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GENERAL REVIEW

Review of Developments

Macroeconomic Overview

The reforms undertaken over the last four and a half years have led to a revival of strong economic growth, rapid expansion of productive employment, a reduction of poverty, a substantial boom in exports and a marked decline in inflation. The full dimensions of the recovery produced by the far reaching reforms initiated in 1991-92 are now becoming clear. Growth of real GDP at factor cost, which had fallen to a mere 0.8 per cent in the crisis year of 1991-92, recovered within a year to reach 5.1 per cent in 1992-93. This represents one of the fastest economic recoveries from a macroeconomic crisis. Fiscal and macroeconomic policies helped in maintaining a growth rate of 5 per cent in 1993-94, despite the disturbing events of late 1992-93. Overall economic growth accelerated significantly in 1994-95 to attain 6.3 per cent and is projected to record a similar high growth of 6.2 per cent in 1995-96. Thus, despite the deep crisis of 1991-92, average growth over the first 4 years of the Eighth Plan at 5.7 per cent is higher than the Plan target of 5.6 per cent. This is a remarkable post-crisis achievement by international standards.

2. Even more important, the current momentum of growth appears to be much more sustainable. The growth recovery has been accompanied by much lower current account deficits in the balance of payments, a drop in inflation below the historical average of around 8 per cent, a rise in the domestic saving rate to a record high level of 24.4 per cent of GDP and a reduction in the gross primary fiscal deficit to its lowest level in decades. These achievements can be traced directly to the far-reaching reforms initiated simultaneously with the introduction of fiscal stabilisation measures since 1991-92.

3. The reforms have also had clear beneficial impact on living standards and social indicators. Following an initial deterioration resulting from the 1991 crisis, the setbacks to real agricultural wages, mortality rates and the growth of employment, were soon reversed. After declining by 6.2 per cent in the crisis year of 1991-92 the growth of real wages of unskilled agricultural labour has averaged 5.1 per cent per annum in the next three years. Provisional estimates by the Planning Commission indicate that in 1993-94 the incidence of poverty had declined to below 19 per cent of India's total population. The rate of poverty reduction, in terms of per cent of people below the poverty line, during 1987-88 to 1993-94 was the same as in the 1983-84 to 1987-88 period, despite the intervening crisis of 1991-92. After the crisis-induced low of 1991-92, annual economy-wide employment growth is estimated to have averaged 6.3 million jobs per year over 1992-93 to 1994-95, with 7.2 million additional employment in 1994-95. This has to be viewed against estimates of annual employment increase of 4.8 million in the 1980s. The available data suggest that reforms have brought significant benefits to the poor. Indeed, but for the stabilisation-cum-structural reforms implemented since 1991, the economic crisis would have worsened and the poor would have been its worst victim.

4. Gross domestic savings as a proportion of GDP, which averaged 21.3 per cent in 1992-93 to 1993-94 because of the poor performance of direct household savings in fixed assets, staged a dramatic recovery in 1994-95 (Table 1.2). The gross domestic saving rate set a new record of 24.4 per cent, exceeding the recent peak of 23.6 per cent in 1990-91. Private saving also recorded its highest level, reaching 22.7 per cent of GDP, based both on a recovery of household saving rate to 18.9 per cent and a record corporate saving rate of 3.8 per cent of GDP.

5. The Economic Survey of 1994-95 had envisaged a sharp increase in gross domestic investment, based on available data on growth of capital goods

TABLE 1.1
Key Indicators

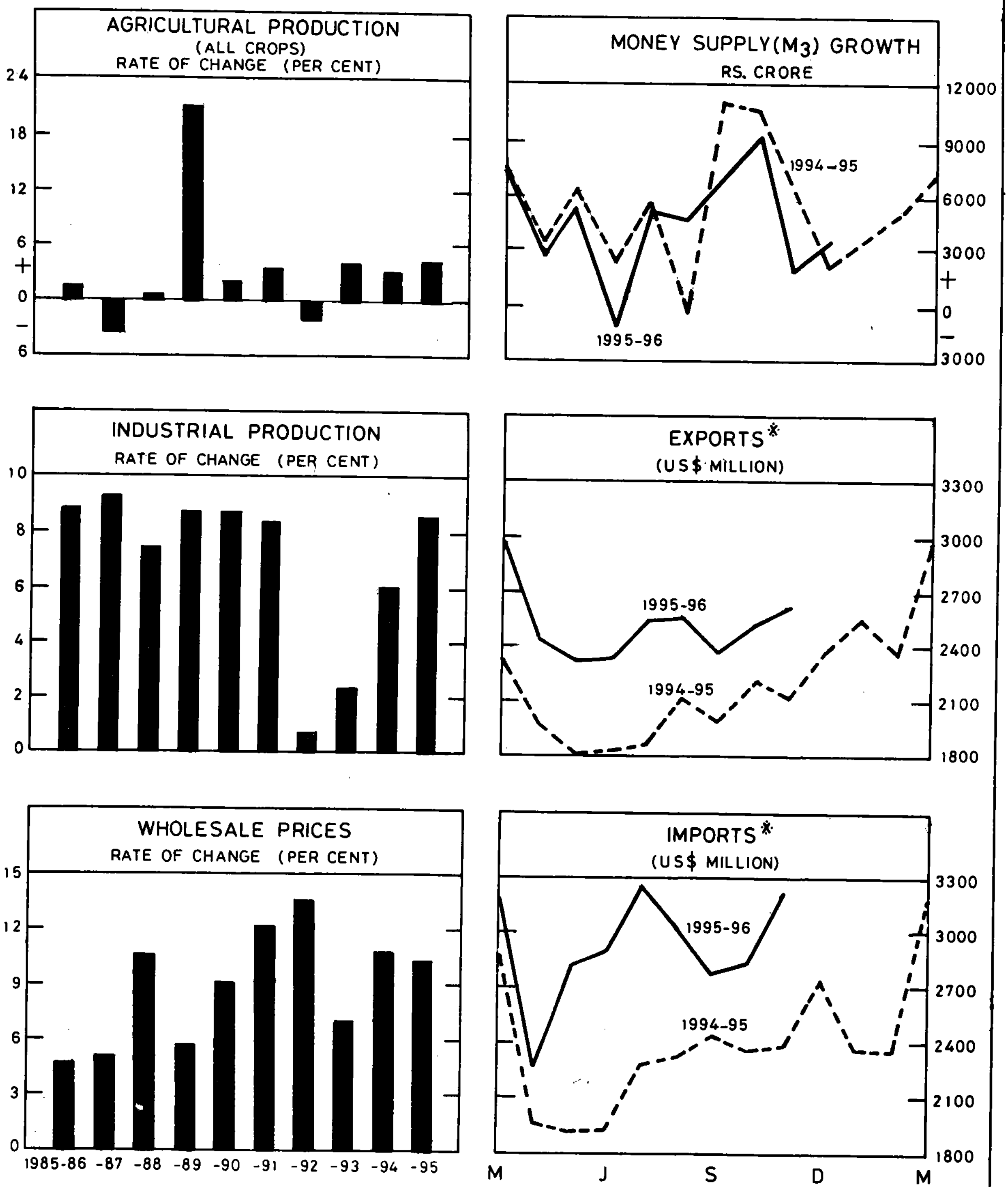
	1992-93	1993-94P	1994-95P	1995-96P	1992-93	1993-94P	1994-95P	1995-96P
	Absolute Values				Per cent change over previous period			
Gross national product (Rs.thousand crore)								
At current prices	618.4	708.5	839.5Q	NA	13.9	14.6	18.5Q	NA
At 1980-81 prices	220.1	230.1	245.6Q	261.1 E	5.0	4.5	6.7Q	6.3 E
Gross domestic product (Rs.thousand crore)								
At current prices	630.2	723.1	854.1Q	NA	14.0	14.7	18.1Q	NA
At 1980-81 prices	224.9	236.1	251.0Q	266.5 E	5.1	5.0	6.3Q	6.2 E
Agricultural production(1)	151.5	156.9	164.1	163.9 A	4.1	3.6	4.6	-0.1 A
Foodgrains production (million tonnes)	179.5	184.3	191.1	190.0 A	6.6	2.7	3.7	-0.6 A
Industrial production(2)	218.9	232.0	252.0	262.6 (3)	2.3	6.0	8.6	12.0 (3)
Electricity generated (Bn.Kwh)	301.1	323.5	351.0	281.5 (8)	4.9	7.4	8.5	9.1 (8)
Wholesale price index(4)	233.1	258.3	285.2	298.0 (5)	7.0	10.8	10.4	5.0 (5)
Consumer price index for industrial workers(6)	243	267	293	317 (7)	6.1	9.9	9.7	9.7 (7)
Money supply (M3) (Rs.thousand crore)	366.8	434.4	530.8	570.2 (10)	15.7	18.4	22.2	7.4 (11)
Imports at current prices								
(Rs. crore)	63375	73101	89971	86064 (8)	32.4	15.3	23.1	34.9 (8)
(US $ million)	21882	23306	28654	26292 (8)	12.7	6.5	22.9	29.3 (8)
Exports at current prices								
(Rs. crore)	53688	69751	82674	74493 (8)	21.9	29.9	18.5	29.6 (8)
(US $ million)	18537	22238	26330	22757 (8)	3.8	20.0	18.4	24.2 (8)
Foreign currency assets								
(Rs. crore)	20140	47287	66006	59540 (9)	38.2	134.8	39.6	-9.8 (9)
(US $ million)	6434	15068	20809	16317 (9)	14.3	134.2	38.1	-21.6 (9)
Exchange rate (Rs/US $)(13)	28.96	31.37	31.40	33.03 (12)	14.9	7.7	0.1	4.9 (12)

