1

GENERAL REVIEW

Review of Developments

Macroeconomic Overview

1. 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 improved as a result of the reforms initiated in 1991. With the passing of election distractions, the pace of economic reform was also revived. Since June 1996, reform initiatives have been introduced or strengthened in almost every critical infrastructure sub-sector. There have also been new policy measures in several areas such as industrial delicensing, foreign investment, trade policy, financial sector and capital markets. With the growing participation of virtually the entire spectrum of political opinion in the reform process, there is a good prospect that a higher growth rate would become a permanent feature of the economy.

2. The initial spurt of reforms from 1991-92 to 1993-94 was very successful by all accounts, resulting in a jump in economic growth to 7.2 per cent in 1994-95 (in terms of GDP at factor cost). Since 1994-95, h wever, there was a marked slow down in the pace of reforms. Nevertheless, GDP grew by 7.1 per cent in 1995-96. The slackening of reforms preceding and during the election period may have been responsible for some loss of momentum, but this has been revived with a series of measures in recent months. Economic growth in 1996-97 is estimated by CSO to be around 6.8 per cent (GDP at factor cost). Thus, the Eighth Plan is likely to end with an average growth of 6.5 per cent per annum, 0.9 per cent point higher than the target rate of 5.6 per cent, and 0.5 per cent point higher than the actual achievement of the Seventh Plan (Tables 1.1 and 1.2). More important for the future is the fact that the average growth during the latest three years is 7 per cent, probably placing India among the top ten performers in the world during this period.

3. As the final year of the Eighth Plan draws to a close, a comparison of some salient dimensions of economic performance between the Eighth Plan period and its predecessor 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 periods;
- 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.

4. Total gross domestic saving reached a new peak of 25.6 per cent of GDP in 1995-96, exceeding its previous peak of 24.9 per cent of GDP in 1994-95. (Table 1.3) This seems to vindicate the reform strategy of encouraging savings by expanding saving and investment opportunities, rather than giving special incentives. The rise in domestic saving in 1995-96 was primarily due to a rise in private saving to 23.7 per cent of GDP. This rise in private saving was smaller than the rise in private investment. As

TABLE 1.1
Key Indicators

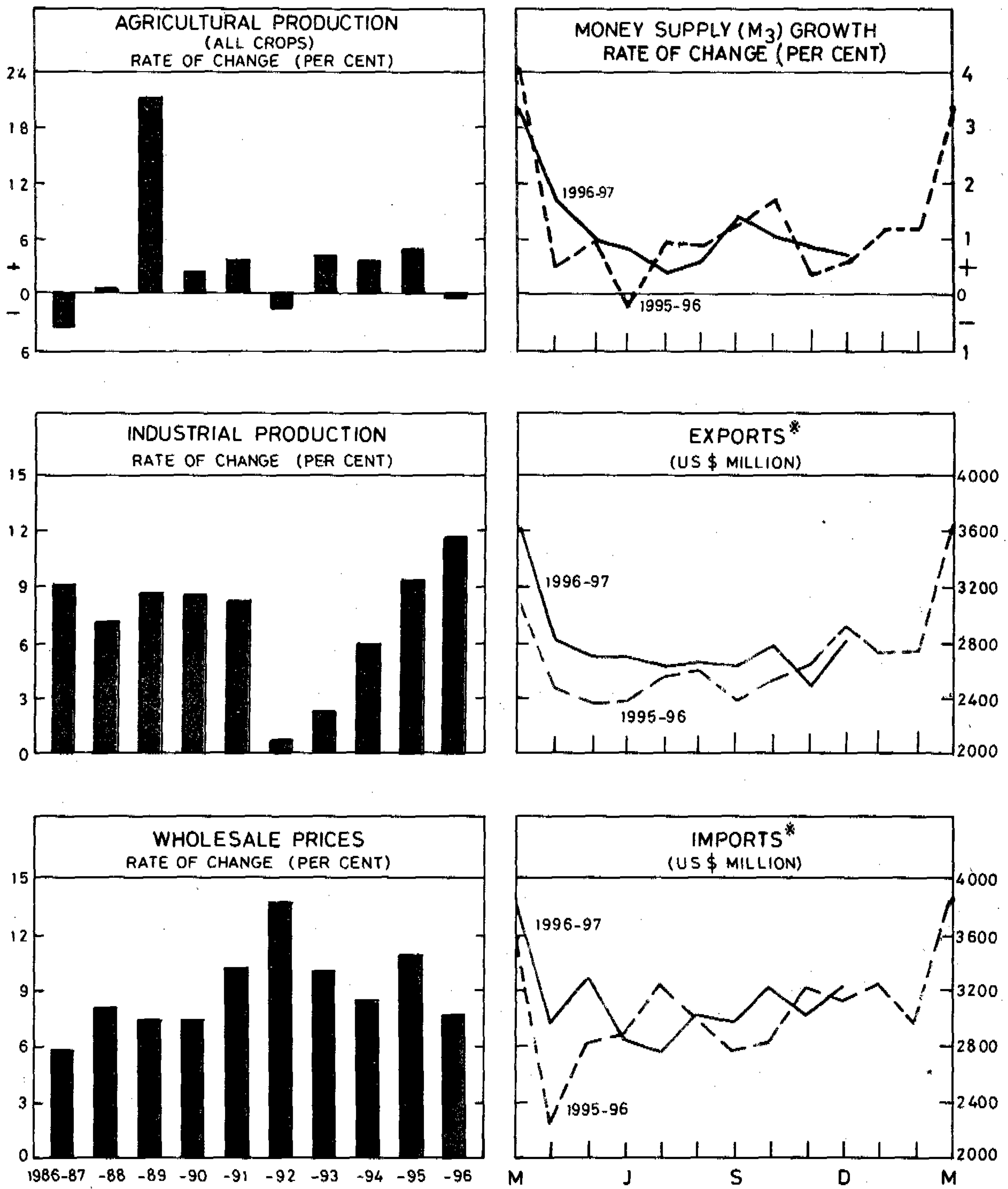
	1993-94	1994-95P	1995-96P	1996-97P	1993-94	1994-95P	1995-96P	1996-97P
	Absolute Values				Per cent change over previous period			
Gross national product (Rs thousand crore)								
At current prices	719 5	843 3	967 8 Q	NA	16 2	17 2	14 8 Q	NA
At 1980-81 prices	233 8	249 9	267 3 Q	285 3 E	6 0	6 9	7 0 Q	6 7 E
Gross domestic product (Rs thousand crore)								
At current prices	731 9	858 3	985 8 Q	NA	16 0	17 3	14 8 Q	NA
At 1980-81 prices	238 9	256 1	274 2 Q	292 9 E	6 0	7 2	7 1 Q	6 8 E
Agricultural production(1)	157 3	165 0	164 3	169 2 A	3 8	4 9	-0 4	3 0 A
Foodgrains production (million tonnes)	184 3	191 5	185 0	191 2 A	2 7	3 9	-3 4	3 3 A
Industrial production(2)	232 0	253 7	283 3	291 2 (3)	6 0	9 4	11 7	9 8 (3)
Electricity generated (TWH)	323 5	351 0	380 1	291 5 (8)	7 4	8 5	8 3	3 5 (8)
Wholesale price index(4)	258 3	286 8	299 5	319 8 (5)	10 8	10 2	4 4	7 6 (5)
Consumer price index for industrial workers(6)	267 0	293 0	319 0	349 0 (7)	9 9	9 7	8 9	8 7 (7)
Money supply (M3) (Rs thousand crore)	434 4	531 4	601 8	655 5 (10)	18 4	22 3	13 2	10 6 (11)
Imports at current prices								
(Rs crore)	73101	89971	122678	97111 (8)	15 3	23 1	36 4	12 8 (8)
(US $ million)	23306	28654	36678	27453 (8)	6 5	22 9	28 0	4 4 (8)
Exports at current prices								
(Rs crore)	69751	82674	106353	85623 (8)	29 9	18 5	28 6	14 9 (8)
(US $ million)	22238	26330	31797	24205 (8)	20 0	18 4	20 8	6 4 (8)
Foreign currency assets								
(Rs crore)	47287	66006	58446	71210 (9)	134 8	39 6	-11 5	21 8 (9)
(US $ million)	15068	20809	17044	19847 (9)	134 2	38 1	-18 1	16 4 (9)
Exchange rate (Rs/US $)+	31 37	31 40	33 45	35 42 (12)	7 7	0 1	6 1	5 6 (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

