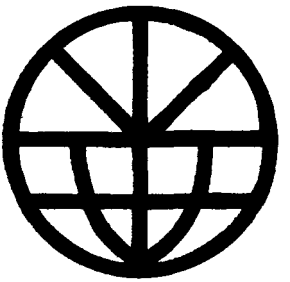
Mid-Year Review of the Indian Economy 2003-2004

Suman K Bery



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SUMAN K. BERY
and
Research Team
NCAER

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Preface

The Mid-Year Review of the Indian Economy (2003-2004), based on a comprehensive presentation made by the National Council of Applied Economic Research, was discussed in India International Centre on 1 November 2003. This volume brings out a detailed account of the same.

The India International Centre would like to express its gratitude to the Malcolm and Elizabeth Adiseshiah Trust, Chennai, which since 2001 has been supporting the Mid-Year Economic Review named in the memory of late Dr Malcolm Adiseshiah, a Life Trustee of the Centre who steered the Economic Affairs Group of the Centre till his passing away in 1994.

The main presentation by Mr. Suman K. Bery, Director-General, NCAER, as in the previous year, gives an in-depth survey of the state of the economy, with forecasts based on the macro-economic models developed by NCAER. Mr. Ajit Mozoomdar as Chair brought the right focus on key economic issues. The contribution of two discussants, Dr Subir Gokarn of CRISIL and Dr Alok Ray of IIM, Kolkata, are reflected in the 'Comments from the Discussants' chapter of the publication.

Factors such as a very good monsoon, the continual growth of the services sector, the pick-up in the manufacturing sector in the first month and the galloping surge towards a $100 million reserve of foreign exchange provided adequate data for painting an optimistic scenario for the rest of the year.

The survey, based on comprehensive data presented, clearly brings out that economic recovery is underway. An excellent monsoon apart, monetary easing has contributed to the recovery and the continuing 'feel good' factor in the market. The survey brings out that while conditions, domestically and globally, provide an optimistic picture of future growth, India could make a major impact globally only with

a further set of reforms, particularly on fiscal and trade policies and on privatisation.

Amongst the important points that emerged during the discussion-non-interest public expenditure being an important part of the high growth-were the need to focus on raising the tax GDP ratio, apart from fiscal deficit and employment growth.

The Centre is thankful to Mr. Suman K. Bery, Mr. Sunil Sinha and other members of the Team for the considerable effort put in by them and the illuminating and in-depth presentation made by them. The Centre is also thankful to Dr Alok Ray, Professor of Economics, IIM, Kolkata, and to Dr Subir Gokarn, Chief Economist of the credit rating agency CRISIL, for the aspects they have touched on and the valuable contribution they have made as Discussants.

A special thanks to Mr. Ajit Mozoomdar, who had kindly agreed to chair the session and for his valuable contribution.

Finally, a word of thanks to all those who were present and who participated in the discussions, which added to the overall value of the discussions in assessing the state of the economy in mid year along with an assessment of prospects for the future.

We also thank Shipra Publications for bringing out this volume.

Bela Butalia
Editor

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An Overview

It was an honour for the National Council of Applied Economic Research (NCAER) to be invited back in 2003 by the India International Centre to prepare the Annual Mid-Year Review of the Indian Economy. A draft document prepared by the NCAER team was made available to the Chairman and discussants prior to the presentation at the IIC on the morning of 1 November, 2003. In this overview, we attempt to capture the highlights of the presentation we made on that occasion and the rich discussion that it stimulated. At the outset we would like to express our thanks and appreciation to the India International Centre; the Malcolm and Elizabeth Adiseshiah Trust, Chennai; the Chair, Mr. Ajit Mozoomdar; invited discussants Drs. Alok Ray and Subir Gokarn; the participants and our own colleagues at the NCAER for their interest and support.

Both in India and in the world, the economic picture looks distinctly more upbeat than a year ago. In its September 2003 *World Economic Outlook*, the IMF projects an acceleration in real world GDP from 3.2 per cent in 2003 to 4.1 percent in 2004.Of the major economic blocs, while both the US and Japan are showing signs of recovery, the growth outlook for the EU remains uncertain. The US economy grew by 3.3 per cent during July-September 2003. Increased personal consumption expenditure, equipment and software, residential fixed investment and exports is the main reason. The US economy could perform even better in the 4th quarter of 2003.

Backed by rising corporate profits and an improving stock market based on banking stocks, the Japanese economy is also showing signs of growth. Japan's GDP during April-June 2003 grew by 3.9 per cent. In order to sustain this growth momentum the Bank of Japan has announced that it will push for more aggressive disposal of

the banking system's non-performing loans and restructuring of firms and maintain an easy monetary policy until deflation is tackled. However, given the dependence of Japan's economy on exports, a rising yen, which the Japanese authorities have been attempting to temper, could still frustrate the recovery.

The September 2003 forecast of the IMF for growth in the Euro zone is 0.5 per cent. According to the OECD, the root cause is the inability of the member countries to carry out structural reforms, particularly in the labour market, trade barriers and an uneven fiscal and monetary policy mix.

The Indian economy is among the few large economies that are witnessing reasonable growth. GDP, after recording growth of 4.3 per cent in 2002-03 grew at 5.7 per cent in the first quarter of 2003-04. Manufacturing GDP grew at 6.4 per cent, and services GDP grew at 7.4 per cent. With uniform and good rainfall, higher growth in agriculture has raised expectations of strong GDP growth in 2003-04.

Industry has consistently clocked growth in excess of 5 per cent during the last four quarters (including Q1: 2003-04). Earlier spikes in industrial growth (1997-98 and 1999-2000) were supported by buoyancy in agriculture in the preceding year. This suggests that the industrial recovery will be sustained.

The latest CII-ASCON Survey covering April-September 2003-04 also points in the same direction. Out of 134 manufacturing segments, 9 recorded excellent growth of more than 20 per cent, 42 registered high growth between 10 and 20 per cent, 55 witnessed moderate growth between 0 and10 per cent, while 28 sectors registered negative growth.

Services maintained their growth momentum, with output increasing by an estimated 7.1 per cent in 2002-03 and by 7.4 per cent during the first quarter of 2003-04. This also meant that the share of services in overall GDP moved up to 56.1 per cent in 2002-03 from 54.6 in 2001-02. The services segments that witnessed significant growth in Q1: 2003-04 is 'trade, hotels, transport & communication' and 'financing, insurance, real estate and business services'. This outweighed the deceleration in the growth of 'community, social and personal services'. Since the 1990s, high growth

in 'trade, hotels, transport and communication' has mainly reflected the robust growth in communications, which has benefited significantly from the reforms underway in the telecom sector. The growth of the communication sector accelerated from an average of 16.9 per cent during 1994-98 to 21.4 per cent during 1998-2002 with its share in GDP doubling by 2001-02.

In 2002-03 exports grew by 19 per cent. In the first four months of this year they have grown at 9.3 per cent. Imports during April-July 2003-04 grew by 22.7 per cent; non POL imports grew by 29% during April-July 2003-04, perhaps a leading indicator of a stronger industrial recovery. The rupee has strengthened against the dollar, and consequently against the Chinese RMB. It is intriguing that this has coincided with a stronger economy, somewhat contrary to the expectations of most analysts.

The growth prospects for the current financial year hinge around the sustainability of the industrial upturn and a recovery in agricultural performance. Indications on both these fronts are positive. Initial expectations support a strong rebound from the absolute decline in agricultural output recorded last year. The climate for industrial revival is showing a distinct improvement in an environment of higher overall growth prospects, low and stable inflation, rising international competitiveness and conducive monetary and fiscal policies. The financial performance of the private corporate sector has shown substantial improvement in terms of sales and profitability. Leading indices of industrial activity are indicating stable growth ahead. The industrial outlook is optimistic with expectations of increasing capacity utilisation and a stabilising of inventory levels. Easing of the constraints in terms of availability of power, procedural bottlenecks, cost and availability of credit, and road and port facilities will further facilitate the industrial recovery. The buoyancy of the services sector would be contingent upon the strength of the symbiotic interface with the goods sector and the growth of 'new economy' activities.

On the basis of the above data, it is clear that economic recovery is underway. The important questions are how durable the recovery is likely to be and what policy action can

be taken in order to increase its longevity. The analysis presented in the Mid-Year Review suggests that the recovery reflects primarily domestic rather than international factors. The international financial environment may, nonetheless, have been crucial in facilitating economic reactivation. It is striking for example that industrial production remained subdued through the late 1990s and 2000, even while the world economy was booming. It is also striking that the economic recovery seems to have begun well before the global recovery, and even in the face of a very weak monsoon last year.

One interpretation is that the Indian economy has benefited from its increasing financial integration with the world, perhaps even more than from its trade integration. Despite the large financing requirement of central and state governments, the Reserve Bank was able to reduce domestic interest rates because of the sharp decline in international rates after 2001. The economy has responded well to this reduction in nominal interest rates particularly in such interest-sensitive sectors as housing and retail finance. Reduced nominal interest rates have also had hugely beneficial effects on the profitability of financial institutions, corporates and commercial banks as well as the government's own finances.

Monetary easing, reinforced by the excellent monsoon in 2003 therefore provides an explanation for the current recovery and the evident feel-good factor in the financial markets. The easing of international uncertainties such as the war in Iraq, the SARS epidemic and the threat of hostility with Pakistan have all additionally contributed to the sense of optimism. Yet there is still little firm evidence of recovery in private investment. Indeed, the NCAER Business Expectations Survey suggests that the surveyed firms remain fairly content with current capacity and do not foresee the need for significant additional capacity. Uncertainty on trade and tax policy are almost certainly inhibiting factors, and these were not dispelled in the last budget, frustrating the efforts of the Kelkar Committees to impart some coherence and predictability to policy on both direct and indirect taxes. The flip flop on implementation of the VAT has fur-

ther aggravated this policy confusion. The abrupt reduction of customs duty on certain capital goods from 25 per cent to 5 per cent in the last budget adds further instability.

An additional argument for more aggressive trade liberalisation arises from the build up of foreign exchange reserves. One can argue that the RBI intervention in the foreign exchange market over the last eighteen months has been overdone, and that it has been too aggressive in selling bonds in the domestic market to offset the monetary effects of this intervention. However, given the increased interest in Asian economies in international financial markets, some offsetting action would have been required. In this environment, trade liberalisation has two beneficial effects: it relieves the pressure in the foreign exchange market, and it also makes it more likely that investment, both domestic and foreign, will be directed to more efficient uses. This is especially important if the economy is importing resources from abroad, which will ultimately need to be serviced in foreign exchange.

Finally, the need for fiscal adjustment is, if anything, heightened in the more buoyant domestic and international environment that we are entering. Fiscal deficits complicate the monetary management task of the RBI, by putting upward pressure on interest rates, and are likely to retard the investment recovery in the private sector when it occurs.

To sum up, domestic and international conditions are propitious for a recovery that could endure. They are equally propitious for another burst of reform, focused particularly on fiscal and trade policies, and privatisation. Were India to grasp this opportunity it could startle the world.

Agriculture

Backdrop

Last year, the monsoon rainfall was around 20 per cent below normal. As a result, after a gap of 14 years, 2002-03 turned out to be a drought year. The impact on agricultural output was quite severe. The extreme deficiency of rainfall experienced during the monsoon season did not affect just one or two crop sectors, but almost the entire sector quite adversely. The food grain production during 2002-03 witnessed a decline of about 14 per cent from 212 million tonnes in 2001-02 to 183 million tonnes in 2002-03 (Table 2.1). Such a high drop in the output of food grains was due to the significant shortfalls in the output of rice and coarse grains, in particular. The output of rice exhibited 19 per cent decrease over the previous year's record output of 93 million tonnes and the production of coarse cereals was down by about 23 per cent from 34 million tonnes in 2001-02 to an estimated 26 million tonnes in 2002-03.

The fall in the output of wheat was, however, marginal from 72 million tonnes in 2001-02 to 69 million tonnes in 2002-03, mainly because it is largely an irrigated crop. Similarly, the output of pulses, which is estimated at 11 million tonnes, suggests a decrease of about 14 per cent over previous year's output of 13 million tonnes. Due to the considerable fall in the output of all crop segments, the overall production of food grains during 2002-03 fell short of the target of 218 million tonnes by about 17 per cent.

The output of other crops such as oilseeds was equally depressing. After having recovered in 2001-02 the production of oilseeds exhibited a huge negative growth, about 24 per cent compared to previous year's output. The production of fibre crop - cotton also decreased by about 8 per cent (from 11 million bales to 9 million bales). The other major crop in the commercial crop segment, sugarcane has

also experienced negative growth of about 7 per cent, the output of which was estimated at 279 million tonnes compared to a record output of 300 million tonnes produced in the preceding year.

As a consequence of these developments the agricultural and allied sector's GDP showed a decline of 3.2 per cent in 2002-03 compared to a healthy growth of 5.7 per cent witnessed during the previous year. These declines in the output of food grains and agricultural GDP were the sharpest in the last 20 years. Though, on the price front the year was characterised by low prices of agricultural commodities, barring only a few exceptions despite shortfalls in the output due to acute deficiency in rainfall (Fig 2.1). The prices of cereals fine cereals in particular, witnessed fall due to more than comfortable supply situation. The record output in 2001-02 coupled with excessive stocks, which stood at 55.4 million tonnes in September 2002, ensured adequate supply of cereals in the economy. Apart from the regular supplies under the Public Distribution System (PDS), significant amounts of cereals were also distributed through various food-for-work programmes.

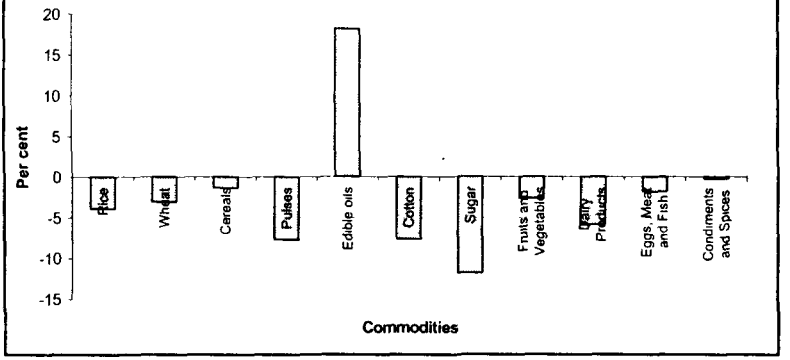
The same was the case with other commodities such as

Table 2.1: Estimated Output of Selected Crops in 2001-02 and 2002-03 (million tonnes)

Crop	2001-02	2002-03	Percentage Change
Rice	93 1	75 7	-18 7
Wheat	71 8	69 3	-3 5
Coarse Cereals	33 9	26 2	-22 7
Pulses	12 3	11 3	-14 3
Total Food Grains	212 0	182 6	-13 9
Oilseeds	20 8	15 8	-24 3
Cotton*	10 1	9 3	-7 7
Jute and Mesta*	11 6	10 8	-7 4
Sugarcane	300 1	278 6	-7 2

Source. Government of India, Ministry of Agriculture, New Delhi.
* Million bales of 170 kgs of cotton and 180 kgs of jute and mesta.

Fig. 2.1: Changes in Real Prices of Selected Agricultural Products (April-March 2002-03 over April-March 2001-02)



sugar, which also witnessed the pressure of excessive stocks. In the case of pulses, the supply situation remained comfortable despite unsatisfactory output due to imports, which compensated for the loss in output. The prices of edible oils, however, witnessed significant increases due to relatively larger decrease in their output. Also, the import duties on edible oils are high as compared to other commodities such as pulses and cotton, which attract lower import duties.

Significance of Monsoon Rainfall

The significance of monsoon rainfall originates from the fact that in general about 80 per cent of the total rainfall that the country receives during a particular year is received in the monsoon season. Further, despite expansion in the coverage under irrigation, un-irrigated area still accounts for about 60 per cent of the country's gross cropped area. This ratio of course varies from state to state—from 9 per cent in Mizoram to 92 per cent in Punjab. But, in 18 of the 25 states of the country for which information on irrigated area is available, the coverage of crop area under irrigation is less than the national average. The states, where the coverage of irrigated area is more than the national average include—Punjab (92 per cent), Haryana

(80 per cent), Uttar Pradesh (66 per cent), Tamilnadu (55 per cent), Bihar (47 per cent), Andhra Pradesh (45 per cent) and Jammu and Kashmir (41 per cent).

Among different crops that are grown in the country, there are just 6 crops for which percentage irrigated area is more than 40 per cent of the total area under that particular crop. These include - sugarcane (92 per cent), wheat (86 per cent), barley (59 per cent), rapeseed-mustard (58 per cent), rice (52 per cent) and tobacco (43 per cent). For all other crops percentage irrigated area is less than 40 per cent of the total area under these crops.

Such a high ratio of un-irrigated area in most states of the country and majority of the crops that are grown in the country clearly shows the dominance of un-irrigated acreage that depends heavily on monsoon rainfall for its water requirements. Further, because there are 36 agro-meteorological sub-divisions in the country even when monsoon rainfall is normal at the aggregate level there are some regions where rainfall remains below normal. For example, Rajasthan, parts of Madhya Pradesh and Gujarat experienced below normal rainfall in 2000-01 and 2001-02 just as three regions during the current year despite the fact that rainfall at the national level remained normal. These statistics point to why this sector still continues to remain at the mercy of the rain gods.

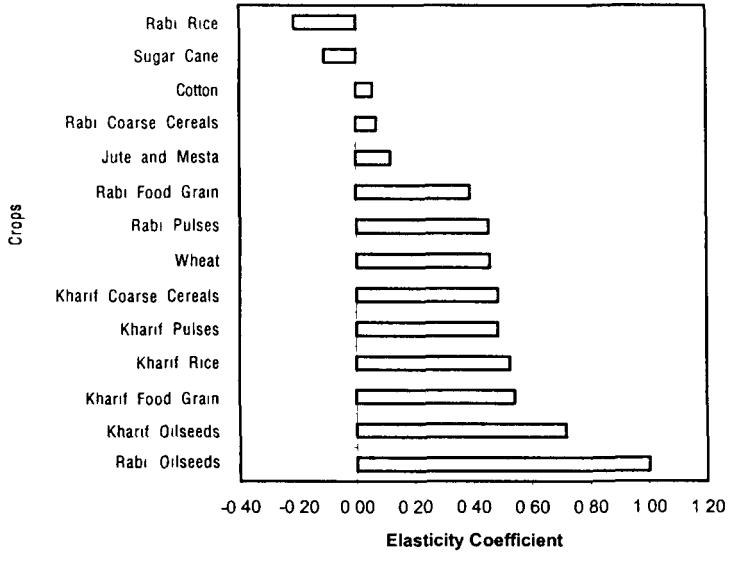
The monsoon rainfall is particularly important for kharif segment of the agricultural output, but, rabi season production is also dependent on the monsoon rainfall. This is because better rainfall during monsoon season replenishes the water table and improves the moisture content of soil for the rabi season as well. Also, well-distributed and satisfactory rains boost the water level of reservoirs.

To test these facts statistically, we have analysed the sensitivity of a few major crops and food grain production to monsoon rainfall using regression analysis. To account for the effect of price, technology and other important variables, price and time trend were included as a set of explanatory variables along with rainfall. The results of sensitivity of crop output with respect to monsoon rainfall

indicate that the estimated coefficients of monsoon rainfall are highly significant for all the major crops.

The magnitudes of rainfall coefficients show that the output of oilseeds, kharif rice, coarse cereals and pulses is more sensitive to monsoon rainfall compared to other crops on account of low coverage of area under irrigation (Figure 2.2). Even wheat, rabi pulses and rabi food grains the bulk of which is constituted by wheat alone are also quite sensitive to monsoon rainfall. This is due to recharging of water table and the water level of reservoirs, which results from better and well-distributed rainfall during monsoon season and is reflected in higher yields and output.

Fig. 2.2: Sensitivity of Crop Output with Respect to Monsoon Rainfall



Onset and Progress of the South-west Monsoon in 2003

The India Meteorological Department (IMD) had expected this year's monsoon to be normal. In the beginning,

though the monsoon's onset was delayed by about a week. As against the normal date of June 1 when monsoon usually arrives in Kerala, this year it reached on the 8th of June Another unusual feature of this year's monsoon rainfall was that it reached in the Northeast earlier than the southern parts. These two abnormalities initially raised conjectures about the probable future course of monsoon rainfall and its normalcy for the entire season because the past experience with the delayed onset of monsoon had not been very encouraging. There have been six occasions in the past when the monsoon was delayed by about 8 to 12 days (Table 2.2). The agricultural growth, however, has been negative in five of these six years. There was just one year, 1983-84 when growth was positive but even this should be seen in the light of a below normal growth in the year immediately preceding it.

Despite these aberrations, the progress of the monsoon rainfall, thereafter, has been quite satisfactory. Monthly progress of the monsoon rainfall shows that during the first

Table 2.2: Years of Delayed Onset of Monsoon and Agricultural Output

Year	Date of onset of monsoon in June	Rainfall for the season (June-Sept)	Change in index of agricultural output over previous year (per cent)	Change in agricultural GDP over previous year (per cent)	Rainfall for the season in the previous year (June-Sept)
1966-67	8th	Below normal	-1 14	-1 34	Below normal
1968-69	8th	Below normal	-2 35	-0 12	Normal
1979-80	11th	Below normal	-15 50	-12 69	Normal
1983-84	12th	Normal	13 20	9 56	Below normal
1995-96	8th	Normal	-2 70	-0 87	Normal
1997-98	9th	Normal	-5 93	-2 43	Normal

Source Developed from Government of India, India Meteorological Department and Government of India, *Agricultural Statistics at a Glance*, Ministry of Agriculture.

32 days of the monsoon season, that is, up to the 2nd of July the monsoon rainfall was normal to excess in 30 of the total 36 agro-meteorological sub-divisions of the country. For the country as a whole the cumulative rainfall in June was about 14 per cent above its normal level.

The rainfall activity maintained its momentum as the season progressed, which is evident from the cumulative rainfall up to the end of July. The data suggests normal to excess rainfall in 32 agro-meteorological sub-divisions of the country. At the aggregate level the cumulative rainfall up to the middle of monsoon season was 10 per cent higher than the normal level.

In August there was further increase in the momentum of monsoon rainfall. Barring the exceptions of two sub-divisions (north interior Karnataka and Kerala), the rainfall remained normal to above normal in the remaining 34 sub-divisions.

Finally, the rainfall data up to the end of the monsoon season indicates that the rainfall during the season remained normal in 33 sub-divisions of the country. The three sub-divisions, where the rainfall remained deficient include north and south interior Karnataka and Kerala. Since these three regions account for just about 8 per cent of the gross cropped area of the country, the deficiency in monsoon rainfall in these regions will not have significantly adverse impact on the performance of the agricultural sector at the aggregate level. This is because at the aggregate regional level, the monsoon rainfall was in excess of the normal rainfall in three of the four major zones of the country—the eastern region, the western region and the northern region (Table 2.3).

At the regional level, however, there may be some impact. The monsoon rainfall has remained below normal in the southern region due to the deficiency in north interior Karnataka and Kerala, the two sub-divisions where the rainfall has remained consistently below normal throughout the monsoon season and also south interior Karnataka, where rainfall was quite deficient in September.

The overall progress of the monsoon rainfall this year, however, has remained quite satisfactory both spatially as

Table 2.3: Deviations in the Monsoon Rainfall Indices from the Normal

Region	June - beginning of July	June - End of July	June - End of August	June - End of September
East	20 9	10 2	5 2	0 9
West	16 9	15 2	-0 4	5 8
North	8 0	7 8	5 0	16 6
South	-14 3	-8 8	-1 4	-15 1
All India	13 9	10 2	-1 9	3 3

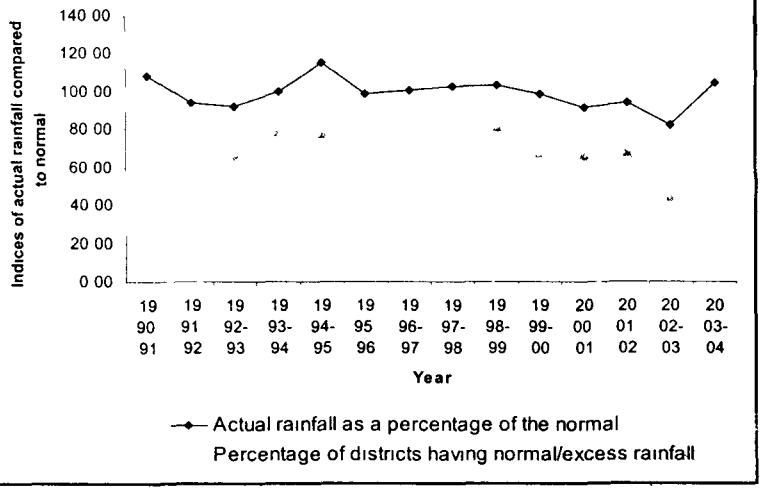
Source Computed

Notes

1 These are deviations in regional level rainfall indices computed on the basis of un-irrigated area under food grains as weights
2 The eastern region includes Assam, Bihar, Orissa and West Bengal
3 The western region includes Gujarat, Madhya Pradesh, Maharashtra and Rajasthan
4 The northern region includes Haryana, Himachal Pradesh, Jammu and Kashmir, Punjab and Uttar Pradesh
5 The southern region includes Andhra Pradesh, Karnataka, Kerala and Tamilnadu

well as temporally barring only a few exceptions. A comparison of the performance of the monsoon rainfall for the season during the 1990s shows that the rainfall has been extremely satisfactory during the current year (Figure 2.3).

Fig. 2.3: Behaviour of Monsoon Rainfall (1990-99 to 2003-04)



Prospects for 2003-04

Given the improved performance of the monsoon rainfall than what had been expected at the beginning of the season it is for sure that the agricultural sector is set to witness a significantly higher rate of growth in 2003-04. Some of the early indications to this effect are provided by the robust growth in fertiliser consumption, which has exhibited significant increase during the current kharif season over last year's kharif sesaon. Also, the reservoir level in 71 important reservoirs of the country is about 81 per cent of last 10 years average and 113 per cent of last year's level.

All the crop segments of the kharif season, that is, rice, coarse grains, pulses, oilseeds and other crops such as cotton, jute and mesta and sugarcane are expected to perform better this year compared to the negative rates of growth witnessed last year (Table 2.4).

Our estimates for crop production reveal that the output of kharif food grains is likely to go up in the range of by 11 to 13 per cent in 2003-04 over last year's output. All the three constituents of food grains—rice, coarse cereals and pulses—are expected to witness an increase. In particular, the output of kharif rice, which fell by 17 per cent last year, is expected to increase by about 8 to 11 per cent. The output of kharif coarse cereals and pulses, which dropped by 25 per cent and 21 per cent, respectively last year is likely to go up by about 20 per cent and 9 per cent, respectively over the preceding year's estimates.

These estimates are lower than those estimated by the ministry of agriculture. The differences in the estimated rates of growth between our estimates and the preliminary estimates released by the ministry of agriculture are due to the differences in methods used to estimate the output growth. While, ministry's estimates are based on information supplied by the state governments, our own estimates are based on the regression models for these crops. These models incorporate the impact of the monsoon rainfall, relative prices of selected crops, which fell last year and the trend factor.

The output of oilseeds was also affected quite severely last year due to the insufficient monsoon rainfall, which is evident from the 30 per cent decrease in the output of kharif oilseeds. Our preliminary estimates for this year, however, show that the output of kharif oilseeds is expected increase in the range of 34 per cent to 50 per cent. A reversal in the output of oilseeds will certainly have some impact on the imports of edible oils.

