998/99</td>
<td>8.3 months</td>
<td>6 months or above</td>
</tr>
<tr>
<td>6) Foreign exchange reserves/3 month import+ one half of debt service charge during 1998/99</td>
<td>205%</td>
<td>100% or above</td>
</tr>
<tr>
<td>7) Current account deposit/GDP ratio during 1998/00</td>
<td>14.3%</td>
<td>15% or above</td>
</tr>
<tr>
<td>Fluctuation band of REER during 1998/99</td>
<td>Monthly variation in index between 103.88 and 95.86(100=199 3/4)</td>
<td>+-5%</td>
</tr>
<tr>
<td>Short-term debt + portfolio stock/foreign exchange reserves ratio at the end of march 1999</td>
<td>60.93%</td>
<td>60% or less</td>
</tr>
</tbody>
</table>

Sources: (1) RBI (1999), Annual Report 1998/00, Mumbai  
(2) RBI (1999), Report of the committee on capital account  
(3) RBI (1997), Report of the Committee on Capital Account Convertibility (Tarapore Committee), Mumbai
Therefore, we have seen that some factors are achieved for CAC. But some are still to be achieved.

IV. FERA to FEMA:

Another step towards exchange rate policy was the introduction of Foreign Exchange Management Act, 1999 which replaced Foreign Exchange Regulation Act, 1973. Therefore, at present, economic scenario FERA has become outdated. FERA laws controlled foreign exchange transactions due to shortage of foreign exchange at that time. FEMA is a complete departure due to comfortable foreign exchange position of the country. It aims to facilitate external trade and payments and promote the orderly development and maintenance of foreign exchange market in India.

FEMA removes restrictions on current account transactions. However, central government will have the authority in exchange market whenever necessary. For capital account, gradual and cautious steps will be taken regarding liberalisation.

However, ‘criminal action’ will not be taken against foreign exchange offenders as it was done in FERA regime.

Therefore, FEMA will enable the foreign exchange market to operate freely and efficiently.

2.1.2.2 Other Trade Policy Reforms:

1) Introduction of Negative List: A new negative list was introduced which contains the name of those goods, whose imports and exports are prohibited, restricted through licensing or subject to canalisation.

This list was pruned from time to time.

2) Export Promotion of Capital Goods (EPCG) Scheme: Under this scheme, capital goods (including spare parts up to 20% of CIF value of capital goods) can be imported with a license at a concessional rate of customs duty subject to an export obligation to be fulfilled within a period of time as per given below:
Table: 2.2

Rates on EPCG Scheme

<table>
<thead>
<tr>
<th>Customs duty</th>
<th>Export obligation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FOB basis</td>
</tr>
<tr>
<td>1) 10%</td>
<td>4times CIF value</td>
</tr>
<tr>
<td></td>
<td>of capital goods.</td>
</tr>
<tr>
<td>2) 0 duty (in case CIF</td>
<td>6 Times CIF value</td>
</tr>
<tr>
<td></td>
<td>value of Rs 20 crores</td>
</tr>
<tr>
<td></td>
<td>and more)</td>
</tr>
<tr>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

However the import of capital goods under this scheme is subjected to Actual User Condition till the export obligations are completed. Both new and second hand capital goods can be imported under this scheme.

The EPCG scheme has been extended to service sector which enables the import of capital goods for rendering services for which payment are received in fully convertible currency.

In 1994, the power to grant EPCG scheme was decentralised.

To avail the benefit of EPCG scheme, the definition of capital goods has been widened to include capital goods used in agriculture, mining and services.

During 1994/95, the threshold limit for 0% duty EPCG scheme was reduced from CIF value of Rs 5 crores to Rs 1 crore and above. Apart from agriculture sector, this policy will also be available to electronics, food processing, garments, leather, sport goods and gems and jewellery. A new 0% duty scheme was specially introduced to software industry with a threshold limit of Rs 10 Lakh.

Under recent modification, if the license used under 0% duty scheme was actually been utilised for import of a value in access of or less than 10% of CIF value of the license, enhancement or reduction in licensed amount and export obligation under it would be automatic. Exporters will also have the option of adding further value to these goods before exporting them. However, here export obligations shall stand enhanced by 50%.