Note : Gross national product and Gross domestic product figures are at factor cost
A-Anticipated, P-Provisional, Q-Quick estimates, E-Advance estimates, NA Not available

1. Index of agricultural production (principal crops) with base triennium ending 1981-82=100
2. Index of industrial production 1980-81=100
3. April-September,1995
4. Index with base 1981-82=100
5. As on January 27, 1996 for 1995-96 and for the last week of March for the earlier years Percentage change relate to point-to-point changes in the index over the year
6. Index with base 1982=100
7. As in December, 1995 and in March for the earlier years Percentage change relate to point-to-point changes in the index over the year
8. April-December, 1995
9. At the end of January, 1996 for 1995-96 and at the end of March for previous years. Percentage change relates to point-to-point changes in foreign currency assets
10. As on January 5,1996
11. April 1,1995-January 5,1996
12. April-January,1995-96 Per cent change indicates the rate of depreciation of the Rupee vis-a-vis the US dollar
13. Average exchange rate for the period, composite rate from March 1992 to February 1993.

Figure 1.1

SELECTED ECONOMIC INDICATORS



* PROVISIONAL

TABLE 1.2

Trends in Savings-Investment

	1989-90	1990-91	1991-92	1992-93	1993-94P	1994-95Q
	As percentage of GDP at current market prices					
Gross Domestic Savings	22.2	23.6	22.8	21.2	21.4	24.4
Public	1.6	1.0	1.9	1.5	0.5	1.7
Private	20.6	22.6	20.9	19.6	20.8	22.7
Gross Domestic Investment*	24.9	27.0	23.4	23.1	21.6	25.2
Public	10.0	9.7	9.2	8.9	8.6	8.8
Private	14.1	15.5	13.5	15.1	12.8	14.3
Gross Domestic Investment*	24.9	27.0	23.4	23.1	21.6	25.2
GFCF	22.5	23.2	22.1	22.5	21.5	22.5
Change in stocks	1.6	2.1	0.6	1.5	-0.2	0.6
Saving-Investment Gap@	-2.7	-3.4	-0.5	-2.0	-0.3	-0.8
Public	-8.3	-8.7	-7.2	-7.4	-8.0	-7.1
Private	6.5	7.1	7.3	4.5	8.1	8.4
	Growth Rate (%) in Capital Formation (at 1980-81 prices)					
GDCF*	4.9	16.4	-14.5	5.2	-0.7	28.5
Public	7.0	4.6	-7.2	2.6	3.4	13.5
Private	-0.8	17.5	-13.3	18.7	-11.0	23.9
GFCF	8.7	9.9	-4.0	6.9	3.4	14.8
Public	0.6	4.8	2.0	-7.2	6.5	14.0
Private	15.5	13.6	-8.1	17.5	1.5	15.3

Note : (i) Gross domestic investment denotes Gross Domestic Capital Formation (GDCF)
(ii) Figures may not add up due to rounding off
* : adjusted for errors and omissions;
@ : refers to the difference between the rates of savings and investment
GFCF : Gross Fixed Capital Formation;
P : Provisional estimates; Q:Quick estimates
Source : Central Statistical Organisation

production, new equity raised and long term loans disbursed. This expectation has been confirmed by the rise in real gross capital formation to 24.9 per cent of GDP in constant prices (Table 1.3). More importantly, real gross fixed capital formation as per cent of GDP at constant prices reached a record 22.2 per cent in 1994-95. This is substantially higher than the recent peak of 21.3 per cent of GDP in 1990-91. Real private fixed capital formation, which recovered as rapidly as GDP growth, had already reached a peak of 13 per cent of GDP (in constant prices) in 1992-93. After falling as a per cent of GDP in 1993-94 to 12.7, the pre-crisis peak level, it has set a new record of 13.7 per cent in 1994-95. Real private fixed capital formation has consequently averaged 13.1 per cent of GDP in the three years following the crisis. The rapid recovery and sustained rise in real fixed capital formation by the private sector is another important indicator of the high quality of India's economic reform programme, compared to other crisis induced reforms across the world.

6. In a period of transition following reforms, inventory changes are particularly reflective of efficiency improvement. This can be seen from the much lower contribution of inventory changes to gross capital formation during the post-crisis years. Real inventory build up has averaged 0.7 per cent of GDP (at constant prices) during 1992-93 to 1994-95, compared to an average of 2 per cent of GDP during 1987-88 to 1989-90. This is due solely to a decline in private inventory accumulation over the same two periods from an average of 2.1 per cent GDP to 0.5 per cent of GDP. The wide-ranging deregulation of imports and industry has played an important role, by reducing both the need to hold

TABLE 1.3
Trends in real GDCF as percentage of GDP

	1989-90	1990-91	1991-92	1992-93	1993-94P	1994-95Q
	As percentage of GDP at market prices (1980-81 prices)					
GDCF*	23.0	25.3	21.6	21.6	20.6	24.9
Public	9.1	9.0	8.3	8.1	8.1	8.6
Private	13.2	14.7	12.7	14.3	12.2	14.3
GFCF	20.4	21.3	20.3	20.6	20.5	22.2
Public	8.6	8.6	8.7	7.7	7.9	8.4
Private	11.8	12.7	11.6	13.0	12.7	13.7
Change in stocks	1.8	2.4	0.7	1.7	-0.2	0.7
Public	0.4	0.4	-0.4	0.4	0.2	0.2
Private	1.4	2.0	1.1	1.3	-0.4	0.5

Note: GDCF:Gross Domestic Capital Formation; GFCF:Gross Fixed Capital Formation; Figures may not add up due to rounding off
***: Adjusted for errors and omissions;**
P: Provisional estimates; Q:Quick estimates
Source: Central Statistical Organisation

high inventories and by increasing competitive pressures to improve efficiency.

7. Reforms of the external sector and the consequent achievements on the balance of payments front have played a key role in the turnaround in growth of GDP, employment and social indicators. After registering a decline in the dollar value of exports in 1991-92, the country has witnessed a strong, three-year boom with annual export growth averaging 19 per cent in 1993-94 and 1994-95 and then accelerating to 24 per cent in the first 9 months of 1995-96. As a result, the ratio of exports to imports which averaged 62 per cent in 1985-86 to 1989-90, has ranged between 81 per cent and 95 per cent in the last four years. Despite the 29 per cent growth in imports during 1995-96 (nine months), fueled by high industrial growth, the export-import ratio in 1995-96 is likely to remain close to the average of 85 per cent for the last four years. The improvements in the trade account have been reinforced by favourable trends on invisible transactions. As a result, India's current account deficit in the balance of payments declined quickly from an unsustainable peak of 3.2 per cent of GDP in 1990-91 and, despite rapid import growth, is projected at a sustainable 1.5 per cent in the current year. Growth of foreign direct investment has averaged 100 per cent per annum over 1992-93 to 1994-95. The same rate of growth was maintained in the first eight months of 1995-96. These favourable trends in both current and capital accounts of the balance of payments have been reflected in foreign currency reserves. Reserves have risen rapidly from a low of one billion dollars in 1991, equivalent to hardly a fortnight's expenditure on imports, and stood at $16.3 billion on January 31, 1996, equivalent to about 5 months of import cover.

