CHAPTER - I

INDIAN ECONOMIC LIBERALIZATION

Development planning has been the delight and despair of many underdeveloped countries including India. In the years following the Second World War, most of the backward countries, following the example of the former Soviet Union, looked upon development planning as the panacea for all economic ills. After decades of planned development, the mystique of planning has lost its spell. In the socialist countries, the command system of central planning has been largely dismantled. Meanwhile, a virtual sea-change has taken place in the economic policy framework in India since July 1991.

In 1991 India was faced with a serious and overwhelming economic crisis. India’s foreign exchange reserves had virtually disappeared, the budget deficit had soared, inflation was rising and the country was on the verge of default in the international market. Dr. Manmohan Singh, the then Congress Finance Minister, was confronted with a difficult choice: the tiger or the tortoise. The first alternative was to follow the East Asian Tiger – the growing East Asian economies – and introduce radical market-friendly economic reforms or globalization. The second alternative was to follow the former Soviet Union – the show lumbering reptile with a mottled protective shield and closed within its shell. Dr. Singh chose globalization and reversed
the old notion of socialist self-sufficiency which had held India in its thrill since the days of Jawaharlal Nehru.

This policy of outward-oriented economic programme or liberalization has three fold features.

(1) opening the economy to the outside world;
(2) reducing import tariffs, state intervention in domestic policy decisions along with a thorough shaking up of the domestic economy; and
(3) immediate stabilization measures and ambitious structural reforms.

The immediate results of globalization measures were not very impressive. This was because the changes were related mainly to policies. There was a partial deregulation of industries. There was increased market orientation; many tariffs were cut, the import licensing system was liberalized, the rupee was made convertible for trade and inward foreign investment was encouraged. An expansionary fiscal policy providing the demand stimulus played an important part in coaxing extra output from the economy. Growth of this nature could not however be sustained. Despite the policy slippage, the stabilization measures and the structural reforms proved sufficient to restore external confidence.

The year 1991-92 has been an exceptionally difficult year for the economy with the deepening of the crisis which began in 1990-91. The balance of payments problems, which emerged in 1990-91, had reached crisis proportions by June 1991. A severe import squeeze, introduced in the course of 1990-91 in response to the shortage of foreign exchange, disrupted
industrial production, which began to decline early in the year 1991-92, Inflation which had begun to accelerate in 1990-91, reached a peak level of 16.7 per cent in August 1991. Growth of real gross domestic product (GDP) decelerated sharply.¹

The new government which assumed office in June 1991 took a series of corrective measures to bring the situation under control. These short-term measures of structural reforms, aimed at improving efficiency and productivity and putting the economy back on the path of sustainable growth with equity and social justice.

Delicensing, decontrol and encouragement to FDI were the crux of the new industrial policy that was announced on 24 July, 1991. The salient features of this policy are as follows:

- no licensing required for most industries except 18 specified industries like coal, petroleum, pharmaceuticals and some luxury items;
- no licensing required for substantial expansion of existing units,
- all existing requisition schemes have been abolished,
- automatic clearance is given for import of capital goods, if the foreign exchange requirement is ensured through foreign equity;
- the concept of monopoly restructured, and permission for expansion of Monopolies and Restrictive Trade Practices (MRTP) industries no longer required;
- threshold limits of assets to regulate under MRTP Act abolished (the purpose of MRTP Act would only be to effectively control unfair and restrictive practices); and

- the role of public sector is reduced and greater participation by private sector, in many areas including infrastructure like power, transport and communication facilitated.

- manufacture of industrial alcohol delicensed and veneers brought under compulsory licensing unit;

- most of the conditions stipulated in the letters of intent and industrial licenses (issued earlier to firms in industries, now delicensed) have been waived.

- the system of endorsement of capacity expansion under modernization/renovation discontinued except in the case of industries which are still under compulsory licensing or are located in restricted areas-small-scale industries engaged in the manufacture of delicensed items are exempted from obtaining "Carry on Business" (COB) licenses on their gradation to medium scale industries.

- the private sector has been invited to invest in oil exploration and refining which is otherwise reserved for the public sector,

- the power sector is now open to both domestic and foreign private investment

- the Chief Inspector of Factories has been designated as the Appropriate Government Authority under the stipulations regarding conversion of letters of intent to industrial licenses in the case of hazardous industries.

- an Investment Promotion and Project Monitoring Cell has been set up in the Department of Industrial Development to provide information and guidance to entrepreneurs regarding licensing policy, tariffs, corporate laws, current status of applications pending with the Department, infrastructure facilities and incentives available at State levels for setting up industries.2

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Reforms to attract FDI

Specific reforms have been introduced to encourage inflow of FDI, viz.:

- in high priority industries FDI up to 51 per cent has been allowed, the limit of foreign equity participation has been raised from 40 per cent to 51 per cent in 34 high priority industries,
- foreign equity upto 51 per cent is allowed for trading companies engaged in export.
- on 24th February 1992, the crucial industry of iron and steel has been added. Several industries which were left out in the previously sanctioned heads under organic and inorganic chemicals, synthetic resins, plastics and man made fibres, engineering plastics, scientific instruments, machine tools, automotive components and electrical equipment have also been included covering almost all the major areas of core industries,
- non Resident Indian (NRIs) and overseas corporate bodies are permitted to invest 100 per cent foreign equity in high priority industries with facilities for full repatriation.
- upto 100 per cent equity participation is now permitted in certain critically important sectors such as power.
- no permission is required for hiring foreign technicians.
- withdrawal of the condition regarding dividend balancing for all industries excepting a select list of consumer industries (earlier, it was required to match foreign exchange outgo in terms of dividend with export obligation over the same period)
- income derived by foreign companies such as dividend, royalty or technical fee, interest is taxed at a rate lower than that applicable to domestic companies.

The Government of India has also allowed reputed Foreign Institutional Investors (FIIs) including pension funds, mutual funds, asset
management companies, investment trusts, nominee companies and incorporated or institutional portfolio managers to invest in the Indian capital market subject to the condition that they register with the Securities and Exchange Board of India (SEBI) and obtain RBI approval under Foreign Exchange Regulation Act (FERA). Portfolio investment by the FIIIs in the primary and secondary markets are subject to an overall ceiling of 24 per cent of the issued share capital in any company and the FIIIs are required to allocate their total investment between equities and debentures in the ratio of 70:30. FIIIs investing under the scheme enjoy a concessional tax rate of 20 per cent on dividend and interest and 10 per cent on long-term capital gains.

Thus the crisis at the end of the decade of the eighties compelled the Indian policy makers to institute such wide spread reforms. Besides, changes in the exchange rate regime complemented the mid-1991 trade reforms. Until 1991 the rupees was tied to the weighted currencies of Indian major trading partners. The first move towards reforms of the exchange rate regime was a 24 per cent devaluation of the rupee from Rs. 21 per dollar to Rs. 25.95 per dollar. Subsequently, in March 1992, the government introduced a dual exchange rate regime designed to liberalize foreign trade. Such liberalization was attempted by subsidizing imports and initiation of the move towards convertibility of the rupee.

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Overview of the Indian Economy since 1991

Compared to overall economic growth of 0.9 per cent in 1991-92, economic growth recovered within a year to 5.1 per cent in 1992-93. Fiscal and macro-economic policies helped in maintaining a growth rate of 5 per cent in 1993-94. Overall economic growth accelerated significantly in 1994-95 to attain 6.3 per cent. Food grain production which declined to 168 million tonnes in 1991-92, touched a record level of 191.1 million tonnes in 1994-95.

The year 1994-95 saw the fastest growth of the Indian economy. After the crisis induced low growth of 0.9 per cent in 1991-92, the economy responded well to reform measures to record growth of 4.3 per cent in 1992-93 and 7.2 per cent in 1994-95. Since 1994-95, however, there was a marked slow down in the pace of reforms.

The performance of the external sector continued to be strong with exports growing by more than 17 per cent in dollar terms in the first ten months of the year, the balance of invisibles climbing to over a billion dollars in the first six months of the year and foreign investment of US$ 3.9 billion in April-December 1994. 4

Indian exports were also better during the period 1994-45. The dollar value of exports has increased by more than 17 per cent in the first ten months of 1994-95, on top of a 20 per cent increase in 1993-94. On 31st March, 1991 India had added US$ 8 billion to her external debt. In the first

half of 1994-95 the level of external debt declined by almost US $ 300 million. Meanwhile, Indian foreign currency reserves also improved. From a level of hardly one billion dollars in June 1991, foreign currency reserves had climbed to over US $ 19.5 billion by mid-February 1995.