In 1999/2000, 0% duty scheme was extended to chemicals and textiles.

However, no additional customs duty was imposed for the export of capital goods for marine and software sector.
(2) **Duty Exemption Scheme (DES):** Under DES, imported raw materials and components required as inputs for export production are made available to registered exporters in advance of the execution of the export order and that too free of customs duty under the following licenses- (1) Quantity based advance license, (2) Value based advance license, (3) Advance intermediate license, (4) Special Imprest license and (5) Advance customs clearance permit.

Maximum value addition under Customs Clearance Permit has been reduced to 10%. A new Duty Entitlement Pass-Book (DEPB) Scheme has been initiated under which an exporter shall be eligible to claim credit as a specified percentage of FOB value of export made in freely convertible currency at a rate specified by DGFT. Any item except those in the negative list will be allowed to import without payment of basic customs duty/special customs duty and additional customs duty. Under DEPB Scheme, third party can also import.

In 1999-2000, The DES was made more flexible. Annual Advance License System was introduced to take care of the whole import need of the exporters. Other facilities include-issuance of license where norms are not fixed or on the basis of self-certifications.

4) **100% Export Oriented Units (EOU)/ Export Processing Zones (EPZ)/ Free Trade Zones (FTZ)/ Special Economic Zones (SEZ):**

(a) **100% EOUs:** 100% EOUs means as industrial units offering for export of its entire production, excluding rejects and items otherwise specifically permitted to be supplied to the Domestic tariff area (DTA). Such units may be set up in EOUs which are engaged in manufacture, production of software, agriculture, aquaculture, horticulture, pisciculture, viticulture, sericulture, animal husbandry and poultry. Units engaged in services are also considered on merits.

The policy of 100% EOUs was introduced to increase the production capacity of exports for providing an appropriate policy framework and other incentives. The units can import various input free of customs duty and if produced domestically, free of excise duty also.

(b) **EPZ/FTZ:** These zones are set up as enclaves separated from DTAs by physical barriers are intended to provide an internationally competitive duty free environment for export
production at low costs. These zones provide basic infrastructural facilities to the exporters and also fiscal incentives.

EOUs/EPZ units engaged in agriculture and allied sectors can sell 50% of their production in value terms in DTA without any stipulation for value addition and have only to ensure positive net foreign exchange earnings. The period of bonding for units under EOU scheme has been reduced from 10 years to 5 years extendable to products requiring significant capital investment and infrastructural support.

C) Export Houses (EH)/Trading Houses (TH)/Star trading Houses (STH)/Super Star trading Houses (SSTH):

Merchant and manufacturer exporters and trading companies including those having foreign equity, EOU units and units located in EPZs/ EHTPs have been recognised as EH/TH/STH/SSTH under the criteria laid to them from time to time.

The criteria for recognition for EH/TH/STH/SSTH will be either on FOB value or on NFE earned on physical exports or export of services during the last three licensing years or preceding licensing year whichever necessary. For SSTHs, export of at least minimum three product groups is necessary.

Table: 2.3

<table>
<thead>
<tr>
<th>Criteria for recognition of EHs/THs/STHs/SSTHs</th>
<th>FOB (Rs Crores)</th>
<th>NFE (Rs Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Av.FOB value</td>
<td>Av.FOB value</td>
</tr>
<tr>
<td></td>
<td>during 3</td>
<td>during preceding</td>
</tr>
<tr>
<td></td>
<td>preceding yrs</td>
<td>licensing yr</td>
</tr>
<tr>
<td></td>
<td>Av.NFE value</td>
<td>Av.NFE value</td>
</tr>
<tr>
<td></td>
<td>during 3</td>
<td>during preceding</td>
</tr>
<tr>
<td></td>
<td>preceding yrs</td>
<td>licensing yr</td>
</tr>
<tr>
<td>EHs</td>
<td>12.5</td>
<td>18.75</td>
</tr>
<tr>
<td>THs</td>
<td>62.5</td>
<td>93.75</td>
</tr>
<tr>
<td>STHs</td>
<td>312.5</td>
<td>468.75</td>
</tr>
<tr>
<td>SSTHs</td>
<td>925.5</td>
<td>1387.5</td>
</tr>
</tbody>
</table>

