CHAPTER

03

EXTERNAL SECTOR: GETTING FDI RIGHT

India's external sector continued to display resilience amidst global headwinds of economic and trade policy uncertainties. Total exports (merchandise and services) have registered a steady growth in the first nine months of FY25, reaching USD 602.6 billion (6 per cent). Growth in services and goods exports, excluding petroleum and gems and jewellery, was 10.4 per cent. Total imports during the same period reached USD 682.2 billion, registering a growth of 6.9 per cent on the back of steady domestic demand.

The evolving global trade dynamics, marked by gradual shifts towards greater protectionism, require assessing the situation and developing a forward-looking strategic trade roadmap. By adapting to these trends and leveraging its strengths, India can accelerate its growth and enhance its presence in global trade. To strengthen its competitiveness and further integrate into global supply chains, the country can focus on reducing trade-related costs and enhancing export facilitation to create a more vibrant export sector. This proactive approach will help India continue to thrive in an ever-changing global market.

On the capital front, foreign portfolio investments (FPIs) have shown a mixed trend in FY25 so far. Uncertainty in the global markets and profit-taking by foreign portfolio investors led to capital outflows. However, strong macroeconomic fundamentals, a favourable business environment, and high economic growth have kept FPI flows positive overall. Gross foreign direct investment (FDI) inflows have shown signs of revival in the first eight months of FY25, though net FDI inflows declined relative to April-November 2023 due to a rise in repatriation/disinvestment.

India's foreign exchange reserves stood at USD 640.3 billion as of the end of December 2024, sufficient to cover approximately 90 per cent of the country's external debt of USD 711.8 billion as of September 2024, reflecting a strong buffer against external vulnerabilities.

INTRODUCTION

3.1 The world is experiencing increasing political and economic uncertainty in the wake of geopolitical conflicts, increasing trends of geoeconomic fragmentation, and recurrent climate events. The Great Election year of 2024, during which more than half of the world's population was exercising their franchise to elect their new governments, meant further declining policy predictability. Such political and economic uncertainty can be detrimental to growth. The International Monetary Fund (IMF) estimates that a one standard deviation increase in uncertainty correlates with a 0.4 to 1.3 percentage point decrease in output growth.[1] Economists like Keynes and Tobin have pointed out that higher uncertainty requires investors to seek more significant compensation for risks, thereby raising risk premia and the overall cost of finance. Additionally, uncertainty increases the likelihood of borrower defaults, leading to higher capital costs. Moreover, uncertainty shocks in advanced economies like the US have often led to lower output and reduced prices.[2]

3.2 Various indicators are used to monitor global risks and uncertainties and measure policy-related uncertainty's impact on global economic activity. These include the Geopolitical Risk (GPR) index[3], which tracks adverse geopolitical events through newspaper articles; the Trade Policy Uncertainty (TPU) index[4], which covers the frequency of articles mentioning trade policy uncertainty and heightened trade tensions, and the Global Economic Policy Uncertainty (GEPU) index[5], which is a GDP-weighted average of national Economic Policy Uncertainty (EPU) indices for 21 countries. These indices capture changes occurring in economies constituting about 71 per cent of global output.[6]

3.3 These indices provide valuable insights into how uncertainty from trade issues, geopolitical events, and economic policy measures can impact global economic conditions. As of November 2024, the GEPU index remains high, reflecting ongoing global economic policy concerns. Similarly, the TPU index has risen since December 2023, primarily driven by trade tensions and policy changes among major economies.

1 Döttling, R., Malaika, M., & Terrones, M. (2013). Held Back by Uncertainty: Recoveries are slowed when businesses and consumers are unsure of the future. Finance & Development, 0050(001), A012. https://tinyurl.com/324z5ux4.

2 Leduc, S., and Liu, Z. (2016). Uncertainty Shocks are Aggregate Demand Shocks. Journal of Monetary Economics, 82, 20-35; Kumar, A., Mallick, S., and Sinha, A. (2021). Is Uncertainty the Same Everywhere? Advanced versus Emerging Economies. Economic Modelling, 101, 105524, https://tinyurl.com/6n74paw2.

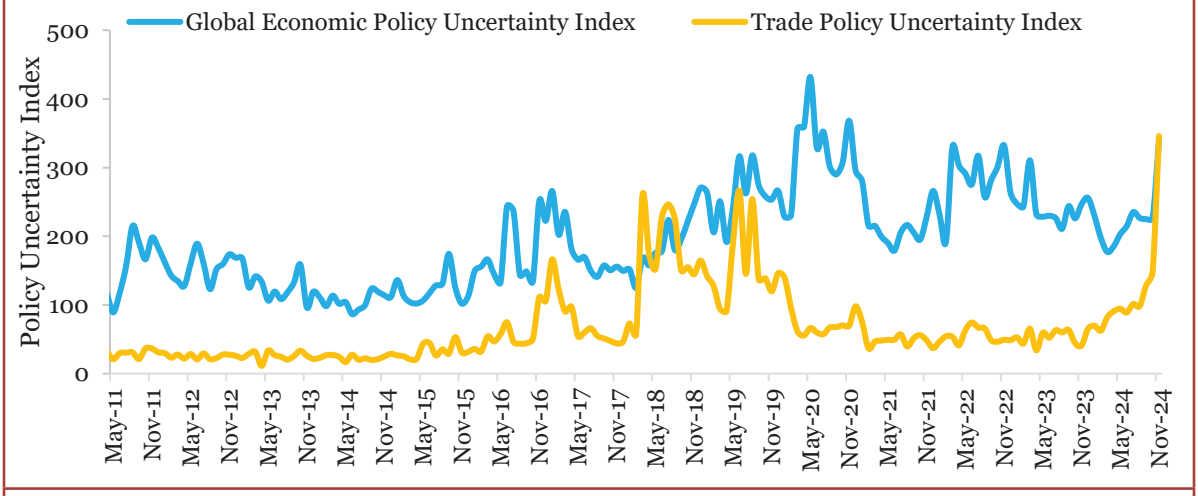
3 Geopolitical Risk Index, https://www.policyuncertainty.com/gpr.html.

4 Trade Policy Uncertainty Index, https://www.matteoiacoviello.com/tpu.htm.

5 Global Economic Policy Uncertainty Index, https://www.policyuncertainty.com/.

6 Global output is calculated on the basis of purchasing power parity. If the economies are accounted at market exchange rates the economies constitute roughly 80 per cent of the global economy.

Chart III.1: Rise in global uncertainty



Source: GEPU Index and TPU Index website

3.4 The Reserve Bank of India (RBI) has developed a policy uncertainty index specifically for India, utilising various global indices. This index leverages internet search data from Google Trends to assess policy uncertainty from domestic and international events. Furthermore, the index is updated in real-time.[7,8]

3.5 With this backdrop, the chapter presents the performance of India's external sector amidst the prevailing global environment. Section I provides an overview of the global trade dynamics, emphasising tariffs and non-tariff measures (NTMs) and the performance of the global external sector amidst challenges. Section II delves into India's trade performance, highlighting the trends across both the merchandise and services sectors. It examines the performance of India's textile exports and the factors restricting its global expansion. Further, a detailed analysis of India's diversification in exports to new markets has been presented. The key drivers and challenges affecting India's e-commerce export growth are also discussed in depth. Section III discusses the factors restricting export growth and outlines the government initiatives to simplify export procedures to enhance trade performance. Section IV presents India's Balance of Payments (BoP) situation, highlighting current and capital account trends, foreign exchange reserves, exchange rate movements, and India's external debt position. The last section concludes the chapter with an outlook for India's external sector, considering the evolving global and domestic economic landscape.

7 When faced with heightened uncertainty, it is typical of economic agents to 'search' for more information. The Google Trends-based uncertainty index (India-GUI) leverages this behaviour to measure overall uncertainty by using internet search volumes for a list of keywords about fiscal, monetary and trade policy in India. The policy-related keywords are curated, based on mentions in central bank policy statements as well as coverage in the financial press.
Pratap, B., and Priyaranjan, N. (2023). Macroeconomic Effects of Uncertainty: a Google trends-based Analysis for India. Empirical Economics, 65(4), 1599-1625, https://tinyurl.com/5fb373we.

8 Recalibrating from Divergence to Convergence: The Indian Experience - Inaugural Address delivered by Michael Debabrata Patra, Deputy Governor, RBI - October 21, 2024 - at the New York Fed Central Banking Seminar organised by the Federal Reserve Bank, New York, USA, https://tinyurl.com/mvajhcj7.

GLOBAL TRADE DYNAMICS

3.6 Disruptions in the Red Sea that began in November 2023 have forced changes in trade routes, causing higher shipping costs and longer delivery times.[9] This is particularly true for trade between Asia and Europe, as 40 per cent of this trade passes through the Red Sea region.[10] Similar conflicts in the Hormuz Strait, which channels 21 per cent of global petroleum liquid consumption, have disrupted energy trade and increased prices. Additionally, climate change is enhancing the uncertainties.[11] For instance, the recent drought in the Panama Canal jeopardised international trade, affecting approximately 5 per cent of global maritime trade volumes that transit through it. These conditions are creating uncertainty, leading to a slowdown in international trade,[12] reshaping the contours of trade in terms of a rise in protectionist trade policies and shifting global supply chains.

3.7 As evident from Chart III.2, there has been a noticeable rise in the political proximity of trade since late 2022. This indicates a preference for bilateral trade between countries with similar geopolitical stances, i.e., friend-shoring[13] and nearshoring.[14] Concurrently, there has been an increasing concentration of global trade[15] to favour significant trade relationships. For instance, Russia and China's trade dependence on the EU and the US's dependence on China has declined in recent years. In contrast, the dependence of Russia and Vietnam on China has increased.[16,17]

3.8 Government interventions, including NTMs, reinforce the change in bilateral trade patterns due to geopolitical considerations. The rise in NTMs, which began after the COVID-19 pandemic, was further fuelled by the conflict between Russia and Ukraine. A report by the United Nations Conference on Trade and Development (UNCTAD)[18] indicates that technical NTMs impact over 30 per cent of products and nearly 70 per cent of global trade. This is discussed further in paras 3.15 to 3.20 of this chapter.

9 UNCTAD rapid assessment, 'Impact to Global Trade of disruption of shipping routes in the Red Sea, Black Sea and Panama Canal', https://unctad.org/system/files/official-document/osginf2024d2_en.pdf.

10 Bonnell and McHugh, 2024, https://tinyurl.com/5n7wy8xj.

11 U.S. Energy Information Administration, https://www.eia.gov/.

12 IMF Working Paper dated 9 July 2024, 'The Heterogenous Effects of Uncertainty on Trade', https://tinyurl.com/2xywd48v.

13 Friend shoring is calculated as trade-weighted political proximity as measured by the United Nations voting patterns.

14 Nearshoring is calculated as the reverse of the trade-weighted average distance in km.

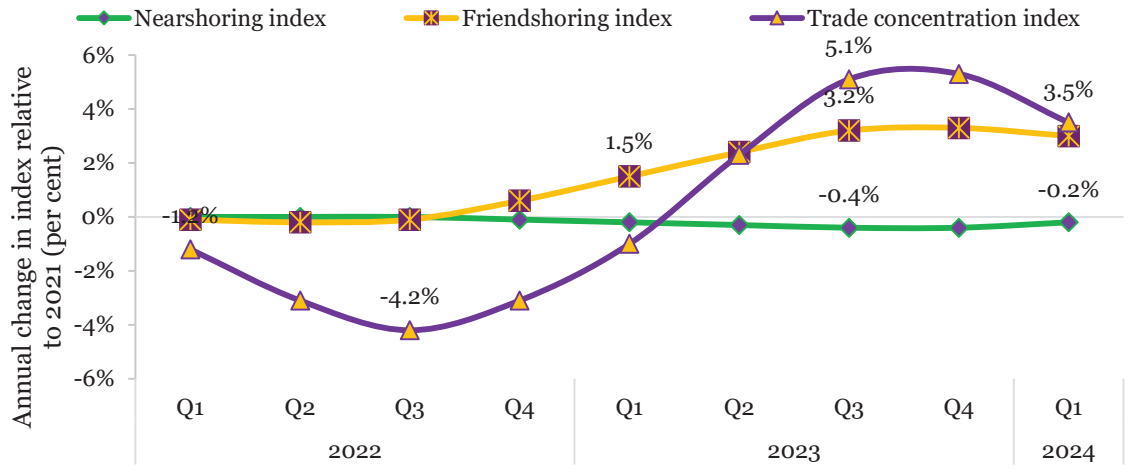
15 Trade concentration is calculated based on the Herfindahl concentration index.

16 UNCTAD estimates based on national statistics (https://unctad.org/statistics)
The dependence of an economy on another is calculated as the ratio of their bilateral trade over the total trade of the dependent economy. Annual change is calculated using a trade-weighted moving average over the past four quarters.

17 UNCTAD Global trade update, July 2024, https://tinyurl.com/uwputbfs.

18 UNCTAD report, 'Tariff trends mostly downward, but non-tariff measures increasingly used', https://sdgpulse.unctad.org/trade-barriers/.

Chart III.2: Friend shoring and trade concentration trends continue to shape global trade



Source: UNCTAD estimates based on national statistics

Global trade performance in 2024

3.9 According to the latest trade update by UNCTAD[19], the gradual increase in global trade that began in H2 of 2023 has persisted into 2024. The World Trade Organisation (WTO) database shows a year-on-year (YoY) growth of 3.5 per cent and 3 per cent, respectively, in global merchandise export and import indices in Q3 of 2024 (seasonally adjusted, 2005 Q1=100). Further, the global services exports and imports grew by 7.9 per cent and 6.7 per cent (YoY) during the same period.

