Public Disclosure Authorized

Policy, Planning, and Research

WORKING PAPERS

World Development Report

Office of the Vice President
Development Economics
The World Bank
August 1989
WPS 51

Background paper for the 1989 World Development Report

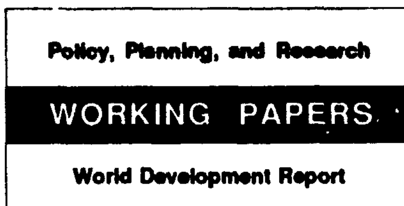
On Participating in the International Capital Market

V.V. Bhatt

Developing countries should participate actively in the international capital market as well as in the Uruguay Round of multilateral trade negotiations on services, to seize export opportunities relating to skill-intensive services — such as financial services a: d computer software, in which countries like India may have a comparative advantage.

The Policy, Planning, and Research Complex distributes PPR Working Papers to disseminate the findings of work in progress and to encourage the exchange of ideas among Bank staff and all others interested in development issues. These papers carry the names of the authors, reflect only their views, and should be used and cited accordingly. The findings, interpretations, and conclusions are the authors' own. They should not be attributed to the World Bank, its Board of Directors, its management, or any of its member countries.

Public Disclosure Authorized



Since 1970, the international credit market has grown in size and sophistication. It offers developing countries many opportunities to meet their growing need for external resources, to manage optimally their foreign exchange assets and liabilities, to accelerate their pace of development, and to expand export possibilities in financial services (particularly relevant for countries like India).

It is essential for developing countries to participate in this market, but to do so they must develop institutional and policy frameworks that help them establish their creditworthiness, integrate their domestic financial markets and organically link them to the international capital market, and develop appropriate institutional expertise and technology.

India is one of the few developing countries capable of developing the expertise and technology needed to participate in the international capital market. It is urgent that India do so quickly, to reduce the foreign exchange cost of operating in this market and to enlarge its export effort.

To take advantage of export possibilities for financial and other services and products, developing countries should also participate actively in the Uruguay Round of multilateral trade negotiations on services.

The idea is to open up opportunities to export skill-intensive services — such as financial services and computer software, in which countries like India may have a comparative advantage. Increased competition would also tend to improve the domestic financial system, which would stimulate productivity and investment in the productive sectors.

Confrontation and rhetoric about special and differential treatment are self-defeating in these negotations and give more discretionary power to administrative authorities in the developed countries. Without a negotiated system of multilateral rules, it is easier for the economically strong countries to dominate the weaker ones through political and economic power.

This is a background paper for the 1989 World Development Report. Copies are available free from the World Bank, 1818 H Street NW, Washington DC 20433. Please contact the World Development Report office, room S13-060, extension 31393 (36 pages with tables).

The PPR Working Paper Series disseminates the findings of work under way in the Bank's Policy, Planning, and Research Complex. An objective of the series is to get these findings out quickly, even if presentations are less than fully polished. The findings, interpretations, and conclusions in these papers do not necessarily represent official policy of the Bank.

Produced at the PPR Dissemination Center

Contents

Glossary and Acronyms *ii*

Introduction and Plan of the Paper *1*

Part I. Nature and Characteristics *3*

1. **Internationalisation** *3*
2. **Globalisation** *3*
3. **Integration** *4*
4. **Innovations** *5*
5. **Size of the Market and Share of Developing countries** *11*

Part II. Rationale for Participation *14*

6. **External Resources** *14*
7. **External Debt Management** *15*
8. **Management of foreign Exchange Reserves** *16*
9. **Import Substitution and Export Possibilities** *16*

Part III. Pre-requisities for Paritcipation: Agenda for Research *18*

10. **Establishing and Maintaining Credit Worthiness** *18*
11. **Integration** *20*
12. **Attracting Foreign Investors to the Indian Market** *21*
13. **Integration and Interest Rate Policy** *23*

Part IV. Liberalisation of the Domestic Financial Markets *26*

14. **Competitive Impulses** *26*
15. **Strengthening Money and Capital Markets** *27*
16. **Structure of Interest Rates** *28*
17. **Prudential Regulation and Supervision** *30*

Part V. Concluding Observations *31*

Part VI. Statistical Appendix *33*

Glossary and Acronyms

CRISIL: Credit Rating Information Services of India Ltd.

DFHI: Discount and Finance House of India

ECP: Euro-Commercial Paper

EMGF: Emerging Markets Growth Fund.

EPF: Employees' Provident Fund

EXIM Bank: Export Import Bank of India

GDP: Gross Domestic Product

GNP: Gross National Product

ICICI: Industrial Credit and Investment Corporation of India

IDBI: Industrial Development Bank of India

IFC: International Finance Corporation

LDCs: Less Developed countries

LIC: Life Insurance Corporation of India

NIF: Note Issuance Facility

NRIs: Non-Resident Indians

OPEC: Organization of Petroleum Exporting Countries

RUF: Revolving Underwriting Facility

SBI: State Bank of India

SDRs: Special Drawing Rights

SEBI: Securities and Exchange Board of India

SHCI: State Holding Corporation of India

UTI: Unit Trust of India

On Participating in the International Capital Market

Since 1970, international credit and capital market has grown in size and sophistication and provides considerable opportunities for the developing countries to operate in this market for the purpose of meeting their growing requirements for external resources and well as for the optimum management of their external assets and liabilities. Further, it enlarges the scope of export possibilities in the field of financial services particularly for the Asian countries like India. Thus, it is essential for the developing countries to participate actively in this market. However, for such participation to be possible, they need to evolve an institutional and policy framework th[illegible] appropriate for establishing their creditworthiness, organically linking [illegible] domestic market with the international market, integrating their domestic financial markets and developing the necessary institutionalized expertise and technology. Moreover, to take advantage of export possibilities with regard to financial services as well as other types of service products, they need to be active participants in the process of multilateral negotiations relating to trade in services in the Uruguay Round of trade negotiations; only thus will they be able to evolve a services compact that suits their needs and capacities.

The rationale for participation as well as the domestic institutional and policy framework, essential for the purpose, are presented in this paper with particular reference to India. However, this is just for the sake of illustration; what is said about India applies to other developing countries of her type as well.

India is one of the few countries in the group of less developed countries (LDCs) that has the potential for developing the needed institutionalized expertise and technology for active participation in the international market; further, there is a certain immediacy as well as urgency for her to do so in order to reduce the foreign exchange cost of operating in this market as well as to enlarge the scope of her export effort. For such active participation, it is essential

for her to adapt her macroeconomic policy framework and institutional capacity to the evolving nature and characteristics of the international market.

Such is the broad theme of this paper. The nature and characteristics of the evolving international capital market are tersely presented in Section I. The immediacy as well as the urgency for participation in this market is the theme of Section III, while Section IV deals with the pre-requisites for such participation in the sphere of institutional and policy framework. Some concluding observations are made in the final Section.

I. Nature and Characteristics

The international capital market that has been evolving since the late fifties and early sixties after a state of suspended animation during the inter-war years is characterized by the interrelated interlinked phenomena of internationalisation, globalisation, integration and innovations.[1]

Internationalisation. This market is international in the sense that it is not subject to the regulation and control of any national authority. The Euro-market is in this respect similar to the informal credit markets in several developing countries—the markets that are out of reach of the national regulating agencies. The former is relevant for large participants—large corporations, public entities and covering governments—while the latter for small enterprises of all types; however, both these markets are characterized by relatively low transaction costs for borrowers partly because of their freedom from regulation.

Globalisation. The globalisation aspect refers to the inter-linkage that is established among national markets as a result of progressive removal of exchange controls on capital flows, liberalization of the various financial centers in the developed countries and the revolution in information gathering, processing and transmission made possible because of technological developments in the fields of computer and telecommunications (both described

1. For an excellent detailed review of the evolution and recent trends in the international capital market see Bank for International Settlements (BIS), *Recent Innovations in International Banking*, (Basle; April, 1986) and Maxwell Watson et el, *International Capital Markets*, (Washington: International Monetary Fund, Jan. 1988).

pithily as computronics). This phenomenon has widened and deepened the scope of the international market as financial institutions are now able to offer 24-hours sales and trading capability in debt and equity instruments; it is possible now to make global offerings of debt and equity, which widens the scope of the market, and the market now provides opportunities for swap deals relating to currency and/or interest rate—the opportunities that deepens the scope of the market.