+ Per cent change indicates the rate of depreciation of the Rupee vis-á-vis the US dollar.
1. Index of agricultural production (principal crops) with base triennium ending 1981-82=100.
2. Index of Industrial production 1980-81=100
3. April-October,1996
4. Index with base 1981-82=100
5. As on January 11, 1997 for 1996-97 and for the last week of March for the earlier years.
6. Index with base 1982=100
7. As in November, 1996 and in the last week of March for the earlier years
8. April-December, 1996.
9. At the end of January, 1997 for 1996-97 and at the end of March for previous years
10. As on January 17, 1997; end of financial year for previous years.
11. April 1,1996 to January 17, 1997
12. April-January,1996-97

Figure 1.1

SELECTED ECONOMIC INDICATORS



* PROVISIONAL

a result, the surplus of private saving over private investment was also smaller at 5 6 per cent of GDP in 1995-96, compared to 7 9 per cent of GDP in 1994-95. Within the private sector, the composition of household saving has also changed, with saving in the form of physical assets rising sharply from 7.7 per cent of GDP in 1994-95 to 10 7 per cent in 1995-96, and saving in the form of financial assets declining from 11 5 per cent to 8 8 per cent of GDP The flow of saving into the organised/financial system declined from 17 2 per cent of GDP in 1994-95 to 14 9 per cent in 1995-96 The saving-investment gap of the public sector fell from 7 per cent of GDP in 1994-95 to 6 2 per cent of GDP in 1995-96

5 Gross domestic investment (adjusted), as a proportion of GDP at current prices, rose even faster than gross domestic saving in 1995-96 to a high of 27 4 per cent from 26 per cent in the previous year Gross domestic investment in real terms, as a proportion of GDP at constant prices, reached a new peak of 27 1 per cent, exceeding the previous peak of 25 9 per cent in 1990-91 (Table 1 4) Gross fixed capital formation which is even more important for productivity and growth, exceeded the 1994-95 peak of 21 9 per cent by a substantial 2 2 percentage points, to reach a new peak of 24 1 per cent of GDP in 1995-96 This new record was due solely to a rise in private fixed investment from the previous record of 13 4 per cent of GDP in 1994-95 to a new record of 16 3 per cent of GDP The contribution of real stock accumulation increased only marginally from 1 8 per cent of GDP in 1994-95 to 1 9 per cent of GDP in 1995-96, and remained below the 2 4 per cent average of the Seventh Plan Private sector investment appears to have responded vigorously to the policy of promoting competition, removing policy distortions and hurdles, and improving access to factors of production (e g technology, capital)

6 Estimates of savings and investment in 1996-97 are not yet available Indicators are mixed On

TABLE 1.4
Real Gross Domestic Capital Formation

	1985-90 7th Plan (Average)	1990-91	1991-92	1992-93	1993-94	1994-95P	1995-96Q	1992-96 (Average)
	(As per cent of GDP at market prices, 1980-81 prices)							
GDCF*	21 8	25 9	21 6	22 4	22 7	25 6	27 1	24 4
Public	9 7	9 0	8 3	8 1	8 1	8 4	7 6	8 0
Private	12 6	14 7	12 7	14 3	12 7	15 3	18 4	15 2
GFCF	19 8	21 3	20 3	20 6	20 8	21 9	24 1	21 8
Public	9 5	8 6	8 7	7 7	7 8	8 5	7 8	8 0
Private	10 3	12 7	11 6	13 0	12 9	13 4	16 3	13 9
Change in stocks	2 4	2 4	0 7	1 7	0 0	1 8	1 9	1 4
Public	0 2	0 4	-0 4	0 4	0 2	-0 1	-0 2	0 1
Private	2 2	2 0	1 1	1 3	-0 2	1 9	2 1	1 3
	(Growth rate, per cent)							
GDCF*	11 5	18 1	-16 3	9 2	6 3	21 5	13 7	12 7
Public	3 4	4 6	-7 2	2 7	4 4	12 1	-2 5	4 2
Private	14 9	17 5	-13 3	18 7	-6 7	29 3	29 1	17 6
GFCF	8 6	9 9	-4 0	7 0	5 6	13 3	18 3	11 0
Public	3 7	4 8	2 0	-7 2	6 9	17 2	-1 5	3 9
Private	13 6	13 6	-8 1	17 5	4 8	11 0	30 9	16 1

Note : GDCF : Gross Domestic Capital Formation at 1980-81 prices, 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

the one hand, domestic capital goods production is buoyant and disbursement of financial institutions are significantly higher. On the other hand, capital goods imports have declined, non-oil imports are lower in the first nine months of the year, corporate demand for credit appears slack, and sanctions of financial institutions are substantially lower.

7. The economy in 1996-97 so far presents a mixed picture in other dimensions as well. 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 (point to point) 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.

Production

8. Agricultural crop production in 1996-97 is expected to show good recovery from the slower growth in 1995-96. Growth is projected at 3 per cent after a fall of 0.4 per cent in 1995-96. The sharp decline in foodgrains production by 3.4 per cent, which was responsible for the slow growth in 1995-96, is expected to be reversed by an increase of 3.3 per cent in 1996-97. Foodgrains production is expected to recover to 191.2 million tonnes, only marginally lower than the level of production in 1994-95. This recovery is primarily due to coarse cereals, as well as an anticipated rise in wheat production which suffered a sharp setback in 1995-96.

9. As the agricultural year runs from July to June, the estimates for 1995-96 were only firmed up after the end of the financial year. A large downward revision (of 3 million tonnes) was made in the estimate of wheat production for 1995-96. The revision was unexpected and unexplained, because average rainfall in 1995-96 was quite normal. The revision, late in calendar year 1996, also created severe problems for the management of the food economy.

10. Commercial crop production has done extremely well in 1996-97 with oilseeds and cotton expected to reach record levels of 24.1 million tonnes and 14.3 million tonnes, respectively. The 9.2 per cent growth in cotton production has come on top of the 10.1 per cent growth last year. Jute and mesta have also shown a growth of 3.4 per cent this year. Sugarcane output is, however, unlikely to maintain the record level of 283 million tonnes attained in 1995-96.