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Exports by state govts and union territories are also encouraged. The Special Import License (SIL) entitlements for EHs/THs/STHs/SSTHs are as follow:

**Table: 2.4**

<table>
<thead>
<tr>
<th></th>
<th>Entitlement rate on FOB basis</th>
<th>Entitlement rate on NFE basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>EHs</td>
<td>6%</td>
<td>7.5%</td>
</tr>
<tr>
<td>THs</td>
<td>8%</td>
<td>10%</td>
</tr>
<tr>
<td>STHs</td>
<td>10%</td>
<td>12%</td>
</tr>
<tr>
<td>SSTHs</td>
<td>12%</td>
<td>15%</td>
</tr>
</tbody>
</table>

**d) Special Economic Zones (SEZ):** SEZ is a specifically created duty free enclave and shall be deemed to be foreign territory for the purpose of trade operations and duties and tariffs. Goods going to the SEZ area from DTA area will be treated as deemed export and goods coming from it will be treated as imports.

The government also decided to set up Agriculture Export Zones.

**5) Software technology Parks (STPs)/Electronic Hardware Technology Parks (EHTPs):**

**a) STPs:** In view of noteworthy development and immense potential shown by Indian software industry, Govt. prepared software promotion scheme wherein in certain earmarked areas requisite satellite communication system between Indian entrepreneurs and overseas buyers will be provided by Overseas Communication Service who will also control and supervise the transmissions to and fro through the satellite medium. These earmarked areas are termed as Software Export Technology Parks/Complexes.
The STPs do not require import licenses for the import of equipment. All the imports are duty free.

(b) EHTPs: To build up a strong electronic industry, to enhance the import potential of the country and to develop efficient electronic component industry, Govt. decides to set up EHTPs.

i) An EHTP may import all types of goods including capital goods duty free, provided they are not prohibited items.

ii) The entire production of EHTPs will be exported to hard currency area except for the DTAs under certain norms.

EHTP shall also be eligible for the following benefits:

1) They will be exempted from Corporate Income Tax for a block of 5 years for first 8 years of its production.

2) NFE earned by EHTPs can be clubbed with NFE of its parent/associate company in the DTA for the purpose of according the EH/TH/STH/SSTH status to the later.

3) Foreign equity up to 100% is permitted to EHTP units.

6) Tariff Reduction:

The need for tariff rationalisation was given importance in Long-Term Fiscal Policy Statement of the govt in 1985. It found that the existing tariff rate is very high, complicated and growth preventing. But the recommendations were never implemented comprehensively. Government appointed Taxation Reforms committee in 1999, in order to make fiscal policy more effective. The committee recommended that-(1) general level of tariff should be reduced, (2) Tariff system should be simplified, (3) Rationalisation of tariff rates along with abolition of exemptions and concessions and (4) abolition of practice of making policy changes through negotiation. Accordingly there has been phased reduction of tariff rates.
In 1992, the peak level of import duties was reduced to 110% with the exception of passenger baggage and alcoholic beverages. The duty on project imports and electronics was reduced to 55% and 50% respectively from 80%. Capital goods for projects of coal mining and crude petroleum industry were reduced to 30%.

The Finance Act, 1993, simplified import tariff by merging auxiliary duty with basic duty and reduced maximum rate of import duty further 85% and in 1994 it climbed down to 65%. This process was continued to reduce to 50% in 1995, 40% in 1998 and further to 35% in 2001.

Moreover 7 major ad-valorem rates of customs duty were reduced to 5 basic rates. At present there are four customs duties rate structures exist. They are- 35%, 25%, 15% and 5%.

Though the imposition of export duty can discourage the export of the particular product, it can be a source of revenue if the country has comparatively stronger place in the export market. But the share of export duties has significantly declined over the years. The reduction of export duty was to encourage the exporters to export to the international market. At present, export duties are levied on a few commodities such as coffee, mica, black pepper, hides and skins and leather.