The preliminary estimates of cotton output suggest about 4 per cent increase. The drop in cotton output last year was about 8 per cent, which was modest in comparison to the other crops due to relatively lower sensitivity of cotton output with respect to monsoon rainfall as compared to other crops. The anticipated rate of growth in the output of jute and mesta is also likely to be in the same region,

Table 2.4: Estimated rates of growth in crop output (2003-04)

Crops	Estimated Output (Ministry of Agriculture) (Million tonnes)		Deviation of the rainfall index from the normal	Deviation of the rainfall index from last year s rainfall (Per cent)	Expected rates of growth in 2003-2004 (Per cent)	
	2001-02	2002-03			E - I	E - II
Rice						
Kharif	79 8	66 5	3 8	15 8	8 6	10 7
Coarse cereals						
Kharif	26 9	20 1	4 8	33 3	17 7	21 0
Pulses						
Kharif	4 9	3 8	5 5	33 3	12 3	3 6
Oilseeds						
Kharif	13 2	9 2	6 4	41 9	51 5	34 7
Cotton[a]	10 1	9 3	-3 3	23 7	3 0	3 9
Jute and Mesta[b]	11 6	10 8	0 9	6 9	4 0	1 7
Sugar Cane	300 1	278 6	13 2	40 2	6 1	12 5

Source Computed

[a] Million bales of 170 kg for Cotton and million bales of 180 kg for Jute and Mesta

Notes

1 Estimate I has been worked out using output equations

2 Estimate II has been worked out using area and yield equations

that is, about 2 to 4 per cent over previous year's estimated output. The estimates for sugarcane output also suggest growth compared to a drop in output witnessed last year.

Thus, compared to the negative rate of growth of (–)3.1 per cent witnessed during the last year, the agriculture and alllied sectors are likely to exhibit a much better rate of growth in the current year. Given the trends in the growth in output of various crops, it seems that agricultural GDP during the current year is likely to witness an increase in the region of 10 per cent.

These developments in 2003-04 signify a healthy development as far as overall growth of the economy is concerned. Higher than expected growth in the agricultural sector will have important implications for the economy, both in terms of expenditure management as well as recovery of the overall economy.

These improvements, however, may not happen without incurring some costs. These include adverse impact on the exchequer due to the pressure on food subsidy bill, which is bound to go up as a consequence of the increase in procurement. The stocks of grains, which had plummeted to 28 million tonnes in early September due to increase in exports and off-take from the PDS and other schemes that had been initiated to support hungry and the poor are likely to go up again. Further, there will be pressures to expand the procurement net both in terms of coverage of regions as also crops, if prices of commodities start plunging due to large surpluses. And, the international trade environment may also not be very healthy after the debacle of WTO Ministerial Conference in Cancun (*see Box*).

Agriculture at Cancun

Among the issues that dominated the agenda of negotiations on trade at Cancun, where the 4th ministerial meeting was held, agriculture was prominent and held the centre stage for most part of the conference. What happened in Cancun was a reflection of the series of events that preceded the ministerial meeting and the discussions that took place when the ministers actually sat in the meetings.

The seeds of confrontation between those who subsidise their agriculture heavily and those who do not were sown in Geneva a few days before the conference, when the US and the EU, the two largest subsidisers among the OECD countries struck a deal on agriculture. The joint text released by the US and the EC on August 13, 2003 basically addressed the concerns that they had on the draft modalities paper prepared for negotiations by Mr. Stuart Harbinson, the chairman of the Committee on Agriculture. The proposal was far less ambitious on production and trade distorting support and more ambitious on market access.

Some of the developing country members, which were upset with the EC and the US proposal joined their hands together and proposed an alternative draft framework (G-21 proposal), which suggested greater reductions in production and trade distorting support. And, linked commitments on market access to these reductions in production and trade distorting support. But, the draft that was prepared by the WTO secretariat for the ministerial meeting before the conference while tried to marry the two proposals, however, took most of the elements suggested by the US and the EC in their framework.

The negotiations, therefore, saw the emergence of a formidable group of 21 developing countries (now G-22 with Indonesia joining the group), which stood up to the challenge posed by the US and the EC. And, also some

of the African countries the economies of which depend heavily on cotton and wanted significant reforms in distortions in cotton that have been created by huge subsidies in the US and the EC.

As the events started unfolding in Cancun it became clear that the grand rhetoric that these negotiations will lead to significant reductions in production and trade distorting support and elimination of export subsidies will never become a reality. The EU for instance denied that it had agreed to eliminate export subsidies in Doha and took cue from the ambiguity in the Doha Declaration. Further evidence to this view was provided by the ministerial draft that was circulated on the 13th morning.

The draft diluted the level of ambition on reductions in trade distorting support and failed to suggest a definitive framework for disciplining some of the production distorting elements of the Green Box payments. The language used for disciplining these payments was as usual quite ambiguous. There was no commitment to phase out export subsidies, which everyone knows are the most trade distorting among all forms of subsidies. The proposals, however, suggested partial elimination of export subsidies on products that are of interest to the developing countries without specifying a list.

The proposals on market access did not touch the developed country framework and retained more or less whatever was mentioned in the earlier draft prepared by the secretariat. But, for developing countries it suggested larger reductions in bound tariffs, which were not commensurate with reductions in production and trade distorting support. The proposal of steep cuts in bound tariffs (use of Swiss Formula) and fixing binding on a few items in the range of 0 to 5 left developing countries wondering as to what happened to their proposal of simple linear reductions in bound tariffs.

The proposals also called for members to extend the peace clause, which provides immunity against

countervailing actions to those countries which subsidise their exports heavily. With the abolition of the peace clause, the members will have recourse to actions against subsidies under the agreement on Subsidies and Countervailing Measures and related provisions.

The treatment that that was meted out to the proposal on cotton put forward by the four African countries (Benin, Burkina Faso, Chad and Mali) and was widely supported by the other developing countries including India was really disturbing. The proposal on cotton had called for the establishment of a mechanism to phase out all forms of support on cotton production with a view to its total elimination. And, transitional measures for cotton-producing least developed countries in the form of financial compensation to offset their loss of revenue till the time support for cotton production has been completely phased out.

In the ministerial draft, however, there was no mention of elimination of subsidies or compensation. On the contrary the draft linked elimination of support for cotton to the review of the textile sector in all the member countries. Further, it even suggested that the countries the economies of which rely heavily on cotton be encouraged to diversify out of cotton. The African countries found these proposals to be highly insulting.

Therefore, to a large extent what happened in the meeting on Singapore issues, when the negotiations actually broke up was also a reflection of these events. Of course, some of the bitterness between developing and developed countries was also due to serious differences on Singapore issues (trade facilitation, government procurement, investment and competition) and delay in the deal on essential medicines for poor countries, which had already been agreed to by the majority of WTO members.

For the future, clearly the objective of the Cancun Ministerial meeting was to give shape to a broad framework for taking the process of negotiations further. Having missed the deadline of 31st of March 2003, which

was fixed for establishing modalities for further reforms in the agricultural sector it was important for members to reach an agreement in Cancun. Now the calendar has been pushed further and chances of concluding the round by December 2004 appear remote. But, members should not lose heart because it took members took eight years during the UR to complete the negotiations as against the original plan of three years. And, as they say, a good agreement is always better than a bad agreement, which leaves everyone unhappy.

Industry

Last year's (2002-2003) mid-year review revolved around two important questions, namely, is there a sign of recovery in industrial growth and what has been the response of the Indian corporate sector to the decade old reforms. On neither count were the signals very clear. But things have changed since then.

Today the issue is not whether industry is recovering but whether the recovery will sustain itself. Second, have the years of restructuring finally made Indian manufacturing globally competitive?

What follows is a modest attempt to seek an answer to these two inter-related questions.

Industrial Growth in 2002-03

Industry ended 2002-03 on a strong note, registering a growth of 6.4 per cent on y-o-y basis for the fourth quarter. For 2002-03 as a whole, it grew at 5.7 per cent with mining and manufacturing growth proving to be the main drivers of industrial activity (Table 3.1). The 5.7 per cent industrial growth came during a generally adverse year that saw a drought and higher oil prices because of the military conflict in Iraq. Stronger oil prices also translated into an upward pressure on inflation during the fourth quarter of 2002-03.

The growth of IIP-General during 2002-03 was 3.0 percentage points higher than the growth recorded during 2001-02. Manufacturing and mining were higher by 3.1 and 4.5 percentage points respectively for the same period. Overall industrial growth, as well as the growth of manufacturing for each month during 2002-03, was higher than for the corresponding month in 2001-02.

Infrastructure also did well in 2002-03. All the six major infrastructure industries, namely, coal, electricity, steel,

Table 3.1: Index of Industrial Production—Growth Rates

Year	General	Manufac-turing	Mining & Quarrying	Electricity	Basic Goods	Capital Goods	Intermedi-ate Goods	Consumer Goods	Consumer Durables	Consumer Non-Durables
1991-92	0 6	-0 8	0 6	8 5	6 5	8 5	-2 1	1 0	-10 9	4 0
1992-93	2 3	2 2	0 5	5 0	2 6	-0 2	5 4	1 8	-0 8	2 4
1993-94	6 0	6 1	3 5	7 5	9 5	-4 1	11 7	4 0	16 1	1 3
1994-95	9 1	9 1	9 8	8 5	9 6	9 2	5 3	12 1	16 2	11 2
1995-96	13 1	14 1	9 7	8 1	10 8	5 4	19 3	12 8	25 8	9 8
1996-97	6 1	7 3	-1 9	4 0	3 0	11 4	8 1	6 2	4 6	6 6
1997-98	6 6	6 6	7 0	6 6	6 8	5 8	8 0	5 5	7 8	4 9
1998-99	4 1	4 4	-0 8	6 4	1 7	12 7	6 1	2 2	5 6	1 1
1999-00	6 6	7 2	1 0	7 3	5 5	7 0	8 8	5 7	14 2	3 2
2000-01	5 1	5 4	3 7	4 0	3 9	1 7	4 7	8 0	14 6	5 9
2001-02	2 7	2 9	1 2	3 1	2 6	-3 4	1 5	6 0	11 5	4 0
2002-03	5 7	6 0	5 7	3 2	4 8	10 6	3 9	7 0	-6 2	11 9

cement, crude oil and petroleum products registered a either a similar or higher growth compared to 2001-02 (Table 3.2).

Table 3.2: Growth of Infrastructure Industries

Sector	2001-02	2002-03
Coal	4 2	4 3
Electricity	3 1	3 1
Steel	4 4	8 7
Cement	7 4	8 8
Crude Oil	-1 2	3 3
Petrol Products	3 7	4 9
Overall	3 5	5 2

The performance of cement and steel is noteworthy. Both increased by more than 8 per cent in 2002-03. While the growth of cement output was mainly driven by the ongoing infrastructure projects such as golden quadrilateral (GQ) and construction activity in housing sector, the growth in steel output was largely an outcome of exports to China.

Power generation recorded a modest growth of 3.2 per cent during 2002-03. The major contribution came from thermal and nuclear power, which grew at 6.1 per cent But thanks to the drought, hydel power generation declined by 12.7 per cent. It had gone down in the previous year also.

Use-based Classification

Used-based classification shows that capital and consumer non-durable goods were the key drivers of growth in 2002-03. Capital goods grew by 10.6 per cent But this growth came on a very low base as growth of capital goods in 2001-02 was -3.4 per cent. Also the growth in capital goods for FY 2002-03 reflects the growth in transport equipment, which shot up by 14.9 per cent. This is more than double the growth recorded during FY 2001-02. The more conventional component of capital goods, machinery & equipment grew by a dismal 1.8 per cent. In 2001-02, it had grown by 1.3 per cent. Since the overall high growth of capital goods is yet to be accompanied by a high growth in machinery & equipment, this suggests that the current growth is still not broad-based.

Growth in basic goods increased from 2.6 per cent in 2001-02 to 4.8 in 2002-03. The impact of the construction boom, fuelled by budgetary help and higher growth in mining, has resulted in this improvement. Railway materials, pig iron, alloy steel, electrical sheets, ferro-chrome, aluminium foils and steel castings were the main drivers of growth.

Intermediate goods grew at 3.9 per cent, up by 2.4 percent from 2001-02. This was mainly due to the 7 per cent growth in passenger cars & utility vehicles and a 17 per cent growth in two wheelers. Thus the auto ancillary segment grew at a phenomenal growth of 40 per cent during 2002-03.

TV picture tubes also grew strongly (thanks to the cricket World Cup in March 2003), as did corrugated boxes/ cartons, viscose staple fibre, sealed compressors, storage batteries, gelatine, railway/concrete sleeper, polished granite and PVC/ rubber sheets. On the other hand, growth in power capacitors, industrial explosives, viscose tyre cord, paints and cotton yarn was negative.

The production of consumer goods increased by 7 per cent on a y-o-y basis compared to 6 per cent during 2001-02. Thus, for the second year running, consumer goods have shown robust growth. In fact, in nine out of twelve months in 2002-03 consumer goods have shown a growth of over 5 per cent. However, a break-up of the consumer goods sector into consumer durables and consumer non-durables indicates that the upturn has been confined to the consumer non-durables only. Consumer non-durables grew at 12 per cent in 2002-03. Consumer durables, however, experienced negative growth of 6.2 per cent for the same period.

In spite of such poor overall growth consumer durable segments such as refrigerators, sewing machines, washing machines, motorcycles and window air conditioners did well. Window air conditioners and washing machines recorded a phenomenal growth of 146 and 50 per cent respectively, but failed to pull consumer durables out of the negative growth category. The reason could be the continued inclusion of obsolete items such as typewriters, tape recorders, alarm clocks etc. in the index. These have been consistently posting negative growth (see Box on IIP).

IIP: How Well Does It Reflect the Industrial Growth?

The index of industrial production (IIP) uses 1993-94 as the base year. The weights assigned to different industries also pertain to the same period. However, both the character as well as composition of industry has changed considerably since then. As a number of industries have grown considerably since the liberalisation was initiated, it is not very clear as to whether their contribution is adequately reflected in the IIP growth. Moreover, since the deregulation of industries in 1991, compulsion to provide production figure by private industries to CSO has also declined.

The lopsided nature of IIP is not difficult to find. Thirty-three items have 50 per cent of the IIP weight. Of these, 12 items have shown a decline in production during the first quarter of 2003-04. This amounts to 35 per cent of the components experiencing decreasing production. On the other hand, a number of high growth industries have low weights, as for example, the auto industry. This industry has undergone a sea change since 1993-94 with the arrival of foreign car manufacturers. But the IIP's base does not reflect this and the weightage of auto industry continues to be 4.2. Similarly while the weight of motorcycles is 3.7, the weight of scooters and mopeds is 5.8. Interestingly, the latter is the highest weight accorded to any category of consumer durable goods. It is well known that in recent years amongst the two wheelers motorcycles are the fast growing segments. It recorded a growth of 31.5 per cent in 2002-03. On the other hand scooters and mopeds clocked a growth of -12.5 per cent. This anomaly was clearly reflected in the growth of consumer durable during 2002-03, which recorded a negative growth.

Another segment that merits a re-look is construction industry. The recent spurt in construction activity coupled with nation wide high development programme has significantly impacted various intermediate industries. However, the positive impact of construction

activity on intermediate industries may not be adequately captured Let us take the case of cement It accounts for only 7 per cent of the infrastructure index Thus in spite of recording a high growth its impact on overall infrastructure index is rather small

Further, as IIP covers the registered sector, it can provide only a partial picture of manufacturing sector A substantial proportion of manufacturing actually takes place in the unregistered sector and therefore gets overlooked

Thus, IIP as an indicator of overall industrial production has its limitations Nevertheless, with all its limitations it is still a useful and widely used indicator of industrial activity

Consumer non-durables, with the exception of June, November, January and March, grew at double-digits The key segments driving growth were edible oils, liquor, confectionery items, leather footwear and goods, cotton hosiery cloth, pharmaceuticals, soaps, auto lamps, fluorescent tubes and syringes The key growth decelerators for were leather garments, toothpaste, contraceptives and writing instruments

Corporate Sector

The growth in sales of the corporate sector broadly show the same trend that has been observed in the case of growth of Index of Industrial Production (IIP) After a lacklustre performance in 2001-02, the corporate sector grew well in 2002-03 Although, there began a gradual increase in demand during 2002-03 which led to better order of books, a large number of companies, hitherto domestic players, used their newly acquired competitive strength to get export orders Sales increased by 10 per cent (Table 3 3) This figure is even higher that the 11 per cent for manufacturing companies Also, the growth in sales is broad-based Sectors as diverse as steel, pharmaceuticals, automobiles, banks, chemicals, engineering and refineries all showed handsome growth in sales

Table 3.3: Corporate Sector Performance

(Rs crore)

	Manufacturing Companies		All Companies	
	2001-02	2002-03	2001-02	2002-03
Net sales	677146	470431	956175	659480
Total Expenses	666142	450916	815782	553724
PBDIT	83754	72202	246644	183096
Interest Expenses	31753	18060	141224	93411
PBDT	52001	54141	105420	89685
PBT	21574	31412	61619	60846
PAT	13922	22986	40975	44313
	Growth (%)			
Net Sales	-3 9	11 6	-3 0	10 7
Total Expenses	-3 0	12 1	-2 8	11 3
PBDIT	0 1	16 8	N A	N A
PBDT	2 6	30 9	6 6	28 8
PBT	-17 5	61 4	0 8	46 1
PAT	-29 9	65 9	-7 7	49 5
	Profitability (%)			
PBDIT/Sales	12 3	15 3	25.8	27 8
PBDT/Sales	7 7	11 5	11 0	13 6
PAT/Sales	2 1	4 9	4 3	6 7
No of Cos	2929	1313	4924	2101

Profitability too improved in 2002-03. Profit before depreciation, interest and tax (PBDIT) as a percentage of sales increased from 25.8 per cent in 2001-02 to 27.8 per cent in 2002-03. Profit after tax (PAT) increased from 4.3 per cent to 6.7 per cent for the same period. One factor that enabled companies to improve bottomlines is lower interest costs The soft interest rate regime of the past few years has indeed helped companies in replacing expensive debt with lower cost finance and also to raise new finance at a cheaper rate. This is also reflected in the growth of PAT, which grew by nearly 50 per cent. Manufacturing did a notch better by recording 66 per cent growth in PAT.

Growth in expenses was more or less in tandem with sales growth. On y-o-y basis total expenses increased from negative 2.8 per cent in 2001-02 to 11.3 per cent in 2002-03.

Current Industrial Performance

Latest data suggest that the recovery of 2002-03 is being sustained so far at least The index of Industrial production for the first five months of the current financial year shows uptick in industrial production

The IIP-G, which on y-o-y basis increased by 5 6 per cent during April-August 2003-04, is about 0 4 percentage point higher than the growth recorded during the same period in 2002-03 (Table 3 4) Manufacturing, which drives industrial sector performance because of its overall weight in the index, grew by 6 2 per cent on y-o-y basis during April-August 2003-04 compared to 5 0 per cent for the same months in 2003-04 On the other hand, the performance of both mining and electricity during April-August 2003-04 lagged behind their own performance during the same period last fiscal

Infrastructure is lagging behind Output growth in each of the six major infrastructure sectors for the period April-August 2003-04 declined in comparison with the same period in 2002-03 (Table 3 5) However, this is more due to the base effect, as infrastructure industries recorded a robust growth in 2002-03 With the exception of crude petroleum all other infrastructure industries have witnessed reasonable increase in output However, the output growth in steel and cement is noteworthy

The strong demand witnessed for steel and cement during 2002-03 is continuing As the lower rates of interest are deepening the demand for housing sector in metro/ big cities and intense competition is driving the housing finance companies to explore newer avenues in smaller cities/semi-urban areas Thus construction activity is unlikely to run out of steam this fiscal year In a recent statement the finance minister said that housing loan facilities would be extended to the rural areas as well This is currently under consultation with NABARD and RBI This would also boost the demand for steel and cement further

Also, as only 1,327 km has been completed out of the 5,846 km long GQ, there is enough activity left on this account as well

Table 3.4: Index of Industrial Production—Growth Rates (April-August)

Year	General	Manufac-turing	Mining & Quarrying	Electricity	Basic Goods	Capital Goods	Intermedi -ate Goods	Consumer Goods	Consumer Durables	Consumer Non-Durables
2002-03	5 2	5 0	7 6	4 2	5 6	7 8	1 9	7 4	-5 4	12 4
2003-04	5 6	6 2	4 4	2 4	4 2	7 8	3 3	8 9	4 8	10 2

Table 3.5: Performance of Six Infrastructure Industries (April-August)

	Electricity (Million Kwh)	Coal (Million Tonnes)	Steel (Thousand Tonnes)	Crude Oil (Thousand Tonnes)	Petroleum Refinery (Thousand Tonnes)	Cement (Thousand Tonnes)	Overall Infrastructure Industries (Index)
Weight	38 1	12 1	19 2	15 6	7 5	7 5	100 0
1999	210261	118	12364	13004	40715	43093	157 1
2000	204306	117	12545	13493	38548	42590	155 6
2001	210261	118	12364	13004	40715	43093	157 1
2002	219051	127	13697	13830	43239	48089	168 5
2003	223635	131	14803	13570	45449	50355	174 9
			% Change over previous year				
2000	-2 83	-0 68	1 46	3 76	-5 32	-1 17	-0 97
2001	2 91	0 68	-1 44	-3 62	5 62	1 18	0 95
2002	4 18	7 56	10 78	6 35	6 20	11 59	7 26
2003	2 09	3 47	8 08	-1 88	5 11	4 71	3 80

The fresh import quota released by China in May 2003 is also keeping steel demand up. The new quota, which is valid for a year, will enable 9.2 million tonnes of steel to be imported into China. This new quota includes about 5.7 million tonnes of cold rolled steel (CR), 2.9 million tonnes of hot rolled steel (CR) and about 0.6 million tonnes of colour coated sheets. China has also lowered the duty to be levied in the event of a country exceeding its quota limit. There is a possibility that India may be granted a preferential treatment on account of it being a developing country. Under this status, Indian steel may well be totally exempted from any duty level even after crossing the quota limit. This augurs well for Indian steel producers.

The use-based classification shows that as in 2002-03, industrial growth during April-August 2003-04 is once again being driven by capital goods and consumer non-durables Capital goods grew by 7.8 in April-August 2003-04 Unfortunately, even in this fiscal period the growth of capital goods largely reflects the impressive production of commercial vehicles and transport equipment, such as diesel engines, broad-gauge covered wagon, shipbuilding and

repairs, wheel and axle, electric generators, dumpers, etc. Segments such as agricultural implements, telecommunication cables, power and distribution transformers, industrial machinery, tractors, boilers and turbines witnessed a fall in production during this period.

While the basic goods sector recorded a growth of 4.2 per cent in April-August 2003-04 (Table 3.4), the intermediate goods sector recorded a growth of 2.3 per cent during the same period this fiscal. This lacklustre performance of intermediate goods sector is largely an outcome of low or negative growth in segments such as polyester filament yarn, viscose staple fibre, PVC resins and fertiliser. However, one segment that stands out is auto ancillary and parts. For the last four years, the auto component exports have grown at a compounded annual growth rate of over 30 per cent and have increased from $300 million in 1998-99 to $800 million in 2002-03. This is slated to cross $2 billion by 2005-06.

The production of consumer goods during April-August 2003-04 increased by 8.9 per cent on a y-o-y basis compared to 7.4 per cent during April-August 2002-03. The growth is still being primarily driven by consumer non-durables, which grew at 10.2 per cent in April-August 2003-04. Consumer durables grew at 4.8 per cent in the same period. But even this modest growth signals a turnaround as it had experienced negative growth in 2002-03. During April-August 2003-04, production growth was largely concentrated in the transport segment. Production of passenger cars was up by 40.5 per cent, motorcycles grew by 13.5 per cent and bicycles grew by 2.3 per cent. The only exception was scooters and mopeds, which witnessed 4.1 per cent decline in production. Other major items whose production was down were telephone instrument by -35.4 per cent, TV receivers by -27.3 per cent, electric fans by -1.5 per cent and alarm timepieces by -14.6 per cent.

Products that contributed significantly in sustaining the growth of consumer non-durables are liquor, sugar, food products, pharmaceuticals and tobacco. Some of the key decelerators for the consumer non-durables sector during April-August 2003-04 are leather, leather garments edible oil and textile products.

The performance of industry at 2-digit classification shows that 12 out of 17 industry groups have experienced positive growth in April-Aug: 2003-04 as compared to 13 during April-August 2002-03 (Table 3.6). Transport equipment and parts have shown the highest growth of 23.7 per cent, followed by 16.6 per cent in beverages, tobacco and related products and 12.4 per cent in basic metal and alloy. On the other hand, leather and leather products have shown a negative growth of 16.3 per cent, followed by a decline of 7.2 per cent in cotton textiles and 1.8 per cent in metal products and parts.

Table 3.6: Industrial Output Growth (% Change y-o-y)

Industries	April Aug 2002-03	April August 2003-04
Food products	8 7	9 3
Beverages, tobacco and related products	17 4	16 6
Cotton textiles	-3 2	-7 2
Wool, silk and man-made fibre textiles	0 8	4 7
Jute and other vegetable fibre textiles (except cotton)	5 3	5 7
Textile products (including wearing apparel)	16 7	-0 4
Wood and wood products, furniture & fixtures	-18 7	12 2
Paper & paper products and printing, publishing & allied industries	4 4	14 0
Leather and leather & fur products	-3 0	-16 3
Basic chemicals & chemical products (except products of petroleum & coal)	7 6	-0 3
Rubber, plastic, petroleum and coal products	2 0	8 4
Non-metallic mineral products	5 5	4 3
Basic metal and alloy industries	7 9	12 4
Metal products and parts (except machinery and equipment)	3 2	-1 8
Machinery and equipment other than transport equipment	2 0	5 7
Transport equipment and parts	10 7	23 7
Other manufacturing industries	-5 8	9 2

The uptake in industrial sector growth is again reflected in the performance of the corporate sector during Q1, 2003-04. Sales grew at 10.3 per cent and PAT at 55 per cent. The performance of the manufacturing sector is even better. The top as well the bottom lines have grown.

Spillover Effect of FDI Flows—Evidence from IT and Automobile Sector

While the literature on FDI flows is ambivalent on its growth implications in the recipient country, it affirms that FDI flows by and large promote spillover effects. When a country receives investments from abroad, it generally gains from transmission of superior technology, introduction of advanced and efficient manufacturing process, sharing of knowledge between the MNC and its affiliate in the host country. As new technologies are generally developed and adapted by firms in industrial countries, FDI may be the most efficient way for developing economies to gain access to them. In addition, this knowledge may become more widely available in the country over time, as employees with experience in the techniques used in foreign companies' switch to other firms. To survive competition from MNCs, it becomes imperative for the local firms to introduce improved production technology. Often, the domestic firms are forced to follow international best practices in the area of corporate governance, transparency, management technique, and they become more quality conscious.

However, very little is available in the Indian context on the spillover effect of FDI flows. An attempt has been made in that direction in an ongoing survey based study at NCAER on Investment Policy, Performance and Perception in India.

It is expected that the entry of foreign firms would benefit the local firms (through technological spillovers) in terms of better management techniques and better quality. Has it really happened in the Indian context? To answer this question, we conducted a small survey (30 respondents) of local firms in the IT and automobile sectors to solicit information on some of these aspects. The findings are shown in Table below. As Table shows, by and large, the local firms have attempted to learn from the MNCs operations. The learning process has been applied to manage time effectively to increase productivity, to adopt new technology and global quality standard.