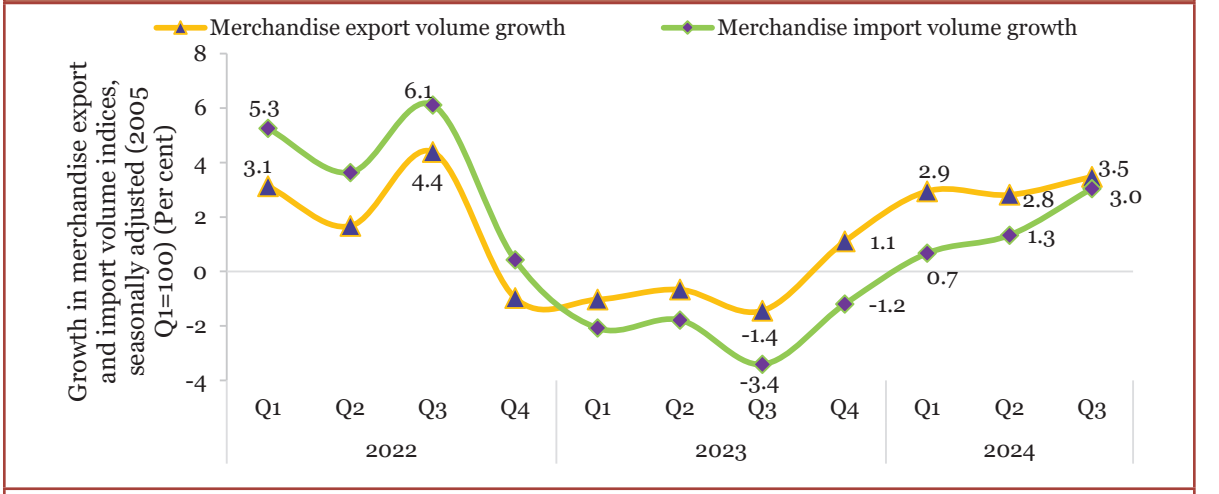
3.10 Over the last four quarters, trade growth in developing countries generally exceeded that of developed nations. However, this trend reversed in Q3 of 2024, with positive developments in developed economies driving trade growth. In contrast, trade growth in East Asia stalled, and several major Asian developing economies experienced negative growth.

3.11 According to the UNCTAD nowcast[20], the positive momentum in global trade witnessed in the first three quarters of 2024 is expected to continue into Q4. As a result, global trade is set to exceed its 2022 record, reaching nearly USD 33 trillion in 2024. This record high is likely to be driven by a 7 per cent increase in services trade (YoY), while goods trade is projected to grow by about 2 per cent in 2024 but remain below its 2022 peak. Overall, global trade is expected to expand by about USD 1 trillion (or 3.3 per cent) in 2024, with goods and services contributing approximately USD 500 billion each.

19 UNCTAD Global Trade Update December 2024, https://tinyurl.com/5n8fr7a3

20 Ibid note 19.

Chart III.3: Rebound in global trade in 2024



Source: WTO Stats

Tariff policies

3.12 To promote free trade, encourage investment, and lower trading costs, countries worldwide have established various trade agreements. The number of regional trade agreements (RTAs) in effect has grown substantially, increasing from 22 in 1990 to 369 as of August 2024.[21] Increased emphasis on free trade and enhanced collaboration in international trade policies under the WTO has reduced border tariffs among nations. For instance, between 2000 and 2024, the average tariff rates on dutiable items in India decreased from 48.9 per cent to 17.3 per cent, while in China, they fell from 16.4 per cent to 8.3 per cent.[22] Commodity-wise, between 2012 and 2022, the Most Favoured Nation (MFN) and preferential tariffs declined in agriculture, manufacturing, and natural resources. Globally, the simple average MFN and preferential tariffs for agriculture dropped by approximately 3 per cent and 1.4 per cent, respectively, between 2012 and 2022. The simple average preferential tariffs decreased by about 1 per cent in the manufacturing sector.

3.13 At a broader level, India's import tariff policy has evolved over time, balancing domestic policy goals with the need to integrate into the global economy. Tariffs vary by sector, with considerations like protecting sensitive sectors from foreign competition and permitting access to important raw materials and intermediate goods. India has ensured that tariff policies comply with WTO rules and regulations. Over time, several efforts have been made to rationalise tariffs further and address the inverted duty structures.

3.14 Tariffs are often perceived to have an impact on competitiveness. However, if used in a calibrated way, tariffs can aid the goals of industrial policy and help in the development of desirable sectors in the economy (Box III.1).

21 WTO data on regional Trade Agreements, https://tinyurl.com/59e3yw6b.

22 Based on the data available on the WTO Integrated Database, https://tao.wto.org/.

Box III.1: Tariffs and successful industrial policy design

Industrial policy refers to measures that target the transformation of an industry in pursuit of a public goal. Tariffs are a standard tool of industrial policy and are often seen as a way to support fledgling industries before they gain traction. However, using tariffs requires a calibrated approach which balances the sector's needs with the costs imposed on the rest of the economy. Tariffs can also be viewed as a lever within a system of tools that can further the goals of industrialisation.

The use of tariffs in industrial policy can be traced back to the Industrial Revolution. Tariffs were commonly used in Western Europe and North America to catch up with the British industrial revolution. As Matthew C. Klein and Michael Pettis note in their book 'Trade wars are class wars',

"Freidrich List, who moved from Germany to America in 1825, wrote that a country such as Germany, which was less developed but "possesses the mental and material means" to become wealthy, should instead avoid free trade and "strengthen her own individual powers." ... The United States levied tariffs on manufactured goods of about 45 per cent from 1870 through 1913...American manufacturers were protected from foreigners but competed within the large—and expanding—domestic market."

This accords with the observations made by Professor Robert C. Allen on the development history of Europe and North America[23]. According to him, North America and Western Continental Europe caught up with the British industrial revolution by adopting the following:

- Internal free market (elimination of internal tariffs)—national single market
- Stable domestic banking system
- High external tariff
- Universal Education
- Infrastructure.

They did not catch up with Britain practising free trade and open capital markets.

Globally, modern-day industrial policies use a mix of policies, including tariff-based protection and other levers such as credit grants and export-related subsidies.[24] Illustrative of this fact, tariffs accounted for just 1.3 per cent of all industrial policy interventions between 2010 and 2022.[25]

Lessons in successful industrial policy design can be gleaned from the support the Korean government extended to its heavy chemicals industry in the Seventies. Korean industrial policy in the heavy chemicals sector led to significant gains in output, labour productivity and long-term comparative advantage of the industry's exports. Tools such as tariff-based protection and quantitative restrictions were used for a limited period, after which protection

23 2013 Gideon Rosenbluth Memorial Lecture delivered by Dr Robert Allen, Canadian Centre for Policy Alternatives, https://tinyurl.com/7cv2hzu6.

24 Juhász, R., Lane, N., & Rodrik, D. (2023). The new economics of industrial policy. Annual Review of Economics, 16, (https://tinyurl.com/3m5f2t2u).

25 Ibid note 24.

tapered in the 1980s.[26] Importantly, in Korea, tariffs were only one element of a composite industrial policy which sought to protect domestic industry and, at the same time, demanded a reciprocal performance obligation on the part of the industry receiving protection.

The recipe for a successful industrial policy lies in the simultaneous use of carrots and sticks, with the sticks often being longer than the carrots. Taking a comprehensive look at the industrial policies of Northeast Asia, Joe Studwell wrote in 'How Asia Works' that the region succeeded with its industrial policy because it punished non-performers more than it rewarded performers. As Studwell notes, the emphasis on infant industry protection in Northeast Asian economies went hand in hand with external benchmarking through export performance. There were special privileges for local businesses, but there was accountability for export performance. That is how scale, productivity, efficiency and rapid economic growth were achieved. Studwell repeatedly notes that Korean industrial policy punished its non-performers more than helped performers.

To summarise, the growth experiences of the industrialised West and the miracle growth economies of the East suggest that tariffs were indeed a prominent tool used to further industrialisation. However, tariffs were used in a calibrated way, and a whole-of-government approach was adopted in crafting tariff policies. Finally, industrial policy goals were achieved not by protection alone but by policies which ensured that the protected industries performed in response to the protection afforded.

Non-tariff measures

3.15 The decline in tariffs globally, as discussed above, has been accompanied by an increase in the implementation of NTMs[27] across countries. The Global Trade Alert database[28] shows that between 2020 and 2024, over 26,000 new restrictions related to trade and investments have been globally imposed. This is further elucidated in Chapter 5. The Technical Barriers to Trade (TBT) affect 31.6 per cent of the product lines, covering 67.1 per cent of the global trade (as of December 2024). This is followed by export-related measures, affecting 19.3 per cent of the product lines and covering 31.2 per cent of the global trade. Sectors most affected by NTMs include agriculture, manufacturing, and natural resources.[29]

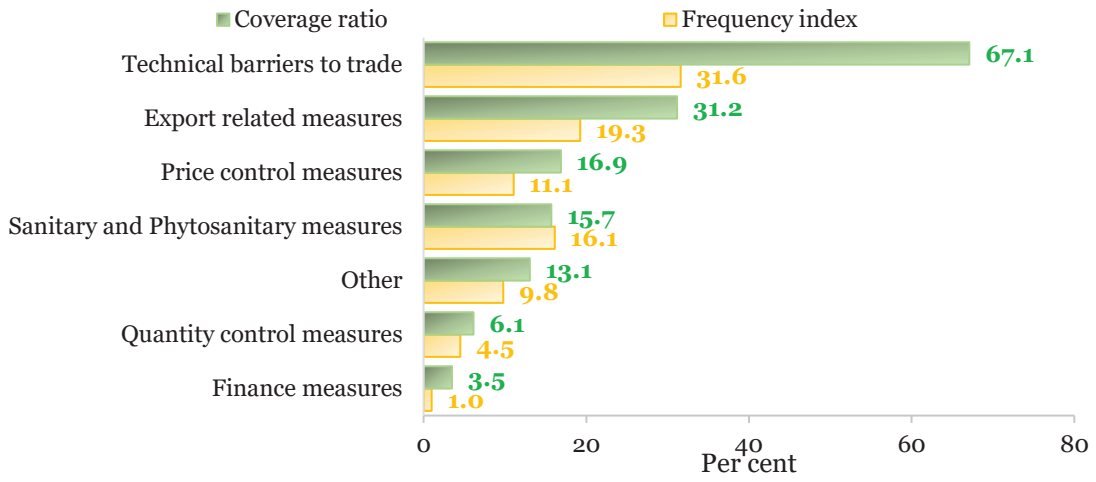
26 Lane, N (2022). "Manufacturing revolutions: industrial policy and industrialization in South Korea", CSAE Working Paper Series, (https://tinyurl.com/ye2ahh7k).

27 UNCTAD defines NTMs as policy measures that are not ordinary customs tariffs but can still significantly impact international trade in goods. These measures can affect either the quantities traded, prices, or both (Classification of NTMs | UNCTAD). NTMs are classified into import-related and export-related categories based on the above classification. Import-related NTMs are further classified as "technical" or "non-technical." Technical measures comprise sanitary and phytosanitary measures (SPS), technical barriers to trade (TBT), and pre-shipment inspections. Non-technical measures encompass traditional trade policies like quotas, subsidies, and trade remedies, including those addressing unfair trade practices.
In 2006, the UNCTAD established the Group of Eminent Persons on Non-tariff Barriers (NTBs) and the Multi-Agency Support Team (MAST) comprising eight international organisations such as the IMF, OECD, UNIDO), UNCTAD, the World Bank and WTO etc. Over the years, MAST has created a coding system as a foundation for collecting and tallying NTMs. The objective of the International Classification of NTMs (refer: UNCTAD report on International Classification of Non-Tariff Measures, https://tinyurl.com/mr3mp5uk) was to provide information and clarification on new and existing measures and to improve their comparability across countries.

28 Global Trade Alert database, https://www.globaltradealert.org/global_dynamics.

29 Based on UNCTAD Trade Analysis and Information System (TRAINS) Database, https://trainsonline.unctad.org.

Chart III.4: Classification of NTMs based on coverage and frequency



Source: UNCTAD TRAINS Database
Note: Other includes 'Pre-shipment inspection and other formalities, contingent trade protective measures, non-automatic import licensing, quotas, prohibitions, quantity-control measures and other restrictions not including sanitary and phytosanitary measures or measures relating to technical barriers to trade, measures affecting competition, trade-related investment measures, distribution restrictions, restrictions on post-sales services, subsidies and other forms of supports, government procurement restrictions, intellectual property and rules of origin. The frequency index is defined as the percentage of HS 6-digit lines covered. The coverage ratio is defined as the percentage of trade that is subject to NTMs

3.16 Globally, NTMs, such as subsidies and export-related measures, have risen in aid of nations' industrial policy goals.[30] Unlike broad-based tariffs, NTMs tend to be granular in their approach.[31] They are often less visible, making them harder to assess.[32]

3.17 A report by UNCTAD and the UNESCAP[33] shows evidence of increased use of NTMs by countries to adapt and mitigate climate change. According to the report, although climate change-related NTMs account for only 2.6 per cent of total measures, they are concentrated in some of the largest and most CO2-intensive trade sectors, such as the automotive industry, electricity and heat generation, transformation, and storage. As a result, 26.4 per cent of global trade, valued at USD 6.5 trillion, is covered by climate-change-related NTMs. TBT comprise over 61 per cent of all identified climate change-related NTMs, followed by export-related and price-control measures (as of December 2024). In the future, the imposition of climate-change-related NTMs by the EU in the form of the Carbon Border Adjustment Mechanism (CBAM)[34] and European

30 Juhász R, Lane N, Oehlsen E, Pérez VC. 2023. The who, what, when, and how of industrial policy: a text-based approach, https://tinyurl.com/ytj2rcwp.

31 Ibid note 30.

32 Kinzius, L., Sandkamp, A., & Yalcin, E. (2019). Trade protection and the role of non-tariff barriers. Review of World Economics, 155(4), 603-643, https://tinyurl.com/dw5pf4w6.

33 UNCTAD and UN ESCAP report, Trade regulations for climate action: new insights from the global non-tariff measures database', https://tinyurl.com/52sfzu93.

34 CBAM is the EU's tool to put a fair price on the carbon emitted during the production of carbon-intensive goods that are entering the EU and to encourage cleaner industrial production in non-EU countries.

Union Deforestation Regulation (EUDR)[35] is anticipated to have broad implications for exporters in emerging economies such as China, India, and Turkey. [36] Box III.2 discusses CBAM and EUDR and their possible impact on India's exports in detail.

Box III.2: CBAM and EUDR and their likely impact on India's exports

Carbon Border Adjustment Mechanism

Implemented by the EU and under consideration by the UK, CBAM aims to align the cost of carbon emissions for imported goods with that of domestically produced products. As countries/groups like the EU phase out the free allowances they offer their industries under the Emissions Trading System (ETS), they are ushering in CBAM to prevent their consumption from shifting to countries with relatively softer environmental regulations. Under the mechanism, importers will buy carbon certificates corresponding to the carbon price paid by the domestic producers/manufacturers under the EU's carbon pricing rules. Thus, CBAM is effectively a carbon price equalisation measure.