This inter-linkage of national markets has evolved particularly after the mid-seventies into an international market in financial instruments, denominated in several key currencies. International transactions were predominantly in sterling during 1870-1914 and in the U.S. dollars in the sixties and early seventies; the international market since then is a multi-key currency market and it is this phenomenon which has made it possible to evolve the currency swap markets after 1982—an evolution which was pioneered by the World Bank in 1983.[2]

The interlinking of national markets—the phenomenon of globalisation—has led to the convergence of interest rates in different national markets. In Euro-markets, covered interest rate parity holds almost instantaneously. More significantly, interest rate changes—nominal and real—originating in one major financial center are being quickly transmitted to the other financial centers, despite the floating of the major key currencies. There has been thus a growing interdependence among major financial centers and this has reduced the scope for national monetary policies that are out of line with those in the other centers. Further, capital flows have become a dominant causal factor at least in the short run in the determination of interest rates and exchange rates; and this can lead to misallocation of resources among various productive sectors as a result of such price signals that may not be consistent with comparative cost patterns. To minimize the adverse effects of speculative capital flows, it has now become essential to have international coordination of macroeconomic policies in major countries, particularly relating to interest rate and exchange rate

---

2. Hakan Lonaeus. "How the Bank Finances Its Operations," *Finance and Development*, Vol. 25, Number 3 (Sept. 1988).

policies, through an international institution like the International Monetary Fund.

Integration. The integration of money, banking and securities markets as a result of progressive deregulation—that is, the removal of legal restrictions on interest rates and the functional scope of various financial institutions particularly since 1979—has integrated the national financial markets, created a competitive environment, and given rise to the phenomenon known as securitization. The large borrowers—and in particular the multinational corporations—find it profitable now to borrow directly from the securities market at a cost lower than the cost of borrowing directly from the international banks. This development has blurred the distinction between investment banks and the commercial banks and both are evolving into universal banks, which provide all types of financial services, a sort of a department store type of banking.[3] This development has widened the market for financial services because of the integration of bank and non-bank financial intermediaries; the borrowers tap now not only the resources of the banks but also the resources of the other financial intermediaries. Even the international banks are now raising resources from the securities market through securitization of their assets as well as by issuing their own securities. The market is also deepened because of the securitization of assets, which otherwise would have been dormant—for example, the assets in the form of houses or loans.

To take advantage of the globalisation and integration phenomena, there has been a progressive implantation of banks worldwide—an institutional internationalisation of banks.[4] Banks have continued rapidly to increase their branches and representative offices abroad. Furthermore, foreign banks have continued to expand their share of total bank business. There has also been a growing importance to banks of international business.

---

3. R.W. Goldsmith. *Some Reflections on the Past, Present and Future of Financial Institutions*, Mimeo (1972).
4. Alexandre Lamfalussy. "Structural changes in the International Financial Markets," *International Journal of Development Banking*, Vol. 4, Number 1, (Jan. 1986).

These developments in the international capital market have increased competition among financial institutions. As a result, the cost of borrowing, for example, for large corporations has declined and the net yield (net of risk and transaction costs) to primary lenders or investors has increased, while the fees and margins of banks have diminished.

Innovations. The widening and deepening of the market and the growing intensity of competition among financial institutions have induced several financial innovations or technical change. As Adam Smith[5] observed long time ago, the size of the market and technical change (or division of labour) are interrelated phenomena: the greater the size of the market, the greater the scope for technical change; the greater the technical change, the greater is the size of the market. And so it has happened in the international financial markets. These innovations[6] or new financial instruments have widened the choice with regard to instruments for both savers/investors and borrowers; investors now can choose instruments with characteristics (relating to yield, liquidity, risk and transaction costs) that they prefer and similarly borrowers too have a wider choice with regard to instruments with different cost-risk combinations.

The basic rationale for these innovations relates to the reduction of subjective risk by wide diffusion and sharing of risk. The *perception* of risk is different for different market participants because of asymmetry of information, different capacity to absorb and process information and the differing attitudes towards risk;[7] these innovations tend to shift risk to willing risk takers—willing partly because their perception of risk or subjective risk is lower than those who want to shift the risk. This process of diffusing, sharing and shifting of risk—largely as a result of the phenomenon of securitization—has its dangers; it creates

---

5. Adam Smith. *The Wealth of Nations*. Ed. Andrew Skinner (London: Penguin Books, 1970). See also Allen Young, "Increasing Returns and Economic Progress." The Economic Journal. Vol. 38. Number 152, (Dec. 1928); and Nicholas Kaldor, "The Irrelevance of Equilibrium Economics," *The Economic Journal*, Vol. 82, Number 328, (December 1972).

6. On the logic of financial innovations, see V.V. Bhatt, "On Financial Innovations and Credit Market Evolution," *Economic and Political Weekly, Volume 22, Number 22 (May 30, 1987).*

7. On the essential subjectiveness of risk perception, see Tony Lawson, "Probability and Uncertainty in Economic Analysis." *Journal of Post Keynesian Economics*, Volume 11, No. 1. (Fall 1988).

uncertainty with regard to the location, extent and pricing of risk and as a result a sort of inertia or lethargy in properly appraising the risk involved in the light of potentially available information.[8] This may lead to instability and vulnerability of the international financial system as a whole because of the inter-locking assets and liabilities of various financial institutions. Further, expectations tend to be based on what Keynes calls, "average opinion thinks about average opinion" or what Pigou calls, "errors of optimism and pessimism," resulting in inherent instability of credit as Keynes christened it.[9] Adequate prudential regulation of the national as well as the international financial system with lender of last resort provision is, thus, essential for the stability of the system as a whole. This is the rationale for an institution like the international central bank.[10] The requirement for prudential regulation is already recognized by the national authorities and an international agreement with regard to capital adequacy requirement for financial institutions is a pointer to what needs to be done at an international level. After this necessary digression to pinpoint the vulnerability of the unregulated international market, let us now revert to the nature of financial innovations that have been introduced in the international financial markets.

In the seventies, the OPEC countries preferred to keep their surpluses arising from the oil price stock—quadrupling of oil prices in 1973, which quintupled in 1979—as euro-dollar deposits with international banks. At the same time, there was instability in the interest rates in the various financial centers. These two events gave rise to the innovation of syndicated bank loans at variable interest rates. These loans were primarily made to the oil-importing developing countries and the lack of proper risk appraisal by the international banks as well as the borrowing developing countries ultimately led to the debt crisis of 1982 and after— a crisis which still remains to be resolved.

---

8. Percy S.. Mistry. "Globalization of Financial Markets: Implications for Asian Developing countries," *International Journal of Development Banking*, Volume 5, No. 2, (July 1987).
9. John Maynard Keynes. *A Treatise on Money*, Volume I, (London: Mac Millan and Co., 1930) p. 27.
10. John Hicks. *Critical Essays in Monetary Theory*, (Oxford : Oxford University Press, 1967), pp. 172-73.

The other important innovations were introduced after 1982. By that time, the payment imbalances were arising largely among the developed industrial countries. The surplus countries like Japan and West Germany preferred to invest in securities, and in the borrowing countries—mainly the U.S.A.— the borrowers preferred to borrow by issuing securities of various maturities. This conjuncture led to the securitization process and the major innovations tried to deal with the risks arising from the volatility of interest rates and exchange rates, resulting from the breakdown after 1973 of the Brettonwoods system of fixed exchange rates, and the structural payment imbalances among the developed countries; these are also the innovations which are relevant for the developing countries that are creditworthy.

The first such innovation is Note Issuance Facility (NIF) or its variants like Revolving Underwriting Facility (RUF) or Euro-Commercial Paper (ECP). A RUF is a facility in which a borrower issues, on a revolving basis, bearer notes which are sold to investors, who may or may not include banks, either by a placing agent or under a tender mechanism. This issuance of notes may or may not be underwritten for a medium term period by a group of underwriting banks. ECP was developed by adopting the technique customary in the U.S. commercial paper market, whereby short term paper of variable maturities is issued to one or more dealers on an uncommitted basis, whose task it is to place it with the banks and other investors.

The main advantage is one of cost. The borrower essentially benefits from short term interest rates and a smaller margin on the rate because the investor is only taking on a short term risk. A small underwriting fee to the underwriter, who will have only a contingent risk, converts it into a medium term facility. The particular advantage to credit worthy LDCs, like some of the Asian countries, is that as the borrower's credit standing improves, the margin on its paper decreases, whereas with a syndicated loan the borrower would be fixed into a margin for the life of the loan. The other advantage to a developing country is that, as the investors are a separate group, it can diversify the funding source away from those banks who have traditionally been lenders to the country—which is obviously very important if the country has substantial

financial needs. Lastly, as notes under a RUF are issued regularly and partly to non-bank investors, a borrower's name would become established in a market which is effectively a bridge between the banking and capital markets, making it possible ultimately to tap the capital market by way of Floating Rate Notes and Euro-bonds.