(7) **Deemed Export:** Deemed export means those transactions, in which the goods supplied do not leave the country and the suppliers in India receive payments for the goods. According to the new EXIM Policy, duty free license holders can use the inputs from local manufacturers instead of importing with the advantage of deemed export benefits. The domestic manufacturers are made eligible for the deemed export benefit such as Special Imprest License /Advance Intermediate License or Deemed Export Drawback Scheme in respect of supply to 0% Duty EPCG license holders and 100% EPCG license holders. Deemed Export benefit of refund of terminal Excise Duty and SIL at the rate of 6% of FOB value would also be available to such supplies against both 10% and zero duty EPCG scheme.
(8) **Duty Drawback Scheme (DDS):** Under DDS exporter of products get the relief of customs and excise duties paid on materials and components used at various stages of production.

Keeping in view the immediate need to boost the export, special care has been taken to add as many new items as possible in this scheme and improve the existing rates to enable the exporters to compete in the international market.

(9) **Diamond, Gems And Jewellery Export Promotion Scheme:** The norms for import of rough diamond have been simplified. Exporters of gold/silver/platinum jewellery and articles thereof may import their inputs directly or free from MMTC/STC/Handicrafts and Handloom Export Corporation, SBI and any agency authorised by the RBI. Under Gems and Jewellery Replenishment Scheme, exports through third party can also be made.

(10) **Quality Control, Pre-Shipment Inspection, Iso-9000/Bis-14000:** Under Export Quality Control and Inspections Act, 1963, many items have to go through pre-shipment inspection. However the number of items exempted from this has been increased and they will have to take responsibility to supply high quality export products.

International Standard Organisation evolved ISO-9000 with the association of EEC to ensure high quality of exported goods. It identifies basic principles underlying qualities and specifies procedures and criteria to be followed to ensure to meet the customers demand.

BIS-14000 is a devise by Bureau Of Indian Standards which is equivalent to ISO-9000 series of standards of quality system to gain competitive edge in domestic as well as international markets.

Govt. has decided to award those who obtained ISO/BIS series certificates or any other internationally acclaimed certificate.

(11) **Special Import License (SIL) Benefits:** Any exporter other than EH/TH/STH/ SSTH who has directly exported goods and services including software but excluding deemed exports of FOB value of Rs 5 crore and above in the preceding licensing year or an average
FOB value of Rs 2 crores and above during the three licensing years have been made eligible for the grant of SIL at a rate of 4% of FOB value of such direct exports made on or after 1st April 1996. The export of diamond, gems and jewellery will be at 50% of actual FOB value of exports.

For small-scale exporters holding ISO-9000/BIS-1400 certificates of exports will be Rs 3 Crore and above in the preceding year or Rs 1 Crore and above in the preceding three licensing years.

Third party exporters will also be granted SIL.

(12) **Export/Import Credit:** The new EXIM Policy will ensure availability of timely and adequate credit at a reasonable rate of interest. The interest on pre-shipment Rupee export credit up-to 180 days and 270 days have been declined to 12% and 14% respectively. And interest on Post-Shipment rupee export for 90 days and 180 days have been declined to 11% and 13% respectively. Scheduled commercial banks have been provided with export reference to the extent of 100% of their increase in outstanding export credit. Under EEFC account, corporate exporters can grant trade related advance up to $3 million to their importer clients out of their EEFC account.

Export credit insurance seeks to create a favourable climate to the exporters to get timely and liberal credit facilities from the banks at home. Govt. introduced Export Credit Guarantee Corporation (ECGC) in 1964, which provides guarantee to the banks to protect them from the risk of loss inherent in granting in various types of finance to the exporters.

(13) **Export By Small Scale Industrial Sector:** Manufacturers of items in SSI sector can increase their capacity by investing in plant and equipment beyond Rs 75 Lakhs provided they export 75% of their actual production.

(14) **Availing Tax Exemptions/Deductions Under Income Tax Act:** Various tax exemptions are provided to exporters and importers. A resident Indian company or a non-corporate tax payer deriving any profits or gains from business by execution of a project
under contract entered by him or any other person with foreign Govt. is entitled to a
deduction of 50% of such profits or gains, subject to certain conditions.