8. The country's external debt situation has also improved markedly in the past few years. The growth of external debt between March 31, 1991 and September 30, 1995 averaged $2.2 billion per year, compared to the much higher average annual increase of $4.9 billion a year (even excluding Defence debt and short-term debt) between end-March 1986 to end-March 1991. The overall external debt to GDP ratio has fallen from a peak of 41 per cent in 1991-92 to 29 per cent in September 1995. The proportion of short-term debt in total external debt has declined from above 10 per cent in March 1991 to less than 5 per cent in September 1995. Correspondingly, debt service payments as a per cent of current receipts have declined from a peak of 35.3 per cent in 1990-91 to 26.6 per cent in 1994-95. In the first half of 1995-96, the level of external debt fell by about US$5.2 billion to $93.8 billion at the end-September, 1995. Two-thirds of the decline reflected strengthening of the US dollar in international markets relative to other major currencies in which India's external debt is denominated.

9. The current year represents a broadening and deepening of growth, with the projected 6.2 per cent growth achieved through strong broad-based

industrial growth of 12 per cent during April-September 1995, and despite a marginal fall in food grains production from 191.1 million tonnes in 1994-95 to an estimated 190 million tones in 1995-96. Public foodstocks are high as a result of good and steady performance of agricultural sector and improved incentives for this sector as a whole.

10. On the prices front, after a temporary set-back in 1994-95, inflation has resumed its downtrend. The annual rate of inflation, as measured by the WPI, has dropped from a peak of nearly 17 per cent in August 1991 to a low of 5 per cent (provisional) on January 27, 1996. This is much below the historical average inflation rate of about 8 per cent and is the lowest rate attained since December, 1988. Furthermore, the price rise in essential commodities of wheat, edible oils and sugar has been even lower than the general inflation rate of 5 per cent.

Production

11. After recording a decline in 1991-92, agricultural production has increased steadily since then at an average growth rate of above 4 per cent per annum. Foodgrains production, which had fallen by about 5 per cent to 168 million tonnes in 1991-92, touched a record level of 191.1 million tonnes in 1994-95. The output of foodgrains in 1995-96 may be marginally lower at 190 million tonnes because of some decline in rice output. Nevertheless, public food stocks soared to a record level of 36 million tones in July, 1995 and stood at 24.6 million tonnes at the beginning of 1996. The robust agricultural performance in the last four years is not just the result of normal monsoons, but also due to improved incentives for the agricultural sector as a whole. Comprehensive reforms of tariff rates, trade policy and the exchange rate system, have greatly reduced the earlier bias in favour of manufacturing arising from high levels of protection and has improved the relative profitability of agriculture. These reforms include the elimination of import restrictions on intermediate and capital goods, the steady reduction in protective customs tariffs from a peak rate of over 300 per cent in 1991 to a peak rate of 50 per cent by March 1995, the exchange rate changes of 1991 and the phased introduction of the market-determined exchange rate mechanism. In addition, a series of measures to free Indian agriculture from controls on domestic and international trade have enhanced the opportunities available to farmers to reap remunerative returns from exporting. Large increases in procurement and minimum support prices for foodgrains have significantly enhanced incentives for food crop production and constitute a large part of the explanation for the strong build-up of public foodstocks. The supply side response of the agricultural sector has lately spilled over to the export market. During 1995-96, 3 million tonnes of rice and 2.5 million tonnes of wheat from public stocks were authorised for exports. However, due to infrastructure constraints some of these exports may not be realized.

12. The industrial sector has surged ahead, registering a growth of 8.6 per cent in 1994-95 and a still higher growth of 12.0 per cent during April-September 1995 (over corresponding period of last year). The capital goods sector has emerged as an important contributor to the industrial recovery, with a growth rate of 25 per cent during 1994-95, and 14.3 per cent in April-September 1995. Industrial recovery has been very broad based, and its width and depth has improved over these two years. In 1994-95, the growth of 8.6 per cent in the general index of industrial production (IIP) was due to a growth of 9 per cent in manufacturing, 8.5 per cent in electricity generation and 6.2 per cent in mining and quarrying. During April-September 1995 overall growth of 12 per cent was due to a growth of 12 per cent in manufacturing, 10.9 per cent in electricity, and 12.5 per cent in mining. A similar growth profile is mirrored in the "use-based classification", where this overall growth in 1995-96 has come from a 14.3 per cent growth in capital goods, 13.5 per cent growth in consumer goods, 12.5 per cent growth in basic goods and 6.3 per cent growth in intermediate goods. Of particular significance is the fact that small scale industrial sector has performed strongly in the post-reform period, growing faster than the overall industrial production in each of the last four years. Overall, there is convincing evidence that economic reforms have enhanced the efficiency and productivity of India's industrial economy, thus allaying any concerns that import liberalization would weaken domestic industry.

13. An analysis of the composition of growth reveals that the recovery and high growth rates are well spread out in the manufacturing sector. Of the 17 sub sectors within manufacturing sector, no sub sector has witnessed a decline in production and nine sectors have registered growth rates of 12 per cent or more during April-September 1995. These sectors are food products (28.2 per cent), wood and wood-products (12.5 per cent), paper and paper products (13.6 per cent), non-metallic mineral products (15.8 per cent), basic metal and alloy industries (12.5 percent), metal products and parts (16.6 percent), non-electrical machinery (20.7 per cent), electrical machinery (12.7 per cent), and transport equipment (20.9 per cent).

14. The improved performance of the industrial sector is attributable to the reforms undertaken during the past five years. These include:

- The sweeping away of industrial licensing controls. The few remaining industries still subject to licensing account for only about 15 per cent of value added in the manufacturing sector.
- The number of industries reserved for the public sector has been reduced to six. These include defence products, atomic energy, coal and lignite, mineral oils, railway transport, minerals specified in the schedule to the Atomic Energy Order 1953. Private participation in these sectors is also permitted on a case by case basis.
- The elimination of the separate permission required by 'large houses' for investment and expansion under the Monopolies and Restrictive Trade Practices (MRTP) Act.
- Automatic approval of foreign investment up to 51 per cent (and foreign technology agreements permitted) for 35 priority industries, which account for about 50 per cent value added in the manufacturing sector. In all other areas, the Foreign Investment Promotion Board (FIPB) has played a proactive role.
- Policy for the drugs and pharmaceuticals industry aligned with the liberalised industrial policy and the span of price control reduced and rationalised.
- Revision of National Mineral Policy and amendment of the Mines and Mineral Development Act, to open this sector to private and foreign investment. Thirteen minerals de-reserved for exploitation by the private sector.
- RBI based automatic approval policy for foreign investment made applicable to mining (except for atomic minerals and mineral fuels), subject to a limit of 50 per cent on foreign equity.

15. The overall performance of the core, infrastructure sectors, which was quite satisfactory during 1994-95, has been sustained in 1995-96. The declining trend of crude oil production was arrested and reversed in 1994-95 due to creation of additional capacities. In 1995-96 (April-December) electricity, coal, salable steel, cement, crude oil and petroleum products, with a combined weight of 28.8 per cent in IIP, showed a growth rate of 8.2 per cent, compared with 8.0 per cent for April-December 1994. Electricity generation grew by 9.1 per cent, salable steel by 9.3 per cent, cement by 9.2 per cent and crude oil by 10.0 per cent. Coal, which had registered a growth rate of 3.2 per cent during April-December, 1994 has now shown an increase of 6.0 per cent during April-December, 1995. Infrastructure sectors not included in the IIP also show good performance during 1995-96. For example, new telephone connections grew by 29.3 per cent, cargo handled at major ports by 10.7 per cent and revenue generating traffic of the railways by 6.3 per cent during April-December, 1995.

16. A number of measures have been announced to facilitate private entry into areas of infrastructure which were formerly the preserve of the public sector, with a view to freeing scarce public resources for social sectors and anti-poverty programmes. Some of the significant developments in this area include:

- Out of 52 proposals received from foreign investors including NRI's and joint ventures for setting up power projects, 16 proposals have already been cleared by the Government.
- Several States have initiated restructuring of their power sectors in order to build long term financial, institutional and operational viability. The process of restructuring of State Electricity Boards has been initiated in Orissa, Haryana, Uttar Pradesh, Rajasthan, Bihar and Andhra Pradesh. Diagnostic studies are being undertaken by external consultants. Orissa has already put in place several of the suggested reform measures.
- The National Telecom Policy 1994 allowed private provision of basic telecom services. For value added services Government has permitted maximum foreign equity of 51 per cent and for basic services, cellular mobile and radio paging this limit is fixed at 49 per cent. An open system of tendering/bidding for cellular licenses has been concluded.
- The Government has decided to set up a statutory Telecom Regulatory Authority of India to separate the regulatory functions from policy formulations and operational functions.
- The Air Corporation Act, 1994 enabled private air taxi companies to operate as regular domestic airlines. Six air taxi operators complying with the Air Craft Rules have been granted scheduled airline status. In addition 19 air taxi operators have been given permit for charter/non-scheduled air transport services.
- Areas like development and maintenance of airport infrastructure and material handling at major airports have been opened up for private participation.
- The National Highway Act has been amended to enable levy of tolls on National Highway users. Further amendment of the Act is being considered to allow private participation in construction, maintenance and operation of roads on build, operate and transfer basis. A project of Thane-Bhiwandi bypass has already

been awarded on build operate transfer (BOT) basis and global tenders have also been invited for five more national highway projects.