11. Industrial production (as measured by the index of industrial production-IIP), grew by 9.8 per cent in the first seven months of 1996-97, 1.9 percentage points slower than the 11.7 per cent growth in the first seven months of 1995-96. IIP growth of 11.7 per cent in 1995-96 was the highest growth rate in the past 25 years, and growth rate of 9.5 per cent to 10.5 per cent for 1996-97 as a whole would still be the second highest growth rate over this 25 year period. The good performance of industrial production in 1996-97 is due entirely to the manufacturing sector, which has maintained its high growth. During the first seven months of 1996-97, for the manufacturing sector, the rate of growth of 12.1 per cent is virtually the same as the 12.3 per cent growth in the first seven months of 1995-96 (based on the IIP for manufacturing). Even if the average growth for the whole of 1996-97 falls below the record breaking growth of 13.0 per cent during 1995-96, it could still be the second highest over the past fifteen years.

12. The slowing of industrial production is clearly attributable to the dramatic fall in the rate of growth of electricity production and a slowing of growth in the mining sector mainly because of the 10 per cent decline in crude oil production. During the first seven months of 1996-97, electricity production (as measured by the index) has grown by only 3.4 per cent compared to the 10.1 per cent growth in the corresponding period of 1995-96. It is somewhat surprising that manufacturing sector growth has been barely affected by the slow growth in electricity production. One possibility is that captive electricity generation, which is increasingly used as a back-up to public supply, has substituted for the lack of generation by electricity boards. The high growth of diesel imports, about 22 per cent by volume in the first seven month of 1996-97 (with total refinery throughput growing in the normal range of around 4 per cent), is consistent with this hypothesis. At present, electricity statistics incorporate little or no data on captive power generation.

13. Another noteworthy aspect of industrial growth this year is the acceleration in the rate of growth of capital goods production to 16.6 per cent in the first seven months of this year from 15 per cent in the first seven months of last year. This has off-set the decline in the rate of growth of consumer goods and basic goods. In contrast, capital goods imports have declined by 6 per cent in the first seven months of 1996-97. This shows the increased competitiveness of the domestic capital goods industry. In the initial stages of reforms, the capital goods sector was subjected to the fastest tariff reduction to ensure a quick recovery of private fixed investment. The sector appears to have adjusted rapidly. Subsequently, some of the tariff anomalies were removed gradually

by reducing tariff rates on steel and other inputs closer to the 25 per cent rate on capital goods. This move to more uniform tariffs on manufactured goods has contributed to the growth of capital goods production, and will have a positive effect on employment generation.

14. The delicensing of investment in durables such as cars and white goods, and the decontrol of imports of parts for these goods, contributed to a boom in investment and production in this sector. The pick-up in growth rate in the production of consumer durables culminated in a phenomenal 37 per cent growth in 1995-96. Accelerated modernisation and development of this relatively backward sector required higher initial imports of capital goods, parts and components. The decline in the growth of consumer durables to 9.8 per cent in the first seven months of 1996-97, compared to 30.2 per cent in the first seven months of 1995-96, suggests that the pent-up demand in the domestic economy has been met. Further growth will depend on increased cost competitiveness, which requires fuller exploitation of the comparative advantage that India has in the production of (skilled and unskilled) labour intensive parts. It is possible that the slowing of non-oil imports is partly due to the maturing of the consumer durable industry.

15. 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 liberalised and made more transparent.

16. 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. 60 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 privatisation of state public sector enterprises.

17. Since February 11, 1997 government has deregulated prices and distribution of D grade of non-coking coal, hard coke and soft coke, in addition to the existing decontrol of prices and distribution of coking coal and A, B and C grades of non-coking coal. The government has also allowed the Coal India Limited and the Singareni Collieries Company Limited to fix the prices of E, F and G grades of non-coking coal as per BICP escalation formula till January 1, 2000 and in relation to market prices after January 1, 2000. The Government has also decided to amend the Coal Mines (Nationalisation) Act, 1973 to allow any Indian company to mine coal and lignite not only for captive consumption but also for sale.

18. The overall performance of the core and infrastructure sectors during the first 8 months of 1996-97 (April-November) has been poor (Table 1.5). Six industries namely, electricity generation, coal, steel, crude oil, petroleum products and cement, with a combined weight of 28.8 per cent in the Index of Industrial Production (IIP), averaged a growth of 4.1 per cent in April-November, 1996, less than half the 8.9 per cent, in April-November, 1995. The deceleration in the growth rate of these infrastructure industries is mainly due to a decline in crude oil production and power generation. Hydro power generation declined by 7.7 per cent, and thermal power generation grew by only 6.4 per cent in April-November, 1996 as compared to 14.6 per cent in the April-March, 1995-96. Coal, cement and refineries' throughput have grown faster in April-November, 1996-97 compared to the corresponding period of 1995-96. Growth of sectors such as railways, ports and telecommunication, which do not appear in the IIP, also slowed. The rate of growth of railways' revenue earning goods traffic decelerated marginally from 7 per cent during 1995-96 to 6.3 per cent for April-November 1996. Growth of cargo handled at major ports and new telephone connections provided decelerated more sharply to 4.7 per cent in April-November, 1996 (from 9.1 per cent in 1995-96) and 8.3 per cent in April-November, 1996 (from 23.3 per cent in 1995-96), respectively. The slower growth in cargo handled by ports is probably the result of a deceleration in the growth of external trade. The telecommunication slowdown, however, suggests that the pace of implementation of telecommunication reform needs to be accelerated and its scope widened to include Department of Telecommunications as a service provider.

19. The past few Economic Surveys have emphasized the need to accelerate, widen and

TABLE 1.5

Growth Rates of Core and Infrastructure Sectors

(Per cent p.a.)

Sectors	Weight (IIP)	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96*	1995-96* (Apr-Nov)	1996-97* (Apr-Nov)
Basic Infrastructure Sectors									
1. Electricity generation	11.4	7.8	8.5	5.0	7.4	8.5	8.3	9.9	3.4
(a) Thermal (incl. nuclear)		5.1	11.1	8.1	9.5	6.1	14.6	16.6	6.4
(b) Hydro		15.2	1.4	-4.0	0.8	17.2	-12.1	-9.3	-7.7
2. Coal	6.6	5.4	8.3	3.9	3.3	3.2	6.4	6.3	9.4
3. Saleable steel	5.2	3.1	8.1	3.9	6.2	8.3	8.9	10.6	2.7
4. Crude oil	2.4	-3.1	-8.1	-11.2	0.3	19.3	9.0	11.6	-10.0
5. Refinery throughput	1.5	-0.3	-0.7	4.0	1.5	3.8	3.6	3.0	6.3
6. Cement	1.6	6.6	5.9	5.0	6.8	7.6	11.2	9.1	11.4
Over All	**28.8**	**5.0**	**6.4**	**3.1**	**5.3**	**7.8**	**7.7**	**8.9**	**4.1**
Other Infrastructure Sectors									
1. Cargo handled at major ports		3.0	3.3	5.7	7.6	10.0	9.1	11.2	4.7
2. New Telephone connections		14.7	51.5	34.2	24.5	44.0	23.3	32.5	8.3
3. Revenue earning goods traffic on railways		2.7	6.2	3.6	2.5	1.7	7.0	5.7	6.3

* Provisional

deepen reforms of the non-tradable infrastructure and energy sectors, to avert an impending mismatch between economic growth and provision of non-tradable services. Given the parlous financial state of many public utilities, particularly the State Electricity Boards, the possibility of crises worsens with each passing year. The new government has repeatedly stressed its firm determination to reform the infrastructure and energy sectors. In line with this commitment, a number of policy decisions have been taken and new initiatives launched. These include:

- 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 authorised share capital of Rs. 5,000 crore.
- 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.
- 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.
- The provisions relating to foreign investment have been further liberalised 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.
- Through an Ordinance, the Government has recently 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 finalised an assignability agreement which will facilitate funding of cellular and basic telecom projects.
- Letters of intent have been given to basic telecom services in Karnataka and Madhya Pradesh. Cellular services are expanding rapidly beyond the four non-metro areas. The Government has

announced that telecom will be treated as infrastructure and all fiscal benefits, like tax holiday and concessional duty on project imports, now being made available to the power sector will be extended to the telecom sector also.