Impact on Local Firms due to MNCs Entry (Percentage of Respondents)

Impact on the firm because of MNC presence	Positive	Negative	No Impact	Total Responses
Available technologies	52	10	38	100
Know-how including shop	60	12	28	100
Product quality/precision	56	8	36	100
Management techniques	49	17	34	100

Source Pohit, Sanjib and Shalini Subramanyam , 2003, "Investment Policy, Performance and Perceptions in India," mimeo, NCAER

Although it may be true that FDI inflow is no magic potion that can eliminate the effects of poor policies, poor endowments and bad luck, large inflows of FDI have, in general, been associated with higher growth, especially in countries and industries that are not too far behind the leader. This view is also supported by our survey report in auto and IT sectors. And there is clear evidence that some countries (for instance, East Asian countries) have succeeded in using FDI flows effectively to promote the growth and transformation of their economies.

Somnath Mukherjee and Sanjib Pohit

The change in the mindset of Indian companies is reflective of the fact that over the last five years, Indian companies have rationalised the work force, modernised and upgraded shopfloors and consciously imparted a focus on quality Moreover, the slowdown in the domestic market since the mid-1990s has acted as a catalyst in bringing about an attitudinal change and Indian firms are starting to focus on global markets. India's merchandise exports in 2002-03 grew by over 18 per cent to $51.7 billion. Also the contribution of manufactured products to exports increased from 67 per cent in 1988 to 76 per cent in 2003.

Although it is difficult to conclude at this juncture whether years of restructuring has finally made the Indian manufacturing sector globally competitive, it can certainly be said that certain segments of the manufacturing sector such as auto ancillary, pharmaceutical, engineering and

chemicals have shown sustainable competitive advantage in the international market. These are skill intensive segments. Like IT companies, even manufacturing companies realised this domestic advantage fairly quickly and begun leveraging it. The results are dramatic. Let us for example look at auto ancillary segment, which has emerged as an outsourcing hub for auto giants like Ford, General Motors, Daimler Chrysler, Toyota, Volkswagen, Volvo, etc. This outsourcing is not of technology but of components like forging, casting, precision machinery, etc. Indian auto component manufacturers enjoy a cost advantage of about 20-25 per cent compared to other competitors. As a result the auto ancillary segment is expected to rake in additional export revenue of USD 1.2 billion over the next five years.

In the pharmaceutical sector also many Indian companies have established their presence on a global scale. In the last decade (1991-92 to 2001-02), drugs and pharmaceuticals recording an export growth of 13 per cent followed by 12 per cent growth in engineering goods and 11 per cent growth in chemicals were the key drivers of manufactured exports. The last three years, (2000-01 to 2002-03) data also shows an acceleration of exports from these sectors. While engineering goods reported 18.6 per cent growth in exports, pharmaceuticals registered a growth of 14 per cent during this period.

Prospects

After a five-year slump, initial data for this year has raised hopes of a sustainable industrial recovery. However, a similar turnaround noticed earlier in 1997-98 and thereafter in 1999-2000 could not be sustained. But the present scenario differs from the previous spikes in industrial output at least in one respect. While the industrial pick-up both in 1997-98 and 1999-2000 was supported by the buoyancy in agriculture in the preceding year, the current industrial growth is actually preceded by one of the worst drought in the past 15 years. The expectations of higher economic growth in general and

sustained industrial turn around in particular therefore appear to be stronger now than they have been ever before since the slow down in the economy had set in around the mid-nineties

Let us first look at the "feel good" factors Soft interest rate, low inflation, burgeoning forex reserve, bullish stock market—all these augur well for further consolidating the industrial recovery With the dust settling down in the Middle East and the two major drivers of global economic growth—USA and Japan—showing signs of recovery, the domestic economy can expect a spurt in export demand as well Yet doubts over sustainability linger

It has already been pointed out that much of the growth in capital goods is on account of transport equipment and that machinery and equipment have registered very low growth This is basically indicative of low investment activity Also, capital goods account for only about 10 per cent of industrial production Therefore, a prognosis of capital goods-led industrial revival may well be premature

On the other hand, the continued growth in consumer non-durables is a welcome sign With 23 per cent weight in manufacturing and 46 out of a total of 58 consumer non-durable items showing positive growth, the sector appears well poised to drive industrial recovery

Although basic goods have posted only a moderate 4.2 per cent growth during April-August 2003-04 increased housing and road construction activity augurs well for this sector in the current fiscal Steel production has been growing rapidly, production of aluminium is on the rise and other metals are back on the recovery track In view of the above, while a continuation of the current recovery seems likely in the immediate future, its deepening will depend on a number of additional factors

The absence of strong investment spending is a cause of worry Indeed, for the first time since 1997-98 the investment rate has fallen below the savings in 2001-02 as reflected in National Accounts data A recovery in investment spending, therefore, would be critical for a sustained industrial turnaround However, the much needed investment revival has failed to materialise The recent ET-

CMIE survey on capital expenditure shows that investment during FY 2002-03 registered a negative growth of 3.2 per cent as compared to 6.6 per cent growth during FY 2001-02. The drop in overall investment in FY 2002-03 is mainly on account of a fall in investment in the electricity sector and a slowdown in investment in the services sector. Amidst this gloomy scenario, however, the silver lining has been provided by the manufacturing sector (Table 3.7).

Table 3.7: Growth in Investment (% change on y-o-y)

Sector	1999-2000	2001-02	2002-03
Manufacturing	-15 7	-5 3	8 3
Mining	13 8	4 8	-9 7
Electricity	9 1	5 4	-17 3
Services	71 1	17 0	4 8
Irrigation	3 6	-1 3	1.5
All Industries	16 0	6 6	-3 2

Source CMIE

After recording a decline for each of the previous four years in investment, the manufacturing sector has finally registered a growth of 8.3 per cent in investment spending during FY 2002-03. While this growth in the manufacturing sector investment has to be seen in the light of the massive contribution of Ennore oil and gas refinery project valued at Rs 23,600 crores, the fact that a number of manufacturing segments such as automobile, steel, textile, beverages have shown improvement in investment is a positive sign.

Not much change is expected even in the near future with regard to investment in the manufacturing sector as the Business Expectations Survey of NCAER for the month of July 2003 reveals that only 57 per cent of the firms reported their capacity utilisation to be 75 per cent or more. This shows that excess capacity built around the mid-nineties still exists. Further with regard to the capacity utilisation during the coming six months only 56 per cent of the firms reported that they expect it to increase; 34 per cent of the firms reported that it would remain unchanged. Not so optimistic an outlook on future capacity utilisation

meant that only about 47 per cent of the firms showed inclination to undertake new investments during the current fiscal. Interestingly a bulk of the intended investment is for enhancing quality and efficiency and not for creating additional capacity.

The fiscal scenario leaves ample room for worry. With the assembly elections coming up in Delhi, Rajasthan, Madhya Pradesh and Chattisgarh later this year and general elections in 2004, the governments both at the Centre and in the States appear to have already entered into election mode. It is time to roll out populist schemes. This may further worsen the already fragile fiscal scenario.

In conclusion, therefore, it can be said that though further consolidation of industrial recovery is definitely on the cards, the key lies with investment demand so far as sustained industrial recovery is concerned. For this, policy reform is essential. Little or no progress on the reforms agenda would mean that structural rigidities of the economy—be it labour laws, domestic tax structure or fiscal indiscipline—would curtail the elbow space of the industrial sector to respond to the changing economic environment.

External Sector

Global Trends and Prospects

The global economy appears to be recovering in the second half of 2003. Real world GDP is expected to accelerate from 3.2 per cent in 2003 to 4.1 per cent in 2004 (Table 4 1). US growth prospects appear to be better than what the *World Economic Outlook* of the IMF had expected about five months ago However, the expected recovery is likely to be fragile since all components are not operating in consonance. While the Japanese economy has started showing promising signs of growth, growth in the EU is slumping. The Cancun Ministerial has failed.

Table 4.1: Real GDP Growth and World Trade (%)

	April 2003 Forecast		September 2003 Forecast	
Countries/Region	2003	2004	2003	2004
A .World Output	3 2	4 1	3 2	4 1
I. Advanced Economies	1 9	2 9	1 8	2 9
US	2 2	3 6	2 6	3 9
Japan	0 8	1 0	2 0	1 4
European Union, *of which*	1 3	2 4	0 8	2 0
France	1 2	2 4	0 5	2 0
Germany	0 5	1 9	-	1 5
Italy	1 1	2 3	0 4	1 7
United Kingdom	2 0	2 5	1 7	2 4
NIEs of Asia	4 1	4 5	2 3	4 2
II. Developing Countries	5 0	5 8	5 0	5 6
Developing Asia	6 3	6 5	6 4	6 5
China	7 5	7 5	7 5	7 5
India	5 1	5 9	5 6	5 9
III. Countries in Transition	4 0	4 1	4 9	4 7

B. World Trade Volume	4 3	6 1	2 9	5 5
I Imports				
Advanced Economies	4 7	5 9	2 8	4 8
Developing Economies	4 7	8 0	5 1	7.8
II Exports				
Advanced Economies	3.8	5 8	1 6	5 2
Developing Economies	3 7	7.6	4 3	6.9

Note World Trade comprises trade in Goods and Services

Source IMF, *World Economic Outlook*, April 2003 and September 2003

It is likely that the US can no longer continue propelling the world economy, which is currently flying, as it were, on one engine. It is startling to note that since 1995, almost 60 per cent of the cumulative growth in world output has come from the US, nearly twice its share of world GDP. Global prosperity depends extensively on American demand. Americans have been spending far beyond their means. The current account deficit of the United States has touched a historic high of 5 per cent turning it into the largest debtor country in the world. Incidentally, it was the largest creditor country in 1980. Net external debt reached 25 per cent of GDP at the end of 2002. The federal budget has shifted from a surplus of over 2 per cent in 2000 to a deficit of over 4 per cent this year. World reliance on one engine is reaching its limits.

Chances are that Americans will eventually start to save more. In case they don't, foreigners may become increasingly unwilling to fund American spending. The share of America's current account deficit that is funded by private foreign investors has started falling. It is Asia's Central Banks, mainly those of Japan and China, that are picking up a bigger share by buying huge quantities of American government bonds. Of course, these central banks are doing this to keep their currencies weak and hence support increasing exports from Asia to the US.

Japan's foreign exchange reserves hit a record high at the end of September 2003 and touched US$ 604.9 billion. The increase of US$ 49.8 million during September was due to massive currency market interventions including a rise in the value of the US bonds held by Japan. The strength-

ening of the euro against the dollar also pushed up the value of Japan's euro-denominated assets in US dollar terms.

China's foreign exchange reserves touched US$ 383.9 billion by the end of September 2003 and reached US$ 383.9 billion. The additional accumulation during the month of September was US$ 19.2 billion. Much of the increase has been on account of new investments in China as well as increase in the value of US bonds held by China.

With elections in the US due in 2004 and given the fact that about 3 million jobs in America have been lost during the past three years, demands for some corrective action are multiplying. The political economy of the United States is expected to mould itself in a strategic way during the coming months.

The US economy is expected to grow by 2.6 per cent in 2003 and 3.9 per cent in 2004. The corresponding forecasts are 0.8 and 2.0 per cent, respectively for the EU; and 2.0 and 1.4 per cent, respectively for Japan. The IMF expects world trade volume to grow by 2.9 per cent in 2003 and 5.5 per cent in 2004.

India's Trade Policy

As with the other sectors of the Indian economy, India's external sector also witnessed major policy changes during the decade of the 1990s. Custom tariffs are now lower and quantitative restrictions on imports have been done away with. Export restrictions have been reduced along with the implementation of various export promotion measures.

The pace of tariff reforms slowed down in India after 1996-97. While the peak rate of duty has been reduced gradually, the average tariff rate remained broadly unchanged and above 30 per cent during the period 1997-2002. However, there has been a sharp increase in the export of commercial services including software, communication and management services during the years 1997-98 to 2002-03 registering a growth rate of about 22.5 per cent per annum. This has offset part of the negative shock to the balance of trade caused by the slowdown in merchandise exports particularly during the years 1997-98, 1998-99 and 2000-01.

Merchandise exports grew by 8.2 per cent during 1997-98 to 2002-03.

The last year Central Budget (2002-03) had recommended that by the year 2004-05 there would be two basic rates of custom duties: 10 per cent generally covering raw materials, intermediates and components and 20 per cent covering all the final products. Then the peak rate of 35 per cent was reduced to 30 per cent. The Central Budget (2003-04) talked about lowering the peak rate further down to 25 per cent but nothing has been said about touching the two slabs of 10 and 20 per cent in 2004-05.

Similarly, custom duty rates in case of some of the items of capital goods have been reduced from 25 to 5 per cent. Ideally, it should have been done in the form of across-the-board reduction from the existing high level of 25 per cent, continued since the time of Central Budget of 1999-00. At that time, the customs rates on some of the capital goods were raised from 20 per cent to 25 per cent. The existing rate of 25 per cent tariff on capital imports remains too high to build new internationally competitive manufacturing plants. Hence, across-the-board tariff cuts under capital goods are expected to boost the investment in new machinery and plants. Depreciation of exchange rate would also have a similar effect provided the degree of tariff escalation is reduced simultaneously.

It was in January 2002 that the Medium Term Export Strategy (MTES: 2002-2007) was announced so as to be co-terminus with the Tenth Five-Year Plan period. It aims at increasing India's share in world trade from about 0.7 per cent in 2002-03 to 1.0 per cent by 2006-07.

The Five-Year Export and Import (EXIM) Policy, 2002-2007, announced on March 31, 2002 aimed at removing all QRs on exports except for a few sensitive items reserved for exports through the State Trading Enterprises. It also outlined a farm-to-port approach for exports of agricultural products, special focus on cottage sector and handicrafts, and Assistance to States for Infrastructural Development for Exports (ASIDE). Other key elements of policy changes with reference to significance to exports included establishing new private sector-run special economic zones, making

labour markets more flexible, significantly reducing the number of goods reserved for the small-scale sector and reducing administrative hurdles relating to exports. The strategic sectors at microeconomic level identified for providing special focus refer to the "3-E"s, namely electronics, electrical goods and engineering goods.

The (EXIM) Policy 2003-04 is, in fact, a statement about certain changes during the second year of the EXIM Policy 2002-2007. Three important engines of export growth have been 'identified' for "provision of extra power to them and building on areas of our core competence". These include services export, revitalising special economic zones and facilitating export of agriculture and allied products. A much awaited and oft repeated intention of simplifying the procedures sharply to reduce transactions costs has also been given a special mention in this policy speech statement.

The new EXIM policy *document* mentions that selected towns producing goods of Rs. 1,000 crore or more will be notified as "Towns of Export Excellence" on the basis of potential for growth in exports. These towns shall receive special attention with regard to infrastructure facilities and simplified rules and procedures. Within the existing policy towards Agri Export Zones (AEZ), corporate sector with proven credentials will be encouraged to sponsor new AEZ or take over already notified AEZ or part thereof for boosting agri exports from the zones.

Service providers (other than hotels) shall be entitled to duty free imports equivalent to 10per cent of the average foreign exchange earned by them in the preceding three years. Hotels shall be entitled for duty free imports equivalent to 5 per cent of the average foreign exchange earned by them in the preceding three years. The duty free entitlement shall be used for import of spares, office equipment and consumables other than agriculture and dairy products. The entitlement and goods shall be non-transferable and would be available only to those service providers who have an average foreign exchange earning of over Rs. 10 lakh in the preceding three licensing years.

The *document* states that with a view to achieve the

share of one per cent of global trade and accelerated growth in exports, the major thrust areas are:

(a) electronic hardware;
(b) textile including garments;
(c) auto components/ancillary industries;
(d) gems and jewellery;
(e) agriculture; and
(f) service sector

One of the major changes in the Export Promotion Capital Goods (EPCG) scheme is that second-hand capital goods up to 10 years old may also be imported. Spares for the existing plant and machinery may also be imported under the EPCG scheme subject to an export obligation equivalent to 8 times of duty saved to be fulfilled over a period of 8 years reckoned from the date of issuance of licence. In the case of EPCG licences issued to agro units in the agri export zones, a period of 12 years reckoned from the date of issue of the licence would be permitted for the fulfilment of export obligation.

Tariffs on inputs and intermediate goods have been lowered at faster rates than on outputs. It is well known, since tariff escalation provides excessive tariff protection to some industries at the cost of others. Various other domestic impediments to investment and growth have also contributed to relatively slow development of India's international trade. These include a relatively restrictive foreign investment regime; continuation of small-scale industry reservation in the case of many sectors of production; the poor quality of public infrastructure including power and transport; the slow pace of industrial restructuring, reflecting weak bankruptcy laws and regulations that severely limit labour market flexibility; and transaction costs associated with administrative hurdles.

India's Trade Performance: Medium-Term Trends

The trends, composition and direction, relating to India's exports during the 1990-91 to 2002-03, are presented in Tables 4.2 to 4.5. The ups and downs in India's exports (US$ terms) during the last two decades have been in tandem

with those in world trade (Figure 4.1). While merchandise exports have grown nearly 3 times, the exports of commercial services have grown by more than five times. India's merchandise exports (DGCI&S) increased from an annual average of US$ 18.18 billion during the triennium ending (TE) 1992-93 to US$ 46.87 billion during the TE 2002-03. The corresponding increase in total export of commercial services during this period has been from US$ 4.73 billion to US$ 21.04 billion. The share of commercial services in India's total exports (merchandise plus commercial services) has gone up from an average of about 21 per cent during the TE 1992-93 to nearly 31 per cent during the TE 2002-03. The merchandise exports have grown by about 9.6 per cent and exports of commercial services by about 15.1 per cent per annum during the period 1990-91 to 2002-03.

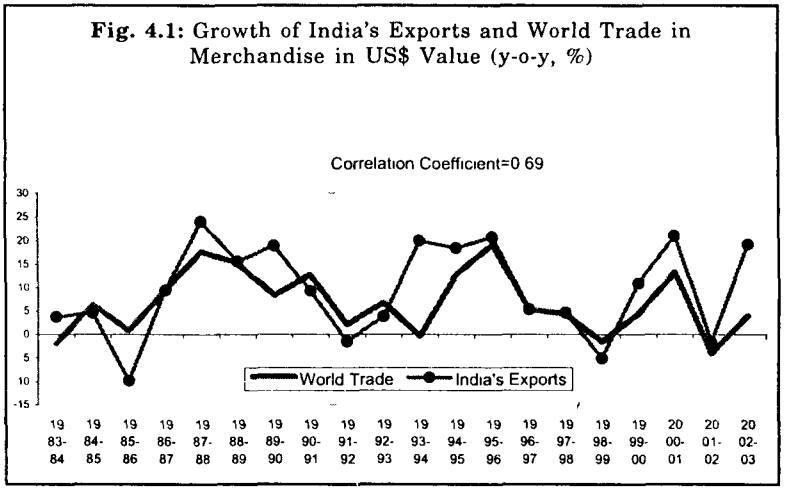


Fig. 4.1: Growth of India's Exports and World Trade in Merchandise in US$ Value (y-o-y, %)

Table 4.2: India's Foreign Trade

Year	Exports US $ Million	Gr %	Imports US $ Million Oil	GR %	Non-Oil	GR %	Total	GR %	Trade Balance
1990-91	18145	9 2	6028	60 0	18044	3 4	24073	13 4	-5927
1991-92	17865	-1 5	5325	-11 7	14086	-21 9	19411	-19 4	-1545
1992-93	18537	3 8	6100	14 6	15782	12 0	21882	12 7	-3344
1993-94	22238	20 0	5754	-5 7	17553	11 2	23306	6 5	-1068
1994-95	26331	18 4	5928	3 0	22727	29 5	28654	22 9	-2324
1995-96	31795	20 8	7526	27 0	29150	28 3	36675	28 0	-4880
1996-97	33470	5 3	10036	33 4	29096	-0 2	39132	6 7	-5663
1997-98	35006	4 6	8164	-18 7	33321	14 5	41485	6 0	-6478
1998-99	33219	-5 1	6399	-21 6	35990	8 0	42389	2 2	-9170
1999-00	36822	10 8	12611	97 1	37059	3 0	49671	17 2	-12848
2000-01	44560	21 0	15650	24 1	34886	-5 9	50536	1 7	-5976
2001-02	43827	-1 6	14000	-10 5	37413	7 2	51413	1 7	-7586
2002-03	52234	19 2	17640	26 0	43646	16 7	61286	19 2	-9052
April - August									
2002-03	20648	18 5	7100 7	8 8	16273 2	4 1	23374	5 5	-2725
2003-04	22505	9 0	7663 1	7 9	20886 2	28 4	28549	22 1	-6045

Note GR = Growth Rate

Source (i) DGCI&S, in *Handbook of Statistics on Indian Economy*, 2002-03
(ii) RBI Annual Report, 2002-03
(iii) Monthly update of trade statistics *htpp //commerce nic in*

Table 4.3: India's Exports of Merchandise and Commercial Services

Fiscal Year	Exports in US $ Million			
	Merchandise	Commercial Services		Total Exports
	Total	Miscellaneous Services		
	(1)	(2)	(3)	(1) + (2)
1989-90	16613	4215	1756	20827 5
1990-91	18145	4536	1987	22681 2
1991-92	17865	5005	1981	22870 4
1992-93	18537	4655	1417	23192 2
1993-94	22238	5234	1455	27472 3
1994-95	26331	6125	1912	32455 5
1995-96	31795	7333	2430	39127 9
1996-97	33470	7402	2354	40871 7
1997-98	35006	9153	4163	44159 4
1998-99	33219	12589	7447	45807 7
1999-00	36822	15127	10513	51949 4
2000-01	44560	18213	12875	62773 3
2001-02	43827	20196	15050	64023 0
2002-03	52234	24679	18735	76913 0
	Growth Rate %			
1990-91	9 2	7 6	13 2	8 9
1991-92	-1 5	10 3	-0 3	0 8
1992-93	3 8	-7 0	-28 5	1 4
1993-94	20 0	12 4	2 7	18 5
1994-95	18 4	17 0	31 4	18 1
1995-96	20 8	19 7	27 1	20 6
1996-97	5 3	0 9	-3 1	4 5
1997-98	4 6	23 7	76 8	8 0
1998-99	-5 1	37 5	78 9	3 7
1999-00	10 8	20 2	41 2	13 4
2000-01	21 0	20 4	22 5	20 8
2001-02	-1 6	10 9	16 9	2 0
2002-03	19 2	22 2	24 5	20 1
Average growth rate %				
1993-98	13 8	14 8	27 0	13 9
1998-03	8 1	22 5	36 8	12 0
1990-03	9 6	15 1	23 3	10 8

Note Commercial Services, include i) Travel, ii) Transport , iii) Insurance, and Miscellaneous

Source (i) RBI, Handbook of Statistics on Indian Economy, 2002-03
(ii) RBI Annual Report, 2002-03

While India's share in world merchandise exports increased from 0.5 to 0.7 per cent during the 20-year period 1980-2000, that of China touched 4 per cent in 2000 compared with about 1.3 per cent in 1980. Foreign Direct Investment inflows to India are also much lower than its expectations as well as when compared to China.

The lack of India's global integration is confirmed by the fact that India has not been able to exploit its export potential. Based on "gravity model" results, it has been pointed out that India's merchandise trade was, on the average, 36 per cent below its "expected level."[1] This, however, is an improvement over an estimated under-trading of about 50 per cent during the early 1990s. The model estimates that about 25 per cent of the shortfall in trade openness, compared with other developing countries over 1995-1999 results from India's relatively restrictive policies, with the remainder attributable to India's low per capita income, geographic factors, and restrictions imposed by other countries.

Compared with the export performance during the Eighth Five-Year Plan (1992-97), one of the most important features of India's foreign trade during the Ninth Five-Year Plan, (1997-2002), has been rapid increase in export of "commercial services." The component "miscellaneous services," which includes IT enabled software services, has performed particularly well. While the exports of "commercial services" grew at an average annual rate of 22.5 per cent during the Ninth Plan compared with only 8.6 per cent during the Eighth Plan, the corresponding numbers for export of "miscellaneous services" are 47.3 and 5.9 per cent, respectively. The average share of commercial services in India's total exports (merchandise plus commercial services) increased from 19 per cent during the Eighth to 27.6 per cent during the Ninth Plan period. The share of "miscellaneous services" in export of "commercial services" more than doubled about 31 per cent during the Eighth to nearly 64 per cent during the Ninth Plan period. However, a word of caution is necessary.