GDP at factor cost grew by 4.3 per cent in 1992-93 and 1993-94. Agricultural growth declined from a high of 5.3 per cent in 1992-93, in 1993-94, however, the agricultural production was better as a result of good monsoons. Modern services such as banking and insurance showed faster growth during the same period, i.e., 1993-94. GDP from manufacturing continued its recovery in 1993-94 with the growth rate increasing from 3.1 per cent in 1992-93. Together with growth of 2.4 per cent in agricultural and allied value added and 5.6 per cent in services, overall GDP growth at factor cost in 1994-95 was 5 per cent as against 3.4 per cent in 1993-94.

Monetary trends observed in the second half of 1993-94, have continued through 1994-95. The rate of growth of money supply M₃ (Currency plus all bank deposits) displayed gradual but sustained uptrend till November 1994.⁵ There was an even stronger acceleration in the annual rate of growth of narrow money, M₁ (currency plus demand deposits of banks). The annual growth rate of M₃, which peaked at 22 per cent in November 1994, has subsequently declined to 18.6 per cent as on January 20, 1995. The reason for the up trend in monetary growth through most of 1994-95

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⁵ Ibid.
was a sharp rise in the growth of reserve money, which followed a similar pattern to that of money supply.

The major problem faced in all the governments of the world was the inability of the Indian Central Government to contain the fiscal deficit. The fiscal deficit continued to be high and this was reflected in continuing inflationary pressure. The borrowing requirements of a high fiscal deficit are a source of pressure on interest rates and adversely.

1995-96 witnessed a very satisfactory growth rate in GDP of 7.1 per cent. The momentum of growth has been maintained in 1996-97, thus providing increasing evidence that the growth potential has increased as a result of the reforms initiated in 1991. Since June 1996, reform initiatives have been introduced or strengthened in almost every critical infrastructure sub-sector. 6 There have also been new policy measures in several areas such as industrial delicensing, foreign investment, trade policy, financial sector and capital markets.

It is interesting to note that the average growth rate has been higher during the Eighth Plan when compared with the previous Plan Period. A comparison of some salient dimensions of economic performance between the Eighth Plan period reveals the following:

- overall economic growth has been faster;
- the manufacturing sector has grown almost 2 per cent points faster per year in the Eighth Plan period;

- agriculture and allied sectors have grown at about 3.5 per cent per annum in both period;
- both exports and imports have grown significantly faster in the Eighth Plan period.
- the balance of payments has strengthened considerably with trade and current account deficits declining as ratios of GDP, while exports and imports have grown rapidly both in value terms as well as in proportion to GDP.
- the Central Government's fiscal deficit as a proportion of GDP has declined significantly;
- the average rate of gross domestic savings has risen substantially from 20.6 per cent of GDP in the Seventh Plan period to 23.9 per cent in the first four years of the Eighth Plan.
- with the exception of telecommunications, the rate of growth of net output (value added) of infrastructure sectors has slowed;
- the average rate of inflation has risen somewhat though remaining below double digits.

Total gross domestic saving reached a new peak of 25.6 percent of GDP in 1995-96, exceeding its previous peak of 24.9 per cent of GDP in 1994-95.

The economy in 1996-97 so far presents a mixed picture. Although overall economic growth remains high at 6.8 per cent, and agriculture has rebounded, the growth of manufacturing value added has slowed and the
performance of key infrastructure sectors, especially power and crude oil is weak. The annual rate of inflation has risen back to average long-term levels and export growth has decelerated markedly in recent months. Despite the slowdown in exports, a combination of sluggish imports and reasonably buoyant inflows of invisibles and capital flows have led to a build up of foreign exchange reserves by over $2.5 billion.

A number of changes have been made so far in 1996-97 in the area of foreign investment. The Foreign Investment Promotion Council has been set up, the Foreign Investment Promotion Board (FIPB) streamlined and made more transparent, and the first ever guidelines have been announced, by the Government for consideration of foreign direct investment proposals by the FIPB, which are not covered under the automatic route. The list of industries eligible for automatic approval of upto 51 per cent foreign equity has been expanded. Foreign Institutional Investors (FIIs) have been allowed to invest in unlisted companies and in corporate and government securities, and external commercial borrowing (ECB) guidelines have been liberalized and made more transparent.

Other industrial policy measures include the setting up of a Disinvestment Commission, delicensing of consumer electronics, changes in the sugar policy, enhancement of investment ceiling on plant and machinery of the small scale industries from Rs.30 lakh / Rs. 75 lakh to Rs. 3 crore and of tiny units from Rs.5 lakh to Rs. 25 lakh, and reduction of export obligation of non-SSI units producing reserved items from 75 per cent to 50
per cent. Another list of 9 industries eligible for automatic approval of upto 74 per cent foreign equity has been announced. State level industrial reforms also took a step forward with several states announcing comprehensive reform policies, including disinvestment in or privatization of state public sector enterprises.

The past few Economic Surveys have emphasized the need to accelerate, widen and deepen reforms. In line with this commitment, a number of policy decisions have been taken and new initiatives launched. These include:

a) to provide long term finance for infrastructure, the Budget announced the establishment of an Infrastructure Development Finance Company (IDFC). The IDFC has since been incorporated under the Companies Act on 30.1.97 with an authorized share capital of Rs. 5,000 crore.

b) a 5 year tax holiday for companies developing, maintaining and operating infrastructure facilities such as roads, bridges, new airports, ports and railway projects, was extended to cover water supply, sanitation and sewerage projects.

c) after the National Highway Act was amended to enable private participation, projects involving Rs.42 crore have been awarded on a Build-Operate and Transfer (BOT) basis. The capital base of the National Highways Authority of India has been increased by a provision of Rs.200 crore, thereby providing greater leverage to borrowing from external funding agencies and other lenders.
d) the provisions relating to foreign investment have been further liberalized to give automatic approval for foreign equity participation up to 74 per cent in key infrastructure sectors such as electricity generation and transmission, non-conventional energy generation and distribution, and construction and maintenance of roads, bridges; railbeds, ports, runways, pipelines and harbours. The automatic approval list for foreign equity upto 51 per cent has been expanded to include support services for land and water transport. This includes operation of highway bridges, toll roads and vehicular tunnels, operation and maintenance of piers, and loading and discharging of vessels.

e) through an Ordinance, the Government has established a statutory Telecom Regulatory Authority of India (TRAI) which will separate the regulatory functions from policy formulation and operational functions. The Department of Telecommunications and financial institutions have also finalized an assignability agreement which will facilitate funding of cellular and basic telecom projects.

f) letters of intent have been given to basic telecom services in Karnataka and Madhya Pradesh. Cellular services have been expanding rapidly beyond the four non-metro areas. The Government has announced that telecom would be treated as infrastructure and all fiscal benefits, like tax holiday and concessional duty on project imports, being made available to the power sector then, would be made available to the telecom sector also.
g) new guidelines have been published for private participation in ports for both leasing out of the assets and construction and operation of new assets such as container terminals, cargo berths, warehousing, dry docking and ship repair. Private investment in ports would be on a BOT basis. It would include leasing out existing assets of ports and construction and operation of additional assets such as container terminals, cargo berth, warehousing, dry docking and ship repair. The concession period would be decided by the Port Trusts, up to a maximum period of 30 years. A contract for a private container terminal at JLPT, valued at Rs.700 crore, had been awarded.

h) an Independent Authority for regulating tariffs in major ports has been created through an ordinance.

i) new guidelines for private investment in the highway sector have been announced, procedures simplified, and environmental clearance and equity participation made easier. An ordinance has been issued containing provisions for acquisition of land for development and maintenance of national highways. Once the Government declares that the land is required for a highway, it would be deemed vested in the Central Government and be non-justiciable. Only compensation can be settled through arbitration.

j) a Common Minimum National Action Plan for Power was approved by the Centre and the States, in December 1996. As a part of this Plan, State Electricity Boards were to be urgently reformed and restructured to give
them more autonomy, retail tariffs and wheeling charges were to be rationalized and independent regulatory commissions were to be set up at the Central and State level. Private participation in distribution was to be encouraged. The central government had already issued an Ordinance allowing private entry into power transmission as an independent service. 

States have been given greater authority; they are now free to clear projects up to 250MW. Renovation and modernization schemes no longer need approval of the Central Electricity Authority.

k) in principle approval has been given by the Government for a rail-based mass rapid transit system (MRTs) in Delhi. The cities of Bangalore, Hyderabad, Mumbai and Kolkata had proposed major improvements in their public transport systems through the introduction/augmentation of rail-based transit systems.

l) a new policy for private investment in civil aviation has been announced and this includes allowing 40 per cent foreign equity in domestic airlines.7

The development in the year 1996-97 in the balance of payments point to an easing of pressure on the current account and to buoyancy in capital inflows. This in turn helped in a sizable build-up of foreign currency reserves. The foreign currency assets of the Reserve Bank of India rose by over US $ 2.8 billion from about US$ 17.0 billion at end-March 1996 to

7 Ibid.
US$ 19.8 billion at end-January 1997, providing cover for about 5.5 months of imports.

There has also been a slowdown in the growth of exports in 1996-97. During April-December 1996, exports in US dollar terms, grew only by 6.4 per cent as against the annual average growth rate of 19.7 per cent during 1993-94 to 1995-96. Among the significant reasons for this decline are the slowdown in world trade growth in 1996.