- Private participation has been invited in leasing of port equipment, operation and maintenance of container terminals, cargo landing terminals, creation of warehouse and storage facilities, transportation within ports, setting up private berths by coast based industries, ship repairs and maintenance. Two dry docks at Calcutta dock system have been privatised and two berths at Haldia Dock Complex had been leased out to SAIL and TISCO and offers have been invited for 15 more berths on BOT basis.

Money and Prices

17. The point-to-point annual rate of inflation, based on movement of the wholesale price index (WPI) touched a low of 5 per cent (provisional) on January 27, 1996. This performance is better than earlier expectations of an inflation rate of 7 per cent to 8 per cent by the end of 1995-96. There has been a sharp deceleration in the growth of WPI during fiscal year 1995-96 (April-December) to 4.3 per cent as against 8.6 per cent during the same period of 1994-95. This subdued trend in the growth of WPI is likely to continue through the last quarter (January-March) of 1995-96, resulting in an inflation of 6 to 7 per cent (provisional) for the full year.

18. The deceleration in growth of prices was seen in all the three sub-groups during the first nine months of 1995-96. The primary articles sub-group showed a modest increase of 4.2 per cent compared to a substantial rise of 12.6 per cent in the corresponding period of the preceding year. In the case of foodgrains the outcome has also been satisfactory, with a modest rise of 4.3 per cent, which is less than half of last year's rise. The manufactured products sub-group showed an increase of 5.2 per cent compared to 7.8 per cent in the preceding year. The sub-group comprising fuel, power, light and lubricants representing mainly goods whose prices are administered showed no increase. Major contributors to the current year's rise in manufactured product prices has been textiles where price rose by 7.9 per cent, paper and paper products (10.5 per cent), non-metallic mineral products (10.7 per cent), and basic metals, alloys and metal products (4.2 per cent). The wholesale prices of 30 essential commodities recorded a rise of 5.3 per cent in the current year (April-December) as against 10.4 per cent in the corresponding period of last year.

19. The most important factor in the decline of inflation during 1995-96 has been the slowing of monetary growth. Other factors include the reduction in the fiscal deficit from 6.7 per cent of GDP in 1994-95 (RE) to 5.5 per cent of GDP in 1995-96 (BE), opening of international trade in agricultural commodities and the active supply management of essential agricultural/food products.

20. The supply side measures undertaken included: (a) continuation of FCI's open market sales of rice and wheat through 1995-96 to check market prices. By November, 1995, 7 lakh tonnes of rice and 30 lakh tonnes of wheat had been sold; (b) allowing import of edible vegetable oils (except coconut oil) under OGL at a reduced duty of 30 per cent and import of 1.5 lakh tones of palmolein at concessional duty of 20 per cent for supply through the PDS; (c) continuing the OGL import policy for sugar and importing sugar in government account for augmenting PDS stocks and step-up in allocation of levy sugar by 5 per cent for the PDS effective August, 1995; (d) import of pulses continued under OGL with further reduction in import duty to 5 per cent; (e) gradual reduction of import restrictions on manufactured consumer goods and reduction in customs and excise duties. Customs duty reductions in combination with excise changes have put competitive downward pressure on domestic prices.

21. Monetary management in 1995-96 was aimed at the twin objectives of reducing inflation and providing necessary credit support for production and investment. The sharp upward trend visible in the growth of money supply in the second half of 1994-95 was reversed in 1995-96. With money supply (M3) growing by only 7.4 per cent in 1995-96 up to January 5, 1996, the annual (point to point) growth of M3, declined from 22.2 per cent on March 31, 1995 to 15.1 per cent on January 5, 1996. It was therefore below the projected growth of 15.5 per cent for 1995-96. The growth of narrow money (M1) has been even lower at 4.3 per cent in 1995-96 up to January 5, 1996 with an annual growth rate of 15.1 per cent. The modest growth in reserve money explains this slower monetary expansion. The unusually slow growth of monetary aggregates in 1995-96 was partly due to the unusually high base on March 31, 1995, resulting from the coincidence of the last reporting Friday for banks being on the final day of the accounting year. With liquidity conditions tightening in the third quarter of 1995-96, the Reserve Bank undertook a phased reduction of the Cash Reserve Ratio between November 1995 and January 1996, which injected more than Rs. 7000 crores of primary liquidity into the system and helped ease credit constraints. Deceleration of reserve money growth started in the second half of 1994-95 and has continued in 1995-96, mainly because of a progressive reduction in the rate of growth of net foreign exchange assets

of RBI. The growth rate of reserve money was slower (6.1 per cent) despite the expansion in net RBI credit to Government by 14.1 per cent.

22. As a result of rising commercial demand for credit, banks which had an excess holding of Government and other approved securities, contributed only Rs.9843 crore to the market borrowing of the Government during the first three quarters of 1995-96 upto January 5, 1996. This was a little over half of the contribution of Rs.15848 crore in the corresponding period of 1994-95. This necessitated sizeable support to market borrowing of the Government from RBI, which in turn increased the growth of net RBI credit to Government. Given the low growth of Rs.1539 crore in RBI credit to banks (including NABARD) and the marginal growth in net foreign exchange assets of RBI, the higher growth of RBI credit to the Central Government did not lead to excessive growth in reserve money.

23. The up trend in the bank credit to the commercial sector that started in the last quarter of 1994-95 with the recovery of industrial production, accelerated in 1995-96. Between March 17, 1995 and January 5, 1996 other bank credit to the commercial sector grew by 14.2 per cent (Rs.38830 crore) compared to a growth of 13.2 per cent (Rs.30540 crore) in the corresponding period of 1994-95. Over the same two periods, scheduled commercial bank non-food credit grew by Rs.35859 crore (1995-96) and Rs. 24735 crore (1994-95). In contrast, other bank credit to government grew by Rs.11058 crore in 1995-96 up to January 5, compared to a growth of Rs.15843 crore in corresponding period of 1994-95.

24. Initiatives taken last year for improving the working of the monetary system were carried forward in 1995-96. The agreement between the RBI and the Ministry of Finance to phase out ad hoc borrowings was carried forward. The year end ceiling on borrowing from RBI against ad-hoc treasury bills was reduced from Rs.6000 crore in 1994-95 to Rs.5000 crore in 1995-96. The within year ceiling on such borrowing was retained at Rs.9000 crore, to take care of the potential monthly mis-match between the revenue and capital inflows and the expenditure outflows. A sharp reduction in Government's market borrowing during the first half of the current financial year has been an important factor in increasing this mis-match. This raised Centre's borrowing against ad-hocs well above the intra-year ceiling. RBI took steps to bring these borrowings down to Rs.6440 crore on September 29, 1995 by selling Central Government securities/ treasury bills in the market. The net increase in ad-hocs again fell to Rs.1990 crore on December 29, 1995 but is expected to be higher in the last quarter of 1995-96.

Fiscal Developments

25. Over the past five budgets the fiscal deficit of the Central Government has declined as a proportion of GDP from 8.3 per cent in 1990-91 to a budgeted 5.5 per cent of GDP in 1995-96. This 2.8 per cent reduction has been brought about by an even sharper 3.8 per cent reduction in the primary deficit. The primary deficit at 0.5 per cent of GDP in 1995-96 (BE) is lower than it has been since at least 1975-76. Unfortunately, this reduction in the primary deficit has been partly offset by a one percentage point increase in interest payments as a proportion of GDP. This, in turn, is a legacy of past fiscal deficits accumulated as debt and the rise in interest rates.