The key sectors covered under the EU CBAM include iron and steel, aluminium, cement, and fertilisers. Reporting requirements for the EU CBAM began on 1 January 2024, with quarterly submissions for the previous quarter. The levy, however, is expected to take effect from 1 January 2026. The UK has also proposed its own CBAM, scheduled to come into force on 1 January 2027, reflecting a broader global shift towards carbon pricing mechanisms. The key sectors covered under the UK CBAM include cement, fertilisers, glass, ceramics, iron and steel, aluminium, and hydrogen. Currently, the EU CBAM addresses only direct emissions from production processes, whereas the proposed UK CBAM intends to cover both direct and indirect emissions. CBAM aims to equalise carbon prices across geographies, thereby negating the comparative advantage of developing members like India and the least developed countries.

The justification offered for the introduction of CBAM is that it prevents carbon leakage.[37] Some jurisdictions believe that the aggregate impact of the countries' nationally determined contributions, if fully implemented, would not put the world on a pathway to achieving the Paris Agreement goal. Therefore, the logic behind CBAM is that as long as they did not have the same level of ambition, CBAM was necessary to protect the integrity of climate mitigation efforts in Europe and ensure they were not undermined by carbon leakage. Moreover, the

35 The EUDR requires operators and traders to ensure that the products placed in the EU market are (i) deforestation-free (i.e., must not be derived from a land which is deforested after December 31 2020); (ii) should be produced following the relevant legislation of the country where the product is produced; and (iii) covers the submission of a due diligence statement before placing the products in the EU.

36 UNCTAD Global trade Update December 2023, 'Global trade expected to shrink by nearly 5 per cent in 2023 amid geopolitical strains and shifting trade patterns', https://tinyurl.com/5n8ueccb.

37 European Commission Taxation and Customs Union website, https://tinyurl.com/ysbxy866.

proposed ban on steel scrap exports from the EU, a key input for steel production, will significantly hinder developing countries' capacity to produce more carbon-efficient steel. This measure can be perceived as the EU attempting to enjoy the benefits of both sides while also imposing trade restrictions.

Likely impact on India

The share of CBAM exports in total Indian exports to the EU has increased substantially from 6.3 per cent in 2014 to 10.5 per cent in 2023.[38] Table III.1 presents the commodity-wise exposure of India's exports to the EU, which are likely to be impacted by CBAM.

Table III.1: India's exposure to CBAM Value of exports (USD million)

	2014	2023
Iron and steel	2962.6	5557.1
Aluminium	151.4	1801
Cement	4.2	8.3
Fertilisers	0.7	2
Source: UNCOMTRADE database (2024)		

According to the World Bank's Relative CBAM Exposure Index[39], India has a score of 0.03, reflecting a high exposure to CBAM.[40] Countries like India face the twin challenge of achieving higher levels of economic development and dealing with climate change mitigation and adaptation. Therefore, the international community must find a balance that supports both environmental sustainability and the economic development needs of developing economies and LDCs, ensuring that multilateralism remains the cornerstone of global trade relations.[41]

European Union Deforestation Regulation

The EUDR (whose implementation will start at the end of 2025 and in 2026 for smaller businesses) seeks to regulate the consumption of products derived from deforested land. The EUDR places several compliances on the operators and traders of the relevant products

38 'Intermingling of Trade and Environment Policy: Implications of EU-CBAM on India and LDCs', EPW, 16 November 2024 https://tinyurl.com/yb32jhdp.

39 CBAM exposure index is measured as the mathematical product of two main elements-the share of a country's exports of the CBAM-related product that goes to the EU and the embodied carbon payment per dollar of export to the EU, determined by the carbon emissions intensity of production and the assumed cost of the CBAM certificates.CBAM exposure index is measured by multiplying the export share by the embodied carbon payment per dollar of export to the EU (the exporter's emission intensity times $100 per ton carbon price).

40 World Banka data on Relative CBAM Exposure Index, https://tinyurl.com/4hbp64z8.

41 Based on the inputs received from the Ministry of Commerce and Industry.

covered under the regulation.[42] It requires the operators and traders to ensure that the products placed in the EU market are (i) deforestation-free (i.e., must not be derived from a land which is deforested after December 31 2020); (ii) should be produced by the relevant legislation of the country where the product is produced; and (iii) covers the submission of a due diligence statement, including supply chain integrity through an elaborate trace and track system before placing the products in the EU.

The regulation also entails devising a country-level benchmarking system indicating the forest degradation and deforestation risk by the EU. The benchmarking system would be based on a three-tier system for classifying countries as low, standard, or high risk, which would be determined based on internationally recognised information and data on whether a country is active in reducing deforestation. High-risk countries would be required to exercise higher due diligence for the relevant products compared to low or standard-risk countries. This categorisation of countries would be used to identify the checks to be carried out by the EU authorities. High-risk countries would be subject to more rigorous checks than countries categorised as having low-risk.[43]

The regulation covers products such as soy, beef, palm oil, wood, cocoa, coffee, rubber, and their derived products, such as leather, chocolate, tyres, or furniture.[44] It puts the onus of proving compliance on the operator or trader who wishes to sell these products in the EU markets.[45] The costs of complying with the regulation include information requirements, risk assessment, risk mitigation and reporting obligations. These costs are not border measures but affect the competitiveness of a country's exports vis-à-vis other countries' compliance costs. Therefore, the Regulation would change the trade costs (increase) for the EU's trading partners in specific commodities.

As per a GTRI study[46], as far as India's exports are concerned, coffee, leather hide and skin preparations, oil cake, paper, paperboard, and wood furniture could be highly impacted by the Regulation. It also compares the tariff lines covered under the Regulation vis-à-vis

42 The Regulation defines an "operator" as natural or legal person who, in the course of a commercial activity, places relevant products on the market or exports them and a "trader" as any person in the supply chain other than the operator who, in the course of a commercial activity, makes relevant products available on the market.

43 As per the Regulation dated 31 May 2023, "In respect of relevant products from countries or parts thereof classified as high risk, the respective operators and traders and the volumes of their share of relevant commodities and relevant products, a twofold approach that provides comprehensive coverage should apply. Competent authorities should thus be required to check on a certain percentage of operators and traders, whilst also covering a specific percentage of relevant products. In respect of relevant products from countries or parts thereof classified as low or standard risk, competent authorities should be required to check at least a certain percentage of operators and traders. The level of checks should be higher for relevant products from high-risk countries or parts thereof whereas it could be lower for standard or low-risk countries or parts thereof."

44 The list of products covered under the Regulation is available at Annex I of the Regulation dated 31 May 2023, available at https://tinyurl.com/bddmuysp.

45 Article 2 (15) of the Regulation states, "An operator is a natural or legal person who places relevant products on the Union market or exports them from the Union market in the course of commercial activity."

46 GTRI brief dated 1 August 2023, 'Deforestation and Compliance Challenges: A Blow to India's Agri Exports as EU's Deforestation Regulation (EUDR) Deadline Looms', https://gtri.co.in/gtriFlagshipRep12.pdf.

CBAM, out of which the latter is wider in its coverage. The CBAM and EUDR are expected to affect USD 9.5 billion of India's exports to the EU, which amounts to 9 per cent of India's exports to the world or 12.9 per cent of India's exports to the EU. The study informs that the regulation effectively encourages local production and export of selected agricultural commodities by erecting more barriers against imports in the name of climate.

According to the United Nations Food and Agriculture Organisation, around 420 million hectares of forest were lost globally due to deforestation between 1990 and 2020, an area the size of the EU.[47] In Europe, conversion to cropland accounted for about 15 per cent of deforestation during the same time period.[48] European agriculture could not have come up without deforestation, and the imposition of EUDR reeks of double standards. Thus, that a region that has resorted to significant deforestation to expand crop production is implementing the EUDR to regulate the consumption of products sourced from deforested land, appears quite contradictory, even as it is unsurprising.

In short, it is hard to shake off the conclusion that both CBAM and EUDR are trade protection measures garbed in the language of climate and environment. The game and the end goals are the same, but the tactics keep changing. Labour standards, gender, democracy, emissions

and deforestation, the innovative list will keep evolving with time. Institutions and practices evolve with development. Today's developed countries do not conform to the standards that they expect from developing countries at a similar stage of development. But then, intellectual consistency is not really the goal here.

3.18 NTMs are playing an increasing role in international trade due to a decline in the usage of tariffs worldwide via successive agreements under the General Agreement on Tariffs and Trade/WTO and due to growing consumer concerns about food safety, quality, and environmental protection.[49] A UNCTAD report[50] notes that NTMs can serve as legitimate policy instruments, fulfilling important roles such as protecting human health and the environment. In some cases, they may even enhance trade. For instance, when an exporting country implements high sanitary and phytosanitary standards, consumers in importing countries tend to have greater confidence in the quality of the food products, which can lead to increased demand. Stricter domestic food safety standards can also help local exporters meet the requirements of their trade partners, further boosting trade opportunities.

3.19 Though many NTMs aim primarily to protect public health or the environment, they also adversely impact trade by increasing information, compliance, and procedural costs. This is significant for exporters and importers because accessing and benefiting from markets increasingly depends on adherence to trade regulations, such as sanitary

47 United Nations Food and Agriculture Organisation, https://tinyurl.com/3fzythxj.

48 https://tinyurl.com/44mu2hnj.

49 UNCTAD document, 'non-tariff measures: definitions and basic facts', https://tinyurl.com/y7hwd55u.

50 UNCTAD report, 'Trade costs of non-tariff measures now more than double that of tariffs,' https://tinyurl.com/55tk5fut.

standards and product quality requirements. For instance, a regulation that limits pesticide residues in food products seeks to achieve a significant public health goal of protecting human health and nutrition. However, this regulation imposes additional compliance requirements on firms in exporting countries, and some may find that exporting is no longer profitable. Consequently, such regulations can restrict trade, leading to lower incomes in exporting countries and higher prices for consumers in importing countries. This issue mainly affects smaller exporters and low-income countries, as they often bear a disproportionate burden from these NTMs.[51]

3.20 NTMs can indirectly affect FDI through their impact on imports. A firm might decide to bypass an NTM by engaging in FDI if the costs associated with this approach are lower than the costs of exporting. Additionally, NTMs can encourage inward FDI to the country that imposes them, as these measures raise barriers to market access. Research has demonstrated that NTMs have a positive impact on FDI. For example, if the average number of NTMs applied to a product increases from 2.5 to 3.5 NTMs per product, FDI could increase by 12 per cent. Certain NTMs, such as intellectual property rights, local content requirements, and TBT in specific sectors, appear to affect FDI significantly.[52]

TREND IN INDIA'S TRADE PERFORMANCE

3.21 India's trade sector has demonstrated remarkable stability and growth, achieving milestones despite global economic headwinds. Following a dip in FY20 amid the global downturn and the pandemic, overall exports rebounded strongly in FY22, reaching a record high in FY23. This momentum continued into FY24, with overall exports surpassing the previous year's record, even as imports moderated slightly.

3.22 India's total exports (merchandise+services) have shown positive momentum in the first nine months of FY25, reaching USD 602.6 billion, witnessing a YoY growth of 6 per cent. This increase demonstrates the resilience of exports, which have been building on a steady upward trend in recent years despite global economic challenges. Total imports during April-December 2024 reached USD 682.2 billion, registering a YoY growth of 6.9 per cent. This positive import growth indicates a steady demand for goods in the Indian market, supporting domestic consumption and production needs. A more significant increase in overall imports compared to exports led to a rise in the overall trade deficit from USD 69.7 billion during April-December 2023 to USD 79.5 billion in the corresponding period of FY25.

3.23 During April-December 2024, non-petroleum exports were up by 7.1 per cent. Over the same period, non-petroleum and non-gems and jewellery exports rose by 9.1 per cent. Specific sectors like drugs and pharmaceuticals, electronic goods, engineering

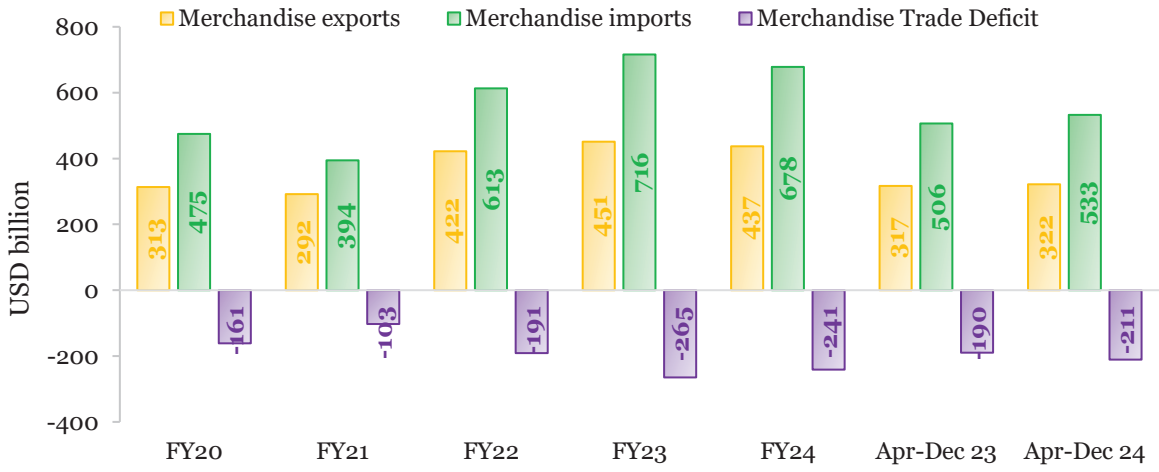
51 UNCTAD document on 'Introduction to NTMs', https://tinyurl.com/mr3a95en.

52 Ibid note 50.

goods, and chemicals saw an increase in exports, growing by 6.4 per cent, 28.6 per cent, 9.9 per cent, and 5 per cent, respectively, during April-December 2024 on a YoY basis. Textile exports[53] also saw a YoY increase of 7.6 per cent during the same period. Rising inflationary pressures on cereals, pulses, and edible oils limited the exports of agricultural and allied products. Overall, merchandise exports registered a modest growth of 1.6 per cent (YoY basis) primarily attributed to a decline in the value of petroleum product exports due to a fall in international commodity prices.