While the "miscellaneous services" grew at an average annual rate of about 65.6 per cent during the period 1997-

1. World Economic Outlook, September 2002.

Table 4.4: Growth Rate of India's Major Export Commodities

Commodity/ Commodity Group	Average Weights % share			Average Growth Rate %			Growth Rate of Exports %						
	1993-96	1996-99	2000-03	1993-96	1996-99	2000-03	1996-97	1997-98	1998-99	1999-00	2000-	2001-02	2002-03
1	2	3	4	5	6	7	8	9	10	11	12	13	14
I. Agriculture and Allied Products	17 8	19 2	13 1	25 8	0 2	4 7	12 8	-3 4	-8 9	-7 1	6 7	-1 0	8 6
1 Tea	1 3	1 3	0 8	1 6	21 0	-6 6	-16 6	72 8	6 6	-23 5	-4 8	-7 8	-7 1
2 Coffee	1 2	1 2	0 5	53 6	-2 3	-15 1	-10 5	13 6	10 0	-19 4	-21 5	-11 3	-12 4
3 Rice	2 5	3 3	1 7	90 4	10 5	19 7	-34 6	1 5	64 6	-51 7	-10 9	3 9	66 4
4 Cotton raw including waste	0 4	0 7	0 0	63 3	167 2	33 2	629 4	-50 1	-77 8	-63 8	172 7	-81 4	8 9
5 Tobacco	0 5	0 7	0 4	3 2	19 2	-2 2	59 6	35 1	-37 1	28 6	-18 3	-10 6	22 4
6 Cashew including Cashew nut shell Liquid	1 4	1 1	0 9	13 8	1 6	-8 8	-1 9	4 3	2 4	46 4	-20 7	-16 2	10 6
7 Spices	0 8	1 1	0 7	20 9	19 0	-6 1	42 7	12 0	2 3	5 1	-13 0	-11 2	6 2
8 Oil meals	2 6	2 3	0 9	12 9	-5 3	-5 1	40 2	-6 1	-50 1	-18 1	18 6	6 2	-40 1
9 Fruits and vegetables	0 5	0 4	0 2	13 7	-6 1	-8 5	3 4	-2 6	-19 1	15 5	33 9	-93 4	43 5
10 Processed fruits, Juices, misc Processed items	0 6	0 6	0 7	57 6	-10 0	21 7	15 7	-43 5	-2 3	16 2	12 6	4 5	14 0
11 Marine products	3 7	3 3	2 9	21 1	1 5	6 1	11 7	6 9	-14 0	13 9	18 0	-11 1	11 6
12 Sugar and molasses	0 3	0 4	0 6	182 0	-22 8	441 7	100 5	-77 4	-91 5	59 9	1091 5	238 7	-3 9

1	2	3	4	5	6	7	8	9	10	11	12	13	14
13 Meat and meat preparations	0 5	0 6	0 6	28 9	0 5	20 1	6 6	8 9	-13 9	0 9	70 4	-22 1	12 4
14 Others	1 6	2 1	2 2	54 3	-0 3	12 9	29 6	-10 7	-19 7	36 6	22 5	28 7	0 2
II. Ores and Minerals	3 8	3 1	3 0	16 8	-8 5	28 6	-0 2	-9 5	-15 8	2 5	26 1	9 7	50 4
1 Iron ore	1 7	1 3	1 1	11 3	-9 0	50 9	-6 6	-0 9	-19 4	-29 4	32 1	19 4	101 5
2 Mica	0 0	0 0	0 0	0 7	11 6	-2 3	-14 6	53 9	-4 4	-5 2	-6 8	29 7	-29 7
3 Others	2 1	1 7	1 9	23 4	-8 1	18 0	5 0	-16 1	-13 1	27 2	-94 2	5 0	25 1
III. Manufactured Goods	75 7	75 7	75 8	19 2	2 9	9 3	3 6	7 9	-2 8	15 2	15 7	-2 6	14 8
1 Leather and manufactures	5 8	4 8	4 1	11 5	-1 6	4 7	-8 4	3 2	0 2	-4 2	22 5	-1 6	-6 5
2 Chemicals and allied Products	7 2	8 6	9 2	24 4	7 9	11 9	14 0	17 8	-8 3	17 3	25 0	1 3	16 1
(a) Drugs, pharmaceutical and fine chemicals	3 0	4 1	4 6	24 4	13 7	14 0	20 0	19 2	2 0	12 2	15 1	7 8	19 4
(b) Others	4 1	4 5	4 6	24 6	3 0	9 9	9 5	16 7	-17 1	22 6	34 4	-4 5	12 7
3 Plastic and linoleum products	1 7	1 5	2 2	63 2	-6 9	25 1	-7 9	-4 6	-8 3	28 0	51 8	8 1	15 5
4 Rubber, glass, Paints, enamels and products	2 2	1 9	2 2	18 1	-1 2	19 9	4 5	3 9	-12 0	10 8	35 2	5 3	16 6
5 Engineering goods	13 6	14 5	15 7	21 0	1 4	18 6	13 0	7 5	-16 3	15 4	30 8	2 9	20 5
6 Readymade garments	11 9	11 8	11 4	15 7	6 0	4 7	2 1	3 3	12 6	9 2	17 1	9 9	7 2
7 Textile yarn, fabrics, Made-ups, etc	10 8	11 9	10 2	23 5	2 7	6 2	15 2	7 4	-14 5	12 5	17 8	-8 4	10 4

1	2	3	4	5	6	7	8	9	10	11	12	13	14
(a) Cotton yarn, fabrics, Made-ups, etc ,	7 8	9 0	7 0	24 8	3 5	2 4	21 2	4 6	-15 1	11 5	13 4	-11 0	6 4
(b) Natural silk yarn, Fabrics, made-ups, etc	0 5	0 5	0 6	-1 1	11 6	9 2	-3 3	37 0	1 0	33 4	29 3	-9 2	7 7
(c) Others	2 4	2 5	2 6	26 0	-0 9	17 3	-0 8	13 4	-15 3	11 2	30 3	-0 3	22 2
8 Jute manufactures	0 6	0 5	0 3	15 3	-7 4	14 7	-16 3	20 2	-26 0	-9 1	47 6	-17 8	41 5
9 Coir and manufactures	0 2	0 2	0 1	26 6	6 4	16 5	-3 0	12 4	9 7	-38 7	4 9	28 0	16 9
10 Handicrafts	20 3	18 6	19 3	17 6	4 8	5 2	-7 6	10 9	11 0	24 4	-92 4	-3 0	20 6
(a) Gems and jewellery	17 2	15 8	16 8	20 0	4 5	6 2	-9 9	12 5	10 9	26 5	-1 4	-0 9	21 1
(b) Carpets (handmade excl silk)	1 7	1 2	1 1	-1 0	-0 8	-8 1	3 8	-5 9	-0 3	21 8	-10 2	-14 8	0 9
(c) Works of art (excl floor coverings)	1 4	1 6	1 4	16 3	13 5	4 4	9 6	10 5	20 4	5 6	-0 9	-16 9	31 2
11 Sports goods	0 2	0 2	0 1	29 0	0 0	1 6	6 0	3 4	-9 3	-8 6	-3 4	6 5	2 0
12 Others	1 2	1 0	1 0	15 1	-3 5	9 4	2 1	-13 9	1 4	27 6	-29 8	-4 4	19 4
IV. Petroleum Products	1 6	0 9	4 6	-0 9	-31 7	1578 7	6 2	-26 8	-74 6	-56 5	4776 1	12 2	14 2
V. Others	1 4	1 1	3 4	62 7	-6 8	118 8	-41 8	23 7	-2 4	32 9	32 7	63 0	167 9
All commodities	100 0	100 0	100 0	19 7	1 6	13 2	5 3	4 6	-5 1	10 8	21 0	-1 6	19 2

Source (i) RBI, Handbook of Statistics on Indian Economy, 2002-03, ii) CMIE, Foreign Trade and Balance of Payments, September 2003

Table 4.5: Growth Rate of India's Exports to Major Destinations

	Average Weights % Share			Average growth rate %			Growth Rate of Exports %					
Countries	1993-96	1996-99	2000-03	1993-96	1996-99	1999-02	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03
1	2	3	4	5	6	7	8	9	10	11	12	13	14
World	100 0	100 0	100 0	22 1	1 5	12 9	5 2	4 6	-5 2	10 7	20 1	-0 4	19 1
USA	18 1	20 2	20 4	18 7	9 4	10 0	18 7	3 8	5 7	16 6	10 2	-7 7	27 4
UAE	4 8	5 0	6 0	24 2	9 4	17 9	3 3	14 7	10 2	11 5	24 2	-3 3	32 9
UK	6 3	5 9	4 9	20 7	-2 4	7 2	1 7	4 6	-13 5	9 7	11 9	-4 7	14 3
Hong Kong	5 7	5 6	5 3	38 1	1 1	-0 3	2 2	3 8	-2 8	32 6	5 7	-9 9	3 2
Germany	6 6	5 6	4 1	13 7	-2 2	6 3	-4 3	1 7	-3 9	-6 3	8 8	-4 9	15 1
China	1 1	1 7	2 7	43 7	20 3	58 3	84 7	16 8	-40 6	26 3	53 9	15 1	105 8
Japan	7 4	5 5	3 7	18 0	-9 3	4 6	-9 5	-5 3	-13 1	2 1	5 7	-15 0	22 9
Belgium	3 7	3 5	3 2	20 4	4 8	7 6	-2 5	11 3	5 8	4 1	8 6	-4 2	18 4
Singapore	3 0	2 2	2 3	18 2	-15 2	29 4	8 4	-20 2	-33 7	29 5	28 8	13 1	46 2
Italy	3 1	3 1	2 7	21 1	2 0	6 7	-8 0	19 5	-5 5	6 2	16 0	-6 8	10 9
Bangladesh	2 6	2 6	2 1	47 0	-0 1	20 5	17 2	-9 5	26 4	-36 0	37 3	15 0	9 1
France	2 3	2 3	2 2	19 0	3 7	6 2	-4 2	6 1	9 1	7 8	13 7	-6 8	11 6
Netherlands	2 3	2 4	2 0	25 4	0 0	5 4	10 8	-5 7	-5 1	16 1	-1 2	-0 8	18 3
Saudi Arabia	1 8	2 0	1 9	9 6	17 1	9 1	19 6	19 6	12 0	-4 0	22 4	-8 8	13 7
Sri Lanka	1 3	1 4	1 6	19 9	3 5	24 1	18 9	2 5	-10 8	14 4	26 2	0 4	45 9
Indonesia	1 5	1 2	1 3	78 8	-31 5	37 2	-10 7	-26 1	-57 7	75 5	21 5	35 6	54 6
Spain	1 1	1 3	1 5	29 0	8 5	14 1	8 6	4 1	12 7	9 9	20 9	2 5	18 8
Malaysia	1 2	1 3	1 5	30 4	-2 4	20 0	35 0	-7 7	-34 4	39 1	34 4	29 1	-3 6
Thailand	1 5	1 1	1 3	26 4	-11 8	16 6	-5 5	-22 9	-7 0	40 2	17 5	20 2	12 2
Russia	3 1	2 4	1 7	22 4	-10 2	-9 6	-22 4	17 5	-25 7	33 8	-8 3	-7 9	-12 7
Canada	1 0	1 2	1 4	19 3	15 8	6 9	15 5	22 7	9 0	22 4	12 6	-9 9	18 0

1	2	3	4	5	6	7	8	9	10	11	12	13	14
Iran	0 6	0 5	0 8	14 9	2 1	73 0	25 7	11 9	-7 4	-4 3	45 8	14 4	158 8
South Korea	1 3	1 3	1 1	41 1	-9 5	12 1	15 6	-9 8	-34 3	55 0	-6 1	5 8	36 6
Israel	0 6	0 9	1 1	40 7	21 7	11 3	-2 5	67 2	0 4	40 3	-5 3	-9 0	48 1
Taiwan	1 0	1 1	0 9	19 1	12 0	25 5	64 4	4 6	-23 9	2 6	23 4	-7 4	60 3
Australia	1 2	1 2	0 9	22 1	1 5	8 2	2 5	13 8	-11 7	3 7	-0 1	4 5	20 2
Brazil	0 3	0 4	0 7	106 4	18 3	60 7	53 7	8 3	-7 2	1 4	65 3	-1 6	118 5
South Africa	0 6	1 1	0 8	758 3	6 3	19 1	-4 1	24 6	-1 7	-26 3	7 9	14 8	34 7
Philippines	0 4	0 5	0 7	42 9	2 3	51 3	27 2	30 0	50 3	21 0	40 3	23 3	90 4
Nigeria	0 5	0 6	1 0	5 7	19 7	19 3	-3 0	47 2	14 9	18 6	28 3	49 8	-20 2
Switzerland	0 9	1 0	0 9	14 5	5 2	2 8	6 4	22 6	13 3	9 6	25 2	-6 2	-10 6

Source CMIE, Foreign Trade and Balance of Payments, Various Issues

98 to 1999-00, the growth is only an average of 21.3 per cent per annum during the following three years from 2000-01 to 2002-03. The corresponding numbers for export of "commercial services" are 27.1 and 17.8 per cent, respectively. Clearly the growth of exports of the "miscellaneous services" has decelerated during the TE 2002-03 compared with TE 1999-00.

The decade of the 1990s witnessed relatively rapid growth in India's exports in volume terms compared with growth in value expressed in US$ terms. While the value of world trade increased by an average of 6.6 per cent per annum during the 1990s, India's exports increased at an average annual rate of 9.8 per cent per annum during the same period. The corresponding average annual volume growth of trade turned out to be higher at 7.4 per cent for the world and 11.8 per cent per annum for India during the 1990s.

The decade of the 1990s has brought good news on terms-of-trade (ToT) for India (Tables 4.6 and 4.7). While the net ToT improved by an average annual rate of 1.6 per cent per annum during 1991-92 to 2000-01, the income ToT grew by about 12.5 per cent per annum during the same period.2 The net ToT had deteriorated by 3.4 per cent per annum, on the average, during 1971-72 to 1980-81 and improved by 3.7 per cent per annum during 1981-82 to 1990-91. On the other hand, the income ToT registered an accelerated improvement during the last three decades. The improvement in India's income ToT was 2.7 per cent per annum during 1971-72 to 1980-81, 9.8 per cent during 1981-82 to 1990-91 and 12.5 per cent during 1991-92 to 2001-02. The first five years, namely 1991-92 to 1995-96, of the 1990s brought marked improvement in net as well as income ToT. While the net ToT improved by over 5 per cent per annum, the income ToT registered a massive 20 per cent growth rate. However, the following six years (1996-97 to 2001-02) did not turn out so well. While the net ToT deteriorated by 1.23 per cent per annum, income ToT registered an improvement of 6.0 per cent per annum compared with 20 per cent plus during the first half of the decade.

2 Net terms-of-trade refers to the ratio of the Unit Value Indx (UVI) of exports to the UVI of imports, expressed in per cent terms. Income terms-of-trade refers to the "import purchasing power" of India's exports and is computed by multiplying net terms-of-trade by the volume index of exports.

Table 4.6 : Unit Value Index, Quantum Index and Index of Terms of Trade of India's Foreign Trade

Base=1978-79=100

Period/ Fiscal Year Average of	Unit Value Index		Quantum Index		Terms of trade		
	Exports	Imports	Exports	Imports	Gross	Net	Income
1971-72 to 1980-81	82 5	83 2	85 5	92 8	109 8	107 4	89 0
1981-82 to 1990-91	192 4	169 7	135 4	193 6	144 8	112 9	153 9
1991-92 to 2001-02	526 9	389 5	380 7	510 6	133 4	135 6	514 3
1990-91	292 5	267 7	194 1	237 7	122 5	109 3	212 1
1991-92	369 5	309 1	208 6	228 0	109 3	119 5	249 4
1992-93	421 5	331 0	222 9	282 0	126 5	127 3	283 8
1993-94	474 1	327 2	257 5	329 1	127 8	144 9	373 1
1994-95	494 6	324 6	292 7	408 3	139 5	152 4	446 0
1995-96	484 2	351 0	384 3	514 8	134 0	137 9	530 1
1996-97	504 7	399 8	411 8	511 8	124 3	126 2	519 8
1997-98	589 4	404 2	386 0	562 1	145 6	145 8	562 9
1998-99	612 0	408 0	399 0	644 0	161 4	150 0	598 5
1999-00	604 0	450 0	461 0	705 0	152 9	134 2	618 8
2000-01	624 0	487 0	571 0	698 0	122 2	128 1	731 6
2001-02	618 0	493 0	593 0	733 0	123 6	125 4	743 4

Source DGCI&S, in *Handbook of Statistics on Indian Economy, 2002-03*

Table 4.7 : Growth Rate of Index Numbers and Terms of Trade of India's Foreign Trade

Period/ Fiscal Year Average of	Terms of trade	
	Net	Income
1971-72 to 1980-81	-3 4	2 7
1981-82 to 1990-91	3 7	9 8
1991-92 to 2001-02	1 6	12 5
1990-91	-9 8	0 1
1991-92	9 4	17 6
1992-93	6 5	13 8
1993-94	13 8	31 4
1994-95	5 2	19 5
1995-96	-9 5	18 9
1996-97	-8 5	-1 9
1997-98	15 5	8 3
1998-99	2 9	6 3
1999-00	-10 5	3 4
2000-01	-4 6	18 2
2001-02	-2 1	1 6

Source DGCI&S, in *Handbook of Statistics on Indian Economy, 2002-03*

Recent Trade Performance

Exports

Notwithstanding the weakness of the global economic recovery, merchandise exports touched $52.2 billion during 2002-03. This translates into 19 per cent growth during 2002-03 compared with 1.6 per cent decline in 2001-02 (Table 4 2). The quarterly growth rates of India's exports during Q1: 1999-00 to Q1: 2003-04 have been depicted in Figure 4.2.

Export growth, however, decelerated to 9.0 per cent in the first five months of 2003-04 compared to 18.5 per cent in the corresponding period of last year. Export growth during 2002-03 had accelerated across all major categories of merchandise exports. The relatively better performing export categories included rice under agricultural and allied products; and chemical products, engineering goods, textiles, wearing apparel, handicrafts (including gems and jewllery) under manufactured products. The major impetus in India's

Fig. 4.2: Quarterly Growth of India's Exports in US$ Value (Y-o-Y, %)

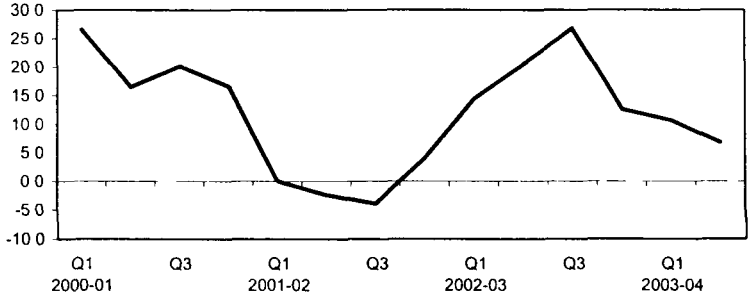


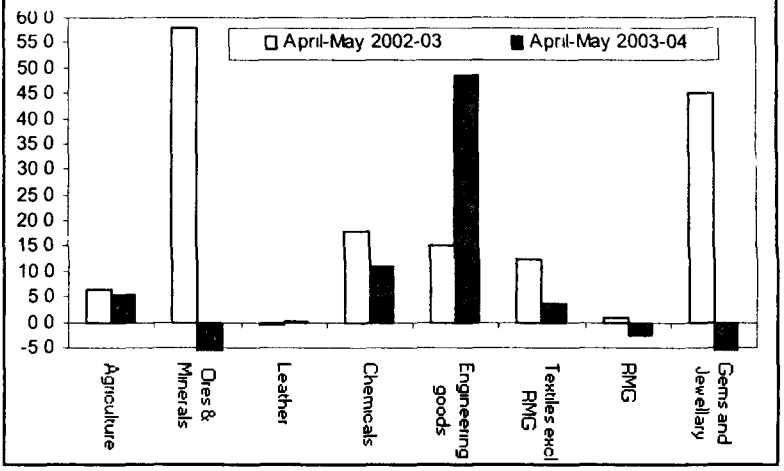
Table 4.8: Growth Rate of Exports of Major Commodities During April-May

Commodity/Commodity Group	US $ million		Growth Rate %	
	2002-03	2003-04	2002-03	2003-04
(1)	(2)	(3)	(4)	(5)
I. Agricultural & Allied products *of which*	970 2	1023 3	6 5	5 5
Basmati rice	58 3	90 6	-20 7	55 4
Cashew	63 8	46 9	6 4	-26 5
Marine products	164 8	173 4	-0 4	5 2
Non-Basmati rice	98 9	89 7	405 8	-9 2
Oil meals	57 0	26 8	13 1	-52 9
Spices	66 7	48 1	9 9	-27 9
Tea	43 9	34 4	-10 9	-21 7
II.Ores & Minerals	309 5	288 3	58 0	-6 9
III. Manufactured Goods *of which*	6125 3	6775 5	18 2	10 6
1 Leather & leather manufacturers	292 1	292 6	-0 5	0 1
2 Chemicals & related products	835 5	927 1	17 8	11 0
3 Engineering goods of which	1284 2	1908 9	15 1	48 6
3 1 Manufactures of metal	284 7	543 0	16 1	90 7

(1)	(2)	(3)	(4)	(5)
3 2 Pri & Sem fin iron & rteel	130 8	343 6	-2 6	162 6
3 3 Machine tools	23 8	14 9	36 7	-37 3
3 4 Machinery & instruments	325 8	408 1	24 6	25 3
3 5 Transport equipment	198 9	227 9	26 5	14 6
3 6 Electronics goods	198 1	245 8	-9 1	24 1
3 7 Computer software	4 8	3 5	-14 0	-27 5
4 Textiles (excl RMG) *of which*	838 9	868 6	12 4	3 5
(1) Cotton yarn fabric madeups	534 9	483 2	8 2	-9 6
(2) Natural yarn fabrics and made ups	48 3	50 9	22 2	5 5
(3) Manmade yarn fabric madeups	204 9	264 6	24 5	29 1
(4) Coir & coir manufact & other manufact	19 1	19 0	13 2	-0 9
5 Readymade garments (RMG)	867 7	845 4	0 9	-2 6
6 Gems and jewellery	1387 7	1293 6	45 0	-6 8
7 Handicrafts	105 9	70 0	27 4	-34 0
8 Carpets	88 6	94 5	-3 3	6 6
9 Other manufactured products	397 0	470 0	21 8	18 4
9 1 Rubber manufactured products	69 3	76 3	23 1	10 0
9 2 Footwear or rubber/canvas etc	4 4	7 1	18 2	63 5
9 3 Glass/glassware/ ceramics/cement	65 9	85 6	28 1	29 9
9 4 Paper/wood products	63 5	80 4	50 5	26 7
9 5 Plastic/linoleum products	180 0	207 8	12 9	15 5
9 6 Sports goods	13 9	12 7	7 9	-8 3
IV.Petroleum & Crude Products	379 4	504 0	23 3	32 9
V. Other Commodities	196 5	266 7	34 0	35 7
All Commodities	7980 9	8857 7	18 3	11 0

Source DGCI&S, *Foreign Trade Statistics of India*, 2002, 2003 May issues

Fig. 4.3: Export Growth of India's Major Commodities
US$ Value (Y-o-Y, %)



exports came mainly from accelerating exports to the US, EU, UAE, Japan, Singapore and China. India's exports to China increased sharply by 106 per cent in 2002-03 compared with an average growth of 32 per cent per annum during 1999-00 to 2001-02 Exports to other, relatively small export destinations, including Sri Lanka, Israel, South Korea, Indonesia, Taiwan and the Philippines also registered smart acceleration thus showing signs of diversified export destinations for India's exports.

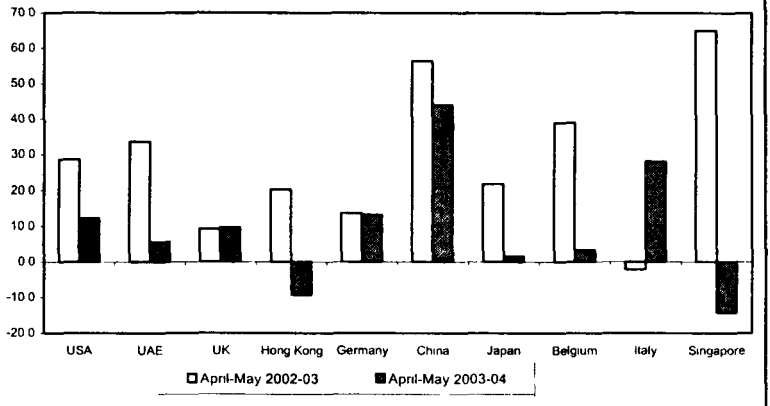
The composition and direction of India's exports during the first two months of the current fiscal (April-May) are detailed out in Tables 4.8 and 4.9, and Figures 4.3 and 4.4.

Table 4.9: Share and Growth of India's Major Export Destinations in April May

Destination Countries	Share in India's Total Exports		Growth rate %	
	2002-03	2003-04	2002-03	2003-04
USA	22 1	19 2	28 6	12 3
UAE	6 1	6 3	33 7	5 6
UK	5 8	5 1	9 3	9 6
Hong Kong	6 2	5 3	20 3	-9 2
Germany	5 0	4 3	13 7	13 2
China	1 9	2 2	56 4	44 1
Japan	4 5	3 4	21 8	1 6
Belgium	3 6	2 8	38 9	3 3
Italy	3 2	3 1	-2 2	28 0
Singapore	1 7	2 5	65 0	-14 2
Bangladesh	1 9	2 2	-16 6	39 7
Netherlands	2 3	1 9	15 0	19 1
Sri Lanka	1 3	1 3	40 8	35 2
Saudi Arabia	2 2	2 0	23 4	-1 5
Indonesia	1 2	0 7	161 3	24 6
France	2 3	2 3	3 1	-3 5
Spain	1 5	1 7	5 2	21 7
Canada	1 3	1 3	17 5	21 7
Malaysia	1 0	1 5	7 5	6 4
Israel	1 2	1 0	27 9	31 4
Iran	0 4	0 6	30 1	97 4
Russia	2 4	1 9	-5 9	-12 0
Thailand	1 0	1 3	13 0	-2 2
Korean Republic	1 2	1 0	57 9	-19 2
Australia	0 9	0 8	36 5	15 5
Nigeria	0 8	1 1	9 4	-5 1
South Africa	0 7	0 6	53 6	2 6
Brazil	0 5	0 6	106 9	-24 3
Switzerland	1 1	1 1	-28 1	18 6
Philippines	0 4	0 5	24 2	38 6
Taiwan	0 8	0 9	18 8	-24 7
ROW	13 3	19 3	-6 1	18 1
Total	100 0	100 0	18 3	11 0

Source DGCI&S, Foreign Trade Statistics of India, 2002, 2003 May issues

Fig. 4.4: % Growth of India's Exports to Major Destinations in US$ Value (y-o-y, %)



Imports

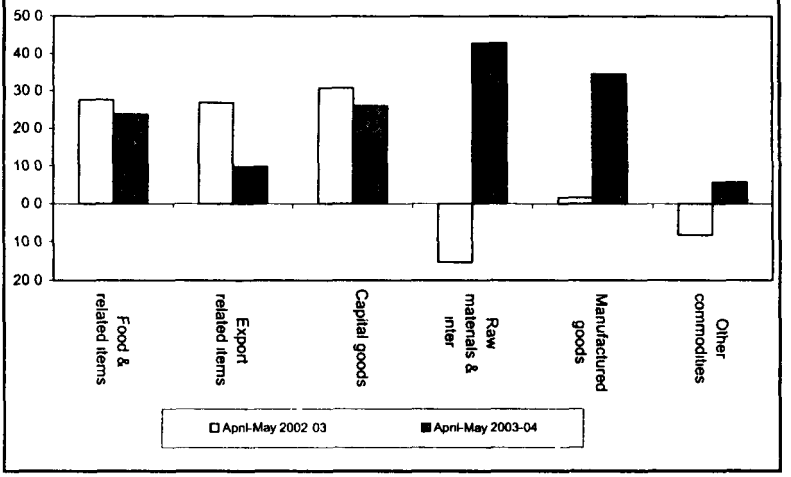
India's merchandise imports touched $ 61.3 billion in 2002-03 thus registering a growth rate of 19.2 per cent. This is quite high compared to an increase of 1.7 per cent in the corresponding period of the previous year. Oil imports grew by nearly 26 per cent in 2002-03 compared to a decline of 10.5 per cent last year. However, non-oil imports growth accelerated to 16.7 per cent as compared to the 7.2 per cent growth last year (Table 4.2). That the domestic economic activity has accelerated during 2002-03 is clear from a sharp increase in non-oil imports. The commodity-wise growth rates of India's merchandise imports during the period 1993-94 to 2002-03 are shown in Table 4.10. It is heartening to note that a large chunk of the increase in imports has been contributed by imports of export-related items, manufactured goods and capital goods.

During April-August 2003-04, India's total imports grew by 22.1 per cent compared to 5.5 per cent in corresponding period of the last year. Oil imports registered an increase by 7.9 per cent compared to an increase of 8.8 per cent last

year. Non-Oil imports registered a sharp increase of 28.4 per cent as compared to 4.1 per cent. This further confirms increasing domestic economic activity in the current fiscal. Import sourcing countries are relatively evenly distributed when compared to its export destination countries.

The composition of India's non-oil imports during the first two months (April-May) of the current fiscal has been detailed out in Table 4.11. The corresponding direction has been depicted in Figure 4.5.