- New guidelines have been published for private participation in ports for both leasing out of existing assets and construction and operation of new assets such as container terminals, cargo berths, warehousing, dry docking and ship repair. Private investment in ports will be on a BOT basis. It will include leasing out existing assets of ports and construction and operation of additional assets such as container terminals, cargo berths, warehousing, dry docking and ship repair. The concession period will be decided by the Port Trusts, up to a maximum period of thirty years. A contract for a private container terminal at JNPT, valued at Rs.700 crore, has been awarded.
- An Independent Authority for regulating tariffs in major ports has been created through an Ordinance.
- 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-justicable. Only compensation can be settled through arbitration.
- 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 are to be urgently reformed and restructured to give them more autonomy, retail tariffs and wheeling charges are to be rationalised, and independent regulatory commissions are to be set up at the Central and State level. Private participation in distribution is to be encouraged. The Central Government has 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 250 MW. Renovation and modernisation schemes no longer need approval of the Central Electricity Authority.
- 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 Calcutta have proposed major improvements in their public transport systems through the introduction/augmentation of rail-based transit systems.
- A new policy for private investment in civil aviation has been announced and this includes allowing 40 per cent foreign equity in domestic airlines.

Money and Prices

20. The deceleration in inflation, initiated last year through a reduction in monetary growth, continued through the first quarter of 1996-97. As measured by the wholesale price index, the annual (point-to-point) inflation rate reached a trough of 4.5 per cent in May and June 1996. Since then the rate has crept up gradually to reach 7.5 per cent (provisional) in mid-January 1997. Despite the recent rising trend in the growth of the WPI, the average inflation for 1996-97 is expected to be at least one percentage point less than the average inflation in 1995-96. This is primarily due to continuing restraint on money supply growth, a reduction in the fiscal deficit (as a proportion of GDP) and the effect of competitive pressures on tradable goods consequent to the opening up of international trade in manufactures.

21. There was a complete change in the sectoral pattern of price changes during 1996-97. The annual rate of inflation accelerated sharply in the "fuel, power, light & lubricants" and "primary articles" groups, while decelerating in the "manufactures" group. The annual rate of price increase in the fuel-power group went up to 17.4 per cent in January 1997, from 1.1 per cent a year ago, mainly because of the increase in the administered prices of oil and petroleum products forced upon the new government in mid-1996, thanks to the failure to correct petroleum prices for two and a half years. The rate of growth of primary prices also accelerated to 11.7 per cent by January 1997 from 2.6 per cent a year before, while the rate of growth of manufactured goods' prices declined to 3.6 per cent from 6.9 per cent in the previous year. As a result, primary goods' inflation contributed 50.4 per cent of the inflation in 1996-97 (up to January 11, 1997), while the "fuel, power, light & lubricants" group contributed 23.3 per cent.

22. The rise in primary goods' prices has been largely due to a rise in the prices of cereals, and fruits and vegetables. Among cereals, wheat was the main contributor to the price rise, and this was solely due to the lower production (3 million tonnes in 1995-96) and the consequent lower procurement (4 million tonnes) during April-June, 1996. After the new Government assumed office, a number of steps were taken to improve the supply position of food items. FCI continued its open market sales of wheat and rice through 1996-97, with a sale of 2.5 lakh tonnes of rice and 27 lakh tonnes of wheat by mid-

January, 1997. FCI's monthly open market sales of wheat were stepped up to 6 lakh tonnes from December 1996. Wheat is also being imported to augment supplies through the Public Distribution System (PDS). The import duty on edible oils was reduced to 20 per cent, and STC imported 2 lakh tonnes of palmolein for PDS supply during 1996.

23. The rise in the international prices of crude and petroleum products during 1996-97 put further pressure on the import bill for petroleum and petroleum products. As administered price changes had been postponed, the effect of this external development (coupled with higher imports necessitated by rising demand and falling domestic production) is channeled through the burgeoning deficit in the oil pool account. Though this deficit does not directly affect the gross fiscal deficit of the Central Government, it adds to the "quasi-fiscal deficit" of the public sector as a whole. And the cumulation of arrears due to domestic oil companies compromises their financial strength and operational effectiveness.

24. Money supply growth has been higher in 1996-97 so far than in 1995-96. Up to the fortnight ended January 17, 1997, broad money (M3) grew by 10.6 per cent as against 8.2 per cent growth in the corresponding period of 1995-96. The annual growth of M3 was 13.2 per cent on March 31, 1996, against the planned growth of 15.5 per cent, due to a somewhat tight monetary policy. This, along with the high real interest rates brought about by a sharp decline in inflation, gave rise to perceptions of a liquidity squeeze, and hence, a need to expand money supply in 1996-97. The growth rate of M3 was still only 15.7 per cent on January 17, 1997, a shade under the planned growth of 16 per cent. The gradual acceleration in money supply growth was not, however, due to any acceleration in reserve money growth. On the contrary, reserve money has declined by 2.9 per cent during 1996-97 (up to January 17, 1997) in contrast to the expansion of 14.0 per cent in the corresponding period of 1995-96. Annual growth of reserve money declined from 14.8 per cent on March 31, 1996 to 7.2 per cent on January 17, 1997.

25. The fall in reserve money growth is primarily due to a sharp reduction in refinance taken from the RBI by commercial and cooperative banks, because of easy liquidity conditions following the reduction in the Cash Reserve Ratio (CRR). Expansion of net RBI credit to Government at 3.3 per cent (Rs. 3987 crore) during FY 1996-97, was much smaller than the 14.7 per cent (Rs. 14961 crore) growth in the corresponding period of 1995-96. Reserve money has, therefore, fallen despite a rise in the net foreign exchange assets of the RBI by Rs. 11482 crore (a growth of 15.5 per cent), compared with the decline of Rs. 485 crore (-0.6 per cent) in 1995-96 (till January 1996). Despite the reduction in reserve money, the growth of money supply accelerated because of reductions in the CRR required to be maintained by the banks against their net demand and time liabilities. The average CRR was reduced from 14 per cent at the beginning of 1996-97 to 10 per cent in January 1997, in several phases.

26. The average effective Statutory Liquidity Ratio (SLR) of the scheduled commercial banks is estimated to have fallen from 28.2 per cent of their net demand and time liabilities in end-March 1996 to 27 per cent by end-December, 1996. The structure of net bank credit to government has also undergone a sharp change in 1996-97. The slower growth of RBI credit to government has been more than offset by an increase in "other banks'" credit to government, which has grown by 18.7 per cent in 1996-97 till January 17, 1997. This compares with a growth rate of 11 per cent in the corresponding period of 1995-96.

27. In contrast, the growth of bank credit to the commercial sector at 5.3 per cent has been less than half of the 11.6 per cent in the comparable period of 1995-96. The growth of "other banks'" credit to the commercial sector has also been lower at 5.6 per cent during the current financial year up to January 17, 1997, as against 11.9 per cent recorded in the last financial year up to January 19, 1996. While non-food credit of scheduled commercial banks has recently shown signs of a moderate pick-up, the overall growth so far (5.2 per cent) is about a third of the growth (15.2 per cent) registered in the corresponding period of 1995-96.