3.24 Merchandise imports grew by 5.2 per cent during April-December 2024. This increase was largely due to a rise in non-oil, non-gold imports, which reached USD 352.1 billion in the first nine months of FY25 compared to USD 340.5 billion during the same period last year, indicating a rebound in domestic consumption despite the inflationary impact. Gold imports increased due to higher international prices, driven by frontloading ahead of festival spending and demand for safe-haven assets. Among the major non-oil, non-gold imports, non-ferrous metals, machine tools, machinery, electrical & non-electrical goods, and transport equipment witnessed remarkable growth in the first nine months of FY25, reflecting growing demand for capital goods. Electronic goods also maintained consistent momentum, signalling a rise in discretionary consumer spending. Additionally, imports of pulses and cotton rose to support domestic production and control inflation.

Chart III.5: Trends in merchandise trade



Source: DGCIS, M/o Commerce & Industry

3.25 The faster pace of increase in merchandise imports compared to exports contributed to the widening of the merchandise trade deficit to USD 210.8 billion in April-December 2024, compared to USD 189.7 billion in the same period last year.

53 Textile exports include Cotton Yarn/Fabrics/made-ups, Handloom Products, Man-made Yarn/Fabrics/made-ups, etc., RMG of all Textiles, Jute Mfg. including Floor covering, carpet and Handicrafts, excluding handmade carpet.

Textile exports

3.26 India's textile sector has been a matter of pride and strength to the nation for centuries. From the unique prints and weaves to the rich dyes and handwork, the textile sector weaves various aspects of our cultural, social, and historical heritage. India is the sixth-largest exporter of textiles and apparel globally. The textile and apparel industry contributes 2.3 per cent of GDP, 13 per cent to industrial production, and 12 per cent to exports.[54] It is also one of the largest employment generators after agriculture, with over 45 million people employed directly, including many women and the rural population.[55] As further evidence of the inclusive nature of this industry, nearly 80 per cent of its capacity is spread across Micro, Small and Medium Enterprises (MSME) clusters in the country.[56]

3.27 India exported textile items worth USD 34 billion in 2023, with apparel constituting 42 per cent of the export basket (USD 14.6 billion), followed by raw materials/semi-finished materials at 34 per cent (USD 11.7 billion) and finished non-apparel goods at 30 per cent (USD 7.8 billion).[57] Europe and the US consumed nearly 66 per cent of India's apparel exports, 58 per cent of finished non-apparel goods and 12 per cent of raw materials/semi-finished materials. Other prominent destinations include the UK (8 per cent of apparel exports) and the UAE (7 per cent).

Chart III.6: India's textile exports over the past decade

Source – Based on analysis at the HS-6 product level, data sourced from ITC Trademap

3.28 Generally, the Indian textile export basket is skewed towards cotton and cotton-based products. In 2023, for example, eight out of the top 10 textile exports (by value) consisted of cotton and cotton-based products. For India's major textile export category,

54 https://www.ibef.org/industry/textiles.

55 Ibid note 54.

56 Invest India report, 'Textile & Apparel Industry: The Change Agent of India', https://tinyurl.com/mtzhfarh.

57 Analysis based on UN COMTRADE data at the tariff level.

i.e., apparel, the country enjoyed a market share of 2.8 per cent globally in 2023. However, this is much lower than that of key players in the industry, such as China (30 per cent), Bangladesh (9 per cent), and Vietnam (7 per cent). Further analysis at the HS-6 levels reveals that while India offers stiff competition to other exporters[58] for nearly USD 3 billion worth of apparel exports, the remaining apparel basket is yet to match our competitors' comparative advantage.

3.29 Textile exports remained resilient throughout the COVID-19 period between 2020 to 2022, but their performance has been weak over a decadal timeframe. Box III.3 elaborates on potential factors that impede export growth and opportunities that must be tapped for the sector to reach its goal of USD 150 billion in textile exports by 2030.[59]

Box III.3: Time to be deft about our warp and weft!

Costs that chip away at textile export growth

India's textile production occurs across multiple independent and clustered Small and Medium Enterprises (SMEs) spread across the country. Take cotton production, for example, which is spread across Gujarat, Madhya Pradesh, and Andhra Pradesh. The fresh produce of cotton then travels down to Tamil Nadu, where cotton yarns are produced. The yarns then travel to parts of Maharashtra and Gujarat before being weaved into cotton fabric. A lack of localisation and the complexity of the value chain, in turn, results in higher costs relative to global competitors. In contrast, vertically integrated 'fibre-to-fashion' firms in competitor nations such as China and Vietnam export low-cost products, maintain consistent quality and are nimble enough to adjust to the fast-changing nature of the industry. Simple and liberal customs procedures further reduce regulatory costs and lend a competitive edge to the exports of global textile competitors such as China and Vietnam.

On the other hand, in India textile exporters are constrained by complex procedures, which, for instance, require exporters to meticulously account for every square centimetre of fabric, buttons and zippers used. Similarly, pre-shipment inspection certificates are required for textile imports, which slows down logistics and raises costs for the textile business.[60]

58 Exports at the HS-6 level enjoy a market share that is within the periphery or higher than the market share of China, Vietnam, Indonesia, and Bangladesh.

59 PIB press release of Ministry of Textiles dated 18 November 2024, https://tinyurl.com/jhvcuttm

60 GTRI report, July 2024, 'How complex procedures, import restrictions and domestic interests hinder India's garment exports', https://tinyurl.com/yxjxjzyz.

Apart from possessing structural attributes (such as vertical integration, liberal labour laws, etc.) that allow for cost advantages, competitors in the textile market also have the added benefit of FTAs with consumer countries. In effect, Indian apparel exports do not face a level playing field compared to its competition. For instance, as noted by Mukherjee et al. 2019[61], even though India has a significant comparative advantage in exporting silk shawls and scarves, the country faces a high tariff rate of 11.3 per cent in the US. In comparison, competitors like Korea face zero tariffs on their silk scarf exports due to trade agreements such as the US-Korea FTA.

In general, the costs for the textile industry are likely to rise over the coming years. A global structural shift towards sustainable sourcing would drive this. Often, such a shift is necessitated by regulatory changes. The EU, for instance, has as many as 16 pieces of legislation spanning the entire fashion value chain, which came into force between 2021 and 2024.[62] As the EU accounts for nearly 20 per cent of our exports, such a shift poses a challenge for small enterprises who need to shift to environmentally sustainable production methods.

Changing trends in the global textile industry

India has a great opportunity to align with the evolving global shifts in apparel demand. While our comparative advantage lies in cotton and cotton-based products, global demand has shifted to products made from man-made fibre (MMF). MMF-based products range from yoga pants and athleisure wear to technical textiles in aviation, aerospace, and automobiles.

As per International Cotton Association, MMF comprised 77 per cent of global fibre consumption in 2024, whereas it was just 22 per cent for cotton.

By tapping into the MMF value chain, India will benefit from the steady rise in global MMF demand. India's share of global MMF production is currently 9.2 per cent, and the potential to catch up with the production levels of global leaders like Vietnam, China, and Taiwan is high.[63]

To match the quality of our competition and reap value gains from MMF production, our MMF sector must move towards vertical integration and significantly invest in research and development and sustainable production techniques.

Fashioning India's textile exports to a global audience–recent schemes and opportunities ahead

In recent years, the government has announced many policies in response to the changing nature of global demand and high relative costs faced by Indian exporters. A PLI scheme has been put in place for the sector with an outlay of ₹10,683 crore, which rewards capacity

61 Ideas for India, 'Trade agreements and their impact on India's apparel exports', https://tinyurl.com/22exauh4.

62 McKinsey article, 'Reimagining the apparel value chain amid volatility', https://tinyurl.com/2nhedse4.

63 As per World Textile Demand Report, 2024; https://tinyurl.com/52m82u5k

Chart III.7: World consumption of major textile fibres

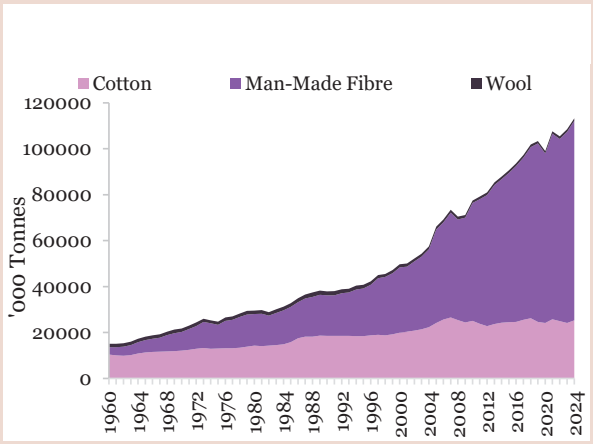
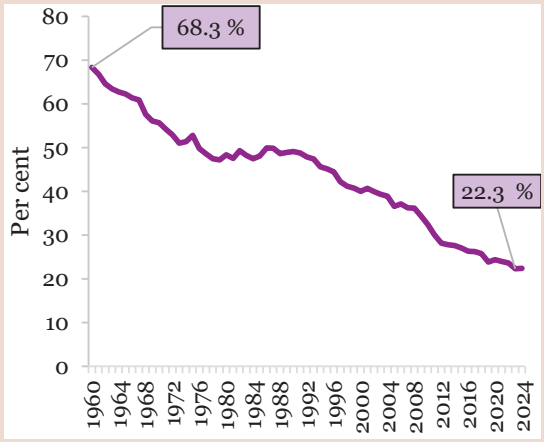


Chart III.8: Cotton's market share in the global market for fibres



Source: International Cotton Association (ICA)

creation through investments in the industry. As MMF products require heavy research and development suited to different use cases, the National Technical Textiles Mission (NTTM) has been approved with an outlay of ₹1,480 crore. As of 2024, 168 research projects (worth ₹509 crore) were approved under the NTTM mission.[64]

In response to the need for a vertically integrated textile industry, the government-sanctioned Pradhan Mantri Mega Integrated Textile Region and Apparel (PM-MITRA) parks across seven sites in 2022 to create world-class plug-and-play infrastructure and invite FDI into the textile sector. World-class, standardised infrastructure will also aid textile exporters in responding better to changing ESG requirements in the industry. To help with cost competitiveness, the Government approved the continuation of the Scheme for Rebate of State and Central Taxes and Levies (RoSCTL) for export of Apparel/Garments and Made-ups up to 31 March 2026 in the interim Union Budget FY25[65]. Further, deep FTAs such as the UAE-India CEPA (2022) have helped reduce India's textile tariffs with a significant market. India is actively working towards negotiating trade deals with top importers such as the EU and the UK.

India's textile sector has several tailwinds working in its favour. For instance, as per McKinsey's chief procurement officer survey, the share of procurement officers looking to form long-term strategic partnerships (including volume commitments) has more than doubled between 2019 and 2023.[66] Further, more than 40 per cent of procurement officers surveyed plan to increase their sourcing from India, Bangladesh, and Vietnam.

64 PIB press release of Ministry of Textiles dated 12 November 2024, https://tinyurl.com/4kf8sdnz.

65 PIB press release dated 1 February 2024, https://tinyurl.com/35faj878.

66 McKinsey article, 'Reimagining the apparel value chain amid volatility', https://tinyurl.com/2nhedse4.

While there are tailwinds which will support the growth of India's textile exports, these cannot be fully exploited without lowering the costs of the textile basket and deepening our market share in the MMF sector. These objectives would require the industry to step up its research efforts and vertically integrate and tailor products to international quality and sustainability requirements.

Simplification, consolidation, and elimination of processes that consume the financial and managerial bandwidth of our exporters is a low-hanging fruit. Addressing these challenges can significantly reduce costs and ease the burden on exporters, helping them become more efficient and competitive.

Diversification of India's exports to new markets

3.30 As discussed in a Collection of Essays of the Department of Economic Affairs[67], over time, India has added a large number of new products to its export basket. Between 1994 and 2022, India has not just carved out new markets but has become the market leader in some of the new product categories. For instance, India is a top exporter of shipping vessels (with nearly 33 per cent market share). Similarly, it is a leading exporter of iron and steel alloys, an unexplored market before 1994.

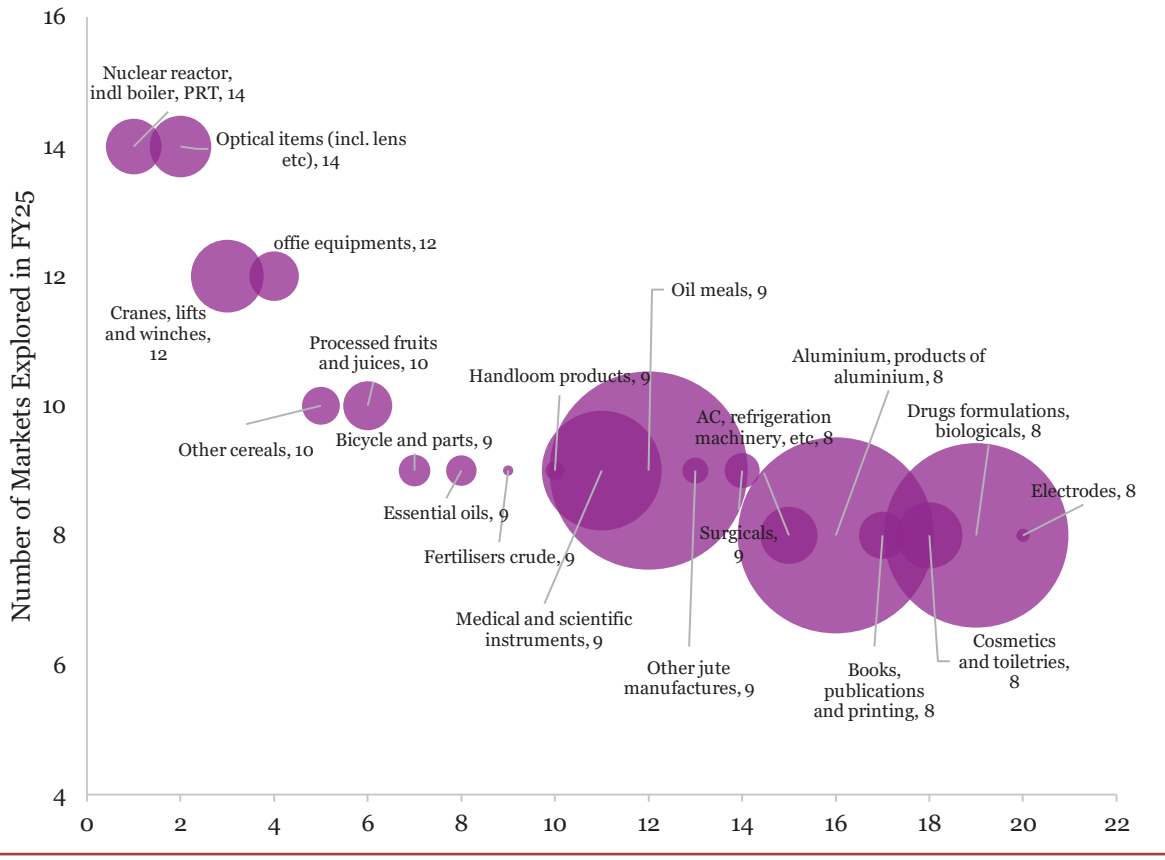
3.31 Between April and November 2024, India's exports saw significant growth and expansion into diverse markets despite high global challenges. The analysis depicts the number of diverse markets, consisting of absolutely new markets where no exports were observed between April and November 2023, but exports happened in the corresponding period of FY25. It also includes new markets where export share was 0-0.1 per cent from April to November 2023 and rose to over 0.1 per cent with growth in value greater than 25 per cent in the corresponding period of FY25. Further, promising markets, where export share was 0.1-1 per cent in April to November 2023 and rose to over 1 per cent with growth in value greater than 25 per cent in April to November 2024. The size of the dot reflects the value of exports. The analysis has been done based on the data available for key Principal Commodities (PCs).