Though so far NIFs have been arranged overwhelmingly for developed countries, a number of developing countries, notably South Korea, Singapore, India and Indonesia, have begun to arrange NIFs, mostly for small amounts. First RUF for an Indian borrower was undertaken by the London branch of the State Bank of India at the end of 1984 which was then refinanced in 1986 partially by way of a Euro-Commercial paper program—again a first for an Indian borrower. This experience enhanced India's credit worthiness; though the first paper was traded at the margin of a few basis points above LIBOR, it was then placed with investors at rates below LIBOR.[11] The first issuance of Euro-commercial paper (ECP) from India has been by the Industrial Credit and Investment Corporation of India (ICICI) in 1987. The Bank of Baroda is currently contemplating (1988) a NUF in the U.S.A. for the purpose of lending in the U.K. market.

While the advantages of the securitized market obviously apply to developing countries, who generate enough bank and investor interest, it also has, in a different form through some methods, a limited application to other countries. These methods may be called *credit enhancement schemes*.[12] In essence, the security—a bond or a note—issued by a borrower would have to be structured in a way to make the risk acceptable to international investors. One way to enhance creditworthiness would be through collateralizing the debt instrument. Such credit support may take the form of direct collateralization by the assignment of certain foreign currency revenues to back principal and interest payments on a bond. Commodity indexed bonds or bonds linked with export performance or performance of specific projects are also instances of such schemes. Credit

---

[11]. Eric Roll. "International Capital and Credit Markets and Developing Countries," *State Bank of India Monthly Review*, Volume 36, No. 6, (June 1987).
[12]. ibid.

enhancement can take other forms such as the comfort to investors of having the Work Bank in a co-financing role or a guarantee from a multilateral agency.

Credit enhancement can be used not only to allow countries of lesser creditworthiness to tap private capital sources but can also be used by other developing countries, including India, to meet other objectives. Collateral, partial or whole, can for example be used to lengthen the maturity of a borrowing beyond the normal term of a market financing. Alternatively, if the collateral were in a foreign currency or linked to a foreign currency, it could be a useful hedge against the risk of a devaluation of the domestic currency. These methods of credit enhancement can, of course, be used on non-securitized financings equally well.

Such innovations, however, can be introduced only if the developing countries become active participants in the international market. The innovations so far introduced have not been motivated by the special needs of the developing countries. The reasons are: developing countries have not been significant participants in the market and secondly most financial institutions are inherently conservative and therefore tend to introduce innovations mainly in there dealings with the most creditworthy borrowers—which developing countries have not been for some time.

The most interesting innovation as a result of globalisation relevant to the developing countries is the development of the swap market in both currency and interest rate swaps. A swap, as the market understands the term currently, is a medium or long term arrangement between two parties in which each party commits to service the debt obligation of the other. This has been the most radical or revolutionary innovation that has been introduced in the international market in recent years.[13] As a result, borrowers are no larger restricted only to those markets in which their name is acceptable or where their credit standing is the highest but which do not provide the currency and type of debt they require. A borrower can tap the market for borrowing, where he is most creditworthy and hence can get the most favourable terms and then trade or

13. A.J. Davis. "The Banking Revolution--Banks and Industry." *State Bank of India Monthly Review*, Volume 36, Number 2 (February 1987).

exchange this debt obligation with the most creditworthy borrower in another market, where his own credit standing is low but which is still preferred by him for business reasons. This in fact is the application of the comparative cost principle to capital transactions. For example, a developing country, traditionally excluded from the fixed rate dollar bond market, can raise a syndicated floating rate dollar-or sterling-loan and swap it into fixed rate dollars. Such swap techniques are not linked to new transactions only. Indeed, to a considerable extent, the swap market does not distinguish between primary and secondary swap transactions and swaps can be arranged in such a way as to match identically the payment date on existing borrowing, that is, for the purpose of the management of existing debt with a view to reducing the risk arising from exchange rate and interest rate changes.

The Industrial Development Bank of India (IDBI) and the Export Import Bank of India (EXIM BANK), for example, have taken advantage of this swap market; so far, the IDBI has entered into four currency cum interest swap transactions and the EXIM BANK has entered into two such deals. (These two along with the ICICI and the State Bank of India (SBI) have resorted to external borrowing from the international market as have some public sector firms like Air India, which also took advantage of one swap transaction to reduce its debt obligation). Some other Asian countries like South Korea have also tapped this market.

Unfortunately, swaps are generally confined to the more creditworthy developing countries like some Asian countries particularly as swap counterparties tend to be large corporations as well as banks who are not in a position to take on third world risk. Certainly, the role of multilateral institutions who may stand up as swap counterparties would be useful and institutions like the World Bank and Asian Development Bank could assume this role. It is the World Bank which pioneered swap transactions in 1983 and it has considerable experience of dealing in the international market as well as taking advantage of financial innovations;[14] it is hence in a position to offer

[14]. Hakan Lonaeus. "How the Bank Finances Its Operations," op. cit.

advisory services to the developing countries and suggest methods and techniques of credit enhancement for participating in the international market.

Size of the Market and Share of developing countries: The size of the market has grown very significantly since 1970 in terms of several indicators. For example, the current account surplus of the payment surplus countries has increased from about $13 billion in 1970 to about $200 billion in 1986. The net resource outflow as a proportion of GDP has increased during 1965 to 1986 in several developed countries; for Federal Republic of Germany, it has risen from 1 percent to 5 percent and for Japan, from 1 percent to 4 percent. The net new resources raised through all facilities in the international market have increased from 5.7 percent of world exports in 1976 to 9.3 percent in 1984 or from about $52 billion in 1976 to $315 billion in 1987.

However, the share of the developing countries in this net resource inflow has declined in the eighties and is currently negative. The net payments surplus of the developed countries was about $7.5 billion in 1970; but by 1986, this was converted into a deficit of about $22.7 billion. In fact, by 1986, the developed countries and in particular the U.S.A. had a net inflow of resources from the developing countries; the surpluses of Japan and Germany were more than offset by the deficit of the U.S.A. The developing countries, thus, have become paradoxically net exporters of capital to the developed countries—the result of the debt crisis which emerged since 1982. The participation of the developing countries as a group in the international capital market is negligible except for a few Asian countries like South Korea and India. The total debt obligations of the developing countries in the international market are much less than 10 percent of the total.[15]

The growth in the size of the market since 1970 has been largely because of the payment imbalances that emerged since then. The OPEC surpluses that emerged after the oil price shocks of 1973 and 1979 were largely kept as deposits with the international banks, who recycled them largely to oil importing developing countries; the latter's external debt as a proportion of GNP rose form

[15]. Donald R. Lessard. *International Financing for Developing Countries*, (Washington D.C.: World Bank Staff Working Paper Number 783, 1986.). p. 25.

about 13 percent in 1970 to about 35 percent in 1986. For the highly indebted developing countries, mainly in Latin America, the external debt as a proportion of GNP rose from about 10 percent in 1970 to about 46 percent in 1986; for the Sub-Saharan countries, it rose from about 13 percent in 1970 to about 57 percent in 1986. Thus all these developing countries lost their creditworthiness by 1982.

The payment imbalances that emerged after 1980 were largely confined to the developed countries; the largest surpluses in 1986 were in Japan and the Federal Republic of Germany. The other major surplus countries were Taiwan, China and South Korea. Most of these surpluses were absorbed by the developed countries like the U.S.A. and what was left for the developing countries out of a total current account surplus of all surplus countries of about $200 billion was a negligible amount of about $11 billion in 1986, which was more than offset by their debt service obligations, resulting into a negative resource inflow for the developing countries as a group.

The size of the market may shrink if the current payment imbalances are corrected by national as well as international policy measures. However, there would be adequate scope for creditworthy developing countries, like the Asian countries, to operate in this market and take advantage of the new financial innovations.

II. Rationale for Participation

The developing countries like India would have to rely increasingly on the international market for several reasons:

- to obtain external resources essential for accelerating their pace of development;
- to manage external debt with a view to reducing debt service obligations;
- to manage international reserves; and
- to take advantage of import substitution and export possibilities relating to financial services.