28. The easing of monetary policy during 1996-97 has been reflected in relatively low call money rates from the very beginning of 1996-97. The average call money rate declined from a high of 13.75 per cent at the beginning of the current financial year to a range of 5 to 11 per cent in September 1996, and ruled between 10 and 11 per cent in December 1996, before falling to low single digits in January 1997. The RBI resumed its repo auctions of government securities in November 1996 and intensified them with continuous operations in January 1997. The reversal of the 1995-96 excess demand for funds for investment in 1996-97 has led to a general softening of interest rates in 1996-97. The cut-off yields on 91-day treasury bills has come down from 12.4 per cent in the first week of July to around 7.5 per cent at the end of January 1997. Cut-off yields on 364-day treasury bills have also declined from around 13 per cent at the end of June 1996 to 10.10 per cent at the end of January 1997. An increase in the rate of growth of deposits, coupled with the fall in demand for bank credit from large corporates, has also led to a reduction in bank interest rates, including the prime lending rates.

Fiscal Developments

29. The Budget for 1996-97 envisaged a reduction of the fiscal deficit by 0.8 per cent point of GDP from 5.8 per cent in 1995-96 (RE) to 5 per cent in 1996-97 (BE) (Table 1.6). The primary deficit is also budgeted to fall from 1.1 per cent of GDP to 0.2 per cent of GDP. The other dimension of fiscal adjustment is its quality, as reflected in the composition of fiscal adjustment. The revenue deficit is budgeted to fall to 2.5 per cent of GDP in 1996-7(BE), from 3.0 per cent in 1995-96 (RE).

30. The reduction in the fiscal deficit has been attempted through an increase in revenues coupled with a reduction in expenditure. Revenue receipts (net) are budgeted to increase by 18.3 per cent during 1996-97. These receipts, as a proportion of GDP, are to edge up from 10 per cent in 1995-96 (RE) to 10.4 per cent in 1996-97(BE). Despite a larger outgo on account of interest payments (Rs. 60000 crore), subsidies (Rs.16320 crore) and provision for revision of salaries and pension benefits (Rs.4000 crore), total revenue expenditure is budgeted to grow at a lower rate of 12.7 per cent compared with 17.5 per cent in 1995-96 (RE). This deceleration in the growth of revenue expenditure has led to a decline in the revenue expenditure to GDP ratio from 13.1 per cent in 1995-96 (RE) to 12.9 per cent in 1996-97 (BE). This favourable outcome on the expenditure side is largely on account of containment of non-interest non-plan expenditure growth at 9.3 per cent during 1996-97(BE), about half the growth of 18.8 per cent in 1995-96 (RE). Consequently, non-interest revenue expenditure as a proportion of GDP is budgeted to fall to 8.1 per cent from 8.3 per cent in 1995-96 (RE). The revenue deficit is budgeted to fall by 0.5 per cent point of GDP.

31. A number of initiatives were outlined in the 1996-97 budget, signaling the Government's resolve to strengthen the infrastructure and social sectors. To provide long term finance for infrastructure sector, an Infrastructure Development Finance Company (IDFC) has been set up. A budgetary allocation of Rs. 500 crore was made as Government's contribution. The budget also provided Rs.200 crore to strengthen the capital base of the National Highway Authority. With a view to improve the living standards of the rural poor, an additional outlay of Rs.2466 crore was provided as Central assistance for States' and Union Territories' Plans for certain basic minimum services. These cover a wide array of social programmes aimed at increasing the provision of safe drinking water, primary education, primary health centres, public housing, mid-day meals, and rural roads. Programmes for completing irrigation projects were augmented. Excise duty was reduced on a number of items of daily consumption and many mass consumption goods were exempted. The subsidy limit on small tractors, power tillers,

TABLE 1.6

Tax Revenue & Expenditure

(As per cent of GDP)

	Seventh Plan (1985-90)	1990-91 Actuals	1991-92 Actuals	1992-93 Actuals	1993-94 Actuals	1994-95 Actuals	1995-96 Revised Estimates	1996-97 Budget Estimates	Eigth Plan (1992-97)
1. Fiscal Deficit	8.2	8.3	5.9	5.7	7.4	6.1	5.8	5.0	6.0
2. Revenue Deficit	2.6	3.5	2.6	2.6	4.0	3.3	3.0	2.5	3.1
3. Budgetary Deficit	2.1	2.1	1.1	1.7	1.4	0.1	0.7	0.5	0.9
4. Primary Deficit	4.8	4.3	1.6	1.3	2.9	1.4	1.1	0.2	1.4
5. Gross Tax Revenue	11.2	10.8	10.9	10.6	9.4	9.7	10.0	10.6	10.0
(a) Direct Taxes of which	2.1	2.1	2.5	2.6	2.5	2.8	3.0	3.1	2.8
(i) Income Tax	1.0	1.0	1.1	1.1	1.1	1.3	1.4	1.4	1.3
(ii) Corporation Tax	1.1	1.0	1.3	1.3	1.2	1.4	1.5	1.6	1.4
(b) Indirect Taxes of which	9.1	8.7	8.5	8.0	6.8	6.9	7.1	7.4	7.2
(iii) Union Excise Duties	4.9	4.6	4.6	4.4	3.9	3.9	3.7	3.7	3.9
(iv) Customs	3.9	3.9	3.6	3.4	2.7	2.8	3.2	3.5	3.1
6. Total Expenditure of which	20.5	19.7	18.1	17.4	17.5	16.9	16.7	16.3	16.9
(i) Interest Payments	3.4	4.0	4.3	4.4	4.5	4.6	4.7	4.8	4.6
(ii) Major Subsidies	1.7	1.8	1.6	1.3	1.3	1.2	1.1	1.2	1.2
(iii) Defence	3.3	2.9	2.7	2.5	2.7	2.4	2.4	2.2	2.5
(iv) Other Non-Plan Expenditure	5.0	5.7	4.5	4.0	3.6	3.6	3.9	3.8	3.8
(v) Budget Support For Plan	7.1	5.3	5.0	5.2	5.4	5.0	4.4	4.4	4.9

sprinklers and drip irrigation equipment was enhanced, to reduce the cost of capital for the agricultural sector. A provision of Rs. 900 crore was made for matching loans from the Centre to the States for the timely completion of selected irrigation projects.

32. The 1996-97 budget also took some steps toward reform of the tax regime. On the import duty side, the basic duty rate on a number of items was reduced to 30 or 40 per cent. Progress was also made in unifying import duty rates on similar items, in order to avoid disputes arising out of mis-classification and multiplicity of rates. On the excise front, the ambit of MODVAT was extended to cover textiles. This would help rationalisation of the rate structure and benefit the textile industry in general. A mandatory penalty for evasion of excise duty or misuse of MODVAT credit scheme on account of fraud, collusion etc., was also introduced.

33. On the direct taxes front, a mix of changes were made. The surcharge on corporate tax was reduced from 15 per cent to 7.5 per cent, bringing down the total company tax rate from 46 per cent to 43 per cent. This was off-set by the introduction of a Minimum Alternate Tax, to raise the effective corporate tax on corporations that do not pay taxes on corporate income because of numerous exemptions, but show high balance sheet profits. Companies engaged in the power and infrastructure sectors are outside its ambit. The scope of the five year tax holiday provision was extended to include enterprises in irrigation, water supply, sanitation and sewerage systems. The long-term capital gains tax for domestic companies was reduced to 20 per cent. The scope of the long term capital gains tax exemption was widened to include investment in shares issued by public companies in specified sectors.