3.32 These 20 PCs were selected based on two criteria: firstly, the PCs were sorted in descending order of the number of new markets explored, and secondly, the PCs had an export value of more than USD 100 million. For instance, Chat III.15 shows that optical items had an export value of USD 16.6 million from April to November 2024 and were exported to 14 new markets (Zimbabwe, Vietnam, Tanzania, Uganda, Tunisia, Romania, Qatar, Philippines, Mozambique, Kuwait, South Korea, Iraq, Ghana, Finland). Similarly, the export of cranes, lifts and winches had a value of USD 23.1 million from April to November 2024, which has been exported to 12 new markets (Taiwan, Somalia, Portugal, Myanmar, Morocco, Madagascar, Lithuania, Jordan, Honduras, Cameroon, Armenia). Further, office equipment & medical-scientific instruments have an export value of USD 10.7 million (exported to 12 new markets) and USD 62.7 million (exported

67 Re-examining Narratives: A Collection of Essays, https://tinyurl.com/4rap2xpx.

to 9 new markets), respectively. Surgicals has also been exported to nine new markets with a total value of USD 5.4 million.

Chart III.9: Number of new markets explored for key PCs (April – November 2024)



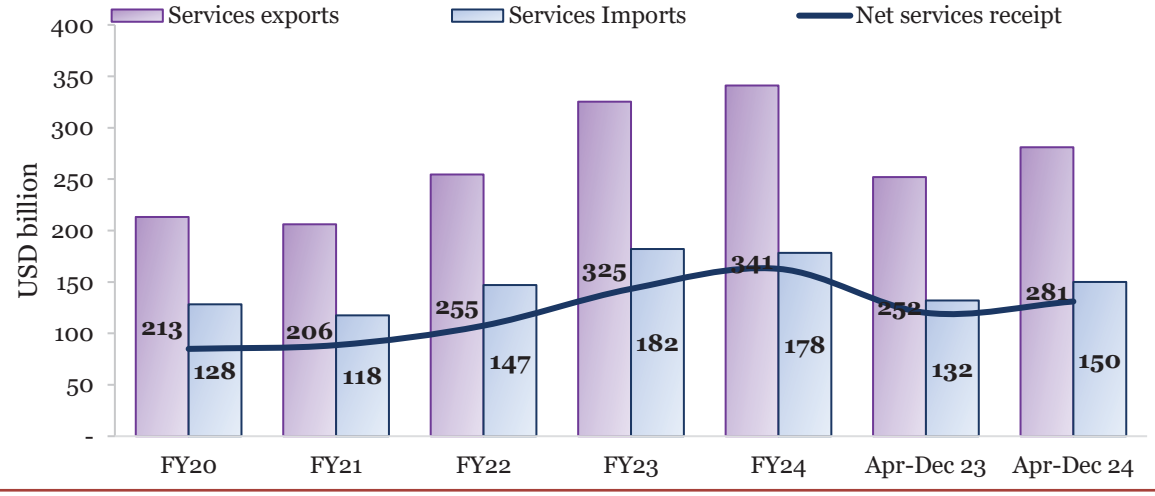
Source: DGCIS

3.33 These trends reflect India's ability to maintain and even strengthen its presence in established markets. It also highlights the country's resilience and adaptability in navigating evolving global landscapes. Simultaneously, the exploration of new markets signifies a proactive approach to expanding its export reach and reducing dependency on any single market or region. This diversification strategy mitigates risks associated with market fluctuations and positions India as a more competitive player in the international trade landscape while contributing to the country's economic development.

Services trade remained resilient amidst global challenges

3.34 Services sector exports have demonstrated resilience, while merchandise exports have witnessed moderation in recent months. They grew at 11.6 per cent in the first nine months of FY25 amidst unfavourable geopolitical conditions. The rise in services exports contributed to an increase in net services receipts from USD 120.1 billion in the first nine months of FY24 to USD 131.3 billion during the corresponding period of FY25.

Chart III.10: Rise in net services receipts in the first nine months of FY25



Source: RBI

3.35 Services exports from India have shown a multi-sectoral presence in global exports, with notable contributions across several sectors. India's share in global services exports has more than doubled, reaching around 4.3 per cent in 2023 from 1.9 per cent in 2005.[68] In 'Telecommunications, Computer, & Information Services', India commands 10.2 per cent of the global exports market (ranking 2nd largest exporter in the world), reflecting its strong position in IT outsourcing, software development, and digital services. The 'Other Business Services sector' also plays a crucial role, with India holding 7.2 per cent of the world share (ranking 3rd largest exporter in the world), driven by its expertise in professional and consulting services.[69]

3.36 'Travel' and 'Transport' services represent areas where India holds a relatively smaller share in global exports, at 2.1 per cent and 2.2 per cent, respectively, likely facing competition from other worldwide tourism and logistics hubs. There are opportunities for further growth, especially in enhancing international tourism infrastructure and global transport networks. India's financial services sector lags behind the global average, highlighting the potential for growth in global banking, insurance, and investment services. On the other hand, with a global share of 3.4 per cent in 'Personal, Cultural, & Recreational' services and 3.5 per cent in 'Construction services,' India ranks 6th and 8th, respectively, demonstrating its competitive edge in cultural exports and international infrastructure projects.

3.37 India remains a global leader in IT and business services, but there is considerable untapped potential in travel, transport, and financial services. As the country becomes a hub for Global Capability Centres and continues to innovate, focusing on skill development and strategic policy interventions will be key to sustaining this momentum. Strengthening emerging sectors and improving global competitiveness will ensure

68 UNCTAD Stats, https://tinyurl.com/2s42av87.

69 Based on UNCTAD-WTO Stats.

India remains a dominant player in the services sector in the times to come.

India's e-commerce exports

3.38 The e-commerce industry in India has experienced swift expansion over the past few years, driven by various elements such as the rise of technology-powered advancements like online payments, localised delivery services, data-driven interactions with customers, and digital marketing. According to a report, the global B2C e-commerce market is expected to grow from USD 5.7 trillion in 2022 to USD 8.1 trillion by 2026 at a CAGR of 9.1 per cent. Correspondingly, India's B2C e-commerce market was worth USD 83 billion in 2022, and it is anticipated to grow to USD 150 billion by 2026, showing a CAGR of 15.9 per cent.[70] However, by current market size, India's e-commerce market makes up a small fraction, about 1.5 per cent of the global market, and it is projected to stay around 2 per cent in the coming years. These exports generated an estimated USD 4 to 5 billion in exports during FY23 and are expected to increase to USD 200 to USD 300 billion by 2030.[71] Box III.4 discusses the factors and policies that have played a key role in enhancing India's e-commerce exports.

Box III. 4: Factors driving India's e-commerce exports

Expanding data connectivity, increased penetration of smartphones, a rise in availability and use of digital wallets and safer online payments, increased customers' income levels and growing familiarity with digital shopping platforms have provided an impetus to India's e-commerce exports. Customers increasingly prefer customised products from skilled artisans, and India can leverage its rich tradition of handcrafted items to meet this demand. Additionally, exporters can increase their profits by reducing costs associated with intermediaries like agents and shopkeepers, making e-commerce a lucrative option for selling products.[72]

Government initiatives, such as Make in India and *Aatmanirbhar Bharat*, have enhanced support and focus on MSMEs and e-commerce exports, thereby paving the way for more domestic sellers going global. These initiatives have provided a conducive environment for businesses to thrive and expand their reach. Recognising the relevance of e-commerce exports, the Foreign Trade Policy (FTP) 2023 has laid down provisions for fostering cross-border digital trade and promoting e-commerce and other emerging export channels. These include the *Niryat Bandhu* scheme[73], financial assistance to e-commerce exporters under the Market Access Initiative (MAI) scheme, export and packing credit[74], e-commerce exporthubs[75],

70 ASSOCHAM and EY report, 'Enabling e-commerce exports from India', https://tinyurl.com/ye29x47m.

71 PIB press release of Ministry of Commerce and Industry dated 31 March 2023, https://tinyurl.com/ny9psh8e.

72 GTRI report dated March 2023, 'Making e-commerce exports a Bigger Success Story than IT: A Blueprint for Realising India's E-Commerce Exports Potential', https://gtri.co.in/gtriRep8.pdf.

73 Handholding and outreach programs, capacity building and skill development building to boost e-commerce exports from the country.

74 Offering collateral-free, low-interest financing for both pre-and post-shipment stages to improve cash flow and aid manufacturing costs, https://tinyurl.com/5cfwwxtx.

75 Through a Public Private Partnership (PPP) model, it aims to centralise facilities (storage, packaging, labelling, certification, testing etc.) and infrastructure for cross-border e-commerce activities.

Dak Niryat Kendra[76], and electronic Bank Realisation Certificate (e-BRC).[77] Further, the GST regime offers the benefit of zero-rated supplies[78], and e-commerce exporters are eligible for GST refunds.[79]

In the recent past, various initiatives have been undertaken by state governments in collaboration with e-commerce market players to boost exports. These have included organising e-export Haat[80] and signing a Memorandum of Understanding (MoU) with leading e-commerce players to drive e-commerce exports, etc.[81] The Uttar Pradesh government has recently implemented measures to enhance packaging and export capabilities by leveraging design, technology, and market access. The government is also planning to set up e-commerce hubs to facilitate small producers to sell to aggregators.[82] The governmen t of Telangana has announced a new MSME policy which, inter-alia, envisages an increase in e-commerce penetration in MSMEs by encouraging the participation of sellers on the ONDC portal and GeM portal.[83]

The central government's E-Commerce Export Hub (ECEH) initiative aims to revolutionise India's cross-border e-commerce. These hubs connect SMEs, artisans, and One District One Product (ODOP) producers to global markets, boosting logistics efficiency and economic inclusion in Tier 2 and Tier 3 cities. On the Government e-Marketplace (GeM), revised pricing slabs now cap charges at ₹3 lakh for orders above ₹10 crore, significantly reducing transaction costs. The *Bharat Mart* in Dubai provides Indian MSMEs affordable access to the Gulf Cooperation Council, African, and CIS markets, enhancing exports to these regions.[84]

The e-commerce export ecosystem in India presents opportunities for growth alongside a few challenges related to regulatory frameworks and compliance obligations. For example, the roles of sellers and e-commerce platform operators are not yet clearly defined. This requires collaboration between sellers and e-commerce operators at various stages of export and payment processes. Presently, exports are facilitated through two primary modes, courier and cargo, with a courier export value limit of USD 12,000 (₹10 lakh), which is less compared to other countries.[85]

76 Scheme for promoting e-commerce exports through postal route to work as a hub and spoke model in collaboration with Foreign Post Offices to enhance e-commerce exports through postal route.

77 Pilot of enhanced electronic bank realisation certificate (e-BRC) system basis in which the exporters can self-certify their e-BRC.

78 As per section 2(47) of the CGST Act, 2017, a supply is said to be exempt, when it attracts nil rate of duty or is specifically exempted by a notification or kept out of the purview of tax (i.e., a non-GST supply).

79 This enables the exporter to claim a refund of tax paid on such supplies and a refund of unutilised input tax credit under the Letter of Undertaking.

80 Amazon news, 'WBICS, Amazon and FICCI join hands to promote e-commerce exports from West Bengal', https://tinyurl.com/4jsratx6.

81 Amazon news, Amazon signs an MoU with Government of Karnataka to drive e-commerce Exports for lakhs of MSMEs in the state', https://tinyurl.com/5afkc7zs.

82 Indian Trade and Logistics news, 'Flipkart opens new fulfilment centres in Unnao, Varanasi', https://tinyurl.com/37zs4h4v.

83 Draft Export Strategy Framework of Telangana, https://tinyurl.com/ysf69a8z.

84 https://pib.gov.in/PressReleasePage.aspx?PRID=2079986.

85 In the case of China, the consignment limit for e-commerce exports is USD 50,000, https://content.dgft.gov.in/Website/EcommExportHandbokMSME_E.pdf.

Additionally, the absence of distinct customs supervision codes for traditional and e-commerce exports leads to delays in customs verification, and hinders data collection for further policy interventions.[86]

The RBI manages the Foreign Exchange Management Act (FEMA) of 1999, which requires foreign exchange receipts within nine months of shipment. This timeline supports efficient transactions but may pose challenges for e-commerce operators handling shipments sold over 12 to 18 months. It opens the door to exploring more flexible reconciliation timelines. The Export Data Processing and Monitoring System (EDPMS) aids in payment reconciliation, with costs ranging from USD 18 to USD 36 (₹1,500-₹3,000). There is a need for cost optimisation, particularly for small-value shipments. Additionally, reimporting of e-commerce refunds/rejects is exempted from duty only when it can be proven that the reimported goods, are the same as those exported, which is a cumbersome process. Simplifying these further could improve operational efficiency.[87]

India's e-commerce exports hold immense potential to grow significantly and become a key contributor to the country's GDP. Addressing some of the existing challenges can further unlock opportunities for the sector to achieve its full potential and strengthen its position among leading global e-commerce exporters.

