

FIEO Chief prescribes pill for economic recovery



Mr Rafeeqe Ahmed, President, FIEO (centre) addressing the Forum of Financial Writers. On his right is Mr Harvir Panwar, President, Forum of Financial Writers; and on his left is Mr Ajay Sahai, DG&CEO, FIEO.

1. Increasing trade deficit – 10 per cent of GDP in the last financial year as against around 3 per cent even during the balance of payments crisis period of 1991-92.

The IMF in its Asia Economic Outlook dated April 27, 2012 forecasts that regional growth will be 6 percent this year, roughly the same level as in 2011, and about 6½ percent in 2013. But there remains considerable regional variation. While emerging Asia will remain the fastest growing region in the world, led by China and India, expanding at 6.9 percent this year, industrial Asia is projected to grow only at 2.2 percent. In particular, a sharp fall in exports to advanced economies and a reversal of foreign capital flows would severely impact activity in the region. This, the report states, would be due to financial turmoil in Europe which would escalate and spread to Asia.

In spite of the slowdown in the advanced economies, the exports in 2011-12 exceeded targets and the strategies of product and market diversification advocated by

the Ministry of Commerce have paid sound dividends. However, the March data has shown ominous signs of decline in exports. In fact, looking at the export data in the first half of fiscal shows an average growth of 40% (\$155.1 billion in April-Sept 2011 over \$108.5 billion in April-Sept 2010) and the remaining part at around 10% (\$148.6 billion in Oct-March 2012 over \$142.6 billion in Oct-March 2011) showing that a slowdown started much before it became evident i.e. in March 2012.

The first nine months of 2011-12 saw a rise in the trade deficit to \$132.3 billion – over \$43 billion in every quarter on an average. But trade deficit for the full year rose to \$184.92 billion, which means over \$48 billion in every three months on an average. It means trade deficit rose in the last three months and stood at 10 per cent of GDP in the last financial year as against around 3 per cent even in the balance of payments crisis period of 1991-92. This is a cause of concern and the Government of India may need to make an assessment of the reasons thereof. A trade deficit of more than 8 per cent of GDP and CAD of

more than 3 percent is a sign of growing imbalance in the country's balance of payments. There is scope therefore to discourage unproductive imports like gold and consumer goods to restore balance.

2. Declining export credit to MSME export sector

According to the Institute of International Finance (IIF) in the second half of September 2011, banks domiciled in emerging market economies continued to experience tight bank-lending conditions. The overall index of bank-lending conditions dipped to its weakest ever level in Q3 (third quarter) 2011. There has thus been a significant deterioration in emerging market bank-lending conditions over the three quarters of 2011, during which time the overall index has moved from its strongest to its weakest level.

The most significant deterioration has occurred in funding conditions facing banks in emerging economies. While local funding conditions are broadly unchanged over Q3, funding conditions in international markets have deteriorated significantly, and across all major regions. This is clear evidence of a spillover to emerging economies from the growing problems in mature economies – most notably, the challenges resulting from the severe debt problems in the euro area.

As a result, export credit growth has decelerated to 8.4 percent in 2011-12 (up to 30 December 2011) over end March 2011 as against 22.2 percent growth in the full financial year (FY) 2010-11. Export credit as a per cent of Net Bank Credit (NBC) has been decelerating over the years and accounted for only 4.2 percent as on 30th December, 2011 compared to the 9.8 percent as on 24th March 2000.

Liberal export credit at internationally comparable rates of interest would be a basic pre-requisite. However, presently the cost of credit with 13 policy hikes since March 2010 till January exceeds 12% whereas benchmark rates in most countries is in the range of 2 to 6% as per table on right.

The Government should provide comparative rate of credit to exporters so as to provide them level playing field. Export credit should be pegged at 7% so as to ensure competitiveness of exports. For ensuring the same, the Government should provide interest subvention to bridge the differential with effect from 1st April, 2012 for all sectors of exports.

3. Deregulation of Pre-Post Shipment Credit in Foreign Currency

The Reserve Bank of India has deregulated the export credit interest rate in foreign currency with effect from 5th May 2012 basically to soften the depreciation of the rupee. However, this is likely to increase the cost of credit

as hitherto banks were to lend to exporters at interest rates which was not exceed LIBOR +350 basis points. The freeing of export credit in the rupee has led to over 40% increase in rupee credit and we apprehend the same trend in PCFC interest rates. Moreover, Banks would prefer to give credit to corporates, who are a safe bet as compared to MSME exporters. MSME exporters will be at the mercy of banks while simultaneously paying higher interest cost. The RBI should ensure enough availability of dollars for export credit and see that de-regulation should not result in hike in interest rates.

4. Containing Rupee volatility

The rupee fell to below 53 to a dollar, the lowest in the last 4 months and showed high volatility. A year ago, for example, the rupee was Rs 44.5 to a dollar and had appreciated 13% from the preceding 13 months and Rs 54 to a dollar between August of last year and mid December of last year showing 21% depreciation indicate the range of volatility which is due to speculative portfolio inflows and bound to impact the MSME export sector.