34. As a follow up to the Finance Minister's announcement in his budget speech, the setting up of a Tariff Commission has been approved by the Government.

Financial Developments

35. Decontrol of the banking system continued during 1996-97. The interest rate on term deposits of over one year was deregulated, as was the interest rate on non-resident external rupee deposits above two years. Selective credit controls on a number of commodities were eliminated from October 1996. The minimum maturity period of term deposits was reduced to 30 days, and the ceiling rate on term deposits of 30 days to one year was reduced to 10 per cent. A number of banks have reduced their prime lending rate (PLR) by 1 to 1-1/2 per cent points and announced a 2.5 to 4.5 per cent maximum margin over PLR. The rules for obligatory consortium lending were liberalised by the RBI in October 1996. The ground rules can now be framed by the participating banks themselves, without reference to the RBI. Competition in the banking sector has increased gradually as ten new private sector banks, out of the thirteen "in principle" approvals given so far, have started functioning. The RBI has issued guidelines for setting up of new local area private banks with jurisdiction over three contiguous districts. Two such banks have already been given "in principle" approval. Banks were allowed to fix their own foreign exchange aggregate gap limits, starting April 1996. From October 1996, banks were permitted to provide foreign currency denominated loans based on their FCNR accounts, to be used for meeting either foreign currency or rupee requirements.

36. There has been a steady improvement in the capital adequacy of public sector banks over the last few years. The State Bank of India and its subsidiaries attained 8 per cent Capital to Risk weighted Assets Ratio (CRAR) by March 1996. Out of 19 nationalised banks, 11 reached the norm of 8 per cent CRAR, while 3 banks had a CRAR of 4 to 8 per cent. The process of tightening norms of banking operations also continued. Recovery proceedings are being gradually streamlined, with six tribunals and one Appellate Tribunal functioning. Under the Banking Ombudsmen Scheme announced in June 1995 to expedite inexpensive resolution of customers' complaints, eleven ombudsmen are now functioning. Banks have opened 125 specialised branches for agricultural credit and 136 such branches for SSI credit.

37. Disbursements by Development Finance Institutions (DFI) grew by 16.6 per cent during April-December 1996, to Rs.22257 crore, from Rs.19088 crore during April - December 1995. This growth is only a little lower than the 17.4 per cent growth rate achieved in 1995-96. Sanctions by DFIs, however, declined by 30 per cent during April-December 1996, as a result of resource constraints, high interest rates and slowing of proposals for new projects from the corporate sector. To raise resources, most DFIs issued bonds during the year. They also began charging market based interest rates in the face of increasing competition for term loans by banks. Their interest rates increased in 1995-96 and in the first half of 1996-97, but declined subsequently. Minimum lending rates were reduced from 17 per cent to 16.5 per cent in October 1996.

38. Non-banking financial companies (NBFCs) have been brought under the regulatory purview of the RBI, through an Ordinance amending the RBI Act, 1934. To protect the interests of ordinary depositors, an NBFC has been defined to include a

company whose "principal business is the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner". All NBFCs will have to meet net worth and capital adequacy criteria. The RBI will also specify accounting, income recognition and other norms under the law. Existing NBFCs will have a transitional period of three years to come up to the specified standards.

39. Steps were taken for development of the Government securities market. A number of primary dealers were set up and participated actively in the auctions. Their purchases through auctions were much higher than the minimum required under the agreement with the RBI, partly because of the commission given to them. The delivery-versus-payment system was extended to auction of treasury bills in February 1996 and to other public debt offices in May 1996. To encourage mutual fund schemes dedicated to Government securities and thus create a wider investor base, the RBI announced liquidity support to such funds in April 1996. The RBI will either purchase outright or engage in reverse repos, up to a maximum of 20 per cent of the mutual fund's outstanding investment in government securities. The RBI issued guidelines to banks in June 1996 for retailing of Government securities to non-bank clients. The ratio of investments to be classified in current category by banks was raised from 40 per cent to 50 per cent for the year ending 1996-97, thus moving closer towards a fully "marked to market" system of valuation. The ratio is already 100 per cent for the new private sector banks. In January 1997, FIIs were allowed to invest in government securities subject to ceilings.

40. An array of capital market reforms was introduced during 1996-97, encompassing primary and secondary markets, equity and debt, and foreign institutional investment. Primary market reforms aimed at imparting greater flexibility in the issue process and strengthening the criteria for accessing the securities market. Reforms in the secondary market aimed at improving market transparency, integrity and trading infrastructure. Among the reforms undertaken were :

- Passing of the Depositories Act, 1996 by Parliament, providing a legal framework for recording ownership details in book-entry form and facilitating dematerialisation of securities. The Depositories Related Laws (Amendment), 1997 issued through an Ordinance, will allow banks, mutual funds and IDBI to dematerialise their scrips.
- Formulation of SEBI (Depositories & Participants) Regulations, 1996, which allow SEBI to regulate establishment and functioning of depositories, and to protect investor interests.
- Tightening of entry norms for equity issue by companies, to improve quality.
- Giving up vetting of public issue offer documents by SEBI, to encourage self regulation. SEBI's comments (if any) to be sent within 21 days of filing.
- Debt issues not accompanied by an equity component permitted to be sold entirely by the book-building process.
- Issuers allowed to list debt securities on stock exchanges even if equity is not listed.
- FIIs permitted to invest up to 10 per cent in the equity of any company, to invest in unlisted companies, to set up pure (100 per cent) debt funds, and to invest in government securities.
- Eligibility criteria for registration as an FII were modified to allow endowment funds, university funds, foundations and charitable trusts/societies to register.
- Stock lending scheme was introduced and this will not attract capital gains.
- The SEBI (Mutual Funds) Regulations, 1993 were revised to provide for portfolio disclosure, standardisation of accounting policies, valuation norms for determining net asset value and pricing.
- SEBI regulations on Venture Capital funds (VCF) were issued, allowing them to invest in unlisted companies, to finance turnaround companies, and to provide loans. These provide flexibility to VCFs so that high risk finance can be provided to the market.
- Modified takeover code, based on the recommendations of the Bhagwati comittee, was approved. It requires a mandatory minimum public offer of 20 per cent purchase, when the threshold limit of 10 per cent equity holding is crossed. Those in "control" are permitted to purchase 2 per cent of shares per annum up to 51 per cent. To discourage frivolous attempts, acquirers will have to deposit a certain value of cash and assets in an escrow account. The escrow deposit would be higher for conditional public offers, unless the acquirer agrees to acquire a minimum of 20 per cent.
- SEBI approved almost all the recommendations of the Dave Committee for improving the working of the Over The Counter Exchange of India (OTCEI).

41. The capital market remained subdued during 1996-97. The primary market was characterised by a reduction in the capital raised from Rs.14151 crore in April-December 1995 to Rs.10369 crore during April-December 1996. The secondary market saw low trading volumes and a downtrend in prices. Mutual funds and market intermediaries also suffered from lower volumes. Besides UTI, there are now 10 public sector mutual funds and 21 private sector mutual funds in operation. During April-December 1996, mutual funds, including UTI, raised Rs.2167 crore from different schemes. At the end of December 1996, 427 Foreign Institutional Investors (FIIs) were registered with SEBI. They have invested around US $2032 million in the securities market in 1996-97 till December, bringing the stock of FII investments to US $ 7235 million. Indian issuers also made Euro-issues (GDR's and FCCB's) of US $1304 million during the same period, an amount higher than that raised through euro-issues in the whole of 1995-96.