Consistent with the liberal thrust of the 1992-97 EXIM Policy, the Government undertook a series of trade liberalization measures in 1996-97. These included shifting of a large number of items, including consumer goods, from the negative/restricted list to the list of items, which can be imported under the export-linked, special import license (SIL) scheme. A large number of SIL items were also moved to the free (OGL) list.

For the first time, detailed guidelines for the Foreign Investment Promotion Board were announced in 1997. The list of industries eligible for automatic approval of foreign investments was expanded considerably. FII investments in securities of companies as 100 per cent debt funds have been allowed subject to certain guidelines; FIIs have also been allowed to invest in gilt-edged securities within the framework of the guidelines. The guidelines for Euro-Issues were liberalized in June 1996 so as to give the market a free play in judging the quality of issues and the number of issues that can be floated in a year. All infrastructure and greenfield projects have been permitted to avail of external commercial borrowing to the extent of 35
per cent of total project cost, as appraised by a recognized financial institution or bank. Further measures were taken to simplify procedures related to the purchase of foreign exchange, so as to enhance current account convertibility.

India’s external debt declined from US$ 99.0 billion at end March 1995 to US$ 92.2 billion at end-March 1996. The downsizing of external debt resulted in a decline in the external debt-to-GDP ratio to 28.7 per cent in 1995-96. Debt service payments as a percent of current receipts, also declined from 27.5 per cent in 1994-95 to 25.7 per cent in 1995-96, and they declined further to about 25 per cent in 1996-97.

In budget 1996-97, the Government’s objective has been to remain steadfast on the course of economic reforms and liberalization aimed at accelerating economic growth with social justice. During the past several years, the endeavour of the government has been to increase revenue without levy of fresh taxes. This has been possible by modernization of the tax rates and rationalization of the tax system. No new taxes were levied in the 1996-97 budget.

As far as trade is concerned, changes in the direction of India’s foreign trade show clear signs of diversification. For example, the OECD (Canada, France, Germany, Italy, Japan, UK and USA) countries as a group accounted for 56.3 per cent of India’s exports and 50.5 per cent of India’s imports during April-September, 1996 compared to 57.1 per cent and 52.7 per cent respectively, during the corresponding period a year ago. Similarly,
the share of trade—both exports and imports— with East European countries declined in April—September 1996. In spite of negative growth rate, the USA, UK, Germany and Japan continued to be the four largest trading partners of India.

Imports from OPEC countries was about three times the value of exports to these countries during the first six months of the financial year 1996, mainly on account of our dependence on these countries for POL imports (petroleum). While our exports to LDCs (other than OPEC countries) increased from 25 per cent in April—September 1995 to 25.9 per cent in April—September 1996; on the other hand our imports from these countries decreased from 18.8 per cent to 17.2 per cent. The importance of East Asian countries (Indonesia, Malaysia, the Philippines, the Republic of Korea and Thailand) declined marginally from 15.1 per cent in the same period a year ago to 14.9 per cent.

The East Asian crisis, which erupted in July 1997, spread rapidly across other emerging economies through 1998. The crisis led to fears of widespread credit crunch and recession. However, beginning early 1999, most of the economies affected by the crisis begun to recover, and global economic and financial conditions have improved markedly. Oil prices recovered in early 1999, after a sharp drop of over 30 per cent in 1998. The decline in many other commodity prices have also been arrested. World trade prices of non-fuel primary commodities declined to 15.7 per cent and 11.2 per cent in 1998 and 1999 respectively.
Slower output growth in all the main country groups in 1998 led to a sharp slowdown in the growth of world trade to an estimated 4.2 per cent in 1998 and 5 per cent in 1999. The international trading and financial situation has been very unfavourable since the economic and financial crisis of East Asia in July 1997. All over the world, developing countries have been experiencing significant pressures on the balance of payments. Despite this, India’s balance of payments remained comfortable in both 1998-99 and 1999-2000 partly due to anticipatory policy actions, such as issue of Resurgent India Bonds.

The deficit in the current account of the BOP in 1998-99 had declined to about 1.0 per cent of GDP as against 1.4 per cent in 1997-98, mainly reflecting sharp declines in POL and non-custom imports. Exports, however, recorded a negative growth of 3.9 per cent in 1998-99, after remaining sluggish in the previous two years. During 1999-2000 exports have shown a welcome recovery with a growth (in Dollar value) of 12.9 per cent as against a negative growth of 2.9 per cent in the same period last year. Total imports recorded a negative growth of over 7 per cent in 1998-99, mainly because of a 21.2 per cent decline in POL imports and over 41 per cent decline in non-customs imports. Non-oil customs imports, however, grew by only 6.3 per cent in 1998-99. Reflecting the trends in exports and imports, the deficit on the trade account of BOP in 1998-99 had narrowed to US$ 13.25 billion from US$ 15.51 billion in 1997-98 to 3.1 per cent of GDP in 1998-99.
Foreign currency reserves at the end of March 1999 amounted to US$ 3.55 billion over the end March level of US$ 25.98 billion and they had increased further by US$ 2.42 billion in 1999-2000. Including gold and SDRs, total foreign exchange reserves at the end of January 2000 was at a record level of US$ 34.90 billion, which provided cover for about eight months of estimated imports in 1999-2000.

As in the previous years, invisible receipts in 1998-99 and in 1999-2000 were buoyant and continued to be a major source of support to sustaining the viability of the overall balance of payments. In 1998-99, net inflow of invisibles amounted to US$ 9.21 billion, compared with US$ 10.01 billion in 1997-98. The decline in total net invisibles in 1998-99 was largely because of a decrease in net private transfers from US$ 11.83 billion in 1997-98 to $10.28 billion in 1998-99.

During 1999, exports have witnessed a significant turnaround with a growth rate of 12.9 per cent (in US$ value) during April-December 1999 as against a decline of 2.9 per cent in the corresponding period last year. The buoyancy is explained partly by the revival of world trade on the heels of the East Asian recovery and a modest recovery in some global commodity prices.

Structural constraints operating on the demand and as well as supply side of our exports contributed to the decline in exports during 1996-97 to 1998-99. The recessionary tendencies across the world affected the demand side of our exports. The reduction in global demand led to a substantial
contraction in world trade. The world economy slowed down from 3.2 per cent in 1997 to 1.9 per cent in 1998. The economic contraction in the East Asian countries resulted in a sharp decline in import demand, which in turn, resulted in a massive turnaround in the current account balance of these countries. The current account balance of the Asian developing countries rose significantly to a surplus of $51 billion in 1998 from a surplus of US $5 billion in 1997. Since Asia accounts for about one fifth of India’s exports, India could not escape the fallout from such import compression.

The slowdown and contraction of world trade in 1997-98 has also resulted in the emergence of protectionist sentiments in some sectors in the guise of technical standards, environmental and social concerns. Non-trade barriers like anti-dumping duties, countervailing duties, safeguard measures, sanitary measures adopted by the developed countries have affected market access for exports from the developing countries. Indian products which have been affected by such barriers in the last two years include floriculture, textiles, pharmaceuticals, marine products and basmati rice to European Union, carpet exports to Morocco, match exports to Egypt, mushroom exports to the US, sports goods and leather exports to the developed world and meat products to West Asia. Such use of non tariff barriers have added to uncertainty in trade and have contributed to market disruption of our exports.