2.2 **Foreign Investment Policies:**

Foreign investment policies can take the form of –

1) Non – Resident Bank Account/ Deposit schemes, and
2) Portfolio investment.

Under non resident bank account/ deposit schemes, Indian nationals or NRIs can
open bank accounts in India freely out of funds remitted from abroad or foreign exchange
brought from abroad or out of funds legitimately due to them in India. RBI has granted
permission to banks in India who are authorised to deal foreign exchange to open such
accounts freely. There are five types of such non-resident accounts which can be maintained
by Ads. They are-

(1) Foreign Currency Non- Resident (Accounts) [FCNR (A)]
(2) Foreign Currency Non- Resident (Banks)[FCNR (B)]
(3) Non- Resident (External) Rupee Accounts [NR (E) RA]
(4) Non- Resident (Non Repatriable) Rupee Deposit Account [NR (NR) RD]
(5) Foreign Currency (Banks and Others) Deposits [FC (B&O) D]

Foreign Direct Investment (FDI) refers to the direct investment by foreign
investors in various plants, projects etc. FDI flow can be through-

(a) RBI automatic route,
(b) Secretariat for Industrial Approval (SIA) / Foreign Investment Promotion Board (FIPB)
route and
(c) NRIs (41% and 100% schemes)

Portfolio investment takes the form of participation of investors in equity,
shares and bonds of Indian companies through primary and secondary market. Portfolio
Investment can be through –

(a) Foreign Institutional Investors (FII)
(b) Euro equities, and
(c) Off- shore funds.
Government has made significant changes in foreign investment policies since 1991.

Since foreign investment is associated with technology transfer, marketing expertise, introduction of modern managerial technique and new policies for promotion of exports, government decided to allow foreign investments to play an important role in the industrial development of the country. Major foreign investment policies since 1991 are discussed below.

(1) In 1991, government announced a specific list of high technology and high -investment priority industries (listed in annex-III), where automatic permission will be given up-to 51% to foreign direct investors. Importance will be given to trading companies engaged in export activities in this regard. Moreover, high priorities industries will get automatic permission for foreign technology agreements under certain conditions.

The industries in which automatic approval has been granted include a wide range of industrial activities in the capital goods and metallurgical industries; entertainment, electronics, food processing and services sector having significant export potential.

(2) To negotiate with large number of international firms and approve direct foreign investment in selected areas, a special Empowerment Board was established.

(3) In 1991/92, government decided to allow foreign private equity participation up-to 26% in development and discovery of oil fields.

(4) In 1993/94, new guidelines were issued to foreign investors to increase their shares up-to 51% in Indian company of high priority under automatic approval scheme for foreign investment.

According to SEBI, existing companies can raise foreign equity at a price decided by share-holders in a special resolution.

In order to reduce discrimination against some shareholders, to increase the flow of foreign investment and to have a market related investment, government decided that potential allotment of shares would be at the market related price for all foreign investment proposals.

(5) Except for 22 consumer goods industries, the earlier stipulation of dividend remittance of companies receiving approval under foreign equity up-to 51% scheme must be balanced by
export earnings over a period of 7 years has been discontinued for all foreign direct investment by non-NRIs/NRIs and OCBs.

(6) (a) FIIIs can now invest in all securities traded in the primary and secondary markets.

(b) Portfolio investment in primary and secondary markets will have a ceiling of 24% of issued share capital for the total holding of all registered FIIIs, in any company. The holding of a single FII in any company will have a ceiling of 55% of all total issued capital.

(c) The maximum holding of 24% for all non-resident portfolio investors also include NRI corporate and non-corporate investment excluding FDI in high priority industries under 51% equity scheme and investments by financial institutions through alternative routes of offshore single/regional funds, GDR and Euro-convertibles.

(d) FIIIs investing under this scheme will get the benefit of concessional flat tax rate of 20% of dividend and investment income and a tax rate of 10% on long-term capital gains.

(e) NRIs/OCBs will get automatic approval by RBI to invest with full repatriation benefit up-to 100% in the issue of capital and convertible debentures of a private/public limited company engaged in high priority industries with some conditions.