26. Non-plan expenditures of the Central Government declined from 14.4 per cent of GDP in 1990-91 to 11.8 cent in 1995-96 (BE), while Plan expenditures went from 5.3 per cent to 4.6 per cent over the same period. Central Government debt, which reached a peak of 69.7 per cent of GDP in 1993-94, declined to 67.0 per cent in 1994-95 (RE). Gross dissavings of the Central Government show a modest decline to 1.7 per cent of GDP in 1995-96 (BE), from 2.0 per cent in 1990-91.

27. Reform of the tax system has been one of the key elements of the structural reforms undertaken since July 1991. The basic approach has been to move to a tax structure which is simple, relies on moderate tax rates with a wider base and better enforcement and serves the objectives of equity and efficiency. Substantial progress has been made in the last five years. The maximum marginal rate of personal income tax was reduced from 56 per cent (inclusive of 12 per cent surcharge) to 40 per cent. The rates of corporate income tax (inclusive of 15 per cent surcharge), which were 51.75 per cent for publicly held companies and 57.5 per cent for closely held companies were unified and reduced to 46 per cent.

28. On the indirect tax side reforms have covered both customs and excise. Peak import duty rates which in several cases were around 300 per cent prior to reforms, were brought down in a phased manner to 50 per cent to reduce the input cost for producers in India and promote competition. The import duty on capital goods for general projects and machinery, which was 85 per cent prior to reforms, was brought down to 25 per cent in 1995 and unified for nearly four-fifths of machinery imports. The number of customs duty rates were sharply reduced to 12 and a large number of end-use exemptions were eliminated. The excise duty regime has been greatly improved with a significant switch over from specific to ad-valorem duties to

ensure built in revenue elasticity. The ambit of MODVAT, entailing credit for taxes paid on inputs, was extended to cover capital goods, specified quality control, testing, pollution control and R & D equipment, petroleum products used in industry and spun yarn made from fibres. The number of ad-valorem excise duty rates were reduced to 10 and a large number of end-use exemptions eliminated.

29. These tax reforms have helped in restructuring the tax system by increasing the role of direct taxes and reducing that of customs duties. This will increase both the equity and efficiency of the tax system, as the former is regarded as more progressive and the latter as an efficiency-inducing tax. As a result of the reforms revenues from direct taxes are budgeted to rise from 2.1 per cent of GDP in 1990-91 to 2.9 per cent in 1995-96 (BE), while customs revenues declined from 3.9 per cent of GDP to 2.8 per cent (BE) over the same period. As a consequence, the share of direct taxes in the gross tax revenue of the Centre is expected to rise from 19.1 per cent in 1990-91 to a budgeted 29.2 per cent in 1995-96 (BE), while that of customs revenue is expected to decline from 35.9 per cent to 28.4 per cent (BE) over the same period. The contribution of direct taxes could be even higher when revised estimates for 1995-96 become available.

30. The success of the new approach is also shown by the fact that, despite the lowering of personal and corporate tax rates, the buoyancy of these taxes has increased. Average buoyancy of personal income taxes, as measured by the ratio of change in tax revenue to the change in the GDP at current prices, has risen from 1.1 during 1986-87 to 1990-91, to around 1.5 during 1991-92 to 1995-96 (BE). Similarly the buoyancy of corporate income tax revenues has risen from an average of 0.8 during 1986-87 to 1990-91. to 1.7 in 1991-92 to 1995-96 (BE). Both are likely to be higher on 1995-96 (RE) basis. Despite the very large reduction in peak customs duty rates from over 300 per cent to 50 per cent, the revenue collection rate (ratio of revenue collected to value of imports), only fell from 47 per cent in 1990-91 to 29 per cent in 1994-95, for similar reasons.

31. The 1995-96 Budget estimated a net tax revenue loss to the centre of about Rs.1,600 crore based on conventional methods, which do not incorporate gains from simplification, rationalisation, improved tax compliance and administration. Available trends indicate that gains are likely to be much greater than these conventional loss estimates. For the first nine months of 1995-96 (April-December, 1995), collections from personal income tax and corporation tax at Rs.21327 crore were 27.6 per cent higher than in the same period of 1994. Collections from excise and customs, at Rs.53802 crore during April-December, 1995, show a growth of about 19 per cent.

Financial Developments

32. Reforms in the financial sector have included the phasing in of prudential norms for income recognition, classification of assets and provisioning for bad debts, revised formats for making balance sheet and profit and loss accounts reflect the actual financial health and a time schedule for attaining 8 per cent capital to risk weighted assets for the scheduled commercial banks. The Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) were brought down to reduce the pre-emption of bank credit by Government and government borrowing was undertaken at market interest rates. The effects of these reforms on the financial health and performance of banks is gradually emerging.

33. There has been progress by public sector banks in moving to the target of 8 per cent capital to risk weighted assets ratio (CRAR) by March end, 1996. By end March, 1994, only four public sector banks had a CRAR over 8 per cent, four had between 6.7 per cent and 8 per cent and eight had a CRAR in the range of 4.3 per cent and 6.7 per cent. By end March, 1995 as many as 13 public sector banks reached CRAR of at least 8 per cent, while 10 banks had a CRAR of 4 per cent and above. Only 4 banks have less than 4 per cent CRAR. In the private sector, all the banks had complied with 4 per cent norm by March, 1994 and propose to raise additional capital through public issue to attain 8 per cent CRAR by March, 1996. All new private sector banks start with 8 per cent CRAR.

34. The deregulation of bank interest rates undertaken in 1994-95 with the abolition of the minimum lending rate on bank loans above Rs.2 lakh, was extended to the deposit side in 1995-96. From October 1, 1995 scheduled commercial banks became free to fix their interest rates on domestic term deposits of over two years. The stipulation of at least three slabs with a minimum interest rate differential of 0.25 per cent point imposed in April 1992 on term deposits, was also withdrawn. Banks already have the discretion to fix both maturities and interest rates on non-resident non-repatriable (NRNR) deposits. The entry of 9 new private sector banks during 1994-95 and 1995-96, and the potential future entry of more banks, is likely to spur competitiveness and cost consciousness, and greater attention to depositor interests.

35. The Board for Financial Supervision was set up in 1994-95 with statutory powers over financial institutions, banks and non-bank financial institutions.

It is designed to provide guidance on the supervisory initiatives and interventions of RBI. Its Secretariat is provided by the newly set up Department of Supervision in RBI. In addition, there is also an Advisory Council to provide guidance. There are now five Debts Recovery Tribunals functioning along with an Appellate Tribunal, for expediting the loan recovery process through adjudication. A major institutional step in 1995-96 has been the appointment of eight Ombudsmen under Banking Ombudsman Scheme, 1995 (out of 15 to be appointed for the country as a whole), who will function to resolve customers grievances in a quick and inexpensive manner.

36. The State Bank of India Act was amended to enable the State Bank of India to access capital market and allow 10 per cent voting rights to shareholders. SBI raised over Rs.3200 crore in 1994 through public issue of equity and bonds. The share of the RBI in the capital of SBI. has come down to 66 per cent from 99 per cent earlier. The nationalised banks were also enabled to access the capital market for debt and equity, following the amendment of the Banking Companies Act, 1956. Oriental Bank of Commerce raised Rs.387 crore through its first issue. The Government made a capital contribution of Rs.5700 crores in 1993-94, Rs.5287 crores in 1994-95 and Rs.852 crores in 1995-96 (BE) to public sector banks.

37. The entire range of reforms, aimed at promoting competition within a prudent regulatory regime, is beginning to bear fruit. The financial position of the scheduled commercial banks has improved in 1994-95. The number of public sector banks declaring operating profits went up from 19 in 1992-93 to 26 in 1994-95. Only one reported an operating loss. The number of public sector banks making net profits rose to 19 in 1994-95 from 15 in 1992-93. The average ratio of non-performing assets to the total advances, for the public sector banks, came down to 20 per cent in 1994-95 from 26 per cent in 1992-93.

38. Among the All-India financial institutions, the Industrial Finance Corporation of India (IFCI) made a public issue of capital in 1994-95. The amendment of the IDBI Act, 1964 in March 1995, made possible Industrial Development Bank of India's (IDBI) maiden capital issue in July 1995. A new development finance institution, namely, the North Eastern Development Finance Corporation Ltd., with an initial paid up equity base of Rs.100 crore (and authorised capital of Rs.500 crore), is set to commence operations soon.

39. In the field of rural finance the prudential norms relating to income recognition were introduced for Regional Rural Banks (RRBs). An Expert Group examined the major issues concerning managerial and financial restructuring of RRBs, and the role which could be assigned to non-governmental organisations and self-groups in improving the rural credit delivery system. Steps were taken to increase the flow of credit to the small scale industries (SSI) sector with a special programme to open 100 specialised SSI bank branches in 85 identified districts by March 1996. By December 1995, 56 branches had been set up.