External Resources: The average annual growth rate of GDP for developing countries as a group has declined from 6.1 percent during 1965-80 to 3.8 percent

during 1980-86 partly as a result of a negative resource inflow from abroad. They need net external resources at least equal to 3 percent of their GDP to regain the pre-1973 momentum of development. The opportunities for concessional borrowing from multilateral and official agencies are quite limited because of the fiscal, payments and growth problems facing the developed countries. Thus the developing countries have to take recource to borrowing from the international market.

For India, the average annual growth rate has increased to about 5 percent during 1980-86 from 3.7 percent during 1965-80. However, this growth rate is inadequate for raising appreciably living standards, removal of poverty and securing reasonable levels of employment.

However, even for maintaining the growth rate at 5 percent per year, India requires external assistance of 2.5 to 3 percent of her GDP. It has been estimated by the World Bank that external resource requirement would be about 2.78 percent of GDP during 1988-89 and 2.40 percent during 1990-91 on the assumption that exports would increase at an annual rate of at least 6 percent. The debt service obligations are estimated to be about 1.76 percent of GDP during 1988-89 and about 1.40 percent during 1990-91; thus the requirement of net resource inflow (net of debt service obligations) would be about 1 percent of GDP during 1988-91.

The opportunity of obtaining concessional assistance have been diminishing in importance since 1975; her non-concessional debt as a result has been rising from about 6.5 percent of total external debt to about 27 percent currently and is estimated to be about 50 percent by 1990.

External Debt Management: The external public debt of all developing countries has increased from about 13 percent of GNP in 1970 to more than 35 percent in 1986 and debt service as a percentage of exports of goods and services has risen from about 10 percent in 1970 to about 20 percent in 1986. For India, total external debt as a percentage of GNP has been more or less stable during 1970-86, though private debt as a percentage of GNP has risen from about 0.2 percent in 1970 to about 1.1 percent in 1986; the debt service as a percentage of exports of goods and services, too, has been more or less stable in the range of 24-27 percent during this period.

The debt service obligations change as a result of the volatility of interest rates and exchange rates. However, the risk arising from such changes can be reduced by effective and efficient management of debt. Such opportunity has been created in the international market since 1982 as a result of the innovation of currency-interest rate swaps. It is not possible to avail of this opportunity without actively participating in the international financial markets.

For highly indebted countries, the debt/GNP ratio is very high (about 45 percent in 1986) and the debt service ratio too is quite high (about 30 percent in 1986). For Sub-Saharan countries, the debt/GNP ratio is even higher at 57-58 percent in 1986 and the debt service ratio is about 20 percent. For these countries, the reduction of both these ratios is essential for attaining reasonable rates of growth. For the Sub-Saharan countries, debt relief in various forms is already being considered; it is possible to do so as most of their debt is to official agencies.

However, most of the debt of the highly indebted countries particularly in Latin America is owed to the private sector; for these countries, some radical solution to this problem is imperative. This debt is being securitized and sold at a discount in the international market; but the advantage of this discount is not available to the debtors. It may be possible to devise some mechanism to pass on the discount to the debtors.[16]

Management of Foreign Exchange Reserves: The developing countries as a group have gross foreign exchange reserves equal to about 3.5 months of import coverage (or about $160 billion in 1986); for India, these reserves constitute about 4 months import coverage (or about $10 billion in 1986). The international market provides opportunities of investing these reserves and changing the composition of such investment so as to obtain a satisfactory yield on such investment and reduce the risk arising from interest rate and exchange rate changes.

---

[16]. Dr. Arjun Sengupta, a executive director of the I.MF, has made a very viable and feasible proposal more of less on these lines. See Arjun Sengupta, "A Proposal for a Debt-adjustment Facility in the IMF<" Volume 11, Number 2, (June, 1988)

Import Substitution and Export Possibilities: For some countries like South Korea and India, which have a sound well developed financial system and adequate technical and professional manpower, there is a potential that can be developed, through institutionalized expertise and financial technology, for acquiring the capacity to provide financial services to domestic borrowers, intending to have operations in the international market, as well as to export such services to other developing countries. These services are generally skill-intensive and much less capital-intensive than some of the manufactured products. Developing the capacity for providing such services on the basis of their dynamic comparative advantage would strengthen their payment position by saving on foreign exchange cost relating to their transactions in the international market (import substitution advantage) as well as by earnings from the export of such services. This potential somehow has not been exploited; the necessary institutional and policy changes, hence, have not been identified and implemented. For their effective and efficient participation in the international market, it is essential to seize all opportunities for the actualization of this potential.

III. Pre-requisites for Participation: Agenda for Research

Participation in the international capital market is possible only if certain pre-conditions or pre-requisites are satisfied through an appropriate institutional and policy framework. This framework has to be such as to:

- establish and maintain creditworthiness;
- bring about progressive integration of the domestic and international markets; and
- promote competitive impulses and pressures for improving the effectiveness and efficiency of domestic financial markets in an environment of financial stability ensured through strategic and prudential regulation of the financial system.

These are inter-related and inter-linked policy measures and it is not possible to take action on one front without at the same time relating it to the

other two. How to evolve such an institutional and policy framework requires detailed study and research in the context of a given country like India. At this stage, what is attempted in this and the next section is merely a tentative broad outline of such a framework.

Establishing and Maintaining Creditworthiness: Creditworthiness, as the market understands it, depends generally on certain characteristics of the growth process. One is that external debt should be growing at a rate lower than the growth rate of national income and the other is that exports should grow at a rate higher than the rate of increase of debt servicing obligations. Thus, the higher the growth rate of income and exports, the greater would be the opportunity of external borrowing; and the larger the external borrowing--if productively and efficiently invested--, the higher would be the growth rate of income and exports.

Productivity or efficiency of investment is thus the most critical factor. The institutional and policy framework, however, should be such as to create a favourable environment for entrepreneurial functioning and competitive pressures and incentives for improving investment and productive efficiency. The price system for this purpose has to be as little distorted as possible; otherwise the decision signals would turn out to be misleading. Further, administrative controls or regulations or interventions, when essential for the purpose of accelerating the pace of development, should be minimum, of strategic significance, selective, purposive and time bound and should be, what Bhagwati calls "prescriptive" rather than "proscriptive."[17] The "Far Eastern governments, by and large, issue prescriptions rather than proscriptions..... whereas countries such as India do the opposite. The governments of "dos" generally produce economic performance superior to that produced by governments of "don'ts"[18] The former foster and promote entrepreneurial impulses, while the latter stifle them; the former establish symbiotic partnership relationship with the private entrepreneurs, while the latter induce adversarial response and unproductive wasteful expenditure to overcome or to take advantage of restrictive measures without a positive rationale.

To be creditworthy is not enough. A country has to establish its creditworthiness in the market by its continuous presence in order to seize opportunities as they arise of borrowing as well as management of external assets and liabilities. It may be advantageous to borrow, even when external resources are not required, when one's payments positions is strong and growth experience good; one may obtain most favourable terms in such a situation and the additional resources so obtained can be used for pre-payment of debt incurred earlier on less favourable terms. Further, in such a situation, it may become possible to introduce credit enhancing innovative financial instruments, that tailor debt service obligations to one's ability to repay. Such transactions or operations need to be undertaken in all the major financial centers and in

---

17. Jagdish Bhagwati, *Prottectionism*, (Cambridge, Mass: the MIT Press, 1988) pp. 98-102.
18. ibid, p. 98.

particular in the Asian centers like Tokyo, because of what Linder calls the emergence or arrival of the Pacific Century[19] in place of the earlier American Century and still earlier, the British one or Pax Britannica of the nineteenth century.

For borrowing for financing infra-structure projects, the cost of borrowing from the international market can be reduced if such borrowing can be arranged along with assistance from multilateral international institutions like the World Bank. Such co-financing arrangements can enhance one's creditworthiness in the market and thus make it possible to borrow on favourable terms.

Integration: Such operations are not feasible without some degree of integration of domestic markets with international market--a purposive integration that induces the required capital inflow, while at the same time fosters and promotes the growth of the domestic financial markets.