EASE OF DOING BUSINESS INITIATIVES FOR EXPORTERS

3.39 An important area of focus is enhancing logistics efficiency to strengthen India's manufacturing and export capabilities. The development of logistics hubs, investments in infrastructure, and policy reforms to improve supply chain efficiency are measures in this direction. Such efforts aim to lower costs for Indian businesses, making exports more competitive and enabling quicker, smoother movement of goods domestically and internationally. This approach aligns with the government's commitment to the National Logistics Policy.

3.40 The paperless e-BRC system has reduced costs for 2.5 million e-BRCs annually by over ₹125 crore, streamlined processes and helped exporters benefit from schemes under the FTP. It has cut down both administrative and environmental expenses. Small exporters, especially in e-commerce, have benefitted from the system's efficiency in handling high-volume, low-cost transactions, enabling them to claim benefits and refunds more effectively.

3.41 A new Directorate General of Foreign Trade (DGFT) 'Trade Connect e-Platform' has been launched which is a single window initiative enabling exporters to add newer markets. The e-platform aims to transform the international trade landscape for Indian exporters, especially MSMEs. The platform, developed in collaboration with key partners, including the Ministry of MSME, EXIM Bank, Department of Financial Services, and the Ministry of External Affairs, is set to address information asymmetry by offering exporters comprehensive support and resources. It is a one-stop solution,

86 Ibid note 70.

87 Ibid note 70.

providing exporters with near real-time access to critical trade-related information while seamlessly connecting them to key government entities such as the Indian Missions abroad, the DoC, Export Promotion Councils, and other trade experts. Whether a seasoned exporter or a new entrant, the platform is designed to assist businesses at every stage of their export journey. This e-platform shall connect more than 6 lakh IEC (Importer Exporter Code) holders, over 180 Indian Mission officials, and over 600 Export Promotion Council Officials, besides the officials from DGFT, DoC, banks, etc.

3.42 The DGFT Trade Facilitation Mobile App provides all information on FTP Updates, Import/Export Policy, Export/Import Statistics, the status of applications, and 24×7 virtual assistance. The department also provides 24×7 auto-generation of e-IEC. This enables users to not wait for any approval for an IEC. The IEC details are automatically validated against CBDT, MCA, and PFMS systems.

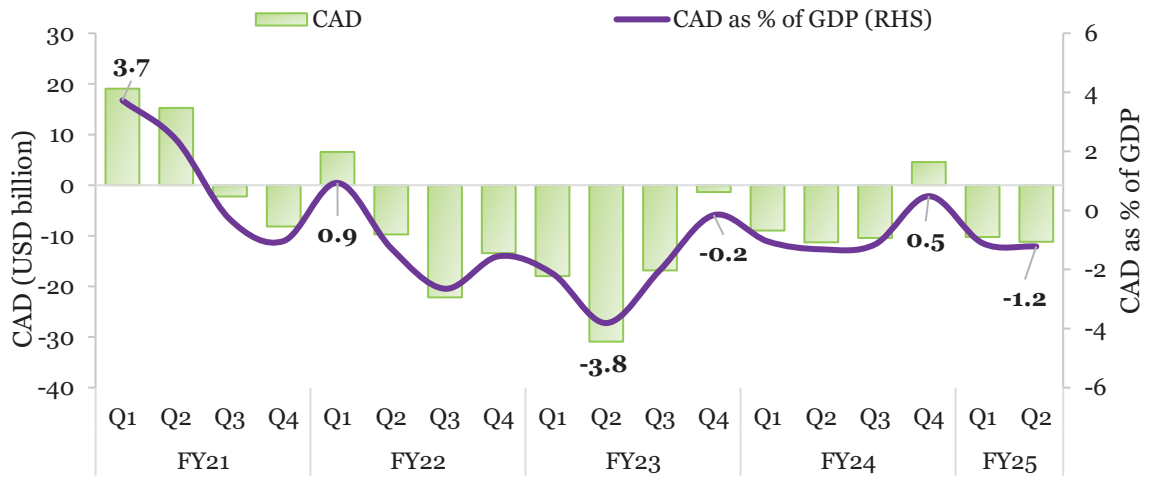
BALANCE OF PAYMENTS: RESILIENCE AMID CHALLENGES

3.43 Against the backdrop of uncertainties in the external trade and investment environment, India's Balance of Payments (BoP) position has remained stable, led by resilient services exports, benign crude oil prices, renewed foreign portfolio inflows, and a revival in FDI flows. These trends are discussed in this Section.

Current account

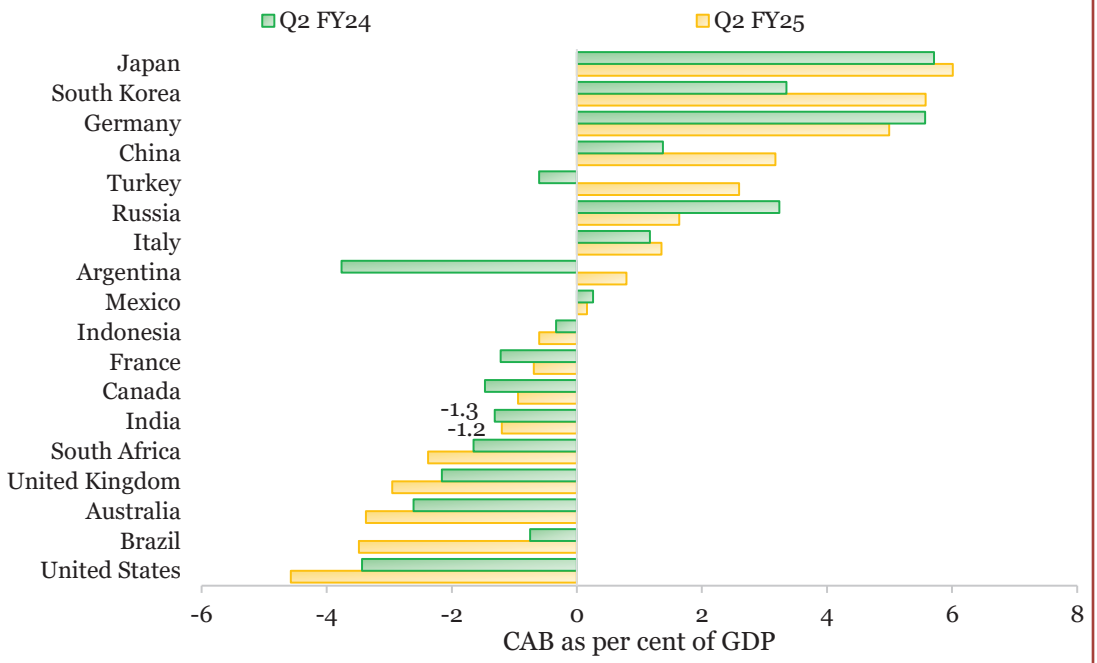
3.44 India's current account deficit (CAD) moderated slightly to 1.2 per cent of GDP in Q2 of FY25 against 1.3 per cent of the GDP recorded in Q2 of FY24. The recent rise in the CAD can be attributed to an increase in the merchandise trade deficit, which rose to USD 75.3 billion in Q2 of FY25 from USD 64.5 billion in the corresponding quarter of the previous year. The rising net services receipts and increase in private transfer receipts cushioned the expansion in the merchandise trade deficit. Net service receipts increased to USD 44.5 billion in Q2 of FY25 from USD 39.9 billion in the corresponding quarter in FY24.

Chart III. 11: Trend in current account deficit



Source: RBI press release on developments in India's Balance of Payments during the second quarter (July-September) of 2024-25

Chart III. 12: Current account balance (CAB) as a per cent of GDP (India vs select countries)



Source: CEIC Data

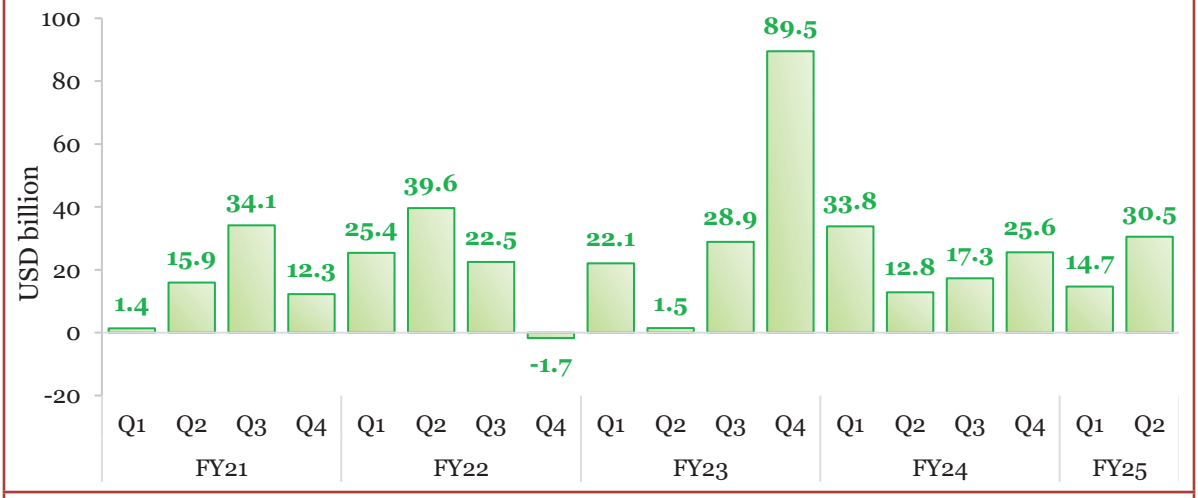
3.45 India's CAD has remained relatively contained compared to other G20 economies, such as Brazil and Australia, which have faced similar external pressures, including higher commodity prices and weaker global demand.

3.46 Private transfers, mainly driven by remittances by Indians employed overseas, formed the bulk of net transfers, growing steadily from USD 28.1 billion in Q2 of FY24 to USD 31.9 billion in Q2 of FY25. This growth reflects the continued strength of India's diaspora and robust remittance inflows despite global economic uncertainties.

Capital and Financial Account

3.47 The Capital and Financial Account is a vital segment of the BoP, serving as the primary mechanism for financing the CAD and strengthening foreign exchange reserves. Over the period from Q1 of FY23 to Q2 of FY25, India has generally recorded surpluses in the capital account, largely driven by robust inflows from FDI, FPI, and external loans. These inflows have supported the country's external position and contributed to building foreign exchange reserves.

Chart III.13: Quarterly trends in net capital inflows



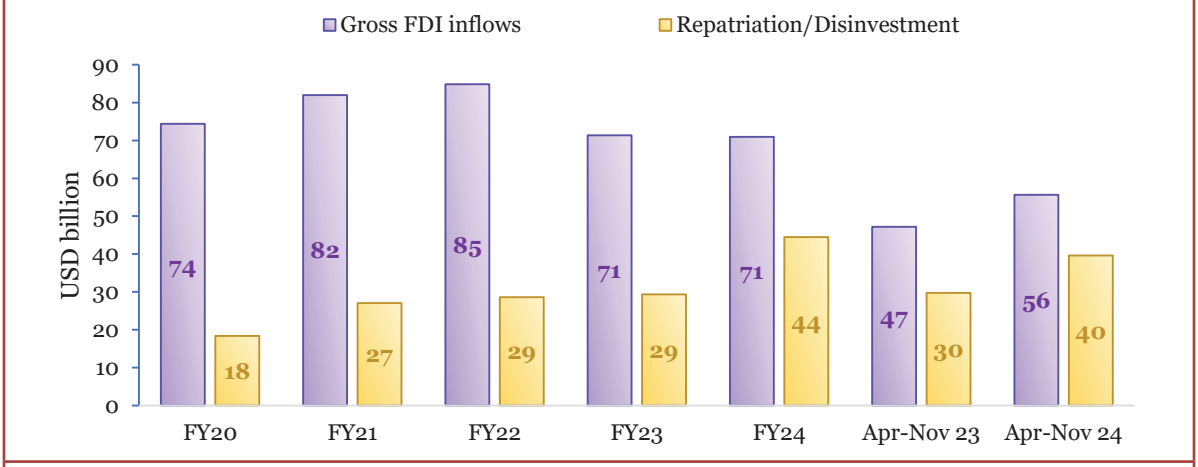
Source: RBI press release on developments in India's Balance of Payments during the second quarter (July-September) of 2024-25

3.48 The growth trajectory of capital inflows has shown signs of revival in recent quarters. In Q2 of FY25, net capital inflows stood at USD 30.5 billion, a significant increase from the USD 12.8 billion recorded during the same period in the previous year. This rise can be primarily attributed to increased FPI inflows, external commercial borrowings, and NRI deposits.

Performance of FDI flows

3.49 FDI recorded a revival in FY25, with gross FDI inflows[88] increasing from USD 47.2 billion in the first eight months of FY24 to USD 55.6 billion in the same period of FY25, a YoY growth of 17.9 per cent.