(7) To avoid the difference of RBI/GOI guidelines and that of SEBI in issuing shares to non-residents, government decided that every preferential allotment of shares by listed companies to foreign investors will be at market price of the shares.

From 1995/96, foreign investors can discount equity shares through stock-exchanges in India.

(8) To make portfolio investment more attractive, NRIs and OCBs will be allowed to acquire shares/debentures of Indian companies through stock exchanges in India up-to 24% of total paid-up capital of a company and 24% of the total paid-up value of each series of convertible debentures issued by a company.

(9) From 1991, NRIs can make 100% investment in EOUs, in power generation sectors and also in sick units.

NRIs can also now invest up-to 100% on repatriation basis in any partnership/proprietorship concern or in any public/private companies without taking prior approval from the RBI.

In 1994/95, various steps were undertaken to attract funds from NRIs in the form of deposits and foreign investment. They are-
a) RBI decided to allow NRIs, FIIIs, and OCBs to invest on repatriation basis, in all activities, except agriculture and plantation activities under certain conditions. Accordingly, Indian companies will be able to issue equity shares/convertible debentures on repatriation basis to NRIs/OCBs and FIIIs provided the shares/convertible debentures do not exceed 24% of the new issue.

b) NRIs/OCBs can purchase the shares of public sector enterprises disinvested by the central government on repatriation basis under some conditions.

c) NRIs resided in Nepal will be allowed to invest in India if the funds are remitted in free foreign exchange through proper banking channel.

(10) From 1995/95, NRIs/OCBs were allowed to sell/transfer shares/bonds/debentures of Indian companies acquired with repatriation benefits through stock exchanges under portfolio investment scheme.

(11) NRIs can also invest funds on repatriation basis on Money Market Mutual Funds floated by commercial banks and other financial institutions.

(12) In 1995/96, incremental deposits under NR(E)RA and NR(NR)RD scheme was exempted from CRR norms. CRR on outstanding deposits under FCNR (B) and NR (E) RA lowered to 7.5% and 10% respectively. SLR on outstanding liabilities under NR (E) RA scheme was reduced to 25% and the interest rate on NR (E) RA term deposits of over two years freed.

(13) Government has set up a bureau called Interface to NRI Scientists and Technocrats (INRIST) to bring NRI scientists, technocrats and Indian industries together.

An “Investment Promotion and Project Monitoring Cell” was also set up in 1991/92 in the Department of Industrial Development to look after pre and post investment scenario in different industrial approvals and other services.

(14) In 1996/97, RBI took measures to facilitate the A Ds to expediously credit the amount of dividend/interest to NR (E) RA account of NRI investors.

ADs were also permitted to use FCNR (B) funds to lend to their resident constituents for meeting their foreign exchange and rupee needs.

(15) From 1995/96, A Ds were allowed to retain foreign equity participation cap as prescribed and restrictions on the number of issues to be made was also removed.
From 1991/92, foreign citizens of Indian origin were allowed to acquire/hold and transfer by sale or inheritance, residential properties situated in India with some conditions.

In 1992/93, the tax rate on short-term capital gains on portfolio investment schemes by FIs was reduced from 65% to 30%.

In 1994/95, Government decided that private sectors will be allowed in Basic Telecom Services and joint ventures between India and foreign companies under National Telecom Policies 1994, with the condition of maximum 49% equity participation by foreign company.

In 1995/96, guidelines for Euro Issues were revised to permit Indian companies to retain issue proceeds as foreign currency deposits with banks and public financial institutions in India. To enable the inflow of funds raised under GDR, companies were permitted to remit funds in India in anticipation of the use of funds for approved purposes.

Also, the Euro Issue companies were allowed to retain the foreign equity participation cap as prescribed and restrictions on number of issues to be made were removed.

The NRIs/OCBs can invest with full repatriation benefit in equity issue of a private/public limited company engaged in high priority industries. Automatic approval by RBI will be granted if (a) the NRI equity covers the foreign exchange requirement for import of capital goods and new plant and machinery, (b) outflow due to dividend payment is balanced by export earnings of items covered in Annex-III over a period of 7 years from starting of commercial production.