To promote such integration, it is essential to develop investment banking expertise and computer and telecommunication facilities for rapid gathering, processing and transmittal of information, essential for decision making. It may not be possible for domestic banks initially to undertake guarantee or underwriting obligations or to lead manage loans or issue of securities. However, it is possible and essential to develop the expertise and capacity to offer advice and assistance to domestic as well as foreign clients, particularly in the developing countries. The domestic banks are likely to have better information and understanding of the domestic and external resource requirement of domestic firms--public or private--as well as of the domestic financial markets and the opportunities they offer; hence, they would be in a better position to offer advice to and formulate suitable proposals for the domestic firms, thus reducing the foreign exchange cost of external transactions. And once this capacity is developed, such advice and assistance can be given to the other developing countries as well, thus exporting financial services on the basis of their dynamic comparative advantage.

Several Indian banks--commercial as well as development banks--have developed merchant banking expertise for offering advice to Indian firms with respect to their operations in the Indian markets. And the banking system has several branches abroad in major financial centers. Thus, it is not difficult for Indian banks to develop the capacity and expertise of operating actively in the international market as some of them like the State Bank of India are already doing to some extent. What is now required is a deliberate strategy for the purpose.

Only four banks--State Bank of India, Bank of Baroda, Bank of India and Indian Overseas Bank--have a significant presence abroad in terms of their branches; State Bank of India has 23 branches; Bank of Baroda 50, the Bank of India 25 and the Indian Overseas Bank 11--accounting in all for 109 branches out of a total of 122 branches for the entire Indian banking system. (Table IX and X). These are the banks that have the institutional basis for operating in the international market, provided they develop the required expertise at the head

---

19. Staffan Burenstam Linder, *The Pacific Century*, (Stanford University Press, 1986).

office as well as in their branches. They need to have a strategy of using purposively their branches abroad for operations in the international market. So far, the top management of these banks have had no strategy with regard to their branches abroad and there was no proper guidance and assistance from the head offices to these branches with regard to their operations--largely because of lack of expertise and experience at the level of top management with regard to the international market and the obsessive involvement of the banking system, including the Reserve Bank of India, with the regulation of interest rates and credit allocation in India without much appreciation of the international context.[20]

It may be necessary for these banks to have a strong link with some international banks for evolving partnership relationships with regard to operations in the international market. In that case, the international banks can lead manage issues of securities or syndicated loans with or without guarantee or underwriting obligations, while the Indian partners could concentrate on the background work relating to formulation of proposals for client firms or institutions; such relationship should ensure equitable sharing of fees and margins between the two partners. Since some of the prominent international banks have branches in India, it should not be difficult to forge such relationships.

Attracting Foreign Investors to the Indian Market: India, like some other countries such as South Korea, has already evolved some financial instruments and institutions to attract foreign investors.

The Unit Trust of India (UTI) started in 1986 INDIA FUND in Guernsey and the India Growth Fund Inc. in the U.S.A. in 1988 in collaboration with Merril Lynch to induce foreign investors and particularly non-resident Indians (NRIs) to invest in the securities market of India. Further, India has attractive deposit schemes and other schemes for portfolio and direct investment in India for the NRIs. All these instruments are primarily developed to attract capital inflow from NRIs and that is quite a good tactical move. NRIs are quite familiar with India, have emotional and other links with India and a strong desire to be fully informed about Indian developments and also to contribute towards her development--particularly if that is also profitable for them. Further, once these instruments become established and well known as a result of NRIs participation, it may not be difficult to attract other foreign individuals and institutions to invest in these instruments.

With the experience gained so far, it may be desirable to offer these facilities for investment to all foreign individuals and institutions. In this effort, the branches of foreign banks in India can be very useful. They have been involved in attracting NRI investment and because of their experience, familiarity and links will the major financial centers, they are in a position to induce foreign investors other than NRIs to invest in India in the instruments currently aimed at only the NRIs.

These foreign banks have been useful also as a catalyst in generating competitive impulses even in the segmented financial markets of India. Though

---

20. S.K. Verghese, "Developments in International Banking and Prospects of Indian Banks' Overseas Business," *Economic and Political Weekly*, Volume 23, Number 18, (April 20, 1988).

their business in India represents only about 3 percent of the total for the banking system, about 24 foreign banks have 150 branches and are quite active in introducing financial innovations. The Standard Chartered is proposing to start a stock broking firm; Grindlays is trying to diversify and enter the fields of venture capital fund, leasing and mutual fund; and Citibank has already started a computer software subsidiary that now ranks third in the business of Indian exports in this field. The banks like the Citibank and the Hong Kong Bank have introduced innovations like Automatic Teller Machine and electronic gadgets that enable customers to perform banking business around the clock. The Citibank has now set the pace in terms of showing what a foreign bank can do in the field of retail banking; it has introduced new ideas relating to personal loans, service on telephone etc. The Bank of America is going upmarket offering the services of personal banking officers to clients who are known in the business as high net-worth individuals. As the Chairman of State Bank of India perceptively observed: the new edge to the competition from the foreign banks "has made us less compacent."[21] It has been a wise decision of the Indian authorities to let these foreign banks operate in India; they are a window to the outside world, an instrument for adapting foreign innovations to the Indian environment and also for integrating Indian markets with the markets abroad. They have provided a fresh breeze of competition in the highly administered system of Indian banking; their presence is an opportunity that can be exploited for forging vital links with the international market.

The other link which needs to be established is with the Emerging Markets Growth Fund (EMGF), sponsored by the International Finance Corporation (IFC) to purchase securities of developing countries' companies listed on foreign as well as domestic stock exchanges. The EMGF is investing in nine emerging stock markets; they include; In Asia, --India, the Republic of Korea, Malaysia, the Philippines and Thailand; and in Latin America--Argentina, Brazil, Chile and Mexico. Other countries currently under consideration include Jordan, Nepal and Turkey.[22] The securities of companies, in which EMGF is interested in investing in the domestic market, can be later on listed in the markets of the major financial centers; the EMGF approval of such securities would enhance their attractiveness to foreign investors in foreign markets.

Of course, it would be essential to reduce the transaction cost to the foreign investors of dealing in securities of Indian firms by streamlining legal and other administrative procedures. The attractiveness of Indian securities for foreign investors can be enhanced by deliberate and purposive elimination of transaction costs and risk, arising from the *functionless* political and bureaucratic procedures or interventions, and reduction of other such costs and risk by innovative ways of handling such transactions with minimum delay, and adequate and timely provision of required information.

Integration and Interest Rate Policy: Integration of domestic with the international market implies that interest rates in India should be related fairly

---

21. T.N. Ninnan, "Foreign Banks Profitable Presence," *India Today*, Volume 13, Number 14, (July 16-31, 1988).

22. "Foreign Portfolio Investment for Development: An IFC Initiative," *Finance and Development*, Volume 23, Number 2, (June, 1986).

closely to the interest rates in the major financial centers. Since, countries like India would like to stimulate capital inflows and discourage capital outflows, domestic interest rates or yields, adjusted for expected exchange rate changes, on deposits and bonds should be higher than those prevailing abroad; and at the same time, to discourage excessive borrowing from abroad, the domestic interest rates or cost of borrowing should be lower than the cost of borrowing abroad, adjusted for expected exchange rate changes. Such interest rate policy can be implemented only if there are pressures and incentives for the domestic banks and financial markets to improve their efficiency of operations by reducing transaction costs for both lenders/investors and borrowers and an exchange rate policy that is consistent with and adequately coordinated with the domestic interest rate policies.

IV. Liberalisation of the Domestic Financial Markets

For gaining access to the international market as well as for improving the investment and productive efficiency in India, it is essential to reduce transaction costs and risk, relating to financial instruments, through financial innovations that provide a wider choice of instruments to savers/investors as well as borrowers. For this purpose, there has to be freedom form functionless legal and administrative restrictions on the functioning of financial markets and deliberate creation of a policy environment favourable for generating competitive impulses and for entrepreneurial functioning.

Competitive Impulses: The restrictions on the functional scope of financial institutions need to be progressively relaxed for creating a competitive environment. As is happening in the major financial centers, the commercial banks should be permitted to engage in investment banking activities, which , as emphasized earlier, are essential for operating in the international market. Several banks have now entered the field of merchant banking, mutual funds, leasing, housing finance etc. and they need to extend their activities to investment banking also.

The entry of commercial banks in this field is essential for another reason also. As is happening in the international market, the major corporate borrowers in India too are increasingly relying on the securitized markets for their resources. The banks are likely to lose this profitable market and if they are to be financially viable, they need to diversify their activities into fields like investment banking that make it possible for them to earn fees from domestic as well as foreign clients.