Fig. 4.5: % Growth of India's Major Non-Oil Imports Commodities in US$ Value (y-o-y, %)



India's Trade with China

India exported about $2 billion worth merchandise to China in 2002-03 with imports from China touching $2.8 billion. While India's import from China increased by 37 per cent exports to China increased by 106 per cent. India's major exports to China include engineering goods, iron ore and chemical products. China's markets have been opening up to greater foreign competition, as well as foreign commercial presence after it became a member of the WTO

Table 4.10 : % Growth Rate of India's Major Import Commodities, US $ Million

Countries	Average Weights % Share			Average growth rate %			Growth Rate of Exports %						
	1993-96	1996-99	2000-03	1993-96	1996-99	2000-03	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03
I Food and Related Items	3 08	4 68	4 07	52 30	36 98	5 08	24 3	22 3	64 3	-3 7	-36 5	38 2	13 5
II Export related Items	16 09	16 39	16 29	8 71	10 78	13 31	16 7	12 7	3 0	-0 2	13 5	2 7	23 7
III Capital Goods	23 70	20 15	12 24	22 21	-2 80	7 11	-2 3	-8 0	1 9	-20 9	-10 5	13 8	18 0
IV Raw Materials and Intermediates	14 16	18 19	18 14	29 86	20 39	1 00	-3 4	43 5	21 0	2 1	-2 4	9 2	-3 8
V Petroleum Crude and Products	21 96	20 14	29 11	9 13	-2 36	13 22	33 3	-18 6	-21 7	97 4	24 1	-10 4	25 9
VI Manufactured Goods	17 68	16 44	15 58	37 32	-1 07	9 72	-13 5	17 8	-7 5	11 4	-1 0	10 0	20 1
VI Others	3 33	4 01	4 57	20 79	15 49	26 92	11 5	29 0	6 0	2 5	10 2	-4 8	75 4

Source CMIE, Foreign Trade and Balance of Payments, Various Issues

Table 4.11: Growth Rate of India's Major Non-oil Imports during April -May

Commodity/ Commodity Group	US $ Million		Growth Rate %	
	2002-03	2003-04	2002-03	2003-04
I. Food & Related Items				
of which	417 6	516 7	27 5	23 7
Vegetable oils fixed (Edibles)	276 7	391 9	33 7	41 7
II. Export Related Items				
of which	1521 3	1670 8	26 8	9 8
(1) Organic chemicals	301 7	412 3	15 6	36 7
(2) Inorganic chemicals	177 4	147 8	4 1	-16 7
(3) Pearls, precious and semiprecious	973 3	1037 0	38 7	6 5
(4) Textiles yarn fab , made ups articles	48 1	59 0	-21 5	22 7
III. Capital Goods *of which*	2002 7	2523 7	30 8	26 0
(1) Machinery except electrical & electronics	484 0	647 3	4 4	33 7
(2) Electrical machinery except electronics	92 1	123 7	2 9	34 4
(3) Prof instruments optical goods	176 5	178 7	16 3	1 2
(4) Transport equipment	248 4	233 9	356 1	-5 8
(5) Project goods	110 5	92 5	-6 7	-16 3
IV. Raw Materials & Intermediaries *of which*	1785 4	2551 5	-15 3	42 9
(1) Coal,coke & briquettes	174 1	209 0	12 6	20 0
(2) Gold & silver	801 1	1445 0	-33 8	80 4
(3) Metaliferrous ores & metal scrap	198 8	206 0	21 8	3 6
V. Manufactured Goods *of which*	581 7	783 1	1 6	34 6
(1) RMG and made up textile articles	11 7	13 1	-30 4	12 5
(2) Iron & steel	142 8	213 3	28 9	49 4
(3) Non-ferrous metals	97 6	129 9	-3 6	33 2
(4) Wood & wood products	65 7	100 3	-7 5	52 6
(5) Fertilizer manufactured	61 2	50 1	21 3	-18 1
VI. Other Commodities	331 2	350 0	-8 2	5 7
Total Non-Oil Imports	6639 9	8395 8	8 9	26 4

Source DGCI&S, *Foreign Trade Statistics of India*, 2003,2002, May Issues

in December 2001. Indian exporters seem to have grasped the new opportunity quite well.

Invisibles

The current account balance (CAB) turned a surplus for the second consequent year in 2002-03. Along with a marginal improvement in trade balance, invisible earnings showed a surplus of $17.1 billion in 2002-03 compared to $13.5 billion last year (Table 4.12). Private transfers, followed by export of software and other business services, dominate India's invisible earnings. The software exports increased by about 27 per cent in 2002-03 and touched $ 9.6 billion. The categories of commercial services comprising travel, transportation, insurance and business services have been experiencing depressed conditions worldwide ever since September 11, 2001.

Reserves

With foreign exchange reserves of about $ 88 billion, equivalent of more than 14 months worth of imports, India is in a comfortable position satisfying all the major metrics of adequacy. It has been pointed out that such metric standards were already satisfied by March 2002 when the reserves stood at $ 54 billion.3 India, however, has added another $34 billion to its foreign exchange reserves during April 2002 to September 2003. A debate is currently going on cost of holding reserves. It has been pointed out that India's policy stance on reserves and the currency is primarily one of exchange rate management on the INR/USD exchange rate, which seeks to obtain low volatility of rate. Fluctuations of reserves appear to be a side effect caused by the pursuit of goals of currency policy.

Post Cancun International Trade Scenario

The Ministerial meeting at Cancun always had a chance of failing because of rigid attitudes on all sides. Sure enough the meeting failed. It happened because of three main reasons. First, the United States was not ready to lower its cot-

Table 4.12: Overall Balance of Payment in India
Net Credit, US $ Million

	2001-02	2002-03	Q1:2002 -03	Q1:2003- 04
A. Current Account				
Merchandise Trade Balance	-12703	-12910	-2752	-5854
Net Invisible Receipts	13485	17047	3162	4650
Current Account Balance	782	4137	410	-1204
B. Capital Account				
Foreign Investment	6692	4555	1097	2761
External Assistance	1117	-2460	89	-331
Commercial Borrowing	-1576	-2344	-746	639
Short Term Credit	-891	979	178	903
Banking Capital	5592	8412	661	1876
Rupee Debt Services	-519	-474	-352	-301
Other Capital *	158	3445	857	519
Capital Account Balance	10573	12113	1784	6066
C. Error and Omission	402	730	-530	308
D. Overall Balance	11757	16980	1664	5170
E. Monetary Movement	-11757	-16980	-1664	-5170
IMF	-	-	-	-
Forex Reserve (Increase —/Decrease +)	-11757	-16980	-1664	-5170

Notes: * Other capital includes delayed export receipts, advance payments against imports, loans to non- residents by residents
Source: RBI

ton subsidies that are upwards of $3 billion a year to appease about 25,000 of its cotton farmers. This adversely affects millions of African cotton farmers mainly in Benin, Burkina Faso, Chad and Mali. These countries had got cotton included as an explicit item in the Cancun Agenda. Second, Japan refused to lower its tariff barriers on imports of rice as well as being non-committal on subsidies to its rice farmers. And, third, the EU offered very meagre concessions on agriculture subsidies. Its dilution of the Singapore Issues also came too late.

Contrary to some of the statements declaring the Cancun failure as a victory for the developing countries, the major losers are these countries. According to the World Bank estimates, a new round of market opening would raise

global output by an estimated range lying between $290 and $520 billion by 2015. About 60 per cent of these gains are expected to be shared by the poor countries with an estimated 144 million people expected to be lifted out of poverty.

An important question now being voiced with increasing concern is about the future of multilateralism, which was in any case under pressure because of the growing number of preferential trade agreements (PTAs) after the Seattle fiasco. Almost all member countries, barring a few like China, have already notified their partnerships in PTAs to the WTO secretariat. The EU has the largest number of PTAs listed against its name. However, India needs a multilateral trading system more than other countries because most of the other major trading countries are already members of meaningful trading blocks. They could now proceed to integrate more strongly within their own trade blocks, which will seek greater co-operation among themselves. So India should work to resuscitate multilateralism instead of preening about mythical "victories." It should also push ahead with the domestic reform that will make it a more powerful trading nation, even with the existing rules. Principal among these should be tariff reduction and reform of agriculture, which needs to hugely enhance production efficiencies.

It must, however, be recognised that the real problem for trade ministers is not just what to talk about; it is how to deal with a changed world environment in trade, economy, politics and international relations. This is a process that will take time. Until then, no effort must be spared to keep the multilateral system going.

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3 Patnaik, Ila. 2003. "India's Policy Stance on Reserves and Currency," ICRIER Working Paper No. 108.

Money and Capital Market

Trends in Monetary Aggregates

The Y-o-Y growth in broad money remained sluggish during the first quarter. (Table 5.1). The pattern of growth in base money has been comparatively more volatile. It grew by 17.3 per cent in the first quarter, but dropped to 9.79 per cent by the end of FY 2003-04Q2 (see September figures in Table 5.1), which is slightly higher than 9.20 per cent growth for FY 2002-03. Narrow money grew by 13.46 and 13.36 per cent respectively during the corresponding periods, which is higher than 11.43 per cent at the end of FY 2002-03. Despite this growth a fall in world oil prices partly explain the recent movements in inflation, which remained subdued during the last six months (Fig 5.1). Inflation is likely to increase further as the lagged effect of narrow money growth, which is also likely to be accompanied with increases in oil prices.

The annual growth in time deposits during the second quarter of FY 2003-04 was 11.70 per cent as against 18.14 per cent during the same period of 2002-03. The change in the growth of demand deposits was much higher. It increased from 9.40 per cent in the 2002-03Q2 to 13.82 per cent during the second quarter of 2003-04 (Table 5.1). The demand deposit growth may decrease as the equity market picks up further.

Foreign exchange assets of the banking sector increased at the high pace of 25.09 per cent in 2002-03. However, the second quarter of 2003-04 has recorded y-o-y growth of 26.98 per cent. The September stock of foreign exchange in banking sector reached a level of Rs. 4,433 billion and each rupee in circulation is now backed by 1.52 rupee equivalent of foreign currency. This has further reduced the role of domestic assets in money creation.

Table 5.1: Changes in Monetary Aggregates and their Components

	Stock	Annual Growth (end of period)				Quarterly Growth) (Y-o-Y, end of period				Monthly Growth Rate Y-o Y					
	Sep 03	March 00	March 01	March 02	March 03	2002-03 Q1	2002-03 Q2	2002-03 Q3	2002-03 Q4	2003-04 Q1	May 00	June 00	July 00	Aug 00	Sept 00
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1 Reserve Money	368773	8 20	8 11	11 43	9 20	4 81	11 12	9 25	9 20	17 34	14 99	17 34	11 06	9 84	9 79
2 Narrow Money	490879	10 59	11 02	11 35	11 90	11 70	12 50	12 64	11 90	13 46	12 24	13 46	13 38	13 84	13 36
3 Broad Money	1837660	14 60	16 82	14 22	15 01	17 55	16 60	16 22	15 01	11 66	11 23	11 66	11 85	11 85	12 14
4. Major Components															
(a) Currency in Circulation	292068	12 06	10 73	15 02	12 55	14 52	14 51	13 17	12 55	13 05	12 60	13 05	13 34	12 17	12 46
(b) Currency with the Public	283472	11 92	10 82	15 20	12 25	15 06	14 86	13 64	12 25	12 66	12 41	12 66	12 91	13 06	13 02
(c) Demand Deposit	207407	8 98	11 25	6 61	11 43	7 37	9 40	11 30	11 43	14 57	11 99	14 57	14 03	14 93	13 82
(d) Time Deposit	1346782	16 44	19 35	15 39	16 23	19 90	18 14	17 59	16 23	10 98	10 84	10 98	11 29	11 13	11 70
(e) Other Deposit	4842	-18 79	19 61	-21 47	13 75	-18 81	-3 57	-7 61	13 75	28 57	8 05	28 57	28 57	21 98	40 39
5. Major Sources of M3															
(a) NRBCG	63082	-2 80	3 79	-1 10	-20 70	-12 77	-15 68	-25 15	-20 70	-21 45	-22 64	-21 45	-37 74	-44 28	-50 79
(b) NBCG	645176	25 19	22 16	21 28	28 34	26 01	23 59	25 23	28 34	23 76	25 15	23 76	28 11	26 25	28 16
(c) NBCC	917514	18 26	15 80	11 34	19 88	20 20	19 81	18 15	19 88	12 21	12 73	12 21	10 65	10 76	10 51
(d) NFEA of Banking sector	443311	15 63	21 48	25 98	25 09	29 96	30 76	35 72	25 09	24 67	28 24	24 67	24 94	23 36	26 98
6. Major Sources of M0															
(a) NFEA with RBI	409702	20 24	18 87	33 88	35 71	38 60	41 30	45 46	35 71	34 49	39 00	34 49	34 53	33 57	35 27
(b) Net Domestic assets	-40929	-5 49	-7 45	-30 28	-85 38	-58 17	-62 45	-92 67	-85 38	-88 62	-89 29	-88 62	-124 83	-164 54	-223 97

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
7. Ratios															
(a) M3/M0	4 98	4 01	4 33	4 44	4 67	4 91	4 88	4 90	4 67	4 68	4 60	4 68	4 77	4 93	4 98
(b) M1/M0	1 33	1 22	1 25	1 25	1 28	1 34	1 29	1 32	1 28	1 30	1 27	1 30	1 29	1 33	1 33
(c) Deposit/RM	4 23	3 34	3 65	3 73	3 95	4 15	4 14	4 15	3 95	3 94	3 86	3 94	4 04	4 17	4 23
(d) NFEA (RBI)/RM	1 11	0 59	0 65	0 78	0 97	0 86	0 90	0 98	0 97	0 99	0 98	0 99	1 03	1 07	1 11
(e) NFEA (RBI)/CC	1 40	0 84	0 90	1 05	1 27	1 07	1 17	1 25	1 27	1 27	1 27	1 27	1 33	1 35	1 40
(f) NBCG/M3	0 35	0 26	0 27	0 29	0 32	0 30	0 31	0 31	0 32	0 33	0 33	0 33	0 34	0 35	0 35
(g) NBCC/M3	0 50	0 52	0 52	0 50	0 53	0 50	0 51	0 51	0 53	0 51	0 51	0 51	0 50	0 50	0 50
(h) Credit/Deposit #	0 54	0 54	0 53	0 53	0 57	0 54	0 54	0 55	0 57	0 55	0 55	0 55	0 54	0 53	0 53
(h) Non-Food Credit/Deposit	0 51	0 50	0 49	0 49	0 53	0 49	0 50	0 51	0 53	0 51	0 51	0 51	0 51	0 50	0 51

NFEA Net Foreign Exchange Assets with RBI, NRBCG Net Reserve bank credit to government, NBCG Net other Bank credit to government, NBCC Net Bank credit to commercial sector
 # Refers to Bank credit by commercial sector, includes food credit
All ratios are end period

Source RBI

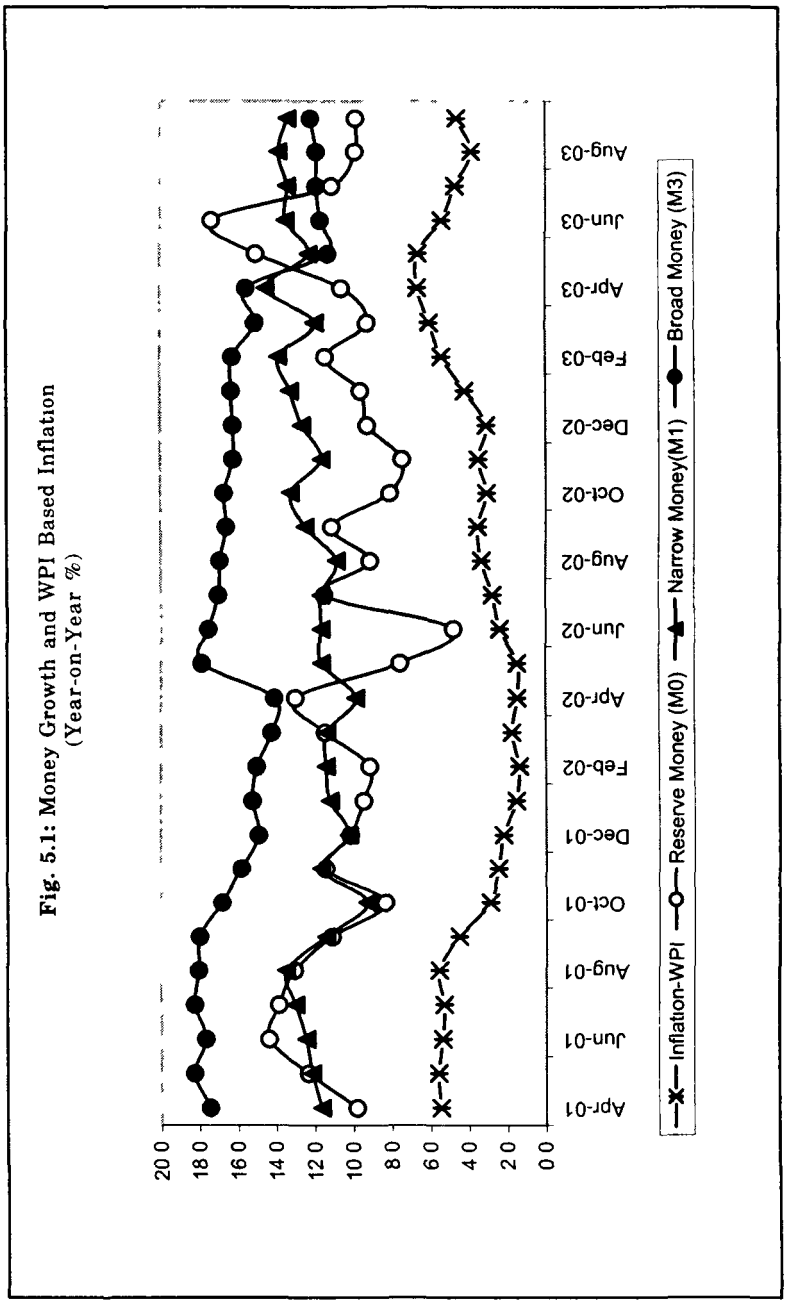
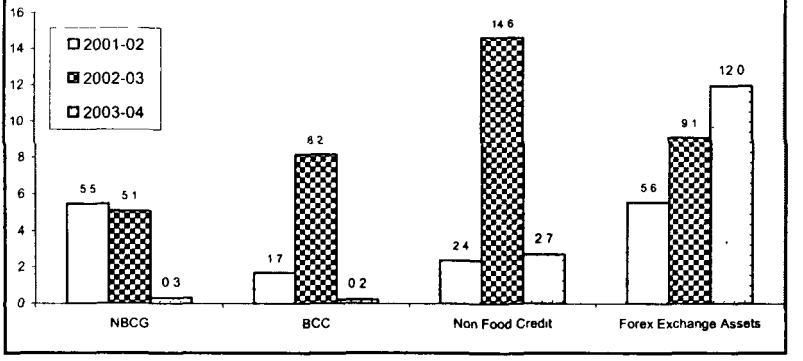


Fig. 5.1: Money Growth and WPI Based Inflation
(Year-on-Year %)

Fig. 5.2: Bank Credit and Foreign Exchange Assets
(percentage change in first half of the financial year)



Sluggish Credit Growth

Following the past trend, the net Reserve Bank Credit to Government (NRBCG) in the second quarter of 2003-04 declined by 50.79 per cent as against 15.68 per cent decline during 2002-03Q2. Overall, FY 2002-03 had ended with a decline of 20.7 per cent.

Y-o-Y growth in net other bank credit to government (NBCG) has picked up from 23.76 per cent in first quarter of 2003-04 to 28.16 per cent in second quarter, which is higher than corresponding figure of 23.59 per cent during second quarter of 2002-03. FY2002-03 had ended with 27.62 per cent growth in NBCG.

Y-o-Y growth in net other bank credit to the commercial sector (NBCC) has fallen to 10.51 per cent during the second quarter of 2003-04 as against 19.81 per cent for the same period last year and 19.88 per cent for FY2002-03. The ratio of non-food credit to deposits increased from 0.50 in 2002-03Q2 to 0.51 in 2003-04Q2. But it is lower than 0.53 recorded at the end of FY2002-03. The growth in non-food credit during first half of FY 2003-04 has been 2.7 per cent only as against 14.6 percent growth recorded during the corresponding period of 2002 (Figure 5.1). Thus, contrary to the expectations expressed in the Monetary and Credit Policy for 2003-04, credit growth has been very sluggish.

For sustaining the economic recovery the cost of credit would have to be lowered further. A higher growth in demand deposits and lower growth in time deposits, as observed above, can lead to credit crunch and a hardening of the lending rates. With a fall in lending rates and a control on the deposit rates, the spread is not enough to motivate people to fix their deposits. Thus, the interest rate will become a de-facto administered as it closes with savings deposit rate.

Interestingly, the sluggish trend in broad money growth is not in conformity with the strong recovery in industrial output since the third quarter of the last financial year. This can be attributed to several reasons.

(1) RBI has been quick to implement the Basel norms. These require the capital adequacy ratio to be risk-weighted and a reduction in the non-performing assets (NPA). Therefore, banks are in the process of cleaning their houses by controlling credits for the time being.

(2) Business proceeds coming as demand deposits are not being ploughed back either into working capital or fixed investment, probably under an expectations of a further softening in interest rates;

(3) The corporate results indicate fall in working capital requirements. This may be an outcome of greater use of information technology, which is very helpful in reducing inventories and other variable costs. Since most of the working capital is raised from banks, it is directly reflected in bank credit off-taken.

(4) Business finds it cheaper to raise funds directly from the public;

(5) Small and medium borrowers are expecting the interest rate to go further down and might be postponing their investment decisions;

This suggests that the lending rate must stabilise as quickly as possible, probably at a lower level. Freeze on policy driven rate cuts may be helpful on connecting market expectations and allow business to take investment decisions. In case liquidity constraint is felt a cut in CRR would be better option, which also reduces bank cost.

Bank Reforms in Pipeline

Financial sector reforms were carried forward during 2002-03 with the announcement of measures for streamlining banking operations, upgradation of risk management systems, operationalisation of consolidated accounting practices and enactment of a new Act to improve the recovery of non-performing loans. The provisions of Basel Capital Accord are due to be implemented by 2006 and banks are preparing for compliance. As such some of the activities are noted as under:

The internationally accepted 90-day norm for recognition of loan impairment would be applicable to commercial banks, co-operative banks and regional rural banks with convergence set for the year ending March 2004.

The transition time for a sub-standard asset to be classified as a doubtful asset has been shortened from 18 months to 12 months with effect from March 31, 2005. The consequent additional provisioning is to be phased over a four-year period with a minimum of 20 per cent each year.

In January 2002 banks were advised to build up Investment Fluctuation Reserve (IFR) of a minimum of 5 per cent of the investment portfolio within a period of 5 years. Effective from March 31, 2003 this ceiling was removed. For capital adequacy purposes, Tier II capital including IFR would be considered up to a maximum of 100 per cent of Tier I capital.

Depending on the risk category of the country of exposures, banks were directed to make provisions, with effect from the year ended March 31, 2003, on the net funded country exposures on a graded scale ranging from 0.25 to 100 per cent. Provisions held for country exposures are allowed to be treated on par with the 'provisions held for standard assets, for being reckoned for Tier II capital, subject to the ceiling of 1.25 per cent of the risk weighted assets.

As a part of a forward-looking refinement of the supervisory function which will help in aligning supervised institutions with the Basel Capital Accord when

it is adopted, the Reserve Bank is moving towards risk based supervision (RBS), which entails the allocation of supervisory resources and focus in accor-dance with risk profiles.

Extracted from Annual Report (2002-03), Unpublished Thesis.

Interest Rates

The average domestic deposit rate offered by major banks on deposits of more than one-year softened further. The rate has remained below 6 per cent since January 2003. July and September both recorded a marginal softening in PLR (average of 5 major commercial banks) by 0.3 per cent over 11.1 per cent prevailing in June 2003. However, the spread between the PLR, the deposit rates, and gilt yield remains more than 5 per cent (Fig 5.3). Therefore, in order to protect small agriculture borrowers from the rigidity in PLR, the government has announced a cap of 9 per cent on farm loans of less than Rs 50,000.

There was softening in the yield on gilts between March and July 2003. The yield curve (Fig 5.4) shifted down from its position in March. It has also became little steeper under an expectation of cuts in the repo rate and higher inflation in the years ahead. Since the cut in the repo rate has already been announced, the lower end is likely to shift further down. It remains tied to around 5 per cent. This is in conformity with the daily call money rate, which was around 5 per cent in July and has come further down to 4.5 per cent since mid-September.

Foreign Exchange Reserves and the Exchange rate

The foreign exchange reserves (FER) touched almost USD 87.738 billion on 3 October 2003, adding USD 12.31 billion to the stock of end-March 2003. 2002-03 witnessed a growth rate of 34.75 per cent (in rupee terms) in net foreign assets with the RBI as against 33.88 per cent growth during 2001-02. This growth continued during the first six

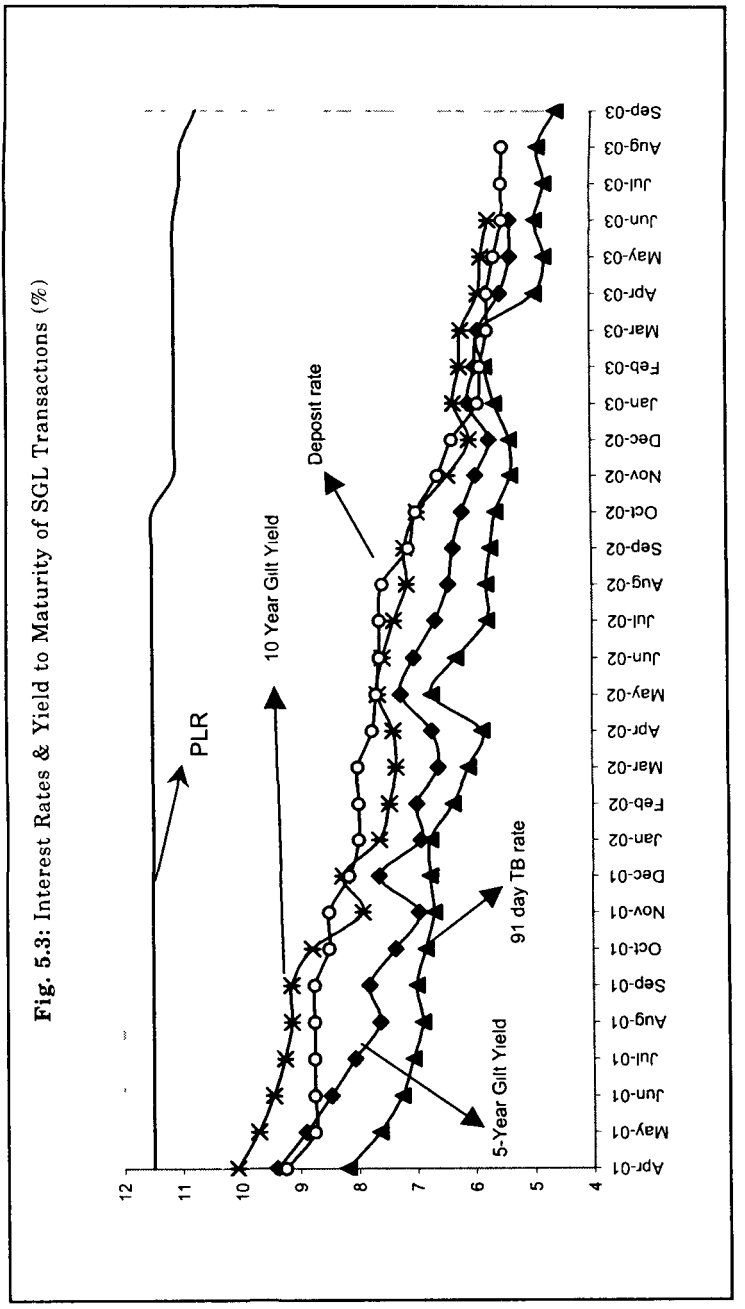


Fig. 5.3: Interest Rates & Yield to Maturity of SGL Transactions (%)

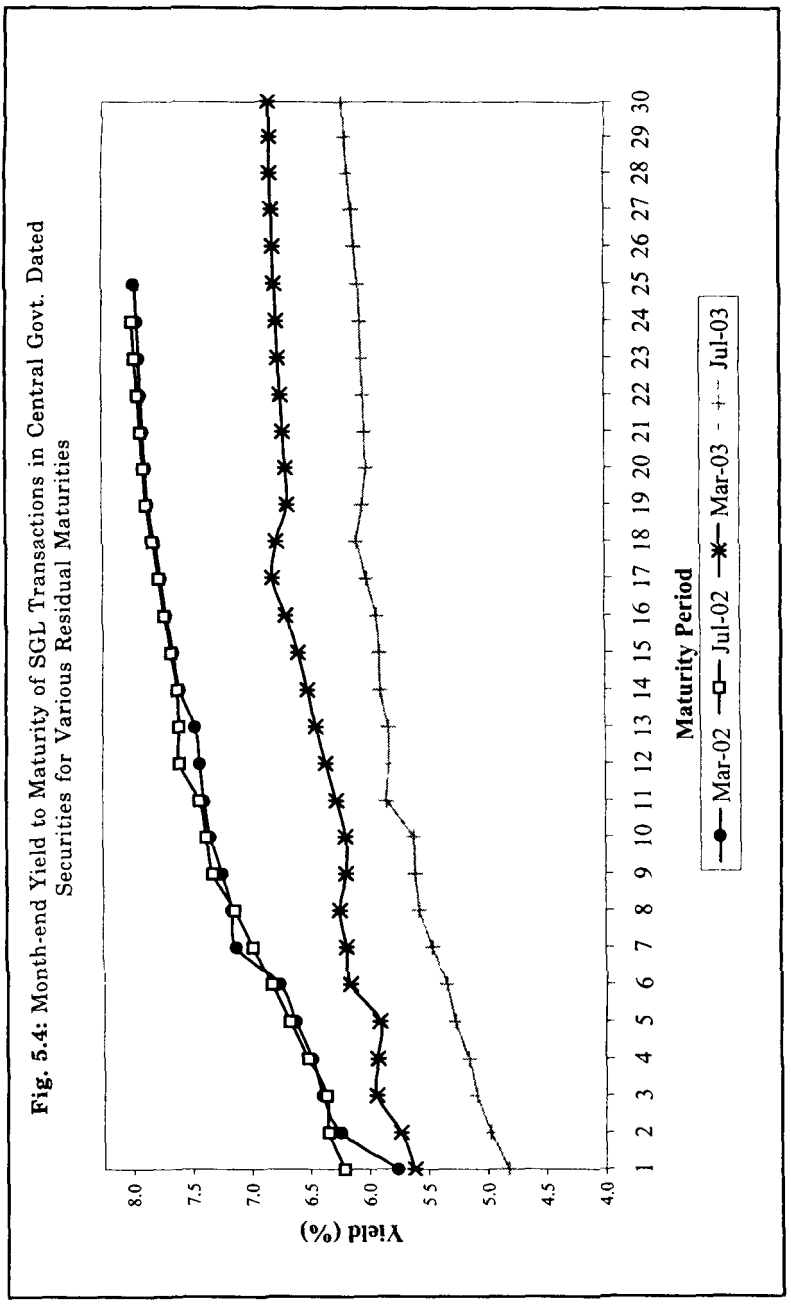


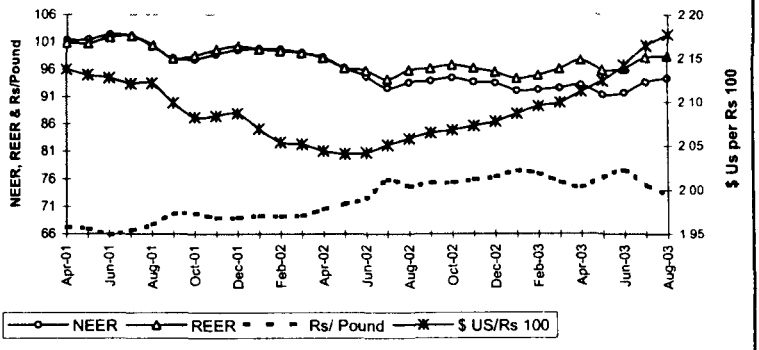
Fig. 5.4: Month-end Yield to Maturity of SGL Transactions in Central Govt. Dated Securities for Various Residual Maturities

months of FY2003-04, with a Y-o-Y growth of 35.27 per cent at the end of 2003-04Q2 (Table 5.1). OMO sales by RBI up to 3 October 2003 were Rs 22,377 crore as against Rs. 27,009 crore up to 3 October 2002. Thus, there is a slight reduction in the role of sterilisation.