40. A number of special schemes/funds were announced in the budget speech of 1995-96, which aim at counteracting shortfalls in priority sector advances and augmenting the flow of funds to relatively neglected areas/sectors. These include: (a) Rural Infrastructure Development Fund (RIDF) of Rs.2,000 crore in the National Bank for the Agriculture and Rural Development (NABARD) to accelerate implementation of investment projects in agriculture, irrigation and allied activities; (b) a scheme for expanded provision of credit facilities to the Khadi and Village Industries Commission by a consortium of banks so as to increase production and employment in off-farm activities in rural areas and; (c) a Scheme for financing primary weavers' co-operative societies by the scheduled commercial banks to assist increased production of handloom cloth. The RIDF will be built with contributions by the scheduled commercial banks which have failed to achieve the target of priority sector advances. They will also be required to participate in the aforesaid schemes.

41. In the area of capital markets, the abolition of the office of Controller of capital Issues (CCI) in May 1992 and the setting up of Securities and Exchange Board of India (SEBI) with statutory powers and functions (February 1992) were the first decisive steps in the move from control to prudential regulation. Prudential regulation is as important as decontrol for the development of a healthy capital market, keeping in view investor interests. The powers and functions of SEBI were strengthened in phases. SEBI has been empowered to regulate business in stock exchanges. Its ambit covers recognition of stock exchanges, their rules, articles, voting rights and nomination of public representatives, stock exchange listing and delivery contracts. The setting up of the National Stock Exchange (NSE) and computerisation of the Bombay Stock Exchange (BSE) will help improve the clearing and settlement mechanisms and substantially raise the levels of transparency.

42. SEBI has issued rules and procedures for registering and regulating the various market participants and intermediaries. These cover brokers, bankers and registrars to an issue, merchant bankers, underwriters, portfolio managers, custodians, credit rating agencies, foreign

institutional investors, venture capital funds, mutual funds and asset management companies. To enable SEBI to effectively carry out its functions of Stock Exchange regulation and investor protection, the Department of Company Affairs has delegated to SEBI powers to file complaints against violations of the Companies Act. The notification covers issues pertaining to primary market such as listing of securities, refund of excess application money, delay in issues of shares and dispatch of dividend warrants. SEBI now has the authority to levy monetary penalties for a range of violations such as failure to redress investor grievances or observe rules and regulations by mutual funds, asset management companies, failure to disclose the aggregate of shareholding in a company, or to make public announcement for acquisition of share in the context of the takeover code.

42.Standards of disclosure and issue procedures have been tightened. Companies are now required to draw up their financial statements on a consistent basis with appropriate audit qualifications. They will be asked to indicate the sources of income from other than normal activities and to make the draft prospectus a public document. Finance companies are eligible to make an issue if they have operated for a minimum of two years, or are registered with RBI as a non-banking finance company or with SEBI as an intermediary.

44. The National Stock Exchange, which was established in 1993, has come of age, with daily average trading volume rising sharply in recent months. Screen based trading has also been instituted in the Bombay and Delhi stock exchanges. Private mutual funds are now permitted and are allowed to apply for firm allotment in public issues. The carry forward system has been reformed. The scrip-wise and broker-wise carry forward position shall be disclosed by the stock exchanges at the beginning of the carry forward session. Members doing financing of carry forward transactions will be subject to a cap of Rs.10 crore. The depositories ordinance, re-issued in January 1996, will provide a legal framework for the establishment of depositories to record ownership details in book entry form. The de-materialisation of scrips that this makes possible will eliminate a number of hazards associated with paper based stock market trading, such as a high proportion of bad deliveries, high risk of loss, cumbersome procedures and long delays .

45. As a result of the past four years of reform, there has been a significant increase in market activity. Equity capital raised, mainly by the private corporate sector, has increased from Rs.5562 crore in 1991-92 to Rs.27621 crore in 1994-95. During April-December 1995, Rs.14155 crore of capital has been raised. The market capitalisation of BSE almost doubled from Rs.3,23,363 crore in 1991-92 to Rs.6,44,678 crore at the end of December 1995. The number of listed firms at the BSE has doubled from 2601 in 1991-92 to 5398 in December 1995. Besides UTI, there are now 9 public sector mutual funds and 16 private sector mutual funds in operation. During April-December 1994-95, Mutual Funds including UTI had raised Rs.1,601 crore through 32 new schemes.

46. At the end of January 1996, 350 foreign institutional investors (FIIs) were registered with SEBI compared to only 10 in January 1993. They had invested a total of Rs.14,129 crore in the securities market. Indian companies were also permitted to access international capital markets through euro-equity shares and by the end of December 1995 Indian firms had raised US $5.18 billion through global depository receipts (GDRs) and foreign currency convertible bonds (FCCBs).

47. Thus the total inflow of foreign Portfolio capital into the Indian capital market since the launching of economic reforms amounts to $8.9 billion. This is further indication of improved international creditworthiness of India resulting from successful economic reforms.

Balance of Payments

48. The strength and resilience of India's balance of payments in recent years has been largely due to the robust export growth, measured in dollar terms, during the last three years. Compared to the negative growth of 1.5 per cent in 1991-92, exports recorded a growth rate of 20.0 per cent in 1993-94, 18.4 per cent in 1994-95 and 24.2 per cent during April-December of 1995-96. Imports, which remained subdued for the greater part of 1993-94, picked up towards the end of the year, in tandem with industrial recovery, ending with a growth of 6.5 per cent. Growth in imports in US dollar terms was 22.9 per cent during 1994-95, compared to 12.7 per cent in 1991-92. During April-December 1995, imports grew at a much faster rate of 29.3 per cent. The trade deficit, measured on the basis of DGCI&S data, was US $1.07 billion in 1993-94 and rose to US $2.32 billion in 1994-95 and widened further to US$3.53 billion during April-December 1995.

49. The developments in India's trade and payments over the past five years mark a noticeable structural change towards a more stable and sustainable balance of payments. During the post-liberalisation period, there has been a sharp improvement in self-reliance as reflected in the coverage of import payments through export earnings. The ratio of exports to imports has averaged around 90 per cent since 1992-93, com[illegible] with only 52 per cent at the beginning of

the 1980s. and a little over 60 per cent in the latter half of 1980s. These favourable developments on the trade account coupled with improvement in the invisibles had an important impact on the evolution of our balance of payments position in the 1990s. As a percentage of GDP, the current account deficit declined from an unsustainable level of 3.2 per cent in 1990-91 to 0.1 per cent in 1993-94 and edged upwards to 0.8 per cent in 1994-95. The current account deficit in 1995-96 is expected to be around 1.5 per cent of GDP, which is well below the average current account deficit of 2.4 per cent of GDP during 1985-86 to 1990-91.

50. The response of foreign investment flows to the liberalisation measures has been very encouraging. Over the last three years they have grown at an average of 100 per cent per year. From US $620 million in 1993-94, foreign direct investment (FDI) more than doubled to US $1.31 billion in 1994-95. During April-November 1995, FDI flows were US $1.27 billion, showing a growth of 110 per cent over the corresponding period of 1994-95.

51. India's external debt rose from US $92.70 billion at the end of March 1994 to US $99.04 billion at the end of March 1995. Of the US $6.34 billion increase in external debt during 1994-95, as much as US $5.61 billion, or 88 per cent of the increase, was due to changes in the exchange of the US dollar versus other major currencies in which India's debt is denominated. The increase in external debt at constant, end-March 1994 exchange rates was only US $794 million during 1994-95. Provisional estimates for the current financial year show that India's external debt declined by US $5.20 billion during the first six months to US $93.84 billion at the end of September 1995. About two-thirds of the decline in external debt reflects the appreciation of the US dollar against major currencies. Long term debt has declined by US $5.43 billion and the short-term debt has increased marginally by US $0.23 billion since end March 1995.

52. An important aspect of India's external debt is that a large part of the debt, specially debt to multilateral development banks and bilateral donors, has a high degree of concessionality. This means that the present value of the debt is much lower than the nominal value. The share of such debt in total debt stock went up from 44.4 per cent (US $41.1 billion) in end March 1994 to 45.3 per cent (US $ 44.8 billion) in end March 1995. A large part of the rise in external debt during 1994-95 was due to an increase in long term debt. This rose from US $89.07 billion in end March 1994 to US $94.78 billion in end March 1995. At both points in time, long term debt accounted for about 96 per cent of total debt stock and this is a vindication of the government's policy of reducing the importance of short term debt. The share of short term debt in total debt stock at end March 1995 was about 4 per cent compared to over 10 per cent in March 1991.