Balance of Payments

42. The developments so far in 1996-97 in the balance of payments point to an easing of pressure on the current account and to buoyancy in capital inflows. The deficit on trade account in 1996-97 is expected to be lower than in 1995-96, largely because of a sharp deceleration in the growth of non-petroleum (non-POL) imports. This improvement in the trade deficit will be partly offset by an anticipated decline in invisible receipts, reflecting an increase in payments for factor services and some decline in private transfers. The current account deficit is expected to decline from 1.7 per cent of GDP in 1995-96 to less than 1.4 per cent of GDP in 1996-97. Net capital inflows in 1996-97 are expected to rise nearly three-fold over the previous year, largely because of buoyant inflows under non-resident deposits and foreign investment flows, including Euro-equities, and a sizable decline in repayments to the IMF. The easing of pressure on the current account and buoyant capital flows in 1996-97 resulted in a sizable build-up of foreign exchange reserves. The foreign currency assets of the RBI rose by over US $2.8 billion from about US $ 17.0 billion at end-March 1996 to US $19.8 billion at end-January 1997, providing cover for about 5.5 months of imports.

43. As per DGCI&S data, the trade deficit for April-December 1996 at US $ 3.3 billion was 8 per cent lower than in April-December 1995. During April-December 1996, imports recorded a growth rate of only 4.4 per cent, entirely due to a sharp 41 per cent increase in POL imports. Non-POL imports, on the other hand, showed a negative growth of 4.2 per cent during April-December 1996. Non-POL imports grew at an annual average rate of 23 per cent during 1993-94 to 1995-96. The pattern of import growth suggests that the hump in imports, normally seen after a major trade and investment liberalisation, is now behind us. The fall in non-oil imports may also partly reflect a slowdown of growth in investment and consumer durables' production.

44. 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 the previous three years (1993-94 to 1995-96). The slow growth in exports during April-December 1996 is accounted for by large declines in exports of unmanufactured tobacco, tea, leather and leather manufactures, gems and jewellery, primary and semi-finished iron and steel, and a sharp decleration in the growth of exports of coffee, electronic goods, ready-made garments and handicrafts. Among the significant reasons for this decline are the slowdown in world trade growth in 1996 (by about 3 percentage points), inadequate availability of non-tradeable infrastructure services, the fall in agriculture production, and large movements in cross-currency exchange rates. The impact of variations in the cross-currency rates is evident from the fact that during the first nine months of 1996-97, exports valued in SDR terms grew by 12.7 per cent compared to only 6.4 per cent when valued in US dollar terms. The latest trend in the growth rates of exports seems to suggest that the initial impact of trade liberalisation is petering out and the trade flows are reverting to their normal trend determined by world demand and domestic activity. Despite the export slow down, self reliance, as measured by the coverage of imports by exports (DGCI&S), has risen to 88.2 for April-December 1996 from 86.7 during 1995-96.

45. 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.

46. In the capital account, foreign investment continued to dominate the capital flows. Total foreign investment (direct plus portfolio) during April-December 1996 surged to over US $ 4 billion, which is more than 50 per cent higher than in the corresponding period of 1995-96. This revival followed a modest decline in such investment flows from US $ 4.9 billion in 1994-95 to US $ 4.3 billion in 1995-96, mainly owing to a sharp fall in the issue

of Euro-equities. Foreign direct investment flows were US $2.1 billion in 1995-96. During April-December 1996, FDI flows were US $1.7 billion, compared with US $ 1.5 billion in the corresponding period of 1995. Portfolio investment, comprising investment by FIIs and Euro-equities, doubled to over US $2.3 billion in the first nine months of 1996-97 from about US $ 1.1 billion in the corresponding period of 1995-96.

47. For the first time, detailed guidelines for the Foreign Investment Promotion Board were announced in January 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; and proprietory FII funds have been allowed to invest in the country. The guidelines for Euro-issues were liberalised in June 1996 so as to give the market a freer play in judging the quality of issues and the number of issues that can be floated in a year. The conditions relating to end-use of GDR proceeds have been relaxed significantly. Investment in the stock market and real estate is not, however, permitted out of GDR proceeds. Similarly, a number of changes were announced in June, 1996 in the external commercial borrowing (ECB) guidelines governing the maximum borrowing limits and end-use restrictions. In particular, exporters can raise ECB for meeting project-related rupee expenditure upto the equivalent of US $ 15 million, or the average annual exports of the previous three years, whichever is lower. The maximum limit under the US $ 1 million window has been enhanced to US $ 3 million, to help small and medium firms meet their working capital requirements. All infrastructure and greenfield projects have been permitted to avail of ECB to the extent of 35 per cent of total project cost, as appraised by a recognized financial institution or bank. Greater flexibility is allowed on merits to power projects. In January 1997, the ECB limit for the telecommunication sector was raised to 50 per cent of the total cost of the project.

48. The exchange rate of the rupee against the US dollar, which had depreciated to a monthly average of Rs. 36.63 in February 1996, recovered to Rs. 34.24 in April 1996. In the subsequent months, the rate moved in the narrow range of Rs. 35.01 to Rs. 35.87. The rupee-dollar rate remained steady although inflation in India was higher than in her major trading partners. This resulted in some appreciation of the rupee in real effective exchange rate terms.

49. Further measures were taken to simplify procedures related to the purchase of foreign exchange, so as to enhance current account convertibility. These included permission to Exchange Earner's Foreign Currency (EEFC) account holders to use these funds for business related current account transactions. Authorised Dealers (ADs) were allowed to export surplus currency to private money changers abroad, in addition to their own branches and correspondents. ADs were empowered to allow Indian resident families to remit US $ 5,000 per year to close relatives abroad, without reference to the RBI. Monetary ceilings on remittances for a wide range of purposes were also removed, so that ADs need not refer to the RBI.

50. 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. The share of concessional debt in the total remains stable at about 45.5 per cent. The share of short-term debt was 5.5 per cent at end-March 1996, and is low by international standards. The high component of concessional debt translates into a present value (PV) of debt at US $ 70.7 billion at end-March 95. 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 are projected to decline further to about 25 per cent in 1996-97.

51. The India Development Bonds (IDB), issued in early 1992, fell due for redemption after five years in mid-January and mid-February, 1997. Of the IDBs falling due, redemption of only about a half in net foreign currency terms continued to demonstrate the relative attractiveness of investments in India.

Social Sectors and the Poor

52. Rapid creation of productive employment opportunities is the best way of reducing poverty. The Economic Survey, 1995-96 reported Planning Commission estimates indicating a sharp increase in additional employment generated in the economy from 3 million in 1991-92 to over 7 million in 1994-95. These old estimates as well as the methodology for estimating employment are currently under review by the Planning Commission, and the employment estimates for 1995-96 have not yet been finalised. However, there is little doubt that the high growth of the last few years would have led to a rapid expansion of employment opportunities.

53. The estimated proportion of population below the poverty line is sensitive to the estimation procedure adopted. However, according to a variety of estimates, the decline in the proportion of population below the poverty line was between 2.9 and 8.7 percentage points in the six-year period ending in 1993-94. The appropriate methodology for estimation of poverty is also currently under review by the Planning Commission.

54. The Common Minimum Programme (CMP), underpins the strong commitment of the Government to the development of social sectors for achieving distributive justice. This commitment is reflected in the increase in Central Government Plan and non-Plan allocations for social services to a record high of 1.19 per cent of GDP in 1996-97 (BE). This ratio was 0.96 per cent in 1995-96. An additional amount of Rs.2466 crore of Central assistance to States' and Union Territories' plans has also been allocated in the 1996-97 budget for expenditure on basic minimum services.