The quantum jump in reserves and the improved current account pressured the rupee to appreciate by 2.5 per cent against the dollar between March 2002 and March 2003 and by 3.8 per cent between March-August 2003. This was with the help of partial sterilisation. However, the 5-country real exchange rate index (REER) depreciated by 2.9 per cent between March 2002 and March 2003 (point to point). During the same period the 5-country nominal effective exchange rate (NEER) depreciated by 6.6 per cent (Fig. 5.5). This real depreciation helped greatly in increasing exports. However, more recently, NEER and REER have also appreciated. It is being argued that this appreciation will make imports of capital goods and intermediates cheaper and thereby improves the competitiveness of the goods that depend on imports. The appreciation may have led to softening of domestic prices through its effect on oil prices, which is helpful in bringing macroeconomic stability. However, it may be preferable to cut import duties and reduce import costs.

At current level of inflation sterilisation does not appear to be justified particularly when exchange rate is appreciating. It is important that RBI should reduce its emphasis on sterilisation and let the exchange rate take its value determined by the forces of supply and demand. In the meantime the stance on open market operation should be taken to keep the inflation in targeted range. The situation is right for allowing experimental stances towards opening the capital account and becoming more proactive in trade liberalisation It is a strength, on which many economic decisions can be taken, which were otherwise unthinkable. However, many commentators feel that the cost of holding reserves is too high and try to calculate the disadvantages in terms of lost growth but such arguments are based on costs only and no effort is made to quantify the benefits.

Fig. 5.5: REER and NEER (5-country Based Bilateral Weights)
Base : 2001-02 (April-March) = 100



Capital Market

The equity off-take during the first and second quarters of 2003-04 recorded Y-o-Y growths of 54.55 and 19.15 per cents respectively as against decrease of 43.62 per cent during 2002-03Q4 (Table 5.2). Debt is now shading its dominance and offshore floatation remains insignificant. However, there has been consistent improvement in net inflows of foreign institutional investment. The announcements of the last budget such as exemption to capital gains tax and Moody's upgradation from Ba1 to Ba2 have helped FII flows to improve, particularly at the face of good monsoon and feel good factor generated through high growth figures released by the CSO for the first quarter. FII investment during the second quarter has been Rs 8698 crore, which is 1342 per cent higher than 2002-03Q2.

On Y-o-Y basis the Sensex recorded a growth 48.9 per cents in September 2003. The highest growths were in the stocks of the public sector, capital goods, and health care sectors (Figures 5.6 & 5.7). This buoyancy is being attributed to strong corporate results and an improved outlook for the economy due to good rains. The prospects of liberalisation of FDI norms for banking stocks have also been helpful. There has been some development on the leg-

Table 5.2: Capital Market Indicators (Rs. Crore)

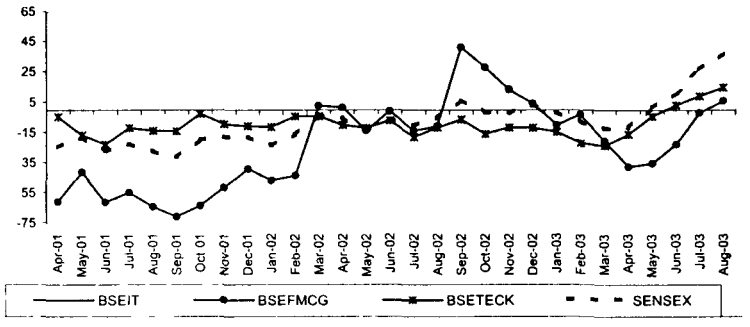
	2001-02				2002-03				2003-04	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Cap-issue (Domestic*)	7187	15392	10095	12685	6303	12275	10607	11230	4838	0073
Equity*	174	122	893	1824	709	602	731	1029	1095	717
Debt*	6965	14611	8897	9100	4704	11000	8378	9339	3723	8874
Offshore*	1380	813	0	70	0	291	198	144	75	0
FII Net Investment	3749	452	1078	3467	-996	603	457	2522	7552	8698
Daily Turnover (BSE)@	1295	912	1364	1491	1247	1169	1377	1194	1094	1755
Market Capitalization (BSE)#	553230	456263	532328	612224	637753	570273	628197	572197	734389	933087

* total for the period, @Period average, # End of the period
Source CMIE

Growth rate (y-o-y) %	2002-03				2003-04	
	Q1	Q2	Q3	Q4	Q1	Q2
Cap-issue (Domestic*)	-12 30	-20 25	5 08	-11 47	-23 25	-17 93
Equity*	306 29	391 72	-18 13	-43 62	54 55	19 15
Debt*	-32 47	-24 71	-5 83	2 63	-20 85	-19 32
Offshore*	-	-64 21	-	105 61	-	-
FII Net Investment	-126 56	33 31	-57 61	-27 26	-858 57	1342 25
Daily Turnover (BSE)@	-3 68	28 13	0 95	-19 92	-12 30	50 13
Market Capitalization (BSE)#	15 28	24 99	18 01	-6 54	15 15	63 62

islative front also during this period such as passage of "Fiscal Responsibility Bill", which is likely to build up market confidence.

Fig. 5.6: Group-wise Growth of Stock Indices (% y-o-y)



Upsurge in FIIs: Will it last?

The Indian capital market has experienced a clear surge in the foreign institutional investment (FII) in the current calendar year. The net investments (difference between gross purchase and gross sale) by FII in the Indian capital market amounts to nearly US$ 3.45bn in the first eight months, which is more than the previous high of $ 3.05bn invested in the whole of 1996. The net effect of this is being shown up in the upward movement of Sensex, which continued a Bull Run for five consecutive months (April-September). Fuelled by sustained buying from FIIs, Sensex crossed the psychological barrier of 4400 to close at 4434.25 on September 8, 2003.

Why foreign institutional investors are so keen to invest in the Indian market? Foremost reason is the India's relative performance, vis-à-vis, other emerging market. Among the emerging markets, Morgan Stanley Capital International (MSCI) India index with a monthly return of 11.48% in August (in terms of local currency beat all other MSCI emerging market country indices in Asia. The same was next only to the MSCI indices of Poland

and Russia among other country-specific emerging market indices of the world (see Table below)

Emerging Markets—Which is the Most Attractive of Them All?

Name	Returns (%)*		
	Monthly	Quarterly	Yearly
China	6 42	16 83	34 79
India	11 48	17 48	19 97
Indonesia	1 51	1 68	19 87
Korea	5 56	15 60	23 14
Malaysia	2 79	7 30	15 58
Pakistan	11 38	26 06	37 21
Philippines	4 93	3 00	18 63
Sri Lanka	1 60	1 69	56 16
Taiwan	7 63	19 28	32 71
Thailand	7 92	10 58	44 92

*Data as on August 29, 2003
(*Source* Morgan Stanley Capital International)

Another reason is that barring China, few nations hold the kind of potential that Indian economy does in terms of growth Indian stocks are still relatively undervalued in the context of their growth potential Moreover, the twin factors, subdued Western economies and sustained appreciation in rupee, have also played a role in the sharp increase in FII flows into India An appreciation of rupee vis-à-vis dollar augurs well for FII money as it raises the return for them

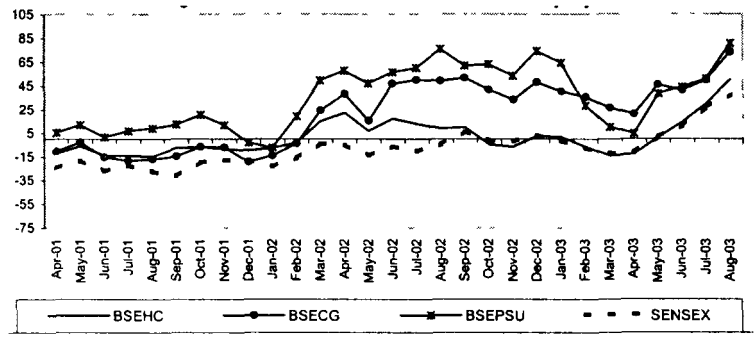
Last but not least, a strong performance by the domestic corporate sector has clearly emerged as one of the significant driving forces for FII investment in the domestic capital market A turnaround in the performance of several industries such as auto, steel, shipping, aluminium, etc , and improved profitability of the same have fetched foreign investment India also offers additional attraction of very strong company fundamentals arising from a four-year period of corporate restructuring and streamlining of operations The domestic companies on the back of operational restructuring and cost-cutting initiatives have been

able to register solid growth. Besides, the efforts on the debt restructuring also helped them to improve their financial health. This is evident from recent reports of ICRA and CRISIL, which show a reduction in downgrades of corporate ratings.

It is evident from the above discussion that foreign investors have shown great interest in Indian capital market in the recent months. However, to sustain this momentum of FII inflows, India really needs to do a lot. Government's privatization program has not been moving as fast as it was perceived. The coming assembly elections in four states and general election in 2004 too are expected to further affect the disinvestment process. Moreover if the US economy continues to recover fast, FII inflows to Indian capital market may dry up substantially. In fact, chances of a majority of these investments being more in the nature of short-term rather than long-term cannot be ruled out completely.

By Somnath Mukherjee and Sanjib Pohit

Fig. 5.7: Group-wise Growth of Stock Indices (% y-o-y)



Further, following the success of the Maruti IPO, the government has sought the consent of strategic partners to sell its remaining stakes in VSNL, CMC, IBP (26 per cent each), IPCL (34 per cent) and BALCO (49 per cent) through public offers. Decks are also cleared for airport privatisation and the process is already started. All theses factor have posi-

tive impact on capital market. However, following the Supreme Court ruling on September 16, 2003 that the Parliamentary approval was necessary for the divestments of oil companies, HPCL and BPCL, it is feared that the whole process of privatisation will be seriously affected. However, the stock market does not appear to be too concerned with this development.

Public Sector Banks

Several significant changes are taking place in the financial sector, of which two are noteworthy. First, there is increased private participation in banking; second the profitability of the public sector banks, which dominate the banking system with a share of 75 per cent, has improved significantly. It is on the latter that we focus here.

Profitability

The operating profit of PSBs as percentage of total assets increased from 1.53 percent in 2000-01 to 1.94 per cent in 2001-02. This is in line with the improvement observed across all groups of banks (Table 1a). This improvement has come from both expenditure management as well as increases in income streams. Expenditure has been reduced from 9.63 per cent of total assets in 2000-01 to 9.43 per cent in 2001-02, while income increased from 10.05 percent to 10.14 percent. Despite cuts in interest rates, the interest income reduced marginally from 8.85 percent to 8.71 percent. There has also been an increase in provisioning (Table 5.1) from 0.92 percent to 1.15 percent. This is driven by the requirements of prudential norms. Trading profits of the public sector banks have increased sharply by Rs 3,749 crores taking their net profits to an all time high of Rs. 8301 crores in 2002. This year, too, the banks are showing sizeable gains in their profitability. The Securitisation and Reconstruction of Financial Assets and Enforcement Security Interest (SARFAESI) Act, 2002 has offered banks opportunities to

Table 5.3: Bank Group-wise Select Indicators of Financial Performance (As percentage of total assets)

Bank Group / Year	Operating Profit	Net Profit	Income	Interest Income	Other Income	Expenditure	Provisions and Contigencies
			SCB				
2000-01	1 53	0 49	10 2	8 88	1 32	9 7	1 03
2001-02	1 94	0 75	9 84	8 27	1 57	9 08	1 19
Public Sector Banks							
2000-01	1 34	0 42	10 05	8 85	1 2	9 63	0 92
2001-02	1 88	0 72	10 14	8 71	1 43	9 43	1 16
			Nationalised Banks				
2000-01	1 29	0 33	10 23	9 09	1 14	9 9	0 95
2001-02	1 83	0 69	10 26	8 78	1 48	9 58	1 15
			State Bank Group				
2000-01	1 42	0 55	9 77	8 47	1 3	9 21	0 87
2001-02	1 94	0 77	9 96	8 62	1 34	9 19	1 17
			Old Private Sector Banks				
2000-01	1 75	0 59	10 76	9 53	1 23	10 16	1 15
2001-02	2 7	1 08	11 74	9 36	2 38	10 67	1 62
			New Private Sector Banks				
2000-01	1 74	0 81	9 52	8 17	1 35	8 71	0 93
2001-02	1 21	0 44	5 66	4 48	1 18	5 22	0 77
			Foreign Banks				
2000-01	3 05	0 93	11 74	9 27	2 47	10 81	2 12
2001-02	3 13	1 33	11 56	8 65	2 91	10 23	1 8

Source Table II 13, Report on trend and progress of Banking in India 2001-02

Table 5.4: Gross Non-Performing Assets

Name of the Bank	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02
As Proportion to Gross Advances						
Nationalised Banks	19 05	16 88	16 02	13 91	12 16	11 01
State Bank Group	15 81	14 57	15 67	14 08	12 73	11 25
Public Sector Banks	17 84	16 02	15 89	13 98	12 37	11 09
Old Private Sector Banks	10 71	10 92	13 06	10 78	10 94	11 01
New Private Sector Banks	2 63	3 51	6 19	4 14	5 13	8 87
Private Sector Banks	8 49	8 67	10 81	8 17	8 37	9 65
Foreign Banks in India	4 29	6 38	7 59	6 99	6 84	5 38
As Proportion to Total Assets						
Nationalised Banks	8 3	7 24	6 83	6	5 44	5 21
State Bank Group	7 03	6 67	6 52	5 88	5 11	4 39
Public Sector Banks	7 83	7 03	6 71	5 95	5 31	4 89
Old Private Sector Banks	5 23	5 06	5 78	5 22	5 14	5 2
New Private Sector Banks	1 34	1 52	2 26	1 6	2 05	3 91
Private Sector Banks	4 19	3 93	4 48	3 61	3 65	4 36
Foreign Banks in India	2 12	3 05	3 1	3 16	3 04	2 43

Sources Report on trend and progress of Banking in India, various issues

step up loan recoveries and tighten credit administration procedures. This could further enhance profitability.

Stock Market Response

These improvements are reflected in stock prices and ratings by international agencies. In 2002, the return on assets was higher compared to many emerging economies and the Moody's Bank Financial Strength Index (2002) placed India at 27.5, which is much better than 16.7 of Korea, 15.8 of Thailand and 12.5 of Japan. These developments have impacted the performance of bank stocks significantly. Since its formation in January 2002 and up to September 2003, the BANKEX has increased by 104 percent as against 34.5 per cent growth in the Sensex. During the period between 1 Jan 2002 and 13 June 2003, the total market capitalisation of BANKEX stocks has increased from Rs. 22970 crore to Rs. 55283 crore.

Non Performing Assets

The gross non-performing assets of SCBs in absolute terms increased by Rs. 7.164 crore to Rs. 70,905 crore in 2001-02. For PSBs, gross NPAs stood at Rs. 56,507 crore at end of March 2002, comprising 79.7 per cent of the sticky loans of SCBs. However, in terms of percentage of total assets and total advances, almost all groups of banks demonstrate an improvement (Table 5.4). The gross NPA as percentage of gross advances in 2001-02 has gone down to 11.1 percent from 12.37 per cent in 2000-01 for PSBs. On the other hand private and foreign banks have a much lower percentage, probably because they are exempted from the provisions of directed lending.

Prices

The price trends prevailing currently are quite different from the ones in Q1: 2003-04. The WPI based inflation rate, as measured on the year-on-year basis, was as high as 6.2 per cent in the first quarter of the fiscal year 2003-04. However, it fell to 3.8 per cent in August 2003, though it again rose to 4.6 per cent in September 2003 (Fig 6.1). A year ago, it was 3.5 per cent in September.

After reaching the peak of 6 per cent in June 2003, core inflation—measured by excluding primary food articles and administered commodities from the WPI basket—had been on a decline (Fig. 6.2). At the end of September, it was only 2.9 per cent, constituting a marginal rise from 2.5 per cent in August. The overall decline could be due to a number of factors such as satisfactory rains in all regions, the slight increase in the index of industrial production (IIP), and the continuous decline in the money supply. The decline in the WPI is backed by the decline in the prices of primary and manufactured products with a noticeable slowdown in the prices of food grains, oilseeds, edible oils, oil cakes, man-made textiles, woollen textiles, tyres, plastic products and basic heavy organic products as well. The few exceptions are dairy products, earthenware, tea and coffee processed, leather and leather products, glass, chinaware and their products, whose prices shows rising tendency

The RBI expects inflation to remain low in the rest of the fiscal year with a possibility of the same falling below the projected rate of 5 - 5.5 per cent. With continuing good monsoons, these are expectations that the prices of primary products would stabilise soon. Following the OPEC's decision to cut output by 900,000 barrels per day since the beginning of November, oil prices are expected to rise both in the global as well as the domestic market.

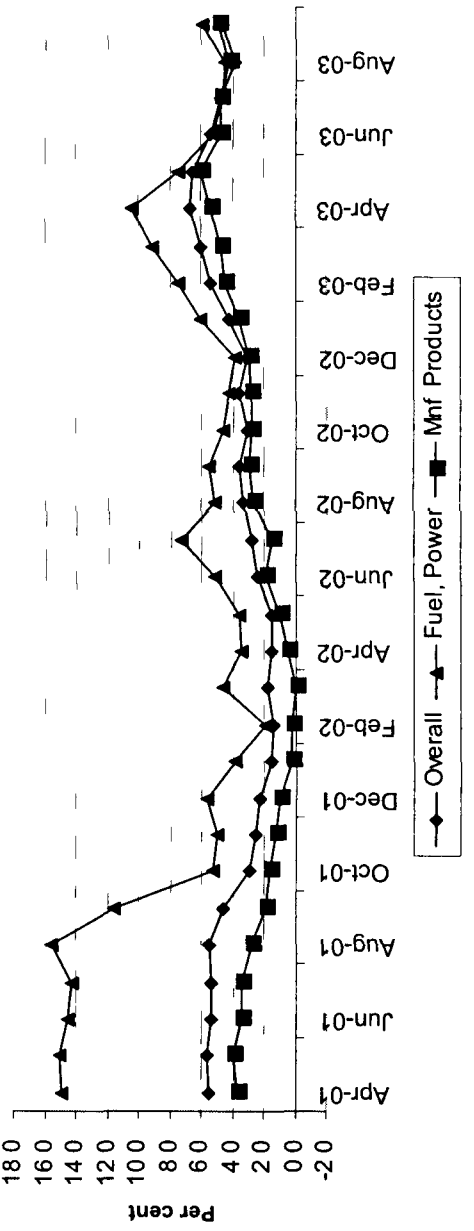
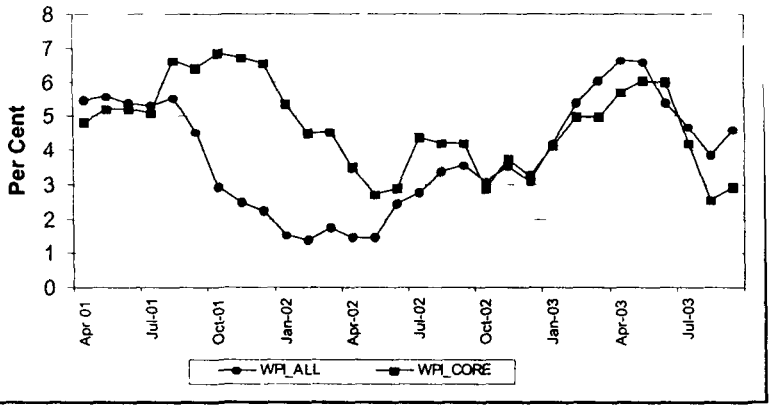


Fig. 6.1: Monthly Inflation Rate % (y-o-y)

Fig. 6.2 · Monthly Inflation Rate % (y-oy)



Agricultural Prices

Prices of selected agricultural products are known to rise rather sharply in times of shortages. Sugar, vegetable oils, onions, other vegetables and fruits are particularly prone to price fluctuations. Along with a depletion of food stocks lately, there has been a steep hike in the prices of fruits and vegetables and a moderate one in edible oils and other food products in the last month. This caused the inflation rate to increase to 4.35 per cent in the week ending September 13 as compared to 4.29 per cent a week before.

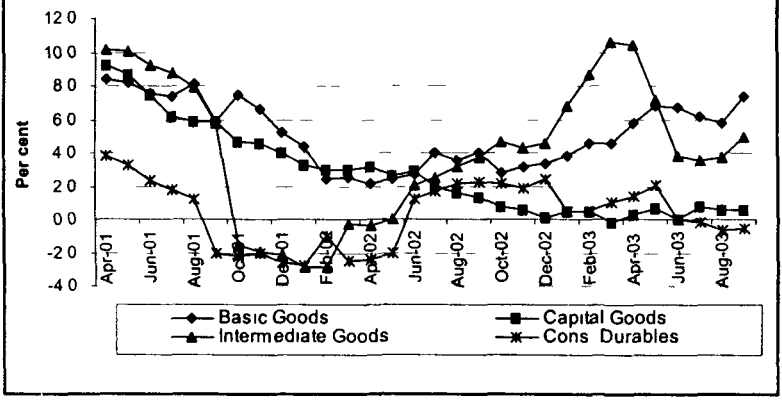
However, an expected bumper harvest in 2003 of over 212 million tonnes is expected to moderate the recent price rise during coming weeks and months. Moreover, with elections due in six states in the country, the Centre is expected to increase the imports of food grains in order to ease the rise in prices further. In fact, it is feared in certain quarters that over production may lead to a crash in commodity prices, which in turn may erode a part of the anticipated increase in rural incomes and purchasing power. While the stability of the price line has been maintained due to the season-end stock depletion, downward pressure will build up once fresh stocks start arriving by the month of October. But if the government intensifies its price support operations

through an increase in procurement, the plunge in prices could be avoided.

Manufactured Products and Energy Prices

The price index of manufactured products (WPI-MFG) has shown a consistent decline in growth rates since the peak of 6 per cent in May 2003. The price index for fuel, power and lubricants (WPI-FPL) also declined from a high of 7.7 per cent in Q1: 2003-04 to 5.9 per cent in September 2003 (Fig. 6.1). Under the use-based classification of goods, the WPI based inflation rate has declined for all categories except capital goods in the same period. One of the more prominent ones is the decline in consumer durables by -0.5 per cent in September 2003 from a positive 2 per cent in May 2003 (Fig. 6.3).

Fig. 6.3 : Inflation Rate of Use Based % (y-o-y)

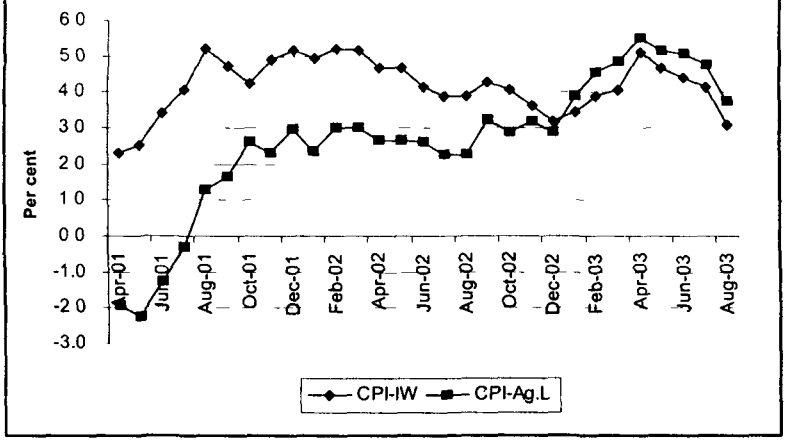


However, the data for September 2003 suggests a slight increase in both WPI-MFG and WPI-FPL since the previous month. With the recovery of IIP underway and the phenomenal success of monsoons, demand for manufactured products from the rural sector is expected to be strong in the coming months. Hence, one can expect a further increase in both these indices in the coming months.

Trends in CPI

At the retail level, the average inflation as measured by the consumer price index of industrial workers (CPI-IW) and the consumer price index of agricultural labourers (CPI-AL) stood at 4.7 per cent and 5.2 per cent respectively, in the first quarter of 2003-04. Both have been on a decline after a brief rise between December 2002 and April 2003 (Fig 6.4). The CPI-IW based inflation rate declined from 5.1 per cent at the end of April 2003 to 3.1 per cent in August 2003, while the CPI-AL fell from 5.5 per cent to 3.8 per cent in the same period.