53. As a percentage of GDP, India's external debt has declined from the peak of 41.0 per cent in 1990-91 to 33.0 per cent in 1994-95. The debt stock at the end of September 1995 works out to about 29.4 per cent of the estimated GDP for 1995-96. Debt service payments as a percentage of current account receipts have also declined significantly from 35.3 per cent in 1990-91 to 26.6 per cent in 1994-95 and is expected to decline further in 1995-96.

54. Another notable feature in the country's capital inflow profile is a major shift in composition from debt creating capital flows in favour of non-debt creating foreign investment flows. On a net basis, the sum of the two major long term debt creating flows, namely, external assistance and commercial borrowing have declined from an average of US $4.5 billion per annum during 1990-92, to US $2.84 billion in 1993-94 and US $2.28 billion in 1994-95. In contrast, total foreign investment flows, direct and portfolio, rose sharply to US $4.1 billion in 1993-94, with a further increase to US $4.9 billion in 1994-95.

55. As a result of prudent external debt management and the stabilisation and structural reform policies put in place during the last four years, international credit rating agencies upgraded India's credit rating to investment grade last year. In July 1995, the Japan Bond Research Institute affirmed the sovereign rating of investment grade for India during the current year as well. Moody's have similarly maintained an investment grade rating during the current year.

56. After a prolonged period of stability in foreign exchange markets with exchange rate at around Rs. 31.4 per US $ from March 1993 to July 1995, there was a high degree of volatility in the second half of 1995-96 with the rupee-dollar rate depreciating to a low of US$=Rs. 36 in October 1995. Some adjustment in the exchange rate was undoubtedly warranted by the fact that the nominal exchange rate had remained more or less constant for two years when domestic inflation was significantly higher than inflation in our major markets. As a result, the rupee had become progressively less competitive and the real effective exchange rate index in August 1995 showed an appreciation of 7 per cent compared with the average index for 1993-94 and 10.5 per cent compared to March 1993. The downward adjustment of the exchange rate in September and October served to correct this real appreciation and bring the exchange rate to a level more appropriate to

ensure export competitiveness. However the downward shift in the exchange rate following a period of prolonged stability also triggered speculative pressures in the foreign exchange markets. The Reserve Bank of India intervened actively to counter these pressures. Exchange markets were further affected by the strengthening of the dollar against all major currencies in January 1996. Understandably, this was a period when the rupee depreciated further against the dollar. There was renewed speculative pressure in foreign exchange markets in January and early February 1996 and the Reserve Bank announced new measures on 8th February 1996 to discourage speculation and encourage timely remittances.

57. One of the noteworthy events of 1995-96 was the emergence of a link between call money markets and foreign exchange markets, an inevitable consequence of the gradual development of these markets over the last few years. RBI's intervention in October-November 1995 to stabilise volatile exchange rates was followed by a sharp rise in the call money rates. The latter was subsequently stabilized by injecting funds in the short term market. These actions helped contain exchange rate volatility and to stabilize the two markets.

The Reforms and the Human Condition

58. Right from the beginning, the economic reforms programme has been explicitly guided by the twin goals of accelerated growth and social equity. These goals have been pursued by the promotion of broad-based, employment-generating growth, enhanced Plan outlays for poverty alleviation and social sectors such as health and education, and the building of social safety nets to cushion the possible adverse effects of reforms on vulnerable sections during the stage of transition.

59. The Government has accorded the highest priority to promoting sustainable, employment-intensive growth in its economic reform policies. As a result, total annual employment growth in the economy is estimated to have increased to about 7.2 million in 1994-95 as compared to only 3 million in the crisis year of 1991-92.

60. The proportion of people below the poverty line declined from 25.49 per cent in 1987-88 to 18.96 per cent in 1993-94, based on the provisional quinquennial data generated from the sub sample I for 50th round of the National Sample Survey. The lower incidence of poverty in 1993-94, despite the intervening crisis of 1991-92, suggests that the various policies and programmes adopted in the process of economic reforms have helped the poor in the country. Other available evidence also supports this view.

61. Average real wages of unskilled agricultural labour, which reflects the economic condition of agricultural labourers, declined by 6.2 per cent in the crisis year of 1991-92 for the country as a whole. But in subsequent years they have increased steadily, showing an average growth of 5.1 per cent per annum during the period from 1992-93 to 1994-95 for the country as a whole.

62. Although too much should not be read into year to year changes in the annual data on vital statistics, it is interesting to see that the all-India infant mortality rate was virtually unchanged in the crisis-affected years of 1991 and 1992, before resuming its pattern of secular decline in 1993 and 1994. Similarly, the death rate rose slightly in 1991 and 1992, before reverting to its declining trend in 1993 and 1994. These tentative trends are consistent with the view that while general living standards were adversely affected by the economic crisis of 1991-92, the reform induced recovery has led to the improvements in general living standards in 1993 and 1994 .

63. Despite stringent resource constraints the Government has steadfastly increased expenditure on social sectors and on programmes of poverty alleviation. In the three years between the budgets of 1992-93 and 1995-96 the Central Plan allocation for education was increased by 92 per cent, with the outlay for elementary education rising by 129 per cent and that for adult education by 95 per cent. The allocation for health was raised by 122 per cent. Perhaps most important, the allocation for Rural Development, which encompasses the major programmes for poverty alleviation, was hiked by 148 per cent from Rs.3,100 crore in 1992-93 (BE) to Rs.7,700 crores in 1995-96 (BE). Correspondingly, the share of social sectors and anti-poverty programmes in total budget support for the Central Plan rose from 35 per cent in 1992-93 (BE) to 47 per cent in 1995-96 (BE).

64. Several important new schemes for social uplift and poverty alleviation were launched during the recent years of reform, including:

- The Employment Assurance Scheme for providing 100 days of unskilled manual labour to rural poor in our 2475 backward blocks including those that are flood prone in the country;
- The Prime Minister's Rozgar Yojana aimed at providing employment to unemployed youth through the creation of micro-enterprises;
- The National Social Assistance Programme which encompasses old age pension, family benefits in case of death of the bread-earner and maternity benefits;

- The Rural Group Life Insurance Scheme, with a subsidised premium;
- The National Programme of Nutritional Support to Primary Education (also known as the Mid-Day Meal Scheme) aimed at providing a nutritious meal to children in primary school;
- The Mahila Samridhi Yojana to promote the savings habit among rural women;
- The Indira Mahila Yojana aimed at more effective empowerment of women.

Furthermore, the nation-wide Public Distribution System for foodgrains and other essential commodities has been strengthened, with the revamped PDS now operating in 1775 backwards blocks and expected to be extended to all 2446 blocks under the Employment Assurance Scheme.

Issues and Priorities

65. The economic reforms of recent years have induced a remarkably swift recovery in the growth of output and employment. They have also ushered in a sea change in the attitudes towards economic policies and programmes. But the task of economic reform is far from over. The strong economic performance of recent years will not continue of its own accord. It requires continuing efforts to deepen and widen the ambit of economic reform and difficult decisions to deal with the emerging new challenges in macroeconomic management. Furthermore, our policy efforts should draw inspiration and guidance from our fast-growing neighbours in East Asia. Over the past two decades the East Asian 'miracle' economies have demonstrated the possibility of sustained economic growth at 8 to 9 per cent per year, coupled with strong external sectors and low inflation in the range of 3 to 7 per cent per annum. In order to raise the living standards of India's people and eliminate the scourge of poverty from our country, we must strive to match the performance of East Asian economies. The priorities for policy action have been outlined in the last two Economic Surveys. Here we shall reiterate a few salient dimensions.

Accelerating Growth with Macro-Stability

66. Sustaining high growth of output and employment in an environment of macro stability requires high rates of domestic savings, supplemented by adequate inflows of foreign savings. Our private savings rates have been comparable to those of high performing East Asian economies. But our record of public savings has been much poorer and needs to be drastically improved. This requires a significant and sustained reduction in revenue and fiscal deficits of Government. Conceptually, the fiscal deficit has two components: the primary deficit, which reflects current fiscal pressures; and the interest payments on debt which mainly reflects the cumulative result of past fiscal laxity. We must work to quickly turn the current primary deficit into a surplus through higher revenue buoyancy from tax reforms, larger non-tax revenues from a determined application of commercial principles in public enterprises and a tight curb on low-priority expenditures. To reduce the build up of debt, disinvestment in public enterprises has to be pursued aggressively. Public savings have to be increased and deficits reduced in State Governments also through analogous measures to raise tax and non-tax revenues, curb low-priority expenditure and enhance efficiency and financial health of state level public enterprises.