Such competitive and entrepreneurial impulses cannot be generated unless the top management of financial institutions has freedom from *ad hoc* interference from the government and other administrative controls and restrictions that prevent them from operating in an entrepreneurial manner. The fixity of tenure, at least for five years, for the top management of these institutions is imperative if they are to function as innovative entrepreneurs. Currently, the entrepreneurial talents of the top management have scope only in a vertical direction, that is, in accommodating the whims and caprices of the

politicians and the bureaucrats rather than in the horizontal direction of improving their services to their customers. This has to change.[23]

Strengthening Money and Capital Markets: Several measures have been taken recently to promote and strengthen the securities markets in India. Discount and Finance House of India (DFHI) has already started it operations relating to short-term financial instruments. Credit Rating Information Services of India Ltd (CRISIL) has been established to rate companies as well as securities listed in the capital market. A national market has effectively been created by an electronic link-up between five major stock exchanges in India, which simultaneously transmits price information and other data to all exchanges. The Stock Holding Corporation of India (SHCI) has been formed by the financial institutions in order to provide clearing house facilities to promote speedier transfer of securities; this corporation acts as a central clearing agency for registering of transfers of securities and reduces considerably the timelag in effecting transfers. Securities and Exchange Board of India (SEBI) similar to the Securities and Exchange Commission of the U.S.A. has been set up to promote orderly and healthy growth of the securities market. All of these developments seek to attract and protect investor interest by provision of better and fuller information with regard to the companies, whose securities are listed in the national stock exchanges.

However, unless the financial institutions are permitted to operate as brokers, dealers, underwriters and investors in the money and capital markets, the growth and development of these markets may be inhibited. Various types of banks should be permitted to assume such functions. In that case, it may become possible to evolve a market in short-term instruments by converting the present intercorporate deposits into a negotiable commercial paper, making company deposits into a tradeable certificate of deposit and bills of exchange into what are known in the international market as NIFs. The markets for these instruments and the treasury bills need to be integrated with the active participation in these markets by the financial institutions including UTI, Life Insurance Corporation of India (LIC) and the Employees' Provident Fund (EPF); for this to be possible, restrictions on their investment portfolio need to be relaxed. The commercial and development banks, if they assume investment banking functions, could strengthen these markets in various ways. These markets can also be widened and deepened by securitizing dormant assets like house mortgages and the like. The commercial and development banks too can securitize some of their assets as a measure of raising more resources for their functioning.

The promotion or strengthening of the market for short-term instruments through refinancing or rediscounting facilities with the Reserve Bank of India or Industrial Development Bank of India is not an effective or efficient method for the purpose; such facilities should be used sparingly and only as a last resort. They become necessary only when the financial markets are fragmented along with the interest rate structure because of administrative regulations. The viable method of strengthening these markets is through an appropriate interest rate policy.

---

23. V.V. Bhatt, "On Restructuring the Monetary System" *Economic and Political Weekly*, Volume 23, Number 8, (March 19, 1988)

Structure of Interest Rates: The fragmentation of financial markets has arisen partly because of the irrationality in the administered structure of interest rates. This structure does not reflect the differential transaction costs and risk attached to various instruments and this gives incorrect signals to investors/savers, lenders and borrowers and prevents integration of the financial markets as well as adaptation of appropriate financial innovations. The lack of integration is further aggravated through fiscal measures like exemption from tax on interest income from some instruments.

This structure hence needs to be rationalized. It may be necessary to have some administered rates but they need to be flexible so as to reflect the changing economic situation. However, even to know the levels at which such interest rates should be fixed and changed in the light of the developing situation, it is essential to have market determined interest rates, particularly related to negotiable tradeable instruments. On this logic, interest rates on bank deposits and government securities should be flexibly administered, while the financial markets and institutions should be free to determine the other rates, including interest rates on loans.[24]

It may be necessary to direct credit to certain so called priority sectors; but these sectors, to be priority sectors, must be very few like small farmers, small enterprises of all types and exports. As is done currently, credit to these sectors should be fixed as some proportion of deposits; but it is not necessary to fix administratively interest rates on advances or loans. Fixing both price and quantity would affect the viability of the banks if they strictly adhere to the directives; if they do not, they will be induced to raise the cost of borrowing by levying non-interest charges to such borrowers, thus adversely affecting the very sectors that are given priority status.

Credit allocation to such sectors through directives without fixing interest rates on loans would induce the banks to introduce such innovations as reduce transaction costs and risk to both lenders and borrowers and thus improve the effectiveness and efficiency of the banking system; at present, there is no such incentive and the financial viability of the banks is already undermined.

Exemption of interest income on some instruments from taxation does not appear to be the right instrument for raising the rate of financial saving; it merely provides artificial incentive for reallocating saving towards favoured instruments. For stimulating saving in terms of financial assets, it would be much more effective to exempt net saving--that is, increase in financial assets minus change in financial liabilities--from taxation; this would raise the net return on all financial instruments and discourage consumption, without fragmenting the financial markets. Such a modified expenditure tax can replace several separate taxes if the following tax base is adopted:

(income from all sources + capital gains + gifts received)--

[(increase in financial assets -- change in financial liabilities) + gifts

24. V.V. Bhatt, ibid and V.V. Bhatt, "Resource Mobilization in Developing Countries: Financial Institutions and Policies." *Economic and Political Weekly,* Volume 21, Numbers 25 and 26, (Issue 21-28, 1986).

given to others + expenditure on one house meant for one's own use]

Such a tax would replace several separate taxes like income tax, capital gains tax, gifts tax and inheritance tax, thus simplifying the tax system, and at the same time stimulate financial saving.[25]

Prudential Regulation and Supervision: Liberalizing financial markets from *functionless* administrative controls, regulations and directives does not mean that there should be no regulation and supervision of these markets. In fact, financial markets are fragile and susceptible to what Pigou calls errors of optimism and pessimism and in addition, unsound financial practices--like cheating, fraud and unwise hasty ill-informed decisions--have large cumulative and self-reinforcing external diseconomies as they affect the entire financial system and through it the productive sectors.

For this purpose, the institutional infrastructure is already in place. The Reserve Bank of India has this responsibility vis-à-vis the banking system; the Industrial Development Bank vis-à-vis the development banks; and the newly created Securities and Exchange Board of India vis-à-vis the securities markets. These institutions need to be strengthened in the light of the emerging needs that may arise as a result of liberalization.

V. Concluding Observations

The international capital market as it has been evolving provides an opportunity for developing countries like India to attract the required capital inflow for accelerating their pace of development, manage their foreign exchange assets and liabilities to their advantage and develop export capabilities in the field of financial services. Active participation in this market would not only improve their access to the market but also indicate the institutional and policy framework essential for developing effective and efficient domestic financial markets. Of course, since participation does imply a progressive integration of domestic markets with the international market, it would make the domestic markets vulnerable to the vicissitudes of the international market. But as the Chinese say: by opening your windows you of course get flies along with fresh air; but if you don't open the windows, you will not get flies but at the same time, no fresh air either.

The possibilities of such participation would be enhanced if the developing countries like India take a constructive stand with regard to the multilateral

---

25. V.V. Bhatt, *Development Perspectives*, (Oxford: Pergamon Press, 1980) Chapter 15.

negotiations in respect of trade in services under the Uruguay Round. Such active participation in negotiations would result into multilateral rules in the sphere of trade in services and safeguards for the developing countries, subject of course to eventual and negotiated erosion with "graduation," perhaps even slower paced then as now discussed for goods.[26]

This would open out opportunities for export of services like financial services and computer software, that are skill intensive and with regard to which countries like India have a potential dynamic comparative advantage; further, the increased competition would also tend to improve the domestic financial system, thus stimulating greater productive and investment efficiency in the productive sectors.

Confrontation and rhetoric for special and differential treatment in the matter of trade as well as trade in services or for an international economic order arouse only hostility and are self-defeating. In fact as it has happened in the area of trade in goods, that would give greater discretionary powers to the administrative authorities in the developed countries; without an agreed and negotiated system of multilateral rules, the international system would provide opportunities for governments of the economically strong countries to dominate in one way or another (witness the Voluntary Export Restrictions—VERs—, and Voluntary Import Expansions—VIEs) the weaker ones.[27] It is to the advantage of the developing countries to have an international system based on multilateral rules rather than political and economic power. And to have such a rule based system, it is essential—nay , vital—for the developing countries to participate actively and intelligently in the negotiations for trade in goods as well as trade in services. Intelligent participation in negotiations would also indicate to the developing countries the areas in which the domestic institutional and policy framework needs change and improvement. Hostility and

---

[26]. Jagdish N. Bhagwati, "Trade in Services and The Multilateral Trade Negotiations." *The World Bank Economic Review.* Volume 1, Number 4 (September, 1987), p. 567-68.