Import growth has been modest with imports during April-December 1999 recording a growth rate of 9.0 per cent in US Dollar value as compared
to a lower growth of 7.2 per cent in the corresponding period last year. An important component of non-oil imports are the imports of gold and silver. With the liberalization of these imports in October 1997, gold and silver imports increased from $3.2 billion in 1997-98 to $4.9 billion in 1998-99. With a view to reduce the import of gold in the long run, the Union Budget 1999-2000 announced the launching of the Gold Deposit Scheme 1999 to draw out privately held gold stocks and reduce India's dependence on imports. Under this scheme, investors can deposit gold with banks and receive fixed term interest bearing certificates or bonds in exchange. On maturity, depositors can take back their gold or its equivalent in Rupees. This scheme was launched in September 1999.8

The main destinations of India's exports during the period included OECD (mainly USA, EU and Japan), Asia and the OPEC region. However, exports to these region, in US Dollar, value were either stagnant (OECD and OPEC recorded an increase of only 0.2 per cent each) or declined (by 14.0 per cent for Asia) in 1998-99. Exports to the African and Latin American regions increased by 9.5 per cent and 9.2 per cent respectively, with Egypt, Nigeria, Tanzania, Ghana, Ivory coast, Kenya, Venezuela, Mexico and Uruguay accounting for major increases. While OECD countries, as a group, increased their share in total exports from 55.7 per cent in 1997-98 to 58.0 per cent in 1998-99. Exports to many developed countries, like UK (-10.9 per cent), Australia (-11.1 per cent), Japan (-13.0 per cent), Germany (-2.1

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per cent) and Netherlands (-2.8 per cent) in this region declined during the year. On the other hand, exports to USA (7.8 per cent), Canada (10.1 per cent), France (10.9 per cent) and Belgium (6.7 per cent) posted healthy growth rates during the year. The pick up in exports to Saudi Arabia helped maintain the share of our exports to the OPEC region. Exports to Eastern Europe declined by 18.6 per cent due mainly to reduction in exports to former Russia.

While the broad trends in share of exports have continued, the trend of declining exports to the Asian region have been reversed somewhat with a growth of 21.1 per cent in (US Dollar value) during April-November, 1999. Exports during this period have increased by 90.8 percent to Indonesia, by 62.4 per cent to former South Korea, by 43.7 percent to Malaysia, by 36.3 per cent to Singapore, by 32.1 per cent to Thailand and by 27.6 per cent to Hong Kong. This has meant that the share of select East Asian countries in our exports has rebounded to 12.7 percent in the first eight months of 1999 as against 10.9 percent during April-November, 1998. Exports to the European Union have increased by 8.8 per cent (as against a decline of 1.4 per cent in 1998-99) due mainly to a turnaround in exports to UK, Germany and Netherlands. Other main countries whose performance have witnessed improvement in the year 1999-2000 are Japan and Australia in the OECD region, Iran in the OPEC region, and former Russia in the Eastern Europe region.9

9 Ibid.
As regards sources of imports, the share of OECD countries declined marginally from 51.4 per cent in 1997-98 to 51 per cent in 1998-99. Similarly, the share in imports of OPEC region declined from 22.7 per cent to 18.7 per cent, due mainly to low international crude prices. The share of Eastern Europe declined from 2 per cent to 1.6 per cent. This decline in share of imports was balanced by an increase in the import share of Asia, Africa and Latin America, mainly contributed by countries like Argentina, Egypt, Ghana, South Africa, South Korea, Malaysia, Indonesia, Singapore and Hong Kong. The share in total imports from Asia increased from 13.7 per cent in 1997-98 to 15.7 per cent in 1998-99. The share of selected East Asian countries in total imports has thus risen from 11.6 per cent in 1996-97, the year preceding East Asian crisis, to 14.4 per cent in 1998-99. Given the recovery in international crude oil prices, imports from the OPEC region increased by 44.6 per cent during April-November, 1999, thus significantly enhancing the share of imports from the region to 24.5 per cent.

Foreign Direct Investment (FDI) inflows into developing countries continue to remain sluggish. In India, FDI inflows declined from US$ 3557 million in 1997-98 to US$ 2462 million in 1998-99. The declining trend continued in 1999-2000. Inflows during the first eight months of 1999-2000 were lower at US$ 1330 million compared to US$ 1610 million during the corresponding period in the previous years.\(^{10}\)

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\(^{10}\) Ibid.
In 1998-99 Mauritius continued to be the largest source of FDI inflows followed by USA, though there has been a substantial decline in inflows from these two sources. Inflows from Mauritius were US $ 900 million in 1997-98, which declined to US$ 590 million in 1998-99. Inflows from USA also declined from US$ 687 million in 1997-98 to US$ 453 million in 1998-99. Both these countries, increased their investments in 1997-98 and in 1998-99. Inflows from Germany were less in 1998-99 compared to the previous year, though it was the fifth largest source of FDI in that year.

In fact, several initiatives have been taken to enhance the flow of FDI into the country. In August 1999, a Foreign Investment Implementation Authority (FIIA) was established within the Ministry of Industry in order to ensure that approvals for foreign investments (including NRI investments) are quickly translated into actual investment inflows and that proposals fructify into projects. In particular, in cases where FIPB clearance is needed, approval time has been fixed to 30 days. In February 2000, the government took a major decision to place all items under the automatic route for FDI/NRI/OCB investment except for a small negative list, which includes the following:

a) items requiring an industrial license under the industries (Development and Regulation) Act 1951,

b) foreign investment being more than 24 per cent in the equity capital of units manufacturing items reserved for small scale industries;
c) all items requiring industrial license in terms of the locational policy notified under the New Industry Policy of 1991;

d) proposals having previous venture / tie-up in India with foreign collaborator;

e) proposals relating to acquisition of shares in existing Indian company by foreign / NRI / OCB investor;

f) proposals falling outside notified sectoral policy or under sectors in which FDI is not permitted and / or applications chosen to be submitted under FIPB rather than automatic route by the investors. This is an important step to dispense with case-by-case approval procedure and to impart greater transparency in the process of foreign investment.

Furthermore, subject to sectoral policies and sectoral caps the automatic route would be available to all foreign and NRI investors with the facility to bring in 100 per cent FDI/NRI/OCB investment. All proposals for investment in public sector units, as also for EUO/EPZ/EHTP/STP units would qualify for automatic approval subject to the aforesaid parameters.\(^{11}\)

Real GDP growth rate in 2000-01 is estimated at 6 per cent compared with a growth rate of 6.4 per cent achieved in 1999-2000 and 6.6 per cent in 1998-99. Despite deceleration of growth rate for the second consecutive year, India has the distinction of being one of the fastest growing economies in the world. The Indian economy has shown remarkable resilience in the face of substantial increase in the international price of crude oil over the last

\(^{11}\) Ibid.
five years. The reduction of overall growth rate of GDP to 6 per cent in
2000-01 is mainly due to a decline in the growth rate of service sector from
9.6 per cent in 1999-2000 to 8.3 per cent in 2000-01. Among services, it is
the community, social and personal services group that has shown the
sharpest decline.

During 2000-01, the annual rate of inflation has shown an increasing
trend due to pressure from energy prices. The inflation rate hovered around a
little over 6 per cent till September 2000 when the hike in prices of fuel
products pushed up inflation to 7.8 per cent for the weak ending September
30, 2000. The inflation rate as on January 27, 2001, was around 8.2 per cent
as compared with 3.6 per cent on the corresponding date of the previous
year. During 1999-2000, Government’s fiscal position remained strained due
to unanticipated expenditure on elections, 50 day war in Kashmir (Kargil
conflict) and the super cyclone in Orissa. The gross fiscal deficit of the
Central Government increased from 5.1 per cent of GDP in 1998-99 to 5.5
per cent of GDP in 1999-2000.

On the external front, exports showed significant recovery in 1999-
2000 from the negative growth in 1998-99. The current account deficit was
contained at 0.9 per cent of GDP in 1999-2000, despite substantial increase
in the oil import bill by 63 per cent due to hardening of international prices
of crude oil and petroleum products.

Export growth rose further in 2000-01 due to Rupee depreciation
along with further trade liberalizations, tariff reductions, and more openness
to foreign investment in export-oriented sectors like information technology.

The issue of India Millennium Deposits by the State Bank of India in October-November 2000 was very successful and raised more than US$ 5.5 billion of foreign exchange. The level of foreign exchange reserves (including gold and SDR) reached a record level of US$ 41.1 billion at the end of January 2001).

Overall GDP growth rate decelerated marginally from 6.6 per cent in 1998-99 to 6.4 per cent in 1999-2000 mainly due to a significant slowdown in agriculture and allied sector growth from 7.1 per cent in 1998-99 to a mere 0.7 per cent in 1999-2000 despite record level of food grains production in 1999-2000. However, in 1999-2000, apart from electricity, gas and water supply, there was acceleration in growth rates of all other major sectors of the economy. There was a significant improvement in overall growth in industrial value added from 3.4 per cent in 1998-99 to 6.4 per cent in 1999-2000 due to acceleration of growth in value added by the manufacturing sector from only 2.5 per cent in 1998-99 to 6.8 per cent in 1999-2000, and that in construction from 6.1 per cent to 8.1 per cent over the same period. Within the industry sector, while mining and quarrying showed some improvement in 1999-2000, there was marked deceleration in the growth rate of electricity, gas and water supply.

Service sectors also performed exceptionally well in 1999-2000. Average growth rate of trade, hotels, transport and communications, improved from 7.1 per cent in 1998-99 to 8 per cent in 1999-2000, and that
of financial, real estate and business services accelerated from 8.4 per cent to 10.1 per cent over the same period. Community, social and personal service also grew at a much faster rate in 1999-2000 than in 1998-99.