55. The Government has also accorded high priority to poverty alleviation programmes. The Central Plan allocations for social sectors and poverty alleviation programmes show highest growth of 85.6 per cent for education in 1996-97 over 1995-96 (BE). The outlay for elementary education has gone up by 247.8 per cent, mainly because of the programme of nutritional support to primary school students. The allocation for health was raised by 21.6 per cent and for rural development, encompassing the major programmes for poverty alleviation, by 12.1 per cent in 1996-97 over 1995-96 (BE).

56. The weaker sections especially scheduled castes/scheduled tribes and women have been given importance in special programmes of poverty alleviation and employment as well as in several other programmes. The PDS has been streamlined recently in order to target the poorer sections of the population.

Issues and Priorities

57. The Update to the Economic Survey 1995-96, published about seven months ago, had emphasised three key challenges for economic policy: how to control the fiscal deficit; how to provide adequate and reliable economic infrastructure services at a reasonable cost and with sustainable financing and pricing policies; and how to ensure broad-based employment-generating growth of agriculture, industry and other sectors, together with strengthened programmes for basic social services and anti-poverty programmes to ensure a rapid alleviation of poverty.

58. These challenges remain central to our concerns. It is essential to keep reducing the Centre's fiscal deficit to below four per cent of GDP as soon as possible in order to: reduce interest rates and free up resources to finance the high levels of investment, both public and private, envisaged in the Approach Paper to the Ninth Plan; to contain Central Government borrowing from the RBI and thus check the growth of inflationary potential and pressures; to moderate the growth of rapidly rising interest payments which preempt the resources available for spending on priority, social and infrastructure needs; to facilitate orderly development of the market for long-term debt securities which is so essential for fostering the financing of infrastructure; and to reduce the risks associated with excessive government borrowing from external sources.

59. The path to fiscal deficit reduction is as well known in theory as it is difficult to implement in practice. We must persevere with our programme of tax reforms which has helped to raise the ratio of revenues to GDP. We must seek higher non-tax revenues in the form of larger dividends from Government equity in public enterprises. We must reduce the growth of subsidies through better targeting and much more systematic application of user charges for Government services. The normally difficult task of expenditure management will be accentuated in the coming years by the challenge of accommodating the recommendations of the Fifth Central Pay Commission. Finally, Government must act expeditiously on the recommendations of the Disinvestment Commission.

60. The responsibility for fiscal consolidation and prudence does not rest with the Central Government alone. The States have to do their part in reducing their borrowing requirements through better design and implementation of their tax systems and through steps to curb low priority expenditures.

61. As described earlier, the Government has taken a wide array of initiatives to accelerate expansion of infrastructure services in power, telecommunications, roads, ports, civil aviation and irrigation. All these initiatives need to be followed through with vigour and dedication. We must quickly resolve the residual difficulties in the induction of private providers of basic and cellular telecom services. We must follow up on the experience with the recently announced guidelines for private projects in roads and ports to iron out any difficulties that may arise. We must resolve remaining ambiguities about our policy on civil aviation. We must urgently complete as many ongoing irrigation projects as possible to bring the benefits of assured water supply to millions of farmers. Above all, we must press ahead with the recently agreed Common Minimum National Action Plan for Power on a war footing.

62. The recurring power failures even in the capital city of Delhi this winter underline the critical nature of the power problem throughout the country. Because of unavailable, uncertain or erratic supplies from the public grid, the economy is paying a heavy price in the form of foregone production, lost exports of goods and services, frustrated investment intentions, recourse to high cost captive power generation, loss of international competitiveness, and barriers to the spread of information technology

which is redefining the terms of production, technical progress and international specialisation throughout the world. The key elements of the Common Minimum National Action Plan for Power, which need to be pursued vigorously, include the establishment of independent State Electricity Regulatory Commissions, the rationalisation of retail power tariffs, induction of private participation in electricity distribution and the restructuring and corporatisation of State Electricity Boards to run on commercial principles.

63. Power is only one, albeit critical, component of our energy economy. Today, the development of our petroleum sector is under a serious threat, with crude oil production having declined, oil imports rising sharply and the deficit on the Oil Pool Account rising each day and expected to exceed Rs.15,000 crore before the end of this financial year. There is no economically viable alternative to adjusting petroleum prices to reflect the impact of international oil price increases. Furthermore, if we are to reap the benefits of increased investment and efficient production in all stages of the petroleum sector (ranging from exploration and development to refining and distribution), we must carry out a phased dismantling of the existing administered price mechanism in this sector. The time for initiating this reform is already overdue.

64. A pick-up in the growth momentum of the economy will intensify the need for garnering increasing amounts of foreign savings to meet the investment requirements of the economy and to sustain the growth momentum itself. Foreign direct investment flows provide such savings without adding to the country's external debt. As indicated in the Common Minimum Programme, foreign direct investment should rise to US $10 billion per year from the current level of US $ 2 to 3 billion. We must learn from the pragmatic nationalism of China which received around US $ 40 billion of investment in 1996, and expects to attract more in 1997. We must also learn from the flexibility and speed of Indonesia, which modified its policies rapidly in response to perceived competition from China and India, to double foreign investment inflows between 1994 and 1995. We must ensure that the regulations governing the inflow of foreign investment are transparent and attractive in comparison with what other Asian economies offer. A review of FERA is underway in this context.

65. Fifty years after achieving independence, poverty, illiteracy, disease and lack of minimum social services continue to afflict hundreds of millions of our people. Experience from all over the world shows that rapid, employment-generating growth is the most effective way of reducing poverty. Our policies and programmes must accord the highest priority to encouraging growth of sustainable and productive job opportunities in all sectors. In agriculture, income earning opportunities for farmers should be expanded by removing existing impediments to domestic and international trade in agricultural products and removing controls on key agro-processing industries. At the same time, there have to be renewed efforts to strengthen rural infrastructure in the form of irrigation, rural roads, soil conservation, seed development, research and extension, and rural credit systems. In many cases this may call for a review and redirection of existing programmes. Besides, it is imperative to find incremental resources for public investment in rural infrastructure. Such resources can be raised only partly through the budget. Without hurting the poor, the bulk of the resources would have to come from the larger and better-off farmers.

66. There is a tremendous scope for expanding productive employment in the construction and other service sectors, especially in the cities and towns. But to realise this potential, the Government must be prepared to remove impediments imposed by various laws and regulations, such as the Urban Land Ceiling Act.

67. For the vast majority of our people to benefit from extension of job opportunities stemming from rapid labour-intensive growth, there has to be a commensurate expansion and quality improvement in the basic social services such as primary education and primary health care. The experience of countries as diverse as China and Indonesia has demonstrated the critical requirement for priority attention to these basic services.

68. For those at the margins of a market driven economy, the effective provision of minimum social services and special programmes for employment and poverty alleviation fulfill an essential need. Over time these special programmes have proliferated, not always rationally. To maximise the beneficial impact of anti-poverty programmes, it would be desirable to seek ways of consolidation and rationalisation, and some attrition. The basic goal should be to enhance sustainable benefits to the poorest segments of the society, while reducing administrative duplication and wastage and minimising well-known "leakages".

69. Over the last 5 to 6 years the Indian economy has demonstrated enviable resilience and buoyancy as a result of wide ranging economic reforms and closer integration with the world economy. On the whole, those dimensions of the economy have performed best where reform efforts have been most thorough and far-reaching. We must learn from this experience as we look ahead to meet the challenges of the future.