Fig. 6.4 · Inflation Rate of CPI % (Y-o-Y)



International Commodity Price Trends

Commodity markets have continued to be heavily influenced by geo-political movements. The volatility of oil prices has been underscored by their recent sharp rise and the subsequent decline. In March 2003, as military action against Iraq became certain, prices fell from over $34 a barrel to $25.5 in just two weeks. Other factors which helped in the reduction were increases in output by other OPEC members broadly offsetting the loss of Iraqi crude oil exports and the post-strike recovery of Venezuelan production proceeding more quickly than anticipated. Nevertheless, industry oil inventories, which had in early 2003 fallen to their lowest

levels in decades, remained low and—together with increased demand from U.S. electricity generation plants and a cut in OPEC production targets as well as setbacks in Iraq's oil production—caused oil prices to rise again since May.

For the time being, oil prices are firm. But the persisting low inventory level, further delays in Iraq's production recovery, the recent decision of the OPEC to cut production quotas beginning November, and the lingering difficulties in Japan's nuclear power sector and the US natural gas sector could provide support to, and possibly even push up, prices in the near term. With winter beginning to set-in in countries of Europe and North America, a greater demand for fuel for heating devices could lead to a further surge in fuel prices.

Non-energy commodity prices were dampened in the first half of 2003 by, SARS-related concerns, and the slower than expected pace of economic activity. Owing to the depreciation of the US dollar against other major currencies, however, non-energy commodity prices rose during the first half of 2003. Other than the possibility of further weather related or other supply shocks, the pace of global economic recovery will clearly affect non-energy commodity price prospects. Prices of agricultural raw materials and food and beverage commodities have eased this year. Among food items, cereal prices have fallen markedly from last year's drought induced peaks. Vegetable oils and meals prices have also edged down this year.

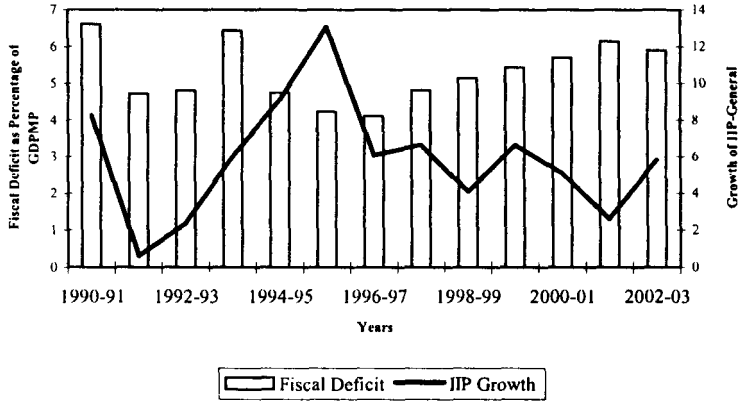
There are reasons to believe agricultural prices will not increase very fast, as, except for fertiliser, there is surplus production capacity. In case of non-agricultural commodities, metal prices are likely to be weak in the coming months due to weak demand and surplus stocks. The one exception is nickel, where strong demand for stainless steel, low inventories, and tight supplies, caused prices to almost double since the lows in 2001. If the global economic growth picks up fast, metals and mineral prices would increase more rapidly in the near term.

The real reason for the surprising strength of some commodity prices may, however, be the weakness of the dollar. Most commodity prices are designated in dollars. It is interesting that in non-dollar terms commodity prices have remained stable.

Public Finance

Public finances continue to cause concern. The combined fiscal deficit of the Centre and states has exceeded 10 per cent in 2002-03. In 1995-96, it was 6.5 per cent. Failure on the fiscal consolidation front can prove detrimental to the growth, needs no explanation. The main reasons for this steady deterioration of public finances are—partial implementation of fifth pay commission's recommendations in 1997, fall in direct and indirect tax rates and also decline in growth of the economy in general and industry in particular (Fig 7.1).

Fig. 7.1: Fiscal Deficit and Growth of IIP-General



Public Finance Restructuring Issues

Restructuring public finances aimed at macroeconomic stabilisation and achieving revenue account balance requires a broad analytical framework. The impact of the size and composition of government expenditure on growth, inflation, interest rate and the external account has to be considered in an inter-dependent framework that takes into account feedbacks of first and subsequent round effects. Restructuring has to spell out adjustments both on the revenue and expenditure sides. Some hard decisions are required to arrest the persistent rise in the debt-GDP ratio.

Fiscal policies will have to be restructured to facilitate acceleration in growth with macroeconomic stability. Public spending in areas such as roads, water supply, power, primary education and primary health will need to be stepped up to provide the appropriate physical and social infrastructure necessary for accelerating growth.

The challenge lies in finding ways of augmenting such expenditure while reducing the overall fiscal imbalances at the same time. Failure to step up expenditure on the necessary items will dampen growth momentum of the economy. Failure on the fiscal consolidation front, on the other hand, can come in the way of faster growth.

Rangarajan C , (2003), Inaugural Address at Conference on Issues before the Twelfth Finance Commission, September 29, 2003, New Delhi

The most worrying aspect is the deterioration of the revenue account. The share of revenue account deficit in the fiscal deficit had increased from 49.3 per cent in 1990-91 to 64.6 per cent in 1994-95. But it was brought down to 58.2 per cent in 1996-97. However, it increased to 74.9 per cent in 1998-99 and has been hovering between 71 to 72 per cent since 2000-01.

Table 7.1: Central Government Accounts (Rs. Crore)

	Revenue/Expenditure Heads	2001-02 (Actual)	2002-03 (Budget Estimate)	2002-03 (Revised Estimate)	2002-03 (Provisional Estimate)	2003-04 (Budget Estimates)
1	Revenue Receipts	201449	245105	236936	230885	253935
2	Tax Revenue (net to Centre)	133662	172965	164177	158311	184169
3	Non-Tax Revenue	67787	72140	72759	72574	69766
4	Capital Receipts	161004	165204	167077	182079	184860
5	Recoveries of Loans	16403	17680	18251	34282	18023
6	Other non-debt Capital Receipt	3646	12000	3360	3150	13200
7	Borrowings and other liabilities	140955	135524	145466	144647	153637
8	Total Receipts (1+4)	362453	410309	404013	412964	438795
8a	Total Receipt ex Borrowings	221498	274785	258547	268317	285158
9	Non-Plan Expenditure	261259	296809	289924	300887	317821
10	On Revenue Account of Which	239954	270169	268979	265398	289384
11	Interest Payments	107460	117390	115663	115630	123223
12	On Capital Account	21305	26640	20945	35489	28437
13	Plan Expenditure	101194	113500	114089	112077	120974
14	On Revenue Account	61657	70313	72669	72350	76843
15	On Capital Account	39537	43187	41420	39727	44131
16	Total Expenditure (9+13)	362453	410309	404013	412964	438795
17	Revenue Expenditure (10+14)	301611	340482	341648	337748	366227
18	Capital Expenditure (12+15)	60842	69827	62365	75216	72568
19	Revenue Deficit (1-17)	100162	95377	104712	106863	112292
20	Fiscal Deficit (1+5+6-16)	140955	135524	145466	144647	153637
21	Primary Deficit (20-11)	33495	18134	29803	29017	30414
22	Revenue Deficit (% of GDPMP)	(4 30)	(3 80)	(4 30)	(4 36)	(4 10)
23	Fiscal Deficit (% of GDPMP)	(6 14)	(5 30)	(5 90)	(5 90)	(5 60)
24	Primary Deficit (% of GDPMP)	(1 46)	(0 70)	(1 20)	(1 18)	(1 10)

Source Central Budget and Controller General of Accounts

Public Finance: 2002-03

The provisional estimate of the fiscal deficit for 2002-03 is now about 5.9 per cent of GDP at market prices. This is less by about half per cent (in value) than what was presented in the Budget for 2003-04.

Net tax revenues are now estimated at Rs. 1,58,311 crore, about Rs. 6,000 crore less than the revised estimates (Table 7.1). The revised estimates are Rs. 9,000 crore lower than the Budget estimate made in February 2002. Thus, the slippage in net tax revenue is around Rs. 15,000 crore. This slippage occurred despite the fact that 2002-03 witnessed good growth in manufacturing. Non-tax revenue performance was better than the tax revenue. Non-tax revenue collection was Rs. 434 crore (Provisional) higher than the budgeted amount. Major reason for higher non-tax collection is on account of improved PSUs performance (Table 7.2 and 7.3, see box for details). This is also evident from the growth of PSUs stocks on BSE (Table 7.4).

Table 7.2: Performance of Central Public Sector Enterprises (Rs. Crore)

Particulars	2000-01	2001-02	April - September		
			2002*	2001*	Percentage Change
Capital Employed	331401	390261	302520	290947	4.0
PBT	24967	38299	19688	11216	75 5
Tax Provisions	9314	12254	7219	4158	73 6
Net Profit	15653	26045	12469	7058	76 7
Profit of Profit Making PSEs	28494	36432	16610	11427	45 4
Loss of Loss Making PSEs	12841	10387	4141	4369	-5 2
No of Profit Making PSEs	123	119	79	79	-
No of Loss Making PSEs	110	109	86	86	-
No of no Profit/no Loss PSEs	1	2	1	1	-

Source Public Enterprise Survey, 2001-02, Volume 1

* Based on common sample of 186 enterprises

Total expenditures are higher by about Rs. 9,000 crore as compared to the revised estimates and about Rs. 3,000 crore higher than the Budget estimates. Surprisingly, pro-

Table 7.3: Sectorwise Turnover and Profitability of Central Public Enterprises during April-September 2002 (Rs. Crore)

Select Group	Turnover during April-September		Percentage Change over	Profit/Loss during April-September		Percentage Change
	2002	2001	2001	2002	2001	over 2001
1	2	3	4	5	6	7
Enterprises Manufacturing/Producing Goods						
Steel	10869	9405	15 6	-520	-942	-44 8
Mineral and Metals	2826	2664	6 1	298	177	68 4
Coal and Lignite	12440	11709	6 2	440	207	112 6
Power	10921	10512	3 9	2691	2101	28 1
Petroleum	134028	127543	5 1	9476	5265	80 0
Fertilisers	3622	3381	7 1	-133	-261	-49 0
Chemicals and Pharmaceuticals	167	183	-8 7	-43	-36	19 4
Heavy Engineering	2505	2750	-8 9	-103	-93	10 8
Medium and Light Engineering	2204	2086	5 7	-221	-135	63 7
Transport Equipments	2071	1976	4 8	105	86	22 1
Consumer Goods	515	555	-7 2	-371	-303	22 4
Agro-based Industries	53	51	3 9	-13	-8	62 5
Textiles	390	376	3 7	-790	-635	24 4
Total (Manufacturing PSEs)	182611	173191	5 4	10816	5423	99 4
Enterprises Rendering Services						
Trading and Marketing Services	8088	6466	25 1	-28	19	-247 4
Transportation Services	4711	4462	5 6	355	259	37 1
Contract and Construction Services	1034	997	3 7	-183	-209	-12 4
Industrial Development and Technical Consultancy Services	1625	1791	-9 3	284	369	-23 0

1	2	3	4	5	6	7
Tourist Services	135	125	8 0	-27	-35	-22 9
Financial Services	3460	2921	18 5	761	514	48 1
Telecommunications and Information Technology Services	2956	3122	-5 3	481	710	-32 3
Section 25 Companies	75	57	31 6	10	8	25 0
Total (Service PSEs)	22084	19941	10 7	1653	1635	1 1
Total (Manufacturing and Servicing)	204695	193132	6 0	12469	7058	76 7

Source Public Enterprise Survey, 2001-02, Volume 1

Table 7.4: Groupwise Performance of Stock Indices on BSE (percentage change, y-o-y)

Months	BSEIT	BSEFMCG	BSEHC	BSECG	BSEPSU	BSETECK	SENSEX
Apr-01	-61 0	-4 5	-12 2	-10 5	5 5	-62 1	-24 4
Oct-01	-63 7	-2 6	-7 1	-6 6	20 5-63 4	-19 4	
Apr-02	1 7	-9 9	22 5	38 0	57 6	-2 8	-5 1
Oct-02	28 1	-15 7	-4 8	41 7	63 1	10 9	-1 3
Nov-02	13 3	-11 4	-6 6	33 2	53 2	-0 8	-1 8
Dec-02	4 0	-11 6	2 9	48 1	74 0	-3 2	3 5
Jan-03	-10 0	-14 7	1 7	40 3	64 4	-12 3	-1 8
Feb-03	-3 1	-21 9	-6 6	35 6	28 3	-10 1	-7 8
Mar-03	-20 4	-23 6	-14 1	26 4	10 1	-22 7	-12 1
Apr-03	-37 7	-16 0	-12 9	21 0	4 4	-35 4	-11 3
May-03	-35 4	-4 2	1 2	45 7	38 3	-27 9	1 8
Jun-03	-22 6	3 4	14 5	41 1	44 0	-15 2	11 2
Jul-03	-1 7	9 1	30 1	49 7	50 9	7 6	26 9
Aug-03	6 1	14 9	50 4	73 2	80 5	16 1	37 4
Sep-03	12 7	17 0	52 3	112 9	113 6	30 5	48 9

Source BSE

visional capital expenditure is higher than the revised and budget estimates by about 13,000 crore and about Rs. 5,000 crore respectively. But after a long time, a small reduction in revenue expenditure is discernible. Thus, provisional revenue expenditure is around Rs. 4,000 less than the revised estimates, and around Rs. 3,000 crore less than the Budget estimate. Nearly two thirds of the reduction in expenditure has been contributed by fall in interest payments. Provisional estimates of fiscal and revenue deficits have exhibited a marginal improvement as compared to revised estimates.

The fiscal situation in FY 2002-03 would have been much worse if loan recovery during the last quarter of 2002-03 had not been so good. During last quarter of 2002-03, the government recovered Rs. 18,664 crore, or 54 per cent, of the total recovery during the year. This was primarily due to the debt swap scheme. The debt swap scheme facilitated state government's to swap their high cost debt from the central government by low cost debt. Disinvestment again acted as the villain. Disinvestment proceed during 2002-03 was Rs. 3,150 crore as compared to budgeted amount of Rs. 12,000 crore (26.25 per cent of budgeted).

The slippage in the fiscal deficit is pegged at Rs. 9,123 crore (between budgeted and provisional estimates). Disinvestment is off the mark by Rs. 8,850 crore. This clearly suggests that failure in meeting disinvestment target accounts for 97 per cent of the slippage in the fiscal deficit. Expenditure during the last quarter of the financial year was 38 per cent of the annual expenditure, and expenditure during March 2003 was nearly 21 per cent. More than half of the capital expenditure was undertaken in the last quarter of FY 2002-03 and nearly 37 per cent was undertaken in March 2003 alone. Similarly nearly 1/6th of total revenue expenditure was in the last month of FY 2002-03. This raises the question whether the expenditure made during the last quarter/month of the fiscal is judicious or wasteful.

Two policy announcements made after the presentation of the Budget are worth mentioning. Firstly, the postponement of the implementation of VAT till 2005; and secondly, the prepayment of foreign debt amounting to Rs. 7,500 crore

this year Both will have significant impact on the fiscal position While the delay in implementation of VAT may have an adverse effect on exchequer due to continued tax evasion, the pre-payment of debt will reduce the interest liability of the central government

The interest rate on provident fund continues to be 9.5 per cent (9 per cent plus 0 5 per cent bonus) Most of the investment by provident funds is in the government securities, while some of it is in the form of bad debts. As the interest rate on government securities is declining, additional interest payment will have to be made from the corpus/contingency fund. Thus, if the interest rate on the PF account is kept higher than the market rates, the government may have to bailout the PF Funds in a manner similar to that of UTI

The issue whether equity from public sector banks will be returned to the government at par or at market prices is lingering on There has already been considerable delay in announcing the process for equity return by public sector banks Therefore, it needs to be speedily resolved to avoid needless movements in the stock market, subjecting the common investor to greater volatility

The Fiscal Responsibility and Budget Management (FRBM) Bill, was introduced in Parliament in 2000 It was aimed at putting a legislative mandate so that the government could eliminate the revenue deficit by 2007-2008, and subsequently build a revenue surplus The Lok Sabha passed a diluted version of the bill recently, which is now silent on annual fiscal deficit reduction targets. The original bill had sought to bring down fiscal deficit gradually to 2 per cent of GDP by making an annual reduction of 0.5 per cent The bill has now made it mandatory for the finance minister to make an annual statement in parliament on the fiscal situation, besides explaining any deviations from the fiscal obligations The bill also makes the Union Government responsible for ensuring inter-generational equity in fiscal management and for ensuring long-term macro-economic stability by achieving a revenue surplus

Apart from eliminating the revenue deficit, it also aims to remove the fiscal impediments in the effective control of

monetary policy. It provides for prudential debt management consistent with fiscal sustainability through limits on government borrowings, debt, deficits and transparency in fiscal operations. The new norms for the FRBM are:

- Annual targets for reduction of fiscal and revenue deficit removed
- RBI barred from subscribing to G-securities from primary markets from April 1, 2006
- Centre to initiate measures to eliminate revenue deficit by March 31, 2008
- No cap on government borrowings, centre will decide its level of borrowings

Trends in Public Finance: April-August 2003

The Centre's fiscal deficit during the April-August period is estimated at Rs. 43,467 crore, as against a targeted fiscal deficit of Rs. 153,637 crore (Table 7.5) for the whole year. This is 28.29 per cent of the budgeted amount. The level of the fiscal deficit during April-August 2003 is the lowest in last three years. The main reason for this is that while the money received by the Centre from the debt buyback of the state governments has been shown as capital receipts, the repayments to pay off the central debt to the National Small Savings Fund (NSSF) as capital expenditure has not been incorporated in accounts till August. Once this is done, the fiscal deficit will swell. Yet, the government is going to benefit from this transfer, as the rate of interest on government securities is lower than the interest rate of 10.5 per cent prevailing at the time of borrowing by the government from NSSF in 1999. The impact of this accounting anomaly is clearly reflected in the revenue deficit, which exceeds the fiscal deficit by Rs. 17,302 crore and is 54.12 per cent of the budgeted amount for FY 2003-04. Although interest payments during April-August are marginally higher this year as compared to last year due to the lower fiscal deficit the primary deficit shows a 93.40 per cent decline over last year and is 2.99 per cent of the budgeted amount for FY 2003-04.

The Budget 2003-2004 introduced the cash management scheme as required by the Fiscal Management and Budget Management Bill, with a view to eliminating the practice

Table 7.5: Central Government Accounts

	Revenue/Expenditure Heads April-August (Rs Crore)			April-March (Rs Crore)			April-August as Percentage Fiscal Year (%)		
	2001	2002	2003	2001 *	2002 #	2003 ^	2001	2002	2003
1	2	3	4	5	6	7	8	9	10
Revenue Receipts	56209	66691	63698	202881	230885	253935	27 71	28 88	25 08
Net Tax Revenue	31015	41138	39238	133285	158311	184169	23 27	25 99	21 31
Non-Tax Revenue	25194	25553	24460	69596	72574	69766	36 20	35 21	35 06
Non-Debt Capital Receipts	5809	10174	37774	19978	37432	31223	29 08	27 18	120 98
Non-Debt Capital Receipts (Recovery of Loans)	5809	7160	36676	16333	34282	18023	35 57	20 89	203 50
Non-Debt Capital Receipts (Other Receipts)	0	3014	1098	3645	3150	13200	0 00	95 68	8 32
Total Receipts	62018	76865	101472	222859	268317	285158	27 83	28 65	35 58
Non-Plan Expenditure	87481	97772	108737	258825	300887	317821	33 80	32 49	34 21
Non-Plan Expenditure (On Revenue Account)	80828	90410	102108	236703	265398	289384	34 15	34 07	35 28
Non-Plan Expenditure (On Revenue Account - Interest Payments)	36795	41714	42558	104894	115630	123223	35 08	36 08	34 54

1	2	3	4	5	6	7	8	9	10
Non-Plan Expenditure (On Capital Account)	6653	7362	6629	22122	35489	28437	30 07	20 74	23 31
Plan Expenditure	30616	34589	36202	100245	112077	120974	30 54	30 86	29 93
Plan Expenditure (On Revenue Account)	19021	21806	22359	61773	72350	76843	30 79	30 14	29 10
Plan Expenditure (On Capital Account)	11595	12783	13843	38472	39727	44131	30 14	32 18	31 37
Revenue Expenditure (Plan and Non-plan)	99849	112216	124467	298476	337748	366227	33 45	33 22	33 99
Capital Expenditure (Plan and Non-plan)	18248	20145	20472	60594	75216	72568	30 12	26 78	28 21
Total Expenditure	118097	132361	144939	359070	412964	438795	32 89	32 05	33 03
Fiscal Deficit	56079	55496	43467	136211	144647	153637	41 17	38 37	28 29
Revenue Deficit	43640	45525	60769	95595	106863	112292	45 65	42 60	54 12
Primary Deficit	19284	13782	909	31317	29017	30414	61 58	47 50	2 99

* Actual # Revised ^ Budgeted

of bunching of expenditures by the ministries towards the end of the year As per the government's Quarterly Review, the actual expenditure of nine ministries was 78 85 per cent of the projected cash requirement These nine ministries with interest payments and transfers to the state governments account for nearly 59 per cent of the total expenditure of the central government Not withstanding this positive the fiscal scenario at the centre is grim Even the finance minister in a recent interview admitted that there are "pressure points" on account of subsidies on food and petroleum products In an election year fiscal consolidation may well be difficult Populist measures would rise This may lead to an increase in public debt, which in turn may also exert upward pressure on interest rates

Revenue

Receipts are down by Rs 1,993 crore during April-August 2003 as compared to the same period last year The primary reason for this is lower net tax collection Net tax collections during April-August 2003 are down by Rs 1,900 crore due to tax refund These delayed refunds carried an interest rate of 8 per cent (now reduced to 6 per cent) The interest payable by the assesses to the government, too, has been reduced to 12 per cent from 15 per cent However, the latest trend of direct and indirect tax collection during April-September reflects some sign of buoyancy Service tax collection during April-August 2003 has been Rs 2,270 crore as compared to Rs 1,506 crore same period last year

Non-tax revenue shows a decline of 4 28 per cent during April-August 2003 over the last year However, capital receipts increased by 271 28 per cent due to the debt-swap scheme of the government On the disinvestment front, Maruti IPO turned out to be a success and government was able to garner disinvestment receipts of Rs 1,097 crore However this is just 8 32 per cent of the target for FY 2003-04 The success of Maruti IPO did encourage the government, which was planning to offload more equity of the PSUs where some equity has already been sold off However, the recent Supreme Court ruling on the disinvestment of

HPCL and BPCL seems to have derailed the entire disinvestment process. Total receipts during April-August have been 35.58 per cent of the budgeted amount for FY 2003-04. Non-debt capital receipts during the April-August period are 120.98 per cent of the budgeted amount, mainly due to the debt-swap scheme for state governments. Recovery of loans during the same period stood at Rs. 36,676 crore, which is 203.50 per cent of the target for FY 2003-04.

Indirect tax collection during April-September in FY 2003-04 increased by 8.3 per cent over the same period last year. Direct tax collection during April-September grew by 16 per cent in FY 2003-04, as compared to the same period last year. The surge in direct tax collection is due to the second instalment of advance tax, which is to be submitted by September 30. However, this is yet to be reflected in the Government accounts, as other data are available up to August only.

Expenditure

The total expenditure during April-August 2003 has been estimated at 33.03 per cent of the budgeted amount, marginally higher than the similar figures for the last two preceding years. While the revenue expenditure ratio (April-August to April-March ratio) is marginally higher as compared to the last two years, capital expenditure ratio is higher compared to only last year.

Interest payments during April-August increased by 2 per cent over the same period last year. Non-plan capital expenditure shows a decline of nearly 10 per cent during the first five months of this fiscal, as compared to the same period last year.

Government Debt and Debt Buyback

The fiscal deficit has a direct impact on borrowing by the government. The "Outstanding Liabilities of central government" head shows a trend similar to that of the fiscal deficit. It declined from 55.3 per cent of GDPMP in 1990-91 to 49.4 per cent in 1996-97. Thereafter it started rising. Outstanding liabilities of the central government at the end of

2002-03 stands at 63.2 per cent of the GDPMP.

One of the interesting developments since 1990-91 is the decline in the share of external liabilities in total liabilities over time. It declined from 10 per cent in 1990-91 to 8 per cent in 1996-97 and further to 3.7 per cent in 2002-03. The government is pre paying some of its high cost foreign debt. The impact of these steps is being reflected on lower share of foreign liabilities in total liabilities.

Taking advantage of lower interest rate in the economy, the government decided to buy back debt from banks and financial institutions. The objective was to reduce the debt burden of the government by replacing the illiquid securities with more liquid paper. This is also expected to help in improving banks' balance sheets. The buyback is a simultaneous transaction, with the buyback of illiquid securities and sale of fresh securities. The government has made an offer to buy back securities worth Rs. 82,523 crore. However, the response of banks and financial institutions has been rather timid and securities worth only Rs. 14,434 crore were sold by them (Table 7.6). The government has paid a gross premium of Rs. 3,472 crore while buying high-cost debt from banks and financial institutions. These securities had a maturity period up to 2018 and interest rates varying from 8 per cent to 13.85 per cent. The re-issued securities have a similar maturity profile but pay less interest rate varying from 6.25 per cent to 7.46 per cent. The government is expected to save nearly Rs. 1,200 crore from interest payments over a 16-year period. In the initial seven years, it is expected to save around Rs. 3,600 crore and after that they are expected to lose around Rs. 2,400 crore (Table 7.7).

In Sum

Taking into account the revenue and expenditure pattern for the period April-August 2003, the outlook of public finances for the fiscal 2003-04 do not look very bright. Revenue receipts declined due to huge tax refunds. However, robust industrial growth, rising imports and good agricultural prospects may alter the growth surge in direct and indirect tax collection during September of revenue receipts.

Table 7.6: Details of the Securities Bought Back and Re-issued by the Government

Security	Interest Rate (%)	Date of Maturity	Face Value (Rs Crore)
Securities bought back			
13 85% GS 2006 (Installments)	13 85	24/06/2006	870
13 85% GS 2006	13 85	26/08/2006	300
12 50% GS 2007	12 50	25/03/2007	145
13 05% GS 2007	13 05	22/04/2007	300
12 15% GS 2008	12 15	25/03/2008	1475
12 22% GS 2008	12 22	24/07/2008	205
12 25% GS 2008	12 25	08/09/2008	490
11 50% GS 2009	11 50	15/05/2009	3493
12 25% GS 2010	12 25	02/07/2010	985
12 32% GS 2011	12 32	29/01/2011	1538
8 00% GS 2011	8 00	27/04/2011	5
11 50% GS 2011	*11 50*	*05/08/2011*	*884*
12 00% GS 2011	12 00	21/10/2011	140
10 25% GS 2012	10 25	01/06/2012	181
9 00% GS 2013	9 00	24/05/2013	248
12 40% GS 2013	12 40	20/08/2013	1708
10 47% GS 2015	10 47	12/02/2015	570
11 50% GS 2015	11 50	21/05/2015	613
10 45% GS 2018	10 45	30/04/2018	284
Securities Re-issued			
6 65 % GS 2009	6 65	05/04/2009	2886 8
6 72 % GS 2014	6 72	24/02/2014	5773 6
7 46 % GS 2017	7 46	28/08/2017	2886 8
6 25 % GS 2018	6 25	02/01/2018	2886 8

Table 7.7: Likely Impact of Debt Buyback by the Government (Rs. Crore)

Year	Interest Saved	Expected Interest Outgo	Net Interest Saving
2003-04	1211 14	684 35	526 79
2004-05	1726 82	975 74	751 09
2005 06	1726 82	975 74	751 09
2006-07	1609 01	975 74	633 27
2007-08	1506 32	975 74	530 58
2008-09	1277 35	975 74	301 61
2009-10	889 94	786 40	103 55
2010-11	719 09	783 77	-64 68
2011-12	457 26	783 77	-326 51
2012-13	397 06	783 77	-386 70
2013-14	244 97	783 77	-538 80
2014-15	152 00	434 05	-282 04
2015 16	45 32	395 78	-350 46
2016-17	29 68	395 78	-366 10
2017-18	29 68	131 91	-102 23
2018-19	2 36	-	2 36
Total	12024 83	10842 02	1182 81

Public Sector: Turnaround?