The rates of investment and saving in India are high as judged by its level of economic development. Gross domestic investment (GDI) as percentage of GDP has shown a different trend. It declined from 25.0 per cent in 1997-98 to 23.0 per cent in 1998-99 due to decline of investment in both public and private sectors. It is estimated that GDI as percentage of GDP has improved to 23.3 per cent in 1999-2000 due to higher investment by both public and private sectors. While public investment as percentage of GDP improved from 6.4 per cent in 1998-99 to 7.1 per cent in 1999-2000, private investment as percentage of GDP also improved from 14.8 per cent to 15.6 per cent over the same period.

The trends indicate that sustained high economic growth would require significant improvement in investment, which in turn, would depend on steep rise of foreign direct and portfolio investment, structural reduction in inflationary expectations and real interest rates, reduction in the fiscal deficit and further liberalization of the domestic debt and capital markets.

The tempo of economic reforms was sustained successfully in 1999-2000. Major fiscal reforms were undertaken for broadening the income tax base and streamlining the excise and customs duty structures. There were enabling reforms in foreign investment and trade policy spheres also. Reforms in public sector enterprises were introduced for reducing pressures
on public finances, increasing the efficiency of public sector operations and reducing the incremental capital output ratio (ICOR). Strengthening of legal, institutional and regulatory frameworks in insurance, banking, capital markets, power and telecom were undertaken for inducing greater private investment in infrastructure.

The Union Budget for 2000-01 announced various measures for further deepening of the capital markets and financial sector and allowed private entry in insurance and provident funds. It is expected that these measures would enhance both the savings and investment rates for the economy. The major reforms undertaken during 2000-01 are as follows:

Industry:

a) strong thrust to knowledge based industry by reducing customs duty on several items of information technology, telecom and knowledge – based industries.

b) foreign direct investment permitted through automatic route in all industries except for a small negative list.

c) non-banking financial companies allowed to hold foreign equity upto 100% if they are the holding companies. Their subsidiaries, which are the operating companies, also allowed to hold foreign equity upto 75 per cent.

d) dereservation of the garment sector from the purview of small-scale industries reservation.
Infrastructure

a) securitisation of dues of central sector power and coal utilities for assisting State Electricity Boards in clearing dues.

b) domestic long distance service opened up without any restriction on the number of operators.

c) corporatisation of Department of Telecom Services (DTS) and Department of Telecom Operations (DTO) by creating Bharat Sanchar Nigam Limited (BSNL) w.e.f October 1, 2000.

d) revenue sharing regime, in place of existing fixed license fee, introduced for both basic and cellular service operators.

e) thrust to accelerated implementation of Prime Minister’s National Highways Development Project (NHDP) from petrol and diesel cess and additional fund raising measures for National Highway Authority of India.

f) divestment of Government equity proposed in Indian Airlines and Air India.

g) extension of tax holiday benefits to solid waste management and water treatment for developing urban infrastructure.

Direct Taxes

a) non-agricultural income of farmhouses made taxable.

b) venture Capital Funds accorded complete pass through status with the income being taxed only in the hands of investors.
c) interest from bonds issued by local authorities, as specified by Central Government, made tax free to make funds available for infrastructure.

d) Minimum Alternate Tax (MAT) to be charged at 7.5 per cent of the "book profits" by all companies as determined under the Companies Act instead of the effective rate of 10.5 per cent earlier.

e) tax holiday benefits liberalized in respect of newly established industrial undertakings in Free Trade Zones, Software Technology Parks, Electronic Hardware Technology Parks and 100 per cent Export Oriented Undertaking.

f) weighted deduction for expenditure incurred on scientific research on in-house research and development facility enhanced from 125 to 150 per cent.

g) benefit of exemption of export income by entertainment industry extended to non-corporate assesses.

h) “One-by-six”, criteria, introduced in the Union Budget 1998-99, for identifying potential taxpayers, extended to 79 more cities (from 54 cities) having population of 2 lakh or more.

Indirect Taxes

a) peak protective customs tariff rate reduced from 40 per cent to 35 per cent ad valorem.

b) the existing five major ad valorem rates of basic customs duty reduced to four advalorem rates.
c) the system of central excise was overhauled with the introduction of a single Central Value Added Tax (CENVAT) of 16 per cent ad valorem on all manufactured goods with a few exceptions.

**Fiscal Management**

a) the Fiscal Responsibility and Budget Management Bill, 2000 was introduced in the Lok Sabha in December 2000. The proposed legislation provides for a legal and institutional framework to eliminate revenue deficit, bring down the fiscal deficit and stabilize debt as a proportion of GDP within a time frame.

b) the interest rate on general provident funds reduced by 1 per cent to 11 per cent with effect from April 1, 2000.

c) several measures taken for controlling growth in non-plan, non-developmental expenditure.

**Financial Sector**

a) tightening of entry norms for IPOs through modifications to SEBI (Disclosure and Investor Protection) guidelines.

b) modified guidelines issued for 100 per cent one-stage book building process.

c) legislation initiated for reducing minimum Government shareholding in nationalized banks to 33 per cent.

d) establishment of IRDA.
e) enlargement of functional area and greater autonomy to NABARD through amendment to the NABARD Act, 1981.

f) revised norms for entry of new banks in private sector.

g) permission to banks and NBFCs for undertaking insurance business.

Trade Policy

a) setting up of Special Economic Zones (SEZs) to encourage export production.

b) evolution of a scheme for granting assistance to states based on their export performance for development of export related infrastructure.

c) permission to import second hand capital goods, less than ten years old without obtaining any license on surrender of SIL.

Capital Account

a) foreign Direct Investment (FDI) upto 100 per cent permitted in e-commerce, subject to specific conditions.

b) the dividend balancing condition for FDI in twenty-two consumer goods industries removed.

c) the existing upper limit of Rs. 1500 crore for FDI in projects involving electricity generation, transmission and distribution (other than atomic reactor plants) dispensed with.

d) FDI under the automatic route permitted up to 100 per cent for all manufacturing activities in SEZs, except certain activities.
e) foreign equity participation up to 26 per cent in insurance sector allowed under the automatic route.

f) policy liberalizations effected for facilitating the use of External Commercial Borrowing as a window for resource mobilization.

g) policies pertaining to international offerings through ADR/GDR by Indian companies further liberalized.\textsuperscript{12}

The Budget for 2000-01 was formulated in the backdrop of a series of events such as the 50 day war in Kashmir, long months of political uncertainty before the general elections, the cyclone in Orissa, a somewhat weak monsoon and the continued fragility in world economic recovery. These developments led to an unanticipated expenditure on national defence, elections and the super cyclone during the financial year of 1999-2000. Furthermore, the residual impact of the Fifth Central Pay Commission, the need for special fiscal assistance to the states combined with shortfalls in receipts from disinvestment and revenue, exacerbated the fiscal deficit during 1999-2000. The Budget for 2000-01 envisaged a fiscal deficit target of 5.1 per cent of the GDP.

With a view to put India on a higher growth path, the Budget 2000-01 indicated a seven fold strategy which included the following elements:

1) to strengthen the foundations of growth of the rural economy;

2) nurture knowledge based industries; strengthen and modernize traditional industries;
3) remove infrastructure bottlenecks;
4) accord high priority to human resource development with special emphasis on poorest and weakest sections of society.
5) strengthen the country’s role in the world economy through rapid growth of exports;
6) higher foreign investment and prudential external debt management, and
7) establish a credible framework of fiscal discipline.

The Fiscal Responsibility and Budget Management Bill, 2000 was introduced in the Lok Sabha in December 2000. The bill provides for a legal and institutional framework to eliminate revenue deficit, bring down the fiscal deficit, contain the growth of public debt and stabilize debt as a proportion of GDP within a time frame. The proposed law casts an obligation on the Government itself for conduct of prudent and accountable fiscal policy and pave the way for promoting greater macro-economic stability. This covers only the finances of the Central Government. The principles of fiscal responsibility have been defined in relation to deficit, borrowing and debt.