[27]. ibid and Iam M. Little, *Economic Development* (New York: Basic Books Inc. 1982) pp. 374-375.

confrontation are possible with ignorance; cooperative ventures require intelligence and diligence.

Statistical Appendix

Table I Balance of Payments: Current Account Surplus. 34

Table II Balance of Payments: Current Account Surpluses and Deficits. 35

Table III Gross Domestic Investment, Gross Domestic Saving and Resource Balance. 36

Table IV International Banking and Capital Market Flows. 37

Table V External Public Debt and Debt Services Ratios. 38

Table VI Gross Domestic Product. 39

Table VII India: External Debt. 40

Table VIII India: Balance of Payments: 1987-88 to 1990-91. 41

Table IX Bank-wise and Country-wise Break-up of Overseas Branches of Indian Banks. 42

Table X Country-wise Distribution of Indian Banks Overseas. 43

Table I. Balance of Payments: Current Account Surplus (millions of dollars)

	1970	1986
Industrial Market Economies		
Spain	79	4,102
Italy	902	3,961
Belgium	717	3,586
Netherlands	-483	4,686
Germany, Fed. Rep	853	37,357
Japan	1,980	85,831
Sweden	-265	3,795
Switzerland	72	4,525
United States	2,330	-141,460
United Kingdom	1,913	-1,392
High Income Oil Exporters		
Kuwait	853	6,160
United Arab Emirates	75	6,486
Libya	645	1,890
Saudi Arabia	71	-10,360
Other Countries		
Taiwan, China	1	16,217
Portugal	-158	1,121
Yugoslavia	-372	1,097
Israel	-562	1,262
Hong Kong	225	1,552
Singapore	-572	478
Korea, Rep of	-623	4,617
South Africa	-1,215	3,125
Romania	—	1,489
Iraq	105	—
Peru	202	-1,055

Source: World Development Report 1988; World Bank, Washington, D.C., June 1988.

Table II. Balance of Payments: Current Account Surplus and Deficit (millions of dollars)

	1970			1986		
	S	D	NS	S	D	NS
Industrial Market Economies	10.8	3.2	7.5	147.8	170.6	-22.7
High Income Oil Exporters	1.6	—	1.6	14.3	10.3	3.9
Subtotal	12.4	3.2	9.2	162.1	181.0	-18.9
Other Countries (as in Statement I)	0.5	3.5	-3.0	31.0	1.0	30.0
Total	12.9	6.7	6.2	193.2	182.0	11.2

Source: Same as in Statement I

Note: S = Surplus
D = Deficit
NS = Net Surplus

Table III. Gross Domestic Investment, Gross Domestic Saving And Resource Balance

(Percentage of GDP)

	Gross Domestic Investment		Gross Domestic Saving		Resource Balance	
	1965	1986	1965	1986	1965	1986
Developing Economies	21	24	20	24	-1	—
Oil Exporters	19	23	21	22	2	-1
Exporters of Manufactures	23	29	22	29	-1	—
Highly Indebted Countries	21	19	23	22	2	3
Sub-Saharan Africa	15	14	15	11	-	-3
India	18	23	16	21	-2	-2
China	25	39	25	36	-	-3
Industrial Market Economies	23	21	23	21	-	—
Germany, Fed. Rep.	28	19	29	24	1	5
Japan	32	28	33	32	1	4
United States	20	18	21	15	1	-3
United Kingdom	20	18	19	18	-1	—

Source: World Development Report 1988; World Bank, Washington, D.C., June 1988.

Table IV. International Banking And Capital Market Flows (billions of dollars)

Items	1976	1980	1984	1987
International Bond Issues	25.1	35.3	108.1	n.a.
Syndicaated Bank Loans	27.5	82.9	36.6	255.0
Note Issuance Facilities	—	—	18.9	n.a.
Total	52.6	118.2	163.6	315.0
As a percent of World Exports	5.7	6.3	9.3	n.a.

Source: For 1976 to 1984, Alexandre Lamialussy, Structural Changes in the International Financial Markets, *International Journal of Development Banking,* Volume 4, Number 1 (January, 1986); for other years, World Bank Estimates based on Bank of International Settlements (BIS) data.

Table V. External Public Debt and Debt Service Ratios.

	External Public Debt (% of GNP)		Debt Service (% of GNP)		Debt Service (% of Exports of Goods and Service)	
	1970	1986	1970	1986	1970	1986
Developing Economies	13.1	35.5	1.5	4.4	10.1	20.0
Oil Exporters	12.2	47.6	1.7	6.2	12.0	30.5
Exporters of Manufactures	n.a.	22.7	n.a.	3.1	n.a.	14.0
Highly Indebted Countries	10.2	45.8	1.6	5.0	12.4	29.5
Sub-Saharan Africa	13.1	57.4	1.1	4.3	5.3	19.3
India	15.0	14.0	1.0	1.2	25.8	17.9
Including Private Debt	15.2	15.1	1.1	1.6	27.3	24.6
China	n.a.	6.3	n.a.	0.9	n.a.	7.8

Source: World Development Report 1988; World Bank, Washington, D.C., June 1988.

Table VI. Gross Domestic Product (Average Annual Growth Rate, percent).

	1965-80	1980-86	1986	1987	1988
Developing Economies	6.1	3.8	n.a.	4.5	4.5
Oil Exporters	7.1	1.7	0.4	0.6	2.0
Exporters of Manufactures	6.6	6.2	7.4	6.3	5.8
Highly Indebted Countries	6.6	0.7	3.4	1.6	2.2
Sub-Saharan Africa	5.6	0.0	2.0	-1.5	2.8
India	3.7	4.9	4.9	1.8	7.2
China	6.4	10.5	7.9	9.4	7.6
Industrial Market Economics	3.6	2.5	n.a.	3.2	3.5

Source: World Development Report 1988; World Bank, Washington, D.C., June 1988 for 1965-80 and 1980-86; for 1986, 1987 and 1988, World Bank Estimates.

Table VII. India: External Debt(millions of dollars)

	Debt Outstanding and Disbursed		Disbursements		Principal Repayments		Interest Payments	
	1976-77	1986-87	1976-77	1986-87	1976-77	1986-87	1976-77	1986-87
Concessional of which	12,486	23,219	1,374	1,861	342	756	211	348
IDA	3,333	10,529	533	714	9	61	21	90
IBRD	240	173	3	—	33	13	16	11
Non-Concessional of which	796	8,694	164	1,781	154	825	52	766
IBRD	216	2,494	73	641	24	139	15	284
Bilateral Loans	288	1,185	33	111	63	138	18	106
Commercial Loans	293	5,014	58	1,029	68	548	18	375
Private Non-guaranteed	295	2,598	61	849	62	773	19	244
Total (excluding IMF)	13,577	34,511	1,600	4,491	559	2,354	282	1,358

Source: India: *Recent Developments and Medium- Term Issues,* Vol II; World Bank, Washington D.C. April 27, 1988; pp. 48-51.

Table VIII. INDIA: Balance of Payments: 1987-88 to 1990-91 (millions of dollars at current prices)

	1987-88	1988-89	1989-90	1990-91
A. Exports of Goods and Non-Factor Services	16,954	18,859	20,749	21,719
B. Imports of Goods and Non-Factor Services	-21,848	-24,296	-26,267	-27,804
C. Resource Balance	-4,895	-5,437	-5,518	-6,086
D. Net Factor Income and Net Current Transfers (excluding interest payments)	827	2,450	2,430	2,505
E. Current Balance (excluding interest payments)	-3,968	-2,987	-3,088	-3,581
F. E as a % of GDP at market prices	1.56	1.02	0.96	1.00
G. Interest Payments	-1,652	-1,670	-1,712	-1,820
H. Repayment of Loans	-3,358	-3,474	-3,403	-3,195
I. G + H as a % of GDP at market prices	1.97	1.76	1.60	1.40
Total gross Capital inflow (E + G + H)	8,978	8,131	8,203	8,596
Total gross Capital inflow % of GDP (F + I)	3.53	2.78	2.56	2.40
End-year Reserves (Excluding Gold)	6,354	6,095	7,091	8,237

Source: *India: Recent Developments and Medium- Term Issues*, Vol II; World Bank, Washington D.C. April 27, 1988; pp. 48-51.