67. A clear and sustained improvement in public savings is necessary not only to raise the level of national investment, but also to reduce interest rates, keep inflation firmly in single digits and relieve macroeconomic pressure on the external sector. Without a significant and sustained reduction in the fiscal deficit and a commensurate rise in public savings the prospects for macroeconomic stability are bleak.

68. The provision of adequate and reliable levels of economic infrastructure services at reasonable cost poses a critical challenge to India's future economic development. Without major improvements in this area the recent growth of agriculture, industry and exports is at risk and the prospects for more rapid development elusive. The old public monopoly paradigm for providing basic infrastructure such as power, telecommunications, ports and roads, is no longer able to cope with the rapidly expanding demand for quality infrastructure, budget constraints in the public sector and the pervasive problems of low efficiency and accountability in the public sector. An important beginning has been made to facilitate the entry of private providers in power, telecommunications, civil aviation, ports and roads. But a great deal remains to be accomplished in instituting appropriate regulatory frameworks, undertaking necessary reforms of policies, institutional structures and procedures of public entities (which, in many areas will continue as important providers), developing markets for long-term finance and establishing credible and transparent systems for inducting large scale private investment into effective infrastructure provision.

69. The necessary ingredients for policy reform in this area include:

- Setting up independent regulatory authorities at Central and State levels (as appropriate) to set realistic tariffs, harmonise design standards, encourage investment and promote the public interest;

- Articulation of comprehensive, clear and transparent rules and procedures for private investment in specific infrastructure sectors;
- Well defined and open bidding procedures for licensing of sites and locations;
- Commercialisation of government-owned public utilities and infrastructure-providing departments;
- The development of long-term financing sources through encouragement of bond markets and necessary reforms in insurance and provident fund sectors;
- Speedy allocation of land, water and electricity connections by state level authorities for new enterprises.

70. The growing gap between the supply and demand for power and the associated loss of output, exports and employment illustrates the urgency of effective reforms in infrastructure. For the power sector to become economically and financially viable, the current gross subsidy in the order of Rs.15,000 crores annually has to be phased down through tariff adjustments, the operational efficiency and autonomy of State Electricity Boards has to be greatly enhanced through institutional and personnel changes, the scope of private distribution has to be expanded and the under investment in transmission and distribution has to be corrected. In the other key energy sectors of coal and petroleum also there is urgent need for a phased liberalisation of existing administered pricing and distribution systems, which are today inhibiting requisite levels of investment.

71. The era of concessional development assistance is coming to an end. And yet our needs for external capital to fuel rapid economic development remain substantial. Greater access and use of foreign investment is necessary for promoting higher growth of output, exports and employment. Fifteen years ago when the East Asian Tigers (Korea, Taiwan, Singapore and Hongkong) were beginning to be recognised as successful cases of rapid economic development, there were few convincing examples of foreign direct investment (FDI) leading to or being associated with rapid economic growth. Today, this is one of the more important ingredients of the Asian Miracle in Malaysia, Thailand, China, and Indonesia. FDI has proved to be the most effective and rapid method of technology transfer (in the form of knowledge, technical and marketing skills, organisation and management systems, new material and products) and effective promotion of comparative advantage through exports. Even when it forms a small fraction of the total domestic investment, its catalytic role is out of proportion to its size. For India to aspire to sustained growth at 7 to 9 per cent over the next two decades, we have to be prepared to encourage a rapid increase of FDI to levels comparable to China's $30 billion or more per year. This requires confidence in our own knowledge and capabilities, an open and competitive economy and public confidence in procedures for leasing out publicly owned resources (such as land, mines, electricity distribution networks, ports).

72. Fears of foreign investment swamping our domestic industry or creating unemployment are unfounded or grossly exaggerated. The experience of high growth East Asian economies highlights the potential of foreign investment for accelerating the growth of output, employment and exports. If China can absorb about $30 billion a year of foreign investment and become a powerful and independent-minded nation, we should not feel insecure about using foreign investments to augment the growth of output and jobs in our country.

73. Foreign investment is necessary for reasons cited above and to reduce our reliance on debt-creating flows to manage our balance of payments. But foreign investment also has to be serviced. The strength and viability of our balance of payments will ultimately be assured through rapid and sustained growth of our exports. Over the past four years a strong export boom has been nurtured through a package of policies which includes: a market-determined exchange rate, reduction in quantitative restrictions on exports and imports, phased reduction of excessive protection for import-substituting activities through tariffs and licensing, and effective implementation of schemes for according duty-free access to inputs for exporters. These policies must be pursued and strengthened. We must also devote renewed attention to eliminating procedural impediments to exporters in all areas including ports, railways, customs administration and credit systems.

Employment and Poverty Alleviation

74. The experience from other countries shows that the best way to reduce unemployment and poverty is to ensure sustained, rapid economic growth. The more labour-intensive is the pattern of growth the more beneficial it will be for the poorest segments of our society. Given our low per capita income, India's labour is among the most competitive in the developing world. As China and many other developing countries have shown, rapid expansion of labour-intensive exports can be an important source of new productive jobs if the policy impediments are successfully tackled. Our labour legislation needs to be overhauled to remove the present discouragement to employment of labour in

the organised sector. The need for a broad-based, regionally balanced pattern of industrialisation cannot be over emphasised. Small and medium enterprises have a major role to play in this process and need every encouragement. However, this encouragement must increasingly take the form of removing their handicaps such as those arising out of imperfections of the credit market and ignorance about new technologies and marketing skills rather than through pursuit of policies which perpetuate the backwardness of small enterprises. A number of other policies need to be put in place to facilitate industrial restructuring in a more open, competitive environment.

75. Agriculture still employs two-thirds of India's labour force. There is enormous scope for increasing employment and production in agriculture through higher private and public investment, more and better infrastructure, faster dissemination of best-practice cropping techniques and improvements in water management. The bias against agriculture in the overall incentive framework has been greatly reduced in recent years and should be eliminated. Remaining restrictions on internal and external trade in agricultural commodities should be removed. The sectors of agro-industry, still subject to licensing control, should be delicensed so that competition between manufacturers can work to the benefit of farmers and rural workers. Irrigation is the life-blood of the rural economy, but the funds allocated in State budgets are usually insufficient for maintenance of irrigation canals and channels and the bureaucratic functioning of irrigation departments often impedes best use of water resources. Institutional innovations should be sought to make the provision and maintenance of irrigation services much more responsive to farmer interests. Conversely, farmers must be prepared to shoulder a growing proportion of the costs of irrigation services.

76. In the design of policies to promote employment, the services sector is too often neglected. Yet, all over the world, services are becoming the most important source of new job opportunities. In India, we need to review the policies which today impede the creation of productive job opportunities in key service sectors such as construction, retailing and tourism. It is widely believed that radical and long overdue changes in the Urban Land Ceiling Act, rent control acts and municipal rules and regulations for building could unleash a construction boom across the country with enormous expansion of jobs. Such job-creating construction booms have characterised the cities and towns of all fast-growing Asian countries in the last two decades. Reform of the Urban Land Ceiling Act would also release vital resources necessary for the industrial restructuring, which is going to be increasingly necessary in a more open, competitive economy.

77. While sound policies to promote sustained and rapid economic growth are the best guarantors for increasing employment and alleviating poverty, Government must also discharge its responsibilities for sustaining the special programmes of poverty alleviation and social assistance, which are aimed at distributing the benefits of growth more effectively to the poorest households. The Jawahar Rozgar Yojana, the Prime Minister's Rozgar Yojana, the National Social Assistance Programme, the Mid-day Meal Programme, the Indira Awas Yojana, the Public Distribution System and a number of other programmes today provide a reasonable safety net for the weakest sections of our society. But, India's performance on the yardsticks of literacy, infant mortality, elementary schooling and primary health care is far from satisfactory. The rapid universalization of literacy and primary education and effective spread of universal primary health care will determine how quickly and effectively the poor can benefit from new employment opportunities. The major responsibilities for these programmes, as well as for a range of other social services and much of rural infrastructure rests with State Governments. Hence the paramount importance of tax reform, elimination of losses of state-owned enterprises and expenditure restructuring at the State and lower tiers of government. It is the quality of the village school and primary health care centre which will determine how quickly and effectively India's poor benefit from the process of growth.