The Bill focuses on two deficit indicators, viz., revenue deficit and fiscal deficit, and provides normative ceilings within a time frame for chosen fiscal indictors. The Bill proposes elimination of revenue deficit and progressive reduction of the fiscal deficit to not more than 2 per cent of
Gross Domestic Product within a period of five financial years following the promulgation of the law. Besides, the proposed Bill contains provisions, which will ensure flexibility in fiscal management under extraordinary circumstances like natural calamities and war. Under borrowing related principles, it is proposed to prohibit certain types of borrowing under the Reserve Bank of India and under the debt related principles, it is proposed to prescribe a limit on the debt stock. Accordingly, the Bill envisages that within a period of ten financial years, the total liabilities (including external debt at current exchange rate) would not exceed fifty per cent of the estimated GDP.\footnote{Ibid.}

In fact, during the course of the year 2000-01, the Government took a series of measures for controlling growth in non-plan, non-developmental expenditure which include, a mandatory 10 per cent cut in the budgetary allocation for non-plan non-salary expenditure of all ministries/departments and autonomous institutions; a complete ban on purchase of new vehicles for one year; 10 per cent cut in the consumption and allocation of funds for expenditure on POL for staff cars; ban on creation of new posts for one year; and ban on foreign travel for study tours, seminar etc.

India's balance of payments situation remained comfortable in 1999-2000. The deficit on the current account increased only marginally from US$ 4 billion in 1998-99 to US$ 4.2 billion in 1999-2000, despite an unfavourable environment in international trade and finance and almost two-
third hike in India's oil import bill, reflecting the sharp increase in international prices of crude oil. This was made possible because of a strong recovery of exports and a surge in net inflow of invisibles reflecting sharp increases in software exports and private transfers. Net inflow of invisibles at US$ 12.9 billion covered 76 per cent of the deficit on trade account in 1999-2000, leaving a financing gap of US$ 4.2 billion on the current account. As percentage of GDP, the current account deficit recorded a marginal decline from 1 per cent in 1998-99 to 0.9 per cent in 1999-2000.

The trade deficit on the BOP account widened to US $ 17.1 billion or 3.8 per cent of GDP in 1999-2000 from US$ 13.2 billion (3.2 per cent of GDP) in 1998-99. Exports made a welcome recovery from a negative growth of minus 3.9 per cent in 1998-99 to 11.6 per cent in 1999-2000. Total imports, on payment basis, also rose sharply by 16.5 per cent in 1999-2000 mainly due to a 63 per cent increase in the oil import bill.

According to the latest quarterly estimates of BOP, exports increased by 22.1 per cent and imports by 22.2 per cent, resulting in a widening of trade deficit by 22.3 per cent to US$ 9.2 billion in April-September 2000. Imports of crude and petroleum products showed a substantial increase from US$ 4.5 billion in April-September 1999 to US $ 8.3 billion in April-September 2000 due to continued pressure on international prices of oil. Imports grew by 9.0 per cent in April-December 2000 compared to 10.7 per cent in April-December 1999.
Despite revival of world trade, exports of developing countries like India continue to be threatened by the emerging protectionist sentiments in some sectors in the guise of technical standards, environmental and social concerns. Non-trade barriers like anti-dumping duties, countervailing duties, safeguard and sanitary measures have affected market access for exports from the developing countries. Indian products which have been exports of floriculture products, textiles, pharmaceuticals, marine products and basmati rice to the European Union and Mushroom and steel exports to the USA. Market access is also affected by the tariff differential in imports by the developed countries, with average tariff on developing countries imports being higher than on imports from the developed countries. Amongst the domestic factors that continue to hamper our exports growth are infrastructure constraints, high transaction costs, small-scale industries reservations, labours laws and constraints in attracting FDI.¹⁴

An analysis of the measures announced in the Union Budget 2000-01 throw light on the following:

a) peak rate of basic customs duty was reduced from 40 per cent to 35 per cent and the total number of slabs in customs duty rates was rationalized from five to four (i.e., 35, 25, 15 and 5 per cent).

b) duty on various items (mostly consumer goods and agricultural products) on which quantitative restrictions have been listed and placed at peak rate (35 per cent plus surcharge) to accord adequate tariff protection to these

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¹⁴ Ibid.
items. A number of agricultural and horticultural products placed on the free list of import in the earlier years have also been brought to the peak rate to ensure adequate protection to farmers.

c) for sensitive agricultural products (wheat, rice, sugar, edible oils), suitable enabling provisions to fix statutory tariff rates at appropriately high levels have been made, providing the necessary flexibility for adjusting the applied rates to facilitate suitable supply management of these commodities.

d) phasing out of export concessions, under the income tax over a period of five years. To start with, 20 per cent of the export earnings will be taxed from 2000-01, increasing by a further 20 per cent each year for the next five years.

e) to improve international competitiveness of sectors which are integral part of the “Convergence revolution” and encourage their exports, industry specific concessions have been granted to Information Technology, Telecom and Entertainment industry sectors.

f) continuation of tax holiday for another two years for EOUs in backward areas.

Measures announced in the annual EXIM Policy of the year 2000-01 include the following:

1) quantitative restrictions (QRs) removed from 764 tariff lines including 58 reserved for SSI sector.
2) setting up of Special Economic Zones (SEZ) to encourage export production with fewer rules and regulations governing imports and exports.

3) evolution of a scheme for granting assistance to states based on their export performance for development of export related infrastructure.

4) rationalization of existing export promotion schemes including abolition of Special Import License (SIL) from April 1, 2001, exemption from payment of all kinds of duties on Advance Licenses, extension of EPCGs scheme uniformly to all sectors and capital goods without any threshold limit and on payment of 5 per cent duty and removal of threshold limit of fixing new-DEPB rates.

5) introduction of post-export duty replenishment license scheme for enabling import of inputs on the basis of input-output norms and uniform value addition of 33 per cent.

6) sector specific initiatives to accelerate exports announced for core areas like gems and jewellery, agrochemicals, bio-technology, pharmaceuticals, leather, garments, handicrafts, silk and granite and minerals. In addition, a Diamond Dollar Account Scheme to boost export of gems and jewellery has been introduced.

7) all items under SIL will be importable on surrender of SIL equivalent to 5 times the CIF value of imported goods;

8) permission for import of second hand capital goods which are less than 10 years old without obtaining any license on surrender of SIL.
9) Deemed export benefits rationalized by extending benefits uniformly to eligible categories and expanding the definition of capital goods to include all such items / components/spares / accessories / tools etc. which go into the making of capital goods. Deemed export benefits extended to core infrastructural sectors (involving an investment of Rs. 100 crore and above) like coal and hydrocarbon, to the power sector including modernization and renovation of power plants and to supply of projects funded by UN agencies.

10) Additional benefits permitted to EOU/EPZ include: permission to carry job work for Domestic Tariff Area (DTA) units in all sectors; and all EOUs/units in EPZ having an investment of Rs.5 crore and above, in plant and machinery, will only be required to maintain positive value addition.

11) Project exports / construction companies/ domestic service providers with a domestic turnover of Rs.100 crore or more shall now be eligible for “International Service House” status on signing an MOU for exports.


13) Procedural simplifications like extension of electronic filing of license applications, extension of green channel facility to all manufacturers, exporters holding green cards, delegation of powers to issue Trading House Certificates to regional licensing authorities etc.
Other measures include:

1) Duty Drawback rates rationalized in consonance with changes in customs and excise. The drawback rates in respect of 141 entries were increased, 406 entries have been maintained and for 270 entries revised downwards to reflect appropriate incidence of these duties. A maximum drawback cap has been imposed on 141 entries. Nine new entries have been introduced including plastic jumbo bags, hand-knotted / hand made silk and synthetic carpets, copper cathodes, mechanical pencils and parts of textile machinery.

2) It has been decided to amend the Foreign Trade (Development and Regulation) Act, 1992 for vesting the Government with necessary powers to impose QRS as a safeguard measure.

3) The Monetary and Credit Policy 2000 has extended export refinance limit by permitting bills rediscounted by institutions like the EXIM Bank to be included in the refinance limit.

4) A High Powered Standing Committee on reduction of transaction costs of Indian exports has been set up under the Chairmanship of the Finance Secretary. The Committee meets regularly to resolve various issues relating to interdepartmental cooperation and to review action taken reports of concerned Departments, including recommendations on further follow up measures.

5) De-reservation of the garment sector from the purview of SSI reservation in the new textile policy will facilitate larger investments, including
higher foreign direct investment, in garment manufacturing and would thus provide a fillip to garment exports.\(^{15}\)

As far as external debt is concerned, India’s external indebtedness position further improved in 1999-2000 and 2000-01. Thus, debt service payments, which reached a peak of 35.3 per cent of current receipts in 1990-91, declined steadily to 16.0 per cent in 1999-2000. External debt to GDP ratio, that measures the size of debt in relation to the domestic output, improved from the high of 38.7 per cent at end-March 1992 to 21.9 per cent at end-March 2000 and further to 20.7 per cent at end-September 2000. The stock of debt, which increased from US$ 97.68 billion at end-March 1999 to US 98.44 billion at end-March 2000, declined to US$ 97.86 billion at end-September 2000.