Table IX. Bank wise and country-wise break-up of overseas branches of Indian Banks

Country	Bank of Baroda	Bank of India	Bharat Overseas Bank Ltd	Canara Bank	Indian Bank	Indian Overseas Bank	State Bank of India	Syndicate Bank	UCO	Total
Bangladesh	—	—	—	—	—	—	1	—	—	1
Bahamas	1	—	—	—	—	—	1	—	—	2
Bahrain	1	—	—	—	—	—	1	—	—	2
Belgium	1	—	—	—	—	—	1	—	—	2
Cayman Islands	—	1	—	—	—	—	1	—	—	2
Channel Islands	—	1	—	—	—	—	—	—	—	1
Fiji Islands	11	—	—	—	—	—	—	—	—	11
France	—	1	—	—	—	—	1	—	—	2
Guyana	1	—	—	—	—	—	—	—	—	1
Federal Republic of Germany	—	—	—	—	—	—	1	—	—	1
Hong Kong	—	2	—	—	—	6	1	—	2	11
Japan	—	2	—	—	—	—	2	—	—	4
Kenya	7	2	—	—	—	—	—	—	—	9
Maldive Islands	—	—	—	—	—	—	1	—	—	1
Mauritius	6	—	—	—	—	—	—	—	—	6
Oman	3	—	—	—	—	—	—	—	—	3
Panama	—	—	—	—	—	—	1	—	—	1
Seychelles	1	—	—	—	—	—	—	—	—	1
South Korea	—	—	—	—	—	1	—	—	—	1
Sri Lanka	—	—	—	—	2	3	1	—	—	6
Singapore	—	1	—	—	1	1	1	—	3	7
Thailand	—	—	1	—	—	—	—	—	—	1
United Arab Emirates	6	—	—	—	—	—	—	—	—	6
United Kingdom	11	13	—	1	—	—	5	1	2	33
United States of America	1	2	—	—	—	—	4	—	—	7
Total	50	25	1	—	3	11	23	1	7	122

Notes: (1) Includes 8 off-shore banking units in Bahamas, Bahrain, Cayman Islands, Channel Islands and Singapore.
(2) As at end-December 1997.

Source: Reserve Bank of India.

Table X. Country-wise distribution of Indian Banks Overseas

Country	Branches: Conventional	Branches: Offshore Banking Units	Banking Subsidiaries: Wholly Owned	Banking Subsidiaries: Majority Owned	Affiliates	Representative Offices
Australia	—	—	—	—	—	1
Bangladesh	1	—	—	—	—	—
Bahamas	—	2	—	—	—	—
Bahrain	—	2	—	—	—	—
Belgium	2	—	—	—	—	—
Bhutan	—	—	—	—	1	—
Canada	—	—	1	—	—	—
Cayman Islands	—	2	—	—	—	—
Channel Islands	—	1	—	—	—	—
Egypt	—	—	—	—	—	1
Fiji Islands	11	—	—	—	—	—
France	2	—	—	—	—	—
Guyana	1	—	—	—	—	—
Federal Republic of Germany	1	—	—	—	—	—
Hong Kong	11	—	3	—	—	—
Indonesia	—	—	—	—	—	3
Iran	—	—	—	—	—	1
Italy	—	—	—	—	—	1
Japan	4	—	—	—	—	—
Kenya	9	—	1	—	—	—
Malaysia	—	—	—	—	1	—
Maldive Islands	1	—	—	—	—	—
Mauritius	6	—	—	—	—	—
Nigeria	—	—	—	—	2	—
Oman	3	—	—	—	—	—
Panama	1	—	—	—	—	—
Seychelles	1	—	—	—	—	—
South Korea	1	—	—	—	—	—
Sri Lanka	6	—	—	—	—	—
Singapore	6	1	—	—	—	—
Thailand	1	—	—	—	—	—
United Arab Emirates	6	—	—	—	—	—
United Kingdom	33	—	—	—	—	—
United States of America	7	—	1	—	—	1
Uganda	—	—	—	1	—	1
USSR	—	—	—	—	—	1
Zambia	—	—	—	1	—	—
Zimbabwe	—	—	—	—	—	1
Total	114	8	6	2	4	10

Notes: as at end December 1987.
Source: Reserve Bank of India.

PPR Working Paper Series

	Title	Author	Date	Contact for paper
WPS32	Municipal Development Funds and Intermediaries	Kenneth Davey	July 1988	R. Blade-Charest 33754
WPS33	Fiscal Policy in Commodity-Exporting LDCs	John Cuddington	July 1988	R. Blade-Charest 33754
WPS34	Fiscal Issues in Macroeconomic Stabilization	Lance Taylor	September 1988	R. Blade-Charest 33754
WPS35	Improving the Allocation and Management of Public Spending	Stephen Lister	August 1988	R. Blade-Charest 33754
WPS36	Social Security Finance in Developing Countries	Douglas J. Puffert	August 1988	R. Blade-Charest 33754
WPS37	Black Market Premia, Exchange Rate Unification, and Inflation in Sub-Saharan Africa	Brian Pinto	July 1988	R. Blade-Charest 33754
WPS38	Intergovernmental Grants in Developing Countries	Larry Schroeder	September 1988	R. Blade-Charest 33754
WPS39	Fiscal Policy in Low-Income Africa	Stephen A. O'Connell	July 1988	R. Blade-Charest 33754
WPS40	Financial Deregulation and the Globalization of Capital Markets	Eugene L. Versluysen	August 1988	R. Blade-Charest 33754
WPS41	Urban Property Taxation in Developing Countries	William Dillinger	August 1988	R. Blade-Charest 33754
WPS42	Government Pay and Employment Policies and Government Performance in Developing Economies	David L. Lindauer	August 1988	R. Blade-Charest 33754
WPS43	Tax Administration in Developing Countries: Strategies and Tools of Implementation	Tax Administration Division, IMF Fiscal Affairs Department	August 1989	WDR Office 31393
WPS44	The Size and Growth of Government Spending	David L. Lindauer	September 1988	R. Blade-Charest 33754
WPS45	How Much Do State-Owned Enterprises Contribute to Public Sector Deficits in Developing Countries -- and Why?	Govindan Nair Anastasios Filippides	December 1988	L. Mattheisen 33757
WPS46	The Management of Public Expenditures: An Evolving Bank Approach	Robert Lacey	January 1989	L. Matthiesen 33757

PPR Working Paper Series

	Title	Author	Date	Contact for paper
WPS47	Considerations for the Development of Tax Policy When Capital is Internationally Mobile	Robert F. Conrad	March 1989	L. Mattheisen 33757
WPS48	Do Taxes Matter? A Review of the Effect of Taxation on Economic Behavior and Output	Johnathan Skinner	August 1989	WDR Office 31393
WPS49	Public Sector Pricing Policies: A Review of Bank Policy and Practice	DeAnne Julius Adelaida P. Alicbusan	April 1989	L. Mattheisen 33757
WPS50	Fiscal Policy and Stabilization in Brazil	Celso Luiz Martone	July 1989	L. Mattheisen 33757
WPS51	On Participating in the International Capital Market	V. V. Bhatt	August 1989	WDR Office 31393
WPS52	Financial Innovation and Credit Market Development	V. V. Bhatt	August 1989	WDR Office 31393
WPS53	Venture Capital and Entrepreneurial Development	Fernan Ibanez	August 1989	WDR Office 31393
WPS54	Bank Restructuring in Malaysia, 1985-88	Andrew Sheng	September 1989	WDR Office 31393
WPS55-WPS60	Assigned to WDR			
WPS61	Student Performance and School Costs in the Philippines' High Schools	Emmanuel Jimenez Vicente Paqueo Ma. Lourdes de Vera	August 1988	T. Hawkins 33678
WPS62	Universities in Arab Countries	George I. Za'rour	September 1988	C. Christobal 33640
WPS63	Does Japan Import Less Than It Should?	Kenji Takeuchi	July 1988	J. Epps 33710
WPS64	Cocoa and Coffee Pricing Policies in Cote d'Ivoire	Takamasa Akiyama	August 1988	D. Gustafson 33714
WPS65	Interaction of Infant Mortality and Fertility and the Effectiveness of Health and Family Planning Programs	Howard Barnum	July 1988	S. Ainsworth 31091
WPS66	Slowing the Stork: Better Health for Women Through Family Planning	Anthony R. Measham Roger W. Rochat	July 1988	A. Menciano 33226