Chart III.14: Trends in gross FDI inflows



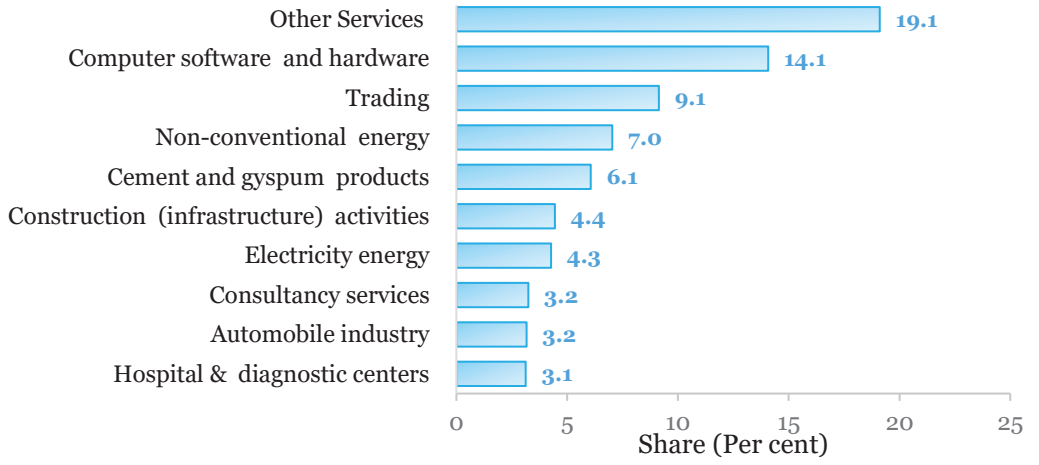
Source: RBI

88 Based on the FDI data released by the RBI.

3.50 Over the long term, FDI inflows into India have surpassed the USD 1 trillion mark from April 2000 to September 2024, solidifying the country's position as a safe and significant global investment destination. According to data from the Department for Promotion of Industry and Internal Trade (DPIIT)[89], the cumulative FDI inflows, which include equity inflows, reinvested earnings, and other capital, reached USD 1,033.4 billion during this period.

3.51 From a sectoral perspective, the services sector[90] remains the largest recipient of FDI, accounting for 19.1 per cent of total equity inflows in H1 of FY25. Other significant sectors attracting foreign investments include computer software and hardware (14.1 per cent), trading (9.1 per cent), non-conventional energy (7 per cent), and cement & gypsum products (6.1 per cent).[91] Despite the short-term volatility in global markets, triggered by factors such as inflationary pressures, rising interest rates in developed economies, and geopolitical tensions, the long-term outlook for FDI in India remains favourable. India's robust economic fundamentals, ongoing structural reforms, and growing consumer market position make it a key destination for foreign investments.

Chart III.15: Sectoral trends in FDI (H1 of FY25)-share in total FDI equity inflows



Source: DPIIT

89 DPIIT data on FDI flows, https://tinyurl.com/4hhws2cz.

90 The Services sector includes Financial, Banking, Insurance, Non-Financial / Business, Outsourcing, R&D, Courier, and Tech. Testing and Analysis, Other.

91 Sector-wise data on FDI inflows is released by DPIIT. RBI gives data on repatriation/disinvestment of FDI flows from India.

3.52 FDI into India has recently been scrutinised due to concerns about declining inflows. However, a broader analysis[92] reveals that FDI flows globally have been hampered by economic uncertainty, geopolitical tensions, and rising borrowing costs. Even though gross FDI inflows to India have increased in the first eight months of FY25, it has been accompanied by a rise in repatriations as international companies realised returns from investments. Many multinational companies have capitalised on India's strong stock market through secondary sales and Initial Public Offerings, indicating investor confidence. In 2024, private equity-backed exits increased, supported by India's stable macroeconomic environment and investor-friendly policies. As per Avendus Spark analysis based on DPIIT data, Private Equity and Venture Capital exit from Indian stock markets stood at USD 19.5 billion from January to September 2024, higher than USD 18.3 billion in the corresponding period of the previous year.[93] The depth and resilience of the Indian capital market offer profitable exits for direct investors, boosting future investments.[94]

3.53 India remains a strong destination for FDI, ranking high in greenfield project announcements and international project finance deals. However, the country has to pay heed to numbers. As per the data published by RBI, net FDI to India during the first eight months of FY25 stood at USD 0.48 billion compared to USD 8.5 billion in the corresponding period of FY24.[95] Similarly, for FY23, the figure stood at USD 19.8 billion. For FY24 as a whole, the net FDI was USD 10.1 billion. The last two financial years have indeed seen much larger repatriation from India. The amounts were USD 29.3 billion and USD 44.5 billion, respectively, in FY23 and FY24. In the current year, up to November, the repatriation amount is USD 39.6 billion. At this rate, the full-year figure might exceed last year's figure.

3.54 To a large extent, this is a success story as foreigners take profits. Second, much of it was sold to portfolio investors. In other words, the large portfolio inflows in FY24 were the other side of the coin of large repatriation. At a gross level, FY23 and FY24 have seen a decline in gross FDI, including earnings retained in India. This has broken the steadily rising trend seen since FY14. The period between FY13 and FY22 witnessed

92 "Behind India's growth over last 10 yrs—increase in repatriations, steady FDI inflows". https://tinyurl.com/2tt3pxsf.

93 Avendus Spark Strategy-Macro Alert-Net FDI inflows fall to a record low in H1 of FY25, https://www.avendus.com/india/reports.

94 https://www.ft.com/content/0575e216-8dae-4df6-bf50-312f78468e99.

95 Net FDI is calculated as follows: -
(1) FDI by foreigners: Foreign direct investment inflows+retained earnings-repatriation
(2) FDI by Indians: Indian investment overseas +retained earnings-repatriation
(3) The net FDI figure: (1)-(2)
(4) Then, there are Portfolio Investment flows: -
(5) Foreign Portfolio Investors' net flows – Indians' Portfolio Investment (Indians' portfolio investment overseas is small)
(6) Total Investment flows: (1)-(2) +(3)

ultra-low interest rates and quantitative easing policies in the developed world. The cost of funds was much lower. Interest rates in developed countries rose sharply in 2022 and 2023. The Federal Funds Rate topped 5 per cent. Other Asian countries such as Thailand, Malaysia and Indonesia also witnessed declines in inward FDI in 2023, according to UNCTAD.

3.55 However, India runs a CAD, and its investment needs are much larger considering the size of its economy. Supplementing domestic savings with reasonably large foreign savings expands the scope for capital formation. If, for various reasons, capital flows are going to be problematic, it raises questions as to the level of sustainable CAD for India. It may not be 2.5 per cent to 3 per cent as before, but it is much lower. It used to be said that a country can run as large a CAD as the Rest of the World (RoW) is willing to finance. If the RoW is unwilling or unable to do so for various reasons, then the size of the CAD will have to be lower. Developed countries, too, are wooing investments, and India is not competing with other emerging economies alone. So, India has two options.

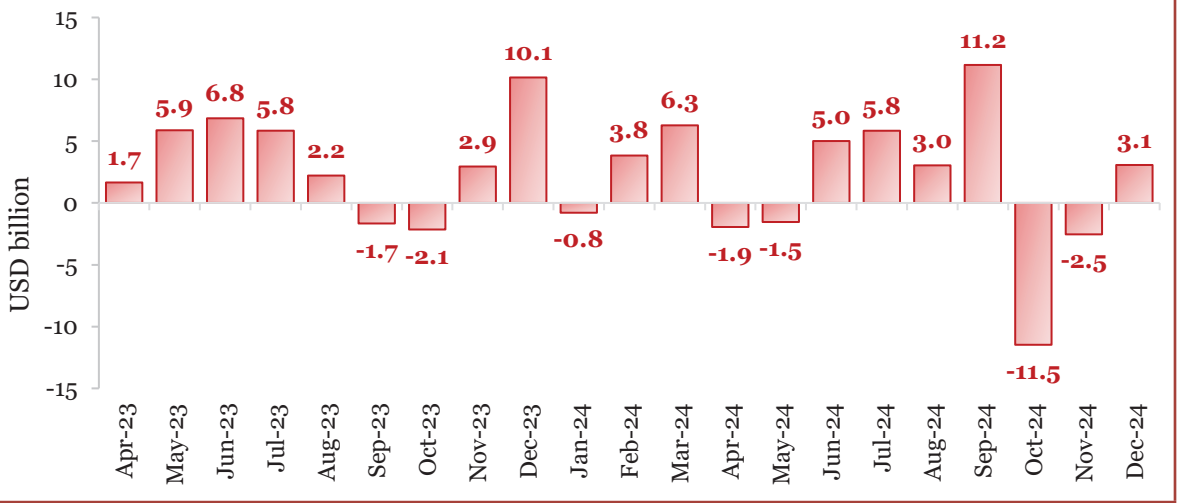
3.56 One, we must pull out all the stops wooing FDI and making itself more attractive for foreign investors. India has been doing so. For example, most sectors in the country are open for foreign investors under the automatic route. The large amount of repatriations, as witnessed in the data, also suggests that it is easy to transfer the returns on investment made in India. However, there is room to improve tax certainty and tax stability in matters such as APA (Advance Pricing Agreement). India has simplified many of its laws, rules and regulations over the years leading to a regime shift in terms of the ease of doing business compared to yester years. At the same time, all statutory and regulatory authorities must bear in mind that international investors benchmark countries cross-sectionally and not longitudinally. That will determine the success of the government's goal to make global companies produce in India for the world, making India a part of the global supply chain.

3.57 The second option is to make the available and existing investments deliver more. In other words, if the investment rate cannot be increased because of capital constraints, then investment efficiency has to go up. That is where deregulation and 'Ease of Doing Business' come into play. That is why the main theme of this Survey is about deregulation. Therein lies the clue to improving India's investment efficiency. Most of the chapters peer into regulations and recommend deregulation. The deregulation theme is explored in greater detail in Chapter 5.

Performance of Portfolio flows

3.58 FPIs became net buyers in the Indian equity market starting in June 2024 after being sellers in the first two months of FY25. This trend continued until September 2024, showcasing a clear preference for Indian equities as FPIs injected substantial capital into the market over those months. However, this trend reversed in October and the first half of November 2024, resulting in a net outflow of USD 11.5 billion and 2.5 billion, respectively. Factors such as concerns about slowing earnings growth, high valuations, rising geopolitical tensions, and recent developments in China[96] led FPIs to withdraw significant funds from Indian equities. However, during the latter half of November 2024, FPIs became more optimistic about the Indian stock market, reversing the significant selling seen in October and early November 2024. This positive trend in FPI inflows continued in December 2024, with net inflows amounting to USD 3.1 billion in December 2024. Factors such as India's strong macroeconomic fundamentals, favourable business environment and robust economic growth have encouraged investors to reverse the outflow trend. On a cumulative basis, the net FPI inflows[97] into India slowed to USD 10.6 billion from April to December 2024 from USD 31.7 billion during the same period the previous year. The volatility in portfolio flows underscores the susceptibility of equity and bond markets to global developments. However, the sound economic and corporate fundamentals in India underpin the long-term attractiveness of the Indian equity market for foreign investors.

Chart III.16: Trends in foreign portfolio investment flows



Source: NSDL

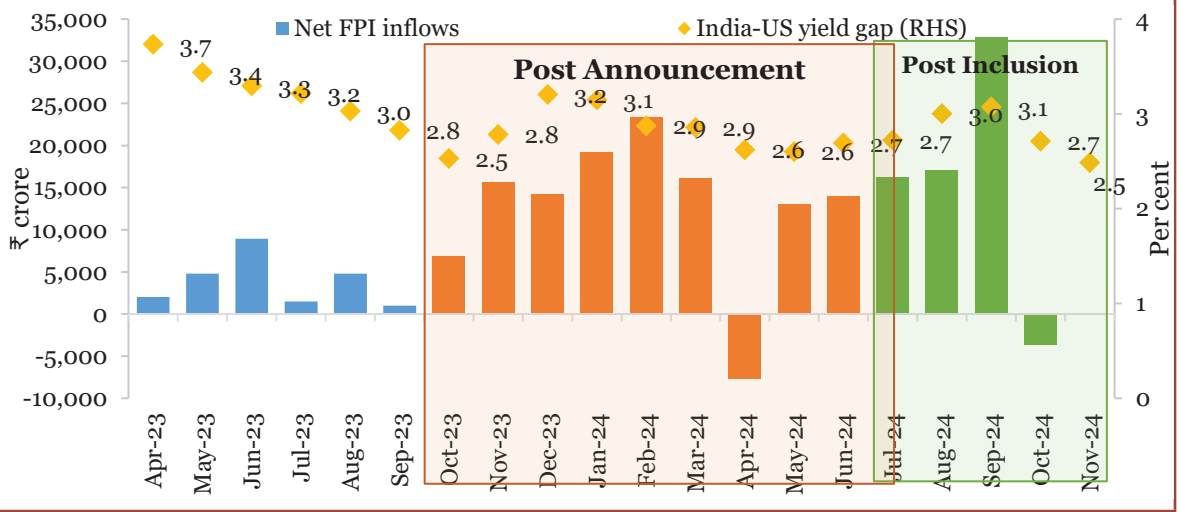
96 These include the stimulus measures announced by the Chinese Government and the cheap valuation of Chinese stocks.

97 Net FPI inflows is the sum of equity and debt inflows.

3.59 The inclusion of Indian Government Bonds (IGB) in some global bond indices this year has significantly supported debt inflows. Since the announcement of inclusion in JP Morgan index in October 2023, there has been heightened activity in the FPI debt segment with cumulative flows of ₹ 1.1 lakh crore from October 2023 to June 2024. Post effective date of inclusion, FPIs invested ₹ 62,431 crore in the debt segment from July to November 2024. Assets under custody, which reflects the total market value of the holdings, shows that FPI's cumulative investment in Fully Accessible Route (FAR) securities crossed the USD 20 billion mark within nine months of the announcement of their inclusion in the JP Morgan EM Bond Index. In FY25, as of 15 December 2024, inclusion already resulted in a net inflow of more than USD 3 billion in Indian FAR bonds, with assets under custody of India FAR bonds standing at USD 28 billion as of 15 December 2024.[98]

3.60 Since the investor sentiment/perception of the trajectory of Fed rates and the interest rate differentials are the key drivers of FPI flows in India, it will be interesting to analyse the trends in FPI debt flows and the yield differential between India and the US. Chart III.17 compares the FPI debt flows and the yield gap between India and US10 year yields, which shows that a widening yield differential in India's favour leads to higher inflows (November 2023 to March 2024) and vice-versa. India's strong growth fundamentals and range-bound inflation also made it a preferred choice amongst foreign investors despite the narrowing yield differentials seen from May to July 2024.