The global economy experienced an overall deceleration and is estimated to record an output growth of 2.4 per cent during the past year. These tendencies were exacerbated in the aftermath of the terrorist attacks in United States in September 2001. Consequently export growth has suffered and industrial profitability has also been affected by the prevailing low commodity and product prices globally. Despite these constraints, growth in real GDP in 2001-02 is approximately 5.4 per cent. This growth rate marks some recovery over the low growth of 4 per cent in 2000-01. It will also be one of the highest growth rates in the world in that year. Although this raises new challenges for reinvigorating growth in the Tenth Five Year Plan.

\(^{15}\) Ibid., pp.101-126.
As per the statistics in the Economic Survey the overall growth of 5.4 per cent in 2001-02 is supported by a growth rate of 5.7 per cent in agriculture and allied sectors, 3.3 per cent in industry and 6.5 per cent in services. The acceleration of the overall GDP growth rate is basically due to a significant improvement in value added in the agriculture and allied sectors from a negative growth rate of minus 0.2 per cent in 2000-01 to 5.7 per cent in 2001-02. There has been a significant deceleration in the growth rate of industry. However, the performance of the services sector has improved moderately.

The average annual rate of inflation increased significantly from 3.3 per cent in 1999-2000 to 7.1 per cent in 2000-01 due to a substantial rise in administered prices of petroleum products. During 2001-02, the inflation rate declined. The 52 week average inflation rate declined from 7 per cent at the beginning of 2001-02 to 4.7 per cent for the week ended January 19, 2002. The point-to-point inflation rate reached a low of 1.3 per cent by the end of January 2002 which was the lowest in over two decades. The gross fiscal deficit as a proportion of GDP is now estimated at 5.5 per cent for 2000-01 and 5.1 per cent for 2001-02.

India’s external debt situation has improved significantly in recent years as a result of effective external debt management by the Government. The external debt-GDP ratio decreased from 28.7 per cent at the end of March 1991 to 22.3 per cent at end-March 2001 and further to 21 per cent at the end of the September 2001. The debt service ratio declined from a peak
level of 35.3 per cent of current receipts in 1990-91 to 16.3 per cent in 2000-01. It is particularly noteworthy that for the first time, the World Bank has classified India as a 'less indebted' country.16

The investment trends for the year 2001-02, have been to be assessed by analyzing the trends in various leading indicators of investment and growth. These trends present a mixed picture. Both domestic production and imports of capital goods have declined considerably. Sanctions and disbursements made by the All India Financial Institutions (AIFIs) have also reduced significantly. On the other hand, foreign investment inflows have recorded distinct improvement. But, most of these inflows are possibly yet to be absorbed as fresh investments due to a build up of record level of foreign exchange reserves. The available trends, therefore, may not indicate any significant recovery of investment in 2001-02.

The external sector viability during the five to six years following the 1991 crisis was made possible because of the dynamic export growth, especially, during 1993-94 to 1995-96, buoyancy in private transfers and a major structural shift of capital flows in favour of non-debt creating foreign investments, both direct and portfolio. The deceleration in export growth in recent years and the sharp slowdown, especially since 1998-99, in foreign investment flows as a fall out at the East Asian crisis have been a major cause for concern in the management of the balance of payment. Maintaining external balance requires achieving an equilibrium position in

16 Ibid.
the current and capital accounts. In practice, it implies achieving a level of current account deficit that could be sustained by medium term capital flows. Despite the unfavourable outcomes on exports (with the recovery in 1999-2000) and foreign investment, the current account deficit has been contained and the viability of the BOP has been sustained, largely because of continued strength of net surplus in the invisibles account and deceleration in import growth.

With international prices of oil having strengthened considerably and with continued revival of industry, the growth of total imports is likely to increase. To ensure the medium term viability of India’s balance of payments it is extremely important to sustain export growth in the range of 12 to 15 (in US dollar terms) per year on average and revive the inflows of foreign investment.

POL imports have risen sharply in 1999-2000, as a result of the substantial increase in international prices of oil. Modernization in POL imports will allow room for larger imports of raw materials, components and capital goods, which are essential for increasing the domestic production of international standards. Towards this goal, there is a need for increasing the domestic production of crude oil substantially from the current level. Simultaneously, the domestic demand for petroleum products will have to respond to market-determined pricing on a continuous basis.

The tourism industry has been a major segment of the Indian economy. It is fast emerging as an industry with substantial potential
contribution to employment generation, environmental regeneration and advancement of women. Tourism has also become an instrument for the promotion of handicrafts, arts, and cultural heritage of the country. Foreign currency receipts from tourism has been sluggish in recent years for various reasons. The tourism industry is handicapped by inadequate basic infrastructure facilities and some impediments to private sector investment in the sector. Vigorous efforts are required to address these issues to make India an attractive tourist destination.

Software exports have emerged as a dynamic item of invisible earnings. Earnings from software exports have grown at a rate of about 52 per cent per annum during 1996-97 to 1998-99. However, in absolute terms, India’s share in total world software trade is still very small. On the other hand, India is blessed with an advantage in terms of possessing an abundant pool of trained English-speaking manpower and its relatively low cost. With growing opportunities in the world market, India has an excellent opportunity to capture a sizeable portion of the global market, especially in opportunities emanating from the explosive growth in e-commerce. To achieve this, concerted efforts will have to be made to move up the value chain by overcoming weaknesses in telecom infrastructure and effectively dealing with competition.

In the last half century, the Government’s production activity has expanded along with fiscal deficit and dis-saving. At the same time; investment in public goods and basic physical and social infrastructure has
contribution to employment generation, environmental regeneration and advancement of women. Tourism has also become an instrument for the promotion of handicrafts, arts, and cultural heritage of the country. Foreign currency receipts from tourism has been sluggish in recent years for various reasons. The tourism industry is handicapped by inadequate basic infrastructure facilities and some impediments to private sector investment in the sector. Vigorous efforts are required to address these issues to make India an attractive tourist destination.

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In the last half century, the Government’s production activity has expanded along with fiscal deficit and dis-saving. At the same time; investment in public goods and basic physical and social infrastructure has
been starved of funds and their quality has deteriorated. It is necessary to get
the Government out of the business of production and enhance its presence
and performance in the provision of public goods. Governments with their
elaborate bureaucratic structures and complex cross-checks are unsuited to
the demands of commercial production in a competitive, fast growing
economy. This has been recognized in principle and privatization has been
initiated. Privatization will allow Government's capital expenditure to be
allocated to public goods and basic infrastructure that is commercially not
viable. A significant portion of central capital expenditure could be
reallocated this way, if all public sector units producing private goods are
sold to the public. The funds received from privatization would also help in
reducing the public debt incurred for setting up these units and will put the
debt-GDP ratio on a sustainable path. Most importantly, privatization would
enable the competitive public enterprises to function effectively and would
help them in contributing to the national economy.

A significant portion of the Indian basic industry remains in the
public sector. Because of the lack of resources, public sector industrial
growth in the 1990s has been significantly lower than that of private sector
industrial growth, and also lower than its own growth in the 1980s. Thus
accelerated privatization of the competitive segment of the public sector
should also serve in stimulating industrial growth.

Expenditure management has been conceived as a major plank for
second generation reforms. The core issue in this regard is minimization of
wasteful expenditure and reallocation of funds to public goods, basic infrastructure and social welfare.

Defence expenditure had fallen from 2.7 per cent of GDP in 1990-91 to 2.2 per cent of GDP in 1996-97. Given the heightened threat perception after Kargil, this has now risen back to the level at the beginning of the 90s. If the increased demand on the equipment budget of the defence services is to be met without raising the ratio further, there is need for a comprehensive introduction of modern management systems. This must cover all the defence production units, procurement systems, supply chain management, logistics and inventory.

Increasing number of economists are aware of the fact that subsidies are similar to indirect taxes in that they open a gap between the cost of production and distribution, and the price paid by the subsidized buyer. They also distort the pattern of consumption. Large subsidies have even more serious problem of providing incentives for rent-seeking diversion and corruption. The larger the unit subsidy the larger is likely to be the leakage. Thus, there is a need to reduce subsides, target remaining subsidies on the poor. This requires progress in reforming the existing control systems governing the fertilizer, petroleum and sugar sectors.

Some expert economic committees have observed, the retention price system in fertilizer is one of the most anachronistic. They observe that depending on world prices, anything between 50 per cent to 75 per cent of the fertilizer subsidy goes to the producers. Several committees, such as the
Hanumantha Rao Committee and the Alagh Committee, have recommended its disbandment. The sooner this is done, the quicker will normal market incentives for improvement in productivity of investment and energy efficiency come into operation. To minimize the effect on farmers, the prices of fertilizer and natural gas should move towards parity with international prices, through appropriate customs and excise duties.