RBI decided to permit, on a near automatic basis, the proposals for transfer/sale of shares for disinvestments. RBI also permits disinvestments proposals where foreign investors want to sell their shares not through a stock-exchange, but on a private basis to another non-resident.

The ceiling for the use of GDR funds for working capital was raised to 25% from 15% and track record requirement for infrastructure industries was abolished.

In August 1999, Foreign Investment Implementation Authority was set up to ensure that approval of foreign investment (including of NRI investment) is quickly translated into actual flow and that proposals fructify into actual practice.
(24) Also from 1999, mutual funds will be able to issue units to NRI/OCBs subject to certain norms. Also, RBI has simplified approval procedures to PIOs by granting them general permission.

(25) In order to ease restrictions on investments by FIIIs in debt instruments, the government of India decided to allow FIIIs to invest up to 100% of their funds on debt instruments in Indian companies through 100% dedicated debt funds. They can also invest in Government of India securities up to 30%.

Moreover, the policies regarding India investment abroad also eased with certain conditions like track record of minimum 3 years, registration with SEBI as category-I merchant banker or with RBI as NBFI etc.

(26) From 1997/98 FDI were allowed to 16 non-banking services like merchant banking, underwriting, portfolio management etc through FIPB under certain conditions.

Moreover, for FDIs under ‘automatic route’ the RBI discontinued the need of its prior approval.

Foreign banks operating in India will be able to remit their profits/surpluses to their head offices without the approval of the RBI.

(27) In Feb. 2000, government decided to place all items under automatic route for FDI/NRI/OCB investment except for a small negative list.

2.3 External Commercial Borrowing:

India had to rely heavily on External Commercial Borrowing (ECB) to meet the balance of payment (BOP) deficits in the 1980s as there was increasing shortage of concessional assistance. But, during 1990/91, access to ECB too became difficult because of perceptions of lenders abroad about India’s polity and economics. The government appointed C. Rangarajan Committee to assess the policies of external sector. According to the Committee, commercial borrowing with a maturity period of less than 5 years should not be encouraged and it favoured a cautious approach to public generating of ECB.
Over the years, the policy towards ECB was carefully calibrated to ensure that total external indebtedness remains within prudent level. Moreover, steps were taken to ensure that infrastructural facilities get most of the benefits.

In order to facilitate Indian corporates to raise their funds from abroad to incur rupee expenditure, India corporates and institutions will be allowed to utilise foreign currency proceeds up-to $ 3 million or equivalent with a minimum of three years of simple maturity. Indian companies will be allowed to raise FCCBs with the non-converted portion having an average tenure of minimum 5 years effective from Nov. 25 1995.

Onlending of ECB proceedings for development financial institutions will be permitted at different maturities and the onlendings can be used for project related rupee expenditure. To encourage the flow of funds to real sector, Indian Development Financial Institutions and corporates engaged in infrastructure projects in telecommunication, oil exploration and other development sectors, the minimum average maturity requirement for ECB of more than $15 million was reduced to 5 years. Infrastructure projects in telecommunication and railway sector, the entire ECB can be utilised for project related rupee expenditure. All infrastructure and green-field projects can avail ECB to the extent of 35% of their total project costs. All exporters, 100% EOUs and EPCG holders can raise ECB up-to maximum $15 million equivalent or average amount of export earnings of the previous 3 years, whichever is lower, for meeting project related rupee expenditure with an average maturity of at least 3 years.

At present the government approves ECB up to $50 million including refinancing of existing ECBs. Govt also delegates sanctioning power of ECBs up to $ 100 millions to RBI.

2.4 Short Term Debt:

The government continuously tries to reduce reliance on short term debt. Policy regarding short term debt highlights the fact that:

1. Restricting the quantity of short term debt to manageable limits,
2. Strictly monitoring such liability,
3. Allowing short-term debt transactions only for import purposes,
(4) A minimum maturity of one year should be fixed for foreign currency denominated non resident debts,
(5) Discouraging roll-over of short term liabilities beyond six months.