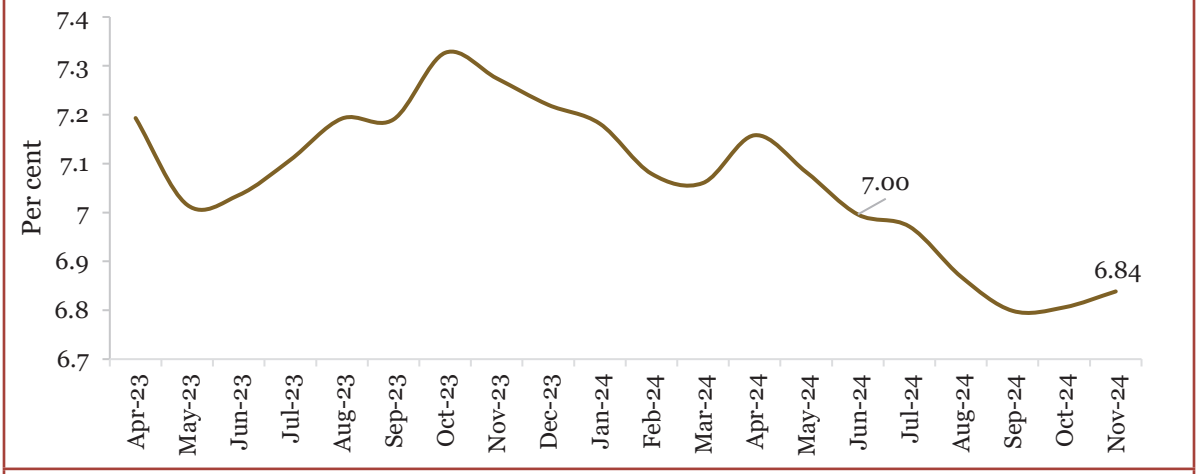
Chart III.17: Net flows by FPIs into debt segment



Source: SEBI

98 Based on the inputs received from the Securities and Exchange Board of India (SEBI).

Chart III.18: Trends in average monthly yield of 10Y G-sec



Source: SEBI

3.61 The increase in demand for India's G-Secs is also set to have a positive externality in terms of lowering the borrowing costs for the government as the yields soften due to heightened demand and limited supply dynamics. The preliminary impact of this is already visible in the Indian 10Y G-Sec yields. The inclusion of Indian bonds in global indices signals a growing appetite amongst foreign investors to include Indian government securities in their investment portfolios, trust in India's growth prospects, and financial stability in the Indian markets.

Others

3.62 NRI deposits, external commercial borrowings (ECBs), and short-term trade credit have contributed additional buffers to India's capital account, though each component exhibits varying degrees of stability. ECBs have shown an upward trajectory in recent months, with net inflows rising to USD 9.2 billion from April to October 2025, up from USD 2.8 billion in the corresponding period of the previous year, reflecting a greater appetite for borrowing from foreign sources. Similarly, Non-Resident Indian (NRI) deposits have also surged significantly, with net inflows increasing to USD 10.2 billion during H1 of FY25, compared to USD 5.4 billion in the same period of the previous year. This growth can be attributed to continued strong remittance inflows and a favourable exchange rate environment, which incentivised NRIs to park their savings in India.

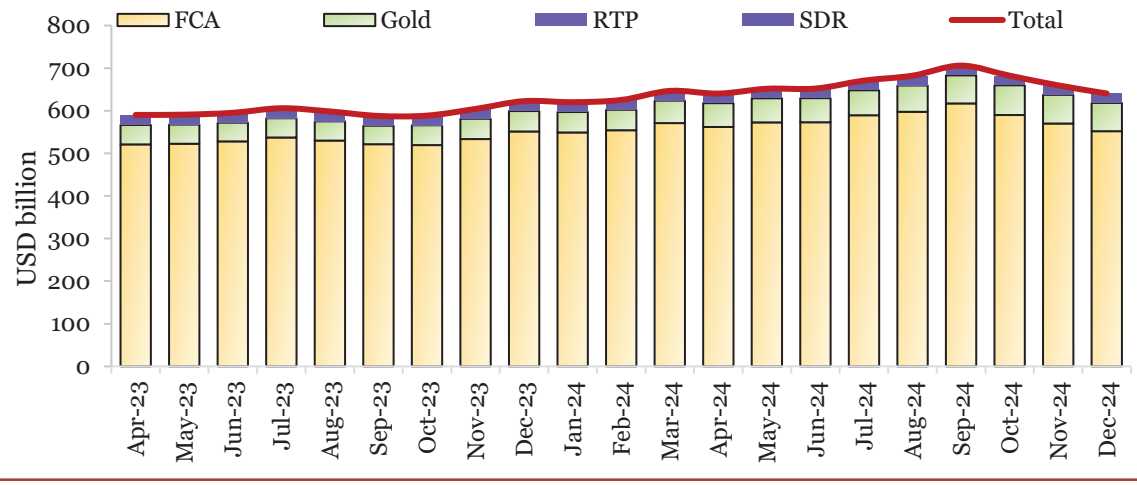
Foreign Exchange Reserves

3.63 India's foreign exchange reserves comprise foreign currency assets (FCA), gold, special drawing rights (SDRs) and reserve tranche position (RTP) in the IMF. After surpassing the USD 700 billion benchmark, India's foreign exchange reserves moderated to USD 640.3 billion as of the end of December 2024. The reserves are sufficient to

cover approximately 90 per cent of India's external debt of USD 711.8 billion as of September 2024, reflecting a strong buffer against external vulnerabilities. As of 2024, India has secured its place among the world's largest foreign exchange reserve-holding countries, ranking 4th globally, following China, Japan, and Switzerland. Supported by net positive capital inflows, India's forex reserves witnessed a notable increase of USD 27.1 billion in 2024. FCA constituted the bulk of this increase, strengthening India's overall reserve position.

3.64 The import cover, a crucial indicator of external sector stability, stood at 10.9 months as of December 2024. This increase enhances India's ability to weather external shocks, with reserve adequacy significantly surpassing the IMF's recommended three-month import cover for emerging economies.[99] The BoP surplus of USD 63.7 billion in FY24, supplemented by a modest valuation gain of USD 4.3 billion, was the key driver of this improvement. In H1 of FY25, forex reserves rose by USD 59.4 billion, driven by a BoP surplus of USD 23.9 billion and a valuation gain of USD 35.5 billion.

Chart III.19: Movements in foreign exchange reserves



Source: RBI

3.65 A global rise in uncertainty has led to fluctuations in the composition of foreignexchange reserves. CY24 saw gold bullion holdings nearing their highest level since World War II, which was largely driven by an accumulation of gold by emerging market central banks.[100] As per the IMF, steady changes are underway in the global reserve system, including a gradual movement away from dollar dominance and a rising role of non-traditional currencies.[101]

99 IMF survey: Assessing the need for Foreign Currency Reserves, https://tinyurl.com/3knsb5se.

100 IMF, Dollar Dominance in the International Reserve System: An Update 2024, https://tinyurl.com/26dn5sxr.

101 Ibid note 100.

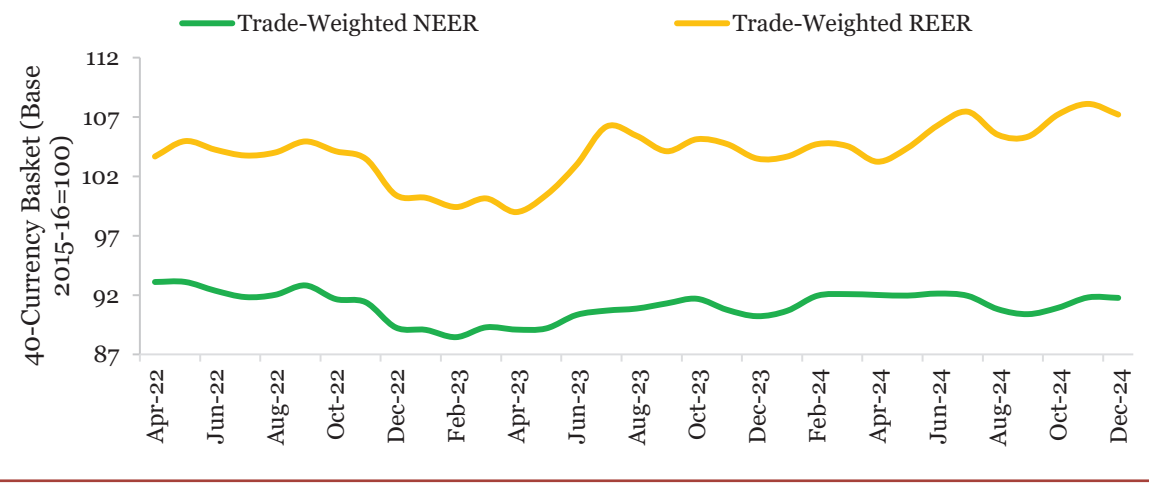
Exchange Rate

3.66 The value of the Indian Rupee (INR) is market-determined, with no target or specific level or band. Various domestic and global factors influence the exchange rate of the INR, such as the movement of the Dollar Index, trends in capital flows, level of interest rates, movement in crude prices, current account deficit, etc. In the first nine months of FY25 (up to 6 January 2025), the INR depreciated a modest 2.9 per cent, performing better than currencies such as the Canadian Dollar, South Korean Won and the Brazilian Real, which depreciated by 5.4 per cent, 8.2 per cent and 17.4 per cent, respectively, during the same period. One of the primary factors behind the rupee depreciation during 2024 has been the broad-based strengthening of the USD amidst geopolitical tensions in the Middle East and uncertainty surrounding the US election.

Chart III.20: Changes in the bilateral exchange rates of the major countries against USD from April to December 2024

Source: IMF
Note: The euro (€) is the official currency of 20 out of 27 EU member countries constituting the Eurozone, officially called the euro area.
To determine currency appreciation or depreciation, the representative exchange rates of major countries are expressed in currency units per U.S. dollar. Exceptions, marked with (1), are presented as U.S. dollars per currency unit.

Chart III.21: Trend in REER and NEER



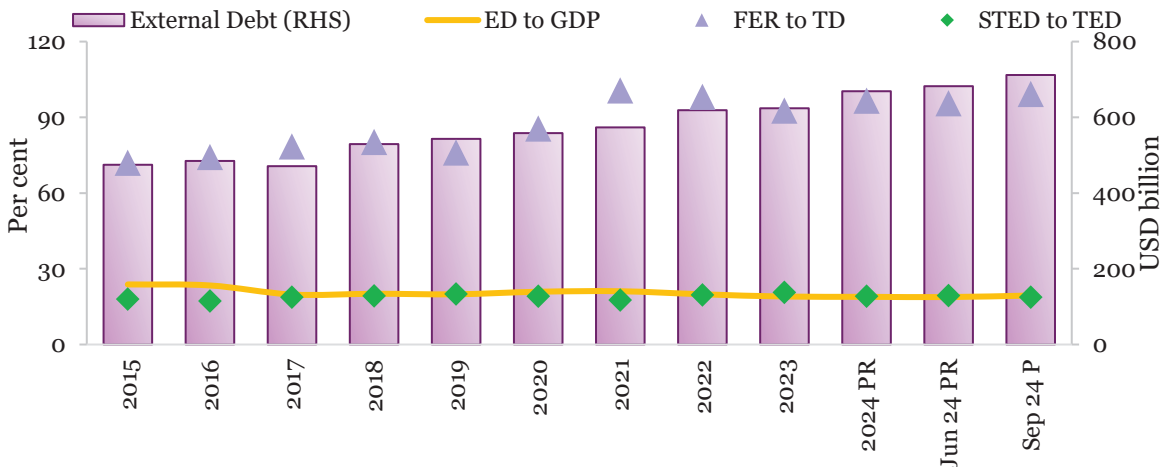
Source: RBI

3.67 After adopting the floating exchange rate regime, Effective exchange rates have become a prominent measure of external competitiveness of an economy's tradable sector relative to the foreign tradable sector. The Nominal Effective Exchange Rate (NEER) for the INR remained stable in the 90-92 range from April to November 2024, indicating relative stability in the currency amidst external uncertainties. The Real Effective Exchange Rate (REER), which reflects the real purchasing power of the currency, steadily appreciated from 103.2 in April 2024 to 107.2 in December 2024.

External debt position

3.68 India's external debt has remained stable over the past few years. A stable external debt position has helped maintain external sector stability, significantly when the rest of the world is affected by geopolitical headwinds. The external debt to GDP ratio rose slightly from 18.8 per cent of the GDP at the end of June 2024 to 19.4 per cent at the end of September 2024. The share of short-term debt (with original maturity of up to one year) in total external debt decreased to 18.8 per cent at the end of September 2024 from 19.4 per cent at the end of June 2024. Similarly, its ratio to foreign exchange reserves decreased to 18.9 per cent at the end of September 2024 from 20.3 per cent at the end of June 2024. Across currencies, the external debt remained primarily denominated in the US Dollar (53.4 per cent), followed by the INR (31.2 per cent), SDR (5 per cent), and the Euro (3 per cent).

Chart III.22: India's stable external debt position



Source: DEA press release: India's External Debt Report for Quarter ending September 2024
Note: PR - Partially Revised, P-Provisional; ED – External Debt, FER-Foreign Exchange Reserves, TED – Total External Debt, STED – Short Term External Debt

OUTLOOK

3.69 India's external sector has performed well amidst unfavourable geopolitical conditions. On the current account front, though merchandise exports have displayed moderate growth owing to a slowdown in external demand, merchandise imports have shown remarkable growth supported by strong domestic demand. Increased net services receipts and growing remittances have cushioned the rise in the merchandise trade deficit. On the capital front, the economy has been witnessing net positive capital inflows. Gross FDI inflows have shown a higher growth in the first eight months of FY25 compared to the corresponding period of the previous year. However, a surge in repatriation has reined in the expansion in net FDI. FPI inflows have shown volatility in the first nine months of FY25, showing mixed trends.

3.70 Global trade dynamics have changed significantly in recent years, shifting from globalisation to rising trade protectionism, accompanied by increased uncertainty. This calls for a new strategic trade roadmap for India. To remain competitive and enhance its participation in global supply chains, India must continue reducing trade costs and improving facilitation to boost export competitiveness. Much remains to be done to enhance trade competitiveness. The good news is that doing so is entirely in our hands. On its part, the industry must continue to invest in quality.

3.71 The state produces governance, and the private sector produces goods and services. If both these actors focus on quality and efficiency, then despite the trade tensions and protectionism that are likely to come in the way of expanding global trade, India can increase its share in overseas markets and generate resources to sustain a higher level of capital formation. Then, it will be possible for us not just to dream of but actually realise higher economic growth rates on a sustained basis.

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