These economic committees have also observed that the coal and petroleum sectors also need to be deregulated so that fertilizer and power producers are free to use any energy input, domestic or imported. Deregulation of the coal and petroleum sectors will also ensure that domestic producers of these products face the rigours of competition on a fair and equitable basis. A competitive system will ensure that fertilizer and power producers get the best inputs at most competitive prices.

Many Indian economist share the perception that a number of other reform measures need to be taken for ensuring that the profitability of farming is enhanced. There is a need for comprehensive decontrol of production, storage, transport, and processing of agricultural goods and the inputs used in agriculture. The management of the food economy needs comprehensive reforms, including a change in the monopoly role of the FCI (Food Corporation of India) and in the administration of the Public Distribution System (PDS). The sugar sector (including its inputs) should be decontrolled, removed from the PDS and the tax incidence on sugar manufacturing should be rationalized. Given the current surplus in
production, these measures will ensure that the market price of sugar is close to the price currently being paid by the poor. In the long term there will be a powerful incentive for increasing efficiency through economies of scale and scope.

Internet telephony needs to be opened up so that internet access and telephone can be bundled together to take the information communication revolution to the rural areas.

Many economists have noted the large size of the Government in terms of number of employees. Few, however, realize that this is largely due to the bloated size of departmental public enterprises. There has been massive over manning, ultimately resulting in a running down of capital and deterioration in service quality. The Indian government is under strong pressure of international Institutions for the conversion of these departmental enterprises into companies essentially for infusing them with commercial culture and subjecting them to competitive pressure. The identification of “public sector” with “state monopoly” needs to be replaced by a public sector that is owned by the people. Shares in these newly formed companies would then eventually be sold to the public while retaining majority only in companies producing major defence systems. The funds generated from the sale of shares could be used to repay debt incurred by and for them. Once downsizing is done, the Government will be forced to become a facilitator of economic growth and investment.
The direct tax reform strategy of reducing rates, broadening the tax base and modernizing tax administration has been by and large successful. Despite the rise in effective marginal rates due to levy of surcharges during the last two years, the rise in the direct tax to GDP ratio has been sustained in the short term. Maintenance of the long term faith of honest tax payers requires that the personal and corporate income tax rates be kept at levels that eliminate the incentives for tax evasion.

Our basic customs duty rates are still among the highest in the world and there is broad agreement on the need for reducing them to Asian levels. This is essential for pressurizing industry and trade to increase efficiency and improve the competitiveness of the Indian economy. The rate reduction, however, must be accompanied by factor market and infrastructure reforms that make it possible for industry in adapting and introducing new technology, improving the productivity of labour, capital and land use and competing in domestic and international markets.

One reason for the fiscal deficit continuing to be high despite a decline in the primary deficit is the rise in interest costs. These interest rates should be benchmarked against equivalent market instruments. The market for Government securities and treasury bills also requires to be adequately broadened and deepened. This requires comprehensive decontrol and provision of a level playing field, so that potential real investors have convenient access to these securities through the stock markets.
Along with the application of competitive pressure, Indian industry must be provided the right environment for being able to compete. With the economic policy changes that have taken place in the 1990s, along with the worldwide changes that have occurred in the economic environment, it is essential for industry to become capable of restructuring on a continuous basis. Measure to promote such restructuring include factor market reforms, an end to any remaining investment controls and provisions for progressive improvement in infrastructure services. These reforms will also help Indian industry in meeting the challenge of imports resulting from the removal of the remaining import restrictions.

These issues assume greater importance in the light of the industrial growth experience of the 1990s. The industrial policy reforms of the 1990s, opening of foreign direct investment, improvement in access to foreign technology, abolition of MRTP and phased manufacturing programmes have led to an expectation of sustained higher growth in industrial production. After some exuberance in the mid-1990s industrial growth has slowed down. It is likely that this has happened due to the existing rigidities in factor markets. Capital remains locked up in sick enterprises due to dilatory bankruptcy procedures.

Inclusion of modern bankruptcy provisions in the Companies Act, repeal of SICA (Sick Industrial Companies Act) and dissolution of BIFR (Board for Industrial and Financial Reconstruction) will facilitate restructuring of Indian industry. The delays currently inherent in the BIFR
process that prevent quick reorganization of sick companies, or closure when required, should be eliminated. This would benefit shareholders, lenders and labour to move to more productive pursuits, thereby promoting industrial growth.¹

The labour laws and procedures have reduced the incentive for organized labour to work efficiently and have made it unprofitable for organized industry to generate new jobs. The states need to follow the lead of the Centre and repeal the Urban Land Ceiling Laws.

Small Scale industry reservation is a variant of investment control. Whereas special support policies for small and medium enterprises are found in most countries of the world, developed and developing alike, the policy of small scale industries reservation is unique to India. As removal of all restrictions on imports was completed in April 2001, the time has come to give up reliance on reservation as an instrument for supporting SSI.¹⁷

The pricing of power at cost of production-cum-distribution is not just a fiscal necessity, but essential for keeping the system from collapsing. Transmission and distribution losses need to be tackled on a war footing to make efficient pricing feasible. A special task force may be needed to be set up to push power sector reforms with State Governments in an organized manner.

In 1999-2000, the combined fiscal deficit of the centre and states was estimated at nearly 10 per cent of GDP, an increase of almost one percentage

The revenue deficit is also threatening to reach unsustainable limits. The result of this fiscal deterioration is that states expenditure on social sectors have remained stagnant. There is little money for improving the extent the and quality of education services or of public health. Similar reforms must be made in the case of urban infrastructure services so that maximum possible private participation can be elicited.

The Indian economy, has performed well over the past two decades. During 1991-2001, it has gone through significant structural change that has been induced by a continuous process of economic reforms. The pace of reform was intensified in the 1990s and the economy has responded well to the new changes that have been introduced in almost all sectors of the economy during this period. As a consequence, the economy has also shown a great degree of resilience even in the presence of adversities, such as the East Asian financial crisis of 1997-98 and the abnormal increase in oil prices more recently.

In view of the many changes that have taken place, it is now quite possible for the Indian economy to attain an even higher growth path. However, as has been outlined in the earlier pages, crucial action is required in a number of key areas in order to obtain the full benefits of the reforms carried out so far. Should these measures be accomplished in an organized manner in the near future, it is quite likely that many of the latent energies that are yet to be released in the country would become apparent and a higher level of economic activity would emerge.
Indian Economy beyond the year 2000

However, it is interesting to note that, one futurologist has recently drawn a truly startling picture of India in the world economy in the year 2030. In this picture, the world at that time will be dominated by four large trading blocs - two small and two large. The two small ones, according to this view, will be –

a) the American trading group, which will be an enlarged version of NAFTA and
b) the European Union including Eastern Europe.

The two large ones will be:
1) China and
2) India.¹⁸

This on the assumption that both China and India will operate under a free market system. The picture of India as the second largest trading bloc in the world in the year 2030 is unbelievable because only a few years ago it was clear that India was being steadily marginalized in the world economic system, as Dr. Manmohan Singh noted shortly after he became the Finance Minister. This is a picture in which India is larger in economic size than not just the United States but the Americas taken as a group, including Eastern Europe. It is larger than Japan. Once India starts using its resources effectively so as to raise per capita income to reasonable level, its huge

population pitches in to give it a great power economic status. Of course, what is critical is what this means for the common man in terms of employment and income.

The year 2030 appears at this time like distant star though not as far the present is from the time we began the second five-year plan based on the strategy and system that we have now given up. For many of us, the relevant question is: what significance does this picture of India in 2030 have for the country now? The answer to this is quite simple.

When a fundamental change is made in economic strategy and even more so when the change involves a fundamental change in the framework within which economic activity is carried on. We must have a clear vision of what India can expect to achieve over the long haul with the new approach. Only a vision of the result that can be rationally expected in the long run can provide the needed sense of purpose and the appropriate direction for economic effort. Only such a vision can infuse meaning into the current policy and help to underline the importance of pressing ahead rapidly with further changes in all aspects of the economic system.

Besides, for India to reach that position in 2030, it will have to pass through stages that are increasingly better than would have been otherwise and also in comparison with the rest of the world. Long before the years have passed, India would already become one of the most important players in international trade.\(^\text{19}\) As it moves towards the projected position, India,

\(^{19}\) Ibid.
will, by say 2010 have achieved such large increases in production and income that it will have wiped out unemployment, raised real wages to reasonable levels for most workers in both urban and rural areas and virtually eradicated poverty.\textsuperscript{20}

Outside recognition of India’s position is, however, not what makes it India’s position, but the improvement in perception that helps to accelerate the process of India’s growth. It provides additional evidence that India is in fact already making the grade in the sphere of international trade and foreign investment.

\textsuperscript{20} Ibid.