A March 2011 study of the RBI indicated that currency volatility had increased after the introduction of futures trading and the susceptibility / vulnerability of the rupee to foreign speculative investors deciding that both the In-

Country	Latest	2011
China	6.56	6.56
Indonesia	5.75	6.00
Turkey	5.75	5.75
South Africa	5.50	5.50
Chile	5.00	5.25
Iceland	5.00	4.75
Mexico	4.50	4.50
Poland	4.50	4.50
Philippines	4.00	4.50
Australia	3.75	4.25
South Korea	3.25	3.25
Malaysia	3.00	3.00
Thailand	3.00	3.25
Israel	2.50	2.75
New Zealand	2.50	2.50
Saudi Arabia	2.00	2.00
Taiwan	1.88	1.88
Sweden	1.50	1.75
Canada	1.00	1.00
Euro Area	1.00	1.00
United Arab Emirates	1.00	1.00
Czech Republic	0.75	0.75
Denmark	0.70	0.70
Hong Kong	0.50	0.50
United Kingdom	0.50	0.50
United States	0.25	0.25
Bulgaria	0.18	0.20
Singapore	0.03	0.02
Japan	0.00	0.00



A view of the members of the Forum.

dian stock market and the rupee are perhaps not such a good bet resulting in the depreciation of the currency as is happening presently.

One of the reasons for the loss of confidence is the alarming increase in the current account deficit and the balance of payments position and is largely due to the speculative element of oil in the international market and hoarding of gold domestically. While India is importing about \$141 billion of oil as against the \$185 billion trade deficit, about \$58 billion of oil is also being exported and large private refiners have the advantage of selling the same in the international market which is not restricted by the administered price mechanism (APM) being suffered by oil companies who incur losses selling the same in the domestic market.

In order to cover the exposure of rupee volatility, the MSME export sector hedges their currency in the forward market and the treasury branches of the banks cover the exposure/risk suffered by the MSME export sector at a cost. Typically, an exporter loses an average of 0.20% to 1% of his inward remittances thereby losing their competitive edge to that extent.

The rupee, therefore, needs to be kept in a band so as to avoid such fluctuations. Further, the Task Force on Reduction of Transaction Costs set up by the Ministry of Commerce may consider determining loss in competitiveness of Indian MSME exports due to such fluctuations of currency.

5. Free trade agreements and impasse/ lack of reciprocity incase of services

Asia and ASEAN continued to be the major sources of India's imports. The composition of imports in the first half of 2011-12 compared to 2000-1 shows a rise in share of Asia and ASEAN from 28.6 percent to 61.5 percent and fall in share of Europe and the USA from 27.5 and 5.7 percent to 18.6 and 4.7 percent respectively. Countrywise, China

remained the largest source with an 11.7 percent share in India's total imports followed by the UAE (7.6 percent), Switzerland (6.6 percent), Saudi Arabia (6 percent), and the USA (4.7 percent) in 2011-12 (April-September).

Through the ASEAN Free Trade Area (AFTA), ASEAN has achieved significant progress in the removal of tariffs. However, free flow of goods would require not only zero tariffs but the removal of non-tariff barriers as well. In addition, another major component that would facilitate free flow of goods is trade facilitation measures such as integrating customs procedures, establishing the ASEAN Single Window, continuously enhancing the Common Effective Preferential Tariffs (CEPT) Rules of Origin including its Operational Certification Procedures, and harmonising standards and conformance procedures. The Common Effective Preferential Tariffs for ASEAN Free Trade Area (CEPT-AFTA) Agreement will be reviewed and enhanced to become a comprehensive agreement in realising free flow of goods and applicable to ASEAN needs for accelerated economic integration towards 2015.

However, the much-awaited services pact between India and the 10-member ASEAN trading bloc has reached an impasse. Since the negotiations started, talks on services trade have faced serious roadblocks, especially over the issue of Mode 4 of services trade that refers to the movement of professionals. Countries like Indonesia and Philippines have strongly opposed liberalising their respective services markets for India, as they feel Indian professionals would take away a large share of jobs in these countries if trade is liberalized. India's primary demand under the deal has been greater job opportunities for its professionals, based on easier visa rules in the markets of Singapore, Malaysia, Indonesia, Vietnam, Thailand, the Philippines, Cambodia, Laos, Brunei and Myanmar.

India wants greater access in sectors such as information technology, healthcare, pharmaceuticals, banking and financial services, tourism and legal services. The Philippines, one of the bigger members of the bloc, feels India is a competitor in the business process outsourcing (BPO) space. The BPO industry in Philippines accounts for about 15 percent of the global outsourcing market.

The India ASEAN FTA, CEPA/CECA with Japan, Malaysia, Singapore and Thailand have all the wherewithal of increasing our intra-Asia trade with addressal of issues referred to above. While we negotiate further on this front, we should look at expansion of India Mercosur FTA and new partnership with African nations. The renewed focus on neighbouring countries like Pakistan, Bangladesh and Iran should gradually pave the way for studies identifying the potential of trade which could be facilitated through PTA/FTAs. ■