2.5 External Assistance:

India has been the recipient of biggest amount of external assistance for development purposes over the years. During 1990/91 external assistance increased substantially due to 'exceptional finance' for BOP support. Under this measure, $66 billion was provided by Germany, $295 million by Japan, $125 million by ADB and $455 billion by the World Bank as Structural Adjustment Loan. However, availability of external assistance declined from 1991/92. It was mainly due to decline of IDA assistance in the World Bank's lending profile as well as shortening of maturity period of IDA lending since 1987. Government undertook several measures to increase aid utilisation which includes waiver of DGTD clearance for the import of capital goods under all externally aided projects, increase of additional assistance to the states to 100% for social sector projects, formation of standard bid documents and simplification of other procedures.

Other measures to increase utilisation of external debt are advance clearance of funds to the state government, disintermediation of loans to central public sector units, streamlining procedures relating to award of contracts and procurements as suggested by the high level task force, setting up of a Project Management Unit in the Department of Economic Affairs to strengthen project monitoring and supervision and several other measures for portfolio rationalisation.

Aid India Consortium was converted into the India Development Fund and private investors were invited to participate in the meeting of IDF reflecting the growing importance of private foreign investment in international capital flows. However, it was decided to reduce dependence on external assistance.
2.6 **External Debt:**

India’s external liabilities consisting of multilateral and bilateral assistance, commercial borrowing and non-resident deposits have been increasing over the years. This was basically resulted from the growing need for financing the widening current account deficits. During the Seventh Five Year Plan, commercial borrowing, non-resident deposits and external assistance played equi-proportional roles in meeting the financial requirement of the country. But, after the economic crises it was realised that such financing pattern is unsustainable. Therefore, the government started to provide incentives to reduce volatility, to initiate borrowing programme based on cost considerations and to eliminate various risk elements involved in the borrowing programmes.

Due to lowering of credit rating, commercial borrowing was reorganised in terms of cost and maturity structure. There was also some efforts made to reduce dependence on short term debts. According to High Level Committee on BOP, these efforts will lengthen the maturity of external commercial borrowing restore the balance between commercial and non-commercial borrowing and ensure that pre-emption of current receipts by debt servicing is not unsustainable.

From 1992, Government decided to keep a close watch on building up of external debt to ensure that it remains within negotiable level. Therefore, government decided to stop the use of short-term debt as an instrument of protecting the foreign exchange reserves.

Government set up a Task Force and Policy Group on External Debt Statistics whose recommendations were published in 1992/93 about the stabilisation on collection and computation of external debt statistics and their monitoring as a debt unit for external sector. The recommendations in short are:

1. Extension of coverage and reclassification of external debt for transparency and in conformity with internationally accepted definitions.
2. Regular report on external debt position.
3. A review of existing policies regarding confidentiality of defence debt
4. Setting up of Debt Unit for External Sector (DUES) as an apex body to integrate debt date and as a Management Information System to aid decision-making.
Government adopted a multi pronged strategy for external debt. Principal elements are:

1. Continuation of annual cap, minimum maturity restrictions and prioritising the use of ECBs,
2. LIBOR based ceilings on interest rates and minimum maturity requirements on foreign currency denominated NRI deposits to discourage hot money,
3. Decrease short term debt together with controls to prevent its undue expansion in future,
4. Retiring/ refinancing of more expensive external debts,
5. Measures to encourage non- debt creating financial flows,
6. Incentives and schemes to promote exports and other current receipts,
7. Conscious build up of foreign exchange reserves to provide insurance against external sector uncertainties.

2.7. Conclusion:

If we compare the policies adopted before 1991 and after, we find that before 1991, the policies were rather restrictive. Exchange rate was kept artificially at a higher rate and foreign trade and payment policies were biased against exports. To finance large export-import gap, various types of external borrowing were taken.

There has been a large-scale changes taken place since then. All the external policies are carried out in a co-ordinated manner to liberalise imports and exports, encourage the inflow of foreign capital in the form of FDI and portfolio investment. For exchange rate, there has been a transition from basket pegged to unified and market determined system. The policies also emphasise in the reduction of reliance on debt creating flows, especially short-term debts. For NRI deposits, though they are encouraged to invest recently, still they are considered as ‘fair weather friend’.