The public sector has played a pivotal role in the industrialisation of India. Its contribution to overall GDP increased from 8 per cent in 1961 to nearly 25 per cent now However, over the years, thanks to a series of policy infirmities, most of the PSUs had become a drain on state exchequer.

However, since the liberalization was initiated in 1991, public sector enterprises like their counterparts in private sector have also initiated several efforts to improve efficiency and productivity through steps such as the voluntary retirement scheme (VRS) and severe restructuring/cost cutting Have these steps improved the performance of public sector?

According to Public enterprise survey, 2001-02, the number of loss making central PSEs gradually declined from 116 (out of 240) in 1993-94 to 100 (out of 236) in 1997-98, but increased to 119 (out of 230) in 2001-02. On

the other hand, due to the policy of selling off mainly profit making PSUs, the number of profit making central PSUs declined to 119 in 2001-02 from 131 in 1992-93.

According to the Public Enterprises Survey for 2001-02, the most notable feature has been the decline in the losses of loss making PSEs in 2001-02 as compared to 2000-01 (Table 7.2). Average growth of losses of loss making PSEs during 1992-93 to 2000-01 has been 16.03 per cent, whereas in 2001-02 losses of loss making PSEs declined by 19.11 per cent as compared to 2000-01.

The declining trend continued in the first six months of FY 2002-03 and losses of loss making PSEs declined by 5.2 per cent as compared to first six months of last year. On the other hand barring 1998-99, profits of profit making PSEs have been continuously increasing. They registered an average growth of 18.66 per cent during 1992-93 to 2000-01. During 2001-02, the profits of profit making PSEs registered a 27.86 per cent growth compared to 2000-01. During the first six months of 2002-03 profits of profit making PSEs increased by 45.4 per cent compared to the first six months of last year. Net profit of all PSEs in the first six months of 2002-03 increased by 76.7 per cent.

Manufacturing enterprises as a whole registered a phenomenal growth of 99.4 per cent in their profits during the first six months of 2002-03 compared to the first six months of 2001-02 (Table 7.3). Among them, petroleum and power account for 112.5 per cent of the total profits during the first six months of 2002-03. Steel reduced its losses from Rs. 942 crore in first six months of 2001-02 to Rs. 520 crore during first six months of 2002-03, largely due to the increased demand from China and the Golden Quadrilateral project. Minerals & metals and coal & lignite also improved their performance by registering profitability growth of 68.4 and 112.6 per cent respectively during the first six months of 2002-03. Fertiliser sector also reduced its losses to nearly half and the transport sector increased its profit by 22 per cent.

However, loss making sectors such as chemicals & pharmaceuticals, heavy, medium & light engineering, consumer goods, agro-based and textiles sectors registered higher losses during the first six months of FY 2002-03 compared to the first six months of FY 2001-02.

Enterprises producing services, trading & marketing, industrial development & technical consultancy and telecommunication & information technology services either registered losses or experienced a decline in their profits during the first six months of 2002-03 as compared to the first six months of 2001-02. Service enterprises as a whole registered a marginal increase of 1.1 per cent in their aggregate profits during the first six months of FY 2002-03 as compared to first six months of 2001-02.

The movement of stock prices is an important indicator of future prospects. A comparison of BSEs PSU index with other group indices shows that during April 2001 to September 2003, except for the period February 2003 to May 2003, PSU stocks led the growth of Sensex by registering maximum year on year growth among the group stocks (Table 7.4).

Profitability of PSUs for FY 2001-02 and first half of FY 2002-03 shows indications that the public sector is coming out of the red. However, a lot will depend on how sincere the efforts to increase efficiency/productivity of the public sector are. Functioning of oil PSUs and public sector banks could acts as lead for other PSUs to improve their efficiency/productivity.

Macroeconomic Outlook

In the first quarter of 2003-04, the Indian Economy recorded a growth of 5.7 per cent, up from 5.3 per cent during first quarter of 2002-03. While sectors like manufacturing, construction, trade, hotels & restaurants, transport, storage and communication and finance, insurance and real estate positively contributed towards the first quarter growth, the low growth in agriculture and mining & quarrying had an adverse impact on the first quarter growth.

The Current Scene

A normal monsoon has enhanced the growth prospects of agriculture. Data for June-September show that rainfall has been 3.3 per cent more than normal. More importantly, the spread of rain across time and space has been very satisfactory. Regions such as Saurashtra and Kutch and other parts of Gujarat, and Western and Eastern Rajasthan, which had received deficient rainfall in the last four years, have received more than normal rainfall. Estimates of kharif production for this year vary from 100 to 102 million tonnes.

IIP data of the first quarter suggest that industrial recovery is on track. Yet a lower credit off take by the corporate sector seems to be a bit puzzling. A plausible reason for this could be the larger dependence of Indian corporates on external commercial borrowings (ECBs) as also excess liquidity in the hands of corporates (Table 8.1). The second quarter (June-September 26) however shows that the non-food credit has increased sharply by 218.3 per cent on quarter to quarter basis. Perhaps the cap put by the government on ECB borrowing is again the reason for the surge in non-food credit.

Soft interest regime so for has not been able to spur the investment activity. This is also a pointer to the fact that lowering of interest alone may not trigger investment in the

Table 8.1: Top Ten Companies with Reserves and Surplus (Rs. Crore)

Private Sector Company	Reserves and Surplus	Listed PSUs Company	Reserves and Surplus	Listed MNCs Company	Reserves and Surplus	Listed Companies Company	Reserves and Surplus
Reliance	28,978	ONGC	28,296	ITC	5,118	Reliance	28,978
Hindalco	6,099	IOC	14,532	Hindustan Lever	3,439	ONGC	28,296
VSNL	5,265	MTNL	8,310	Motor Industries	673	SBI	16,677
ITC	5,118	HPCL	6,340	Cummins India	592	IOC	14,532
Tisco	4,261	GAIL	5,493	Glaxo SmithKline	505	MTNL	8,310
Tata Power	4,103	BPCL	4,447	ABB	470	HPCL	6,340
Zee Telefilms	4,014	BHEL	4,225	ICI India	438	IDBI	6,325
Hindustan Lever	3,439	Neyveli Lignite	3,407	Britannia	429	ICICI Bank	6,321
L&T	3,314	Shipping Corporation	1,852	Siemens	365	Hindalco	6,099
Wipro	3,284	Kochi Refineries	1,299	Hindustan Lever Chem	347	GAIL	5,493

Source Reserves & Surplus BSNL, Reliance, SBI lead A list, ***Hindustan Times***, September 22, 2003

economy. There are other factors that influence investment decisions. Policy uncertainty is one such factor. Ambiguity and no clear road map with regard to import duty structure has already rendered past investment in certain sectors uneconomical. For example reduction of import duty on textile machinery from 25 per cent in the 2003-04 budget.

On the external front, international oil prices have begun to firm up but the economy may not feel the pinch as appreciation of rupee to an extent will keep the dollar outflow on account of POL import in check. But on the other hand at an aggregate level Indian exports is feeling the heat as the rupee is becoming stronger vis-à-vis the US dollar. During April-September 2002 to April-September 2003, the rupee has appreciated by 4.7 per cent. Part of the slowdown in exports during April-August 2003 could be on account of this appreciation.

The fiscal position of the central government looks better after the debt buyback from the state governments. However, adjustment/repayment of the same amount to the NSSF will once again alter the fiscal deficit scenario. Although finance ministry has stated that no slippage in the fiscal deficit will be allowed in 2003-04, chances are slim that the deficit will not slip. The revenue deficit remains a major worry area.

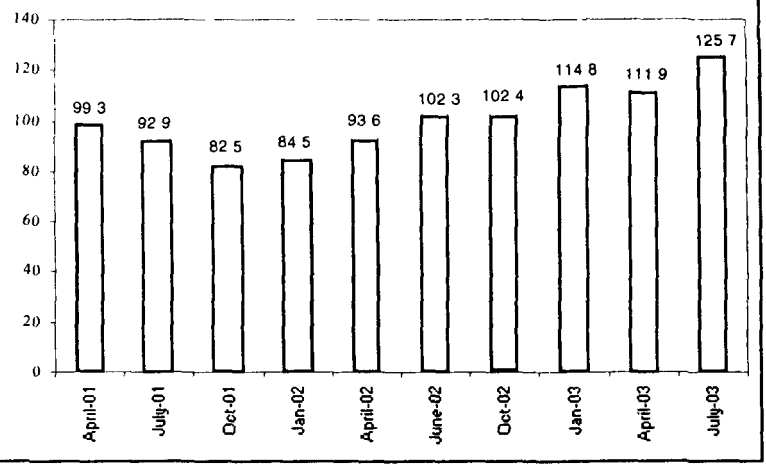
Yet the current mood, which is reflected through the stock market, is bullish. BSEs Sensex increased by more than 50 per cent between the beginning of May and September end 2003. On October 14 the Sensex crossed the 4,900 mark for the first time after July 2000. FIIs have pumped in Rs 15,092 crore in Indian equity market since May.

Business Confidence

NCAER's Business Expectations Surveys (BES), also indicate a strong sentiment of upturn in industrial activity. The Business Confidence Index (BCI) registered a growth of 12.33 per cent in the last quarter. The BCI rose to 125.7 in July 2003, as compared to 111.9 in April 2003 (Fig 8.1). The good monsoon and excellent corporate performance in 2002-03 seems to be behind this upswing in business senti-

ment also contributed to this. The corporate sector, after witnessing a decline in sales during 2001-02, has registered a 10 per cent growth in 2002-03. The manufacturing sector registered an even higher growth of 11 per cent. Profits after tax (PAT), as percentage of sales, increased from 4.7 per cent in 2001-02 to 6.7 per cent in 2002-03. The strong optimism as reflected in the overall BCI is also visible in its four components, viz. overall economic conditions, financial position, investment climate, and capacity utilisation. At the sectoral level, except for consumer non-durables all other sectors show strong positive sentiments, as compared to April 2003.

Fig. 8.1: Business Confidence Index



The BCI for July 2003 portrays a very optimistic picture of industrial recovery. Yet it is too early to say whether the strong optimism would also translate into higher investment spending. Of the total firms surveyed during the 45th round (July 2003) of BES only 47 per cent showed willingness to undertake investment during 2003-04.

Leading Indicators

Time series data in market economies exhibit cyclical patterns with associated peaks and troughs. Highs and lows characterise the course of an economy's growth. The key to interpreting these cycles lies in spotting the turning points beforehand. When the timings of these turning points of cyclical indicators are correlated, a strong suggestion emerges of a lead-lag relationship among the variables.

Economic indicators are typically classified into three categories—leading, coincident and lagging—based on the expected timing of the movements over the course of a business cycle. Coincident indicators such as employment and production measure economic activity in broad aggregate terms, and thus define the cycle. Leading indicators, on the other hand, tend to shift direction in advance of the business cycle. Lagging indicators tend to change direction last, both confirming movements in the coincident series and warning of structural imbalances. The Index of Industrial Production for manufacturing (IIPM) is an indicator of the current state of economic activities. Changes in the cyclical components of selected economic time series, relative to the cyclical changes in IIPM, provide a basis for assessing the future course of the economy. It should be noted that the IIPM does not capture the level of economic activity as a whole, but acts as a proxy in the absence of a more comprehensive measure on a monthly basis.

The cyclical components of time series that are derived by taking out the trend, seasonal and random components have been estimated here to indicate the movement in selected variables that are likely to be leading the changes in economic activity. Here we examine the index of industrial production and other variables that have shown cyclical behaviour to assess the emerging trends.

The downtrend in the movement of cyclical components of the monetary variables (such as bank credit to the commercial sector and bank credit) continued in August 2003 (Table 8.2). The only monetary variable whose cyclical component has shown an upward movement is the currency with the public (Fig 8.2). One of the plausible reasons for this is

the holding of cash by the public and not putting into the saving instruments due to low returns. Although the cyclical components of credit-deposit ratio and non-food credit moved marginally up in August 2003 (Fig 8.3), the movement has been in a narrow band since May 2003. On the basis of such a marginal upward movement it is too early to conclude that indicators will continue moving up with industrial recvery.

Fig. 8.2: Cyclical Component of Monetary Variables with IIP-Mfg

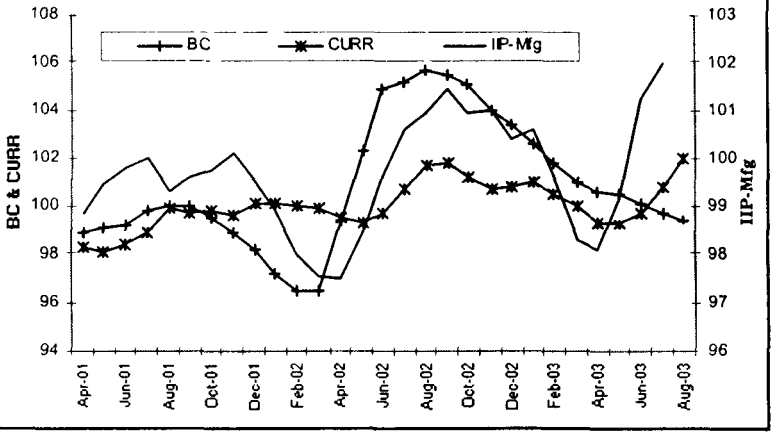


Fig. 8.3: Cyclical Component of Moneatary Variables with IIP-Mfg

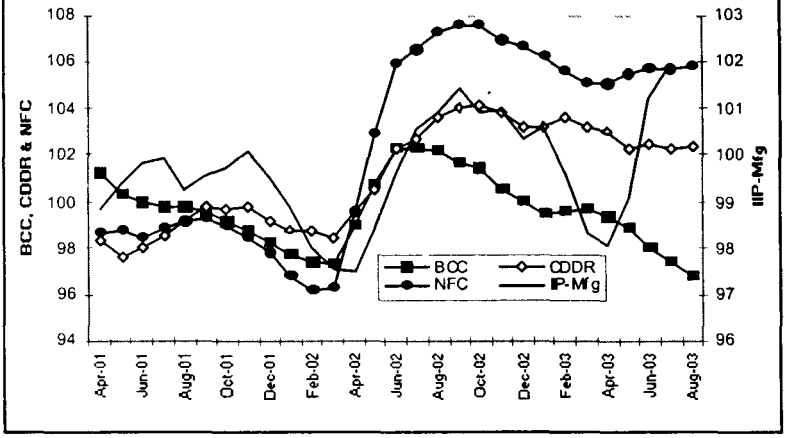


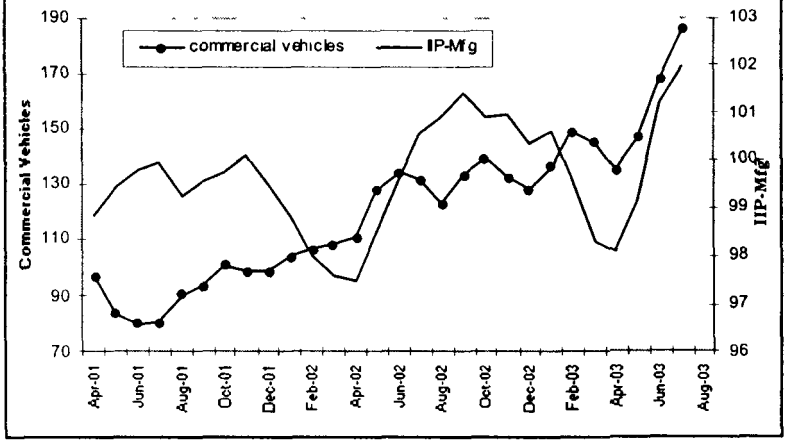
Table 8.2: Cyclical Components of Selected Time Series

Months	Bank Credit (Rs crore)	Bank Credit to Commercial Sector (Rs crore)	Credit Deposit Ratio	Currency with the Public (Rs crore)	Non-food Credit (Rs crore)	Non-Pol Imports in Dollar terms	Production Commercial Vehicles ('000)	Production of Cement ('000 tones)	BSE Sensex Index
Apr-02	99 4	99 0	99 6	99 5	99 5	112 6	110 4	103 2	87 9
May-02	102 3	100 7	100 5	99 3	102 9	124 6	127 5	105 3	88 0
Jun-02	104 8	102 3	102 3	99 7	105 9	117 9	133 7	103 6	87 1
Jul-02	105 1	102 3	102 7	100 6	106 5	103 7	131 6	100 5	87 1
Aug-02	105 6	102 2	103 6	101 7	107 3	104 3	123 4	99 6	83 0
Sep-02	105 5	101 7	104 0	101 7	107 6	110 7	133 2	99 0	81 7
Oct-02	105 1	101 4	104 2	101 2	107 6	124 7	139 3	101 4	83 2
Nov-02	104 0	100 5	103 8	100 7	106 9	130 8	132 1	101 8	89 5
Dec-02	103 3	100 0	103 2	100 7	106 7	117 4	128 4	101 1	92 9
Jan-03	102 5	99 5	103 2	101 0	106 2	99 7	136 5	99 2	91 9
Feb-03	101 7	99 6	103 6	100 5	105 6	85 7	148 7	97 3	86 2
Mar-03	101 0	99 7	103 3	100 0	105 1	113 0	145 0	97 2	82 0
Apr-03	100 6	99 4	103 1	99 3	105 0	143 5	134 9	100 2	82 3
May-03	100 5	98 9	102 3	99 2	105 5	158 8	146 8	103 6	89 5
Jun-03	100 1	98 0	102 5	99 7	105 7	153 1	167 9	104 0	99 6
Jul-03	99 7	97 4	102 2	100 8	105 6	135 1	185 4	100 3	108 8
Aug-03	99 4	96 8	102 4	102 0	105 8				114 1

The rising trend in exports since the fourth quarter of 2001-02 till the third quarter of 2002-03 was curbed in the fourth quarter. It has dropped further in the first quarter of 2003-04. Imports in dollar terms also showed a similar trend. The rising trend in Non-POL imports in dollar terms since the first quarter of 2002-03 dropped sharply to 6.74 per cent in the fourth quarter of 2002-03, but again rose sharply in the first quarter of 2003-04 to 27.8 per cent. However, the cyclical components of imports and Non-POL imports have shown a decline in June and July, after having continuously risen since February 2003. The cyclical component of exports has been experiencing an upward trend since April.

The production of commercial vehicles (Fig 8.4) depicts a rising trend since the first quarter of 2002-03. The growth dropped to 11.7 per cent in the first quarter of 2003-04 from 35.8 per cent in the previous quarter. The cyclical component, however, shows a rising trend since April 2003.

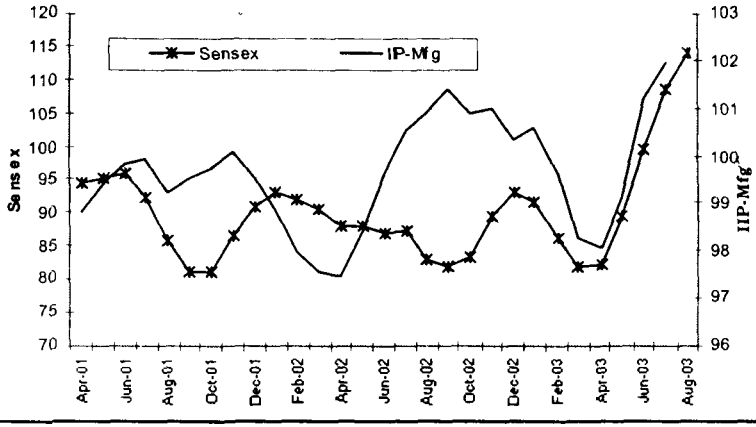
Fig. 8.4: Cyclical Component of Commercial Vehicles with IIP-Mfg



The cyclical component of the BSE Sensex (Fig 8.5) is moving upwards since March. In real terms also, the Sensex, which had remained below 3,500 throughout 2002-03 and had continued there till June, started to rise and had con-

tinued its trend in September, crossing the 4,450 mark. The Y-o-Y growth rate has also moved in the upward direction since May 2003.

Fig. 8.5: Cyclical Component of Sensex with IIP-Mfg



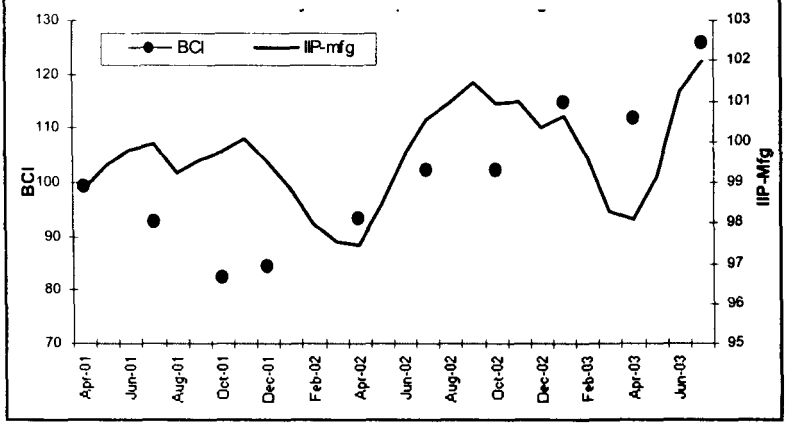
The NCAER Business Confidence Index (BCI) is a good leading indicator of IIPM and it has been tracking the turning points most of the time (Fig 8.6). The BCI, constructed on a quarterly base, is a measure of optimism of the business sector on the performance of the economy in the short term.

To conclude, monetary variables, which are strongly correlated with current trends in economic activity, present a mixed picture. Trade variables also present a similarly mixed picture. Therefore, caution is needed in interpreting the data. Although the leading indicators suggest a mixed scenario, the forward-looking Business Confidence Index provides a strong case for optimism.

Short-Term Forecast

The current short-term forecast for 2003-04 is prepared taking into consideration the current domestic and global developments affecting the Indian economy. This forecast is

Fig. 8.6: Business Confidence Index with the Cyclical Component of IIP-Mfg



formulated by using NCAER's short-term macro model. The major driving force behind this forecast is the combination of four factors, viz. rainfall, revival of the world economy, revival of capital markets and budget constraints.

The key assumptions are:

- A record monsoon leading to a 7 per cent growth in agriculture, with a 4 per cent rise in agricultural prices
- A 25-basis-point decline in interest rates
- Nominal appreciation of the rupee of 2 per cent as in Simulation 1, and 4 per cent in Simulation 2 against the dollar
- World GDP growth of 3.5 per cent
- Oil prices rise by 20 per cent
- Government consumption increases by 9 per cent in nominal terms
- Government investment increases by 10 per cent
- Indirect domestic tax rates increase by 2 per cent
- Tariff rates decline on an average by 9 per cent

The only difference between the two simulations is the assumption regarding the appreciation of the rupee vis-à-vis the dollar.

India wide rainfall levels during June-September 2003, have been 3.3 per cent above the normal rainfall. Its spread and distribution has also been good. This has brightened the prospects of agricultural growth in 2003-04. The industrial recovery that began in the second quarter of 2002-03 had been continuing till April-August 2003. Trade growth has been affected by the appreciation of the rupee but other competing Asian currencies have also appreciated (Table 8.3). However, there is high possibility that exports would be able to achieve the targeted 12 per cent growth in dollar terms by the end of the current fiscal year.

GDP is expected to grow by 6.63-6.98 per cent (Table 8.4) in 2003-04, the growth rates being 1.5-1.8 percentage points higher than our forecast for FY 2002-03. The major driver of growth is agriculture. Another driver of growth is private investment fuelled by growth in exports (in US dollar terms). Industry is expected to grow at 6.45 per cent in Simulation 1. However, the higher appreciation of the rupee pulls down the growth of industry to 5.7 per cent in Simulation 2. The growth of services, too, is expected to be around 6.9-7.1 per cent, as against 6.68 per cent forecast for previous year. A higher appreciation of the rupee would pull down the growth of services by 0.25 per cent in Simulation 2.

As mentioned, despite the hardening of the rupee, exports are expected to meet the targeted growth of 12 per cent in dollar terms in 2003-04. However, due to a stronger rupee and increased industrial activity, the growth of imports is expected to overshoot exports growth. This results in a widening of the trade deficit, along with a marginal surplus on the current account.

With higher GDP and lower import prices, inflation is likely to be lower in the range of 2.9-3.8 per cent range in 2003-04. The fiscal deficit may hover around 6 per cent (5.8-6.1 per cent) of the GDP at market prices.

Table 8.3: Exchange Rate Movement (percentage change, y-o-y)

Months	Taiwan Dollar	Pakistan Rupee	Sri Lankan Reuppe	Indonesian Rupiah	Philippines Pesos	Thai Bhat	Brazilian Reals	Indian Rupee
August-02	-2 19	-6 99	7 02	-0 12	-0 02	-6 01	23 62	3 10
September-02	-0 12	-7 52	6 61	-3 84	1 71	-3 31	25 38	1 68
October-02	1 05	-4 72	6 00	-9 38	2 31	-2 47	38 61	0 72
November-02	0 53	-4 14	4 04	-14 17	2 60	-2 38	40 98	0 54
December-02	0 40	-3 92	3 78	-13 14	3 31	-1 41	53 45	0 46
January-03	-1 33	-3 26	3 58	-14 51	4 24	-2 85	44 42	-0 83
February-03	-0 92	-3 51	3 57	-13 14	5 49	-2 12	48 29	1 97
March-03	-0 87	-3 55	2 33	-9 98	6 89	-1 44	47 28	-2 26
April-03	-0 27	-3 77	1 14	-7 32	3 52	-1 16	34 01	-3 20
May-03	0 75	-3 77	1 06	-7 71	5 58	-1 45	18 86	-3 94
June-03	2 28	-3 91	1 00	-5 57	5 93	-1 14	6 47	-4 68
July-03	3 47	-3 49	1 07	-7 02	6 22	1 35	-1 98	-5 27
August-03	1 37	-2 95	0 86	-4 54	6 11	-1 23	-3 29	-5 47
September-03	-1 60	-2 48	-0 85	-5 67	5 52	-5 61	-12 92	-5 40

Table 8.4: Alternative Projections of Key Macro Variables

Variables	Unit	2001-2002 (Acutal)	2002-03 Model Base	Growth in 2003-04 June	Sim1	Sim2
Real GDP	Rs Crore	1265429	5 17	5 83	6 98	6 63
Estimated Value of Output (1994-95 Prices)						
Agriculture	Rs Crore	140671	1 00	4 00	7 00	7 00
Industry	Rs Crore	495466	6 68	5 91	6 45	5 71
Service	Rs Crore	366388	7 15	6 36	7 13	6 88
Investment (Nominal)						
Public	Rs Crore	135669	12 00	10 00	10 00	10 00
Private	Rs Crore	361609	12 00	13 35	14 33	14 32
M3	Rs Crore	1500003	14 25	10 00	10 00	10 00
Exports (Nominal)	Rs Crore	209018	18 57	9 35	11 72	8 77
Imports (Nominal)	Rs Crore	245200	13 13	12 95	11 15	11 51
Exports (Nominal)	bill $	43 83	15 12	10 45	14 00	13 30
Imports (Nominal)	bill $	51 41	9 83	14 09	13 42	16 16
Average Price	INDEX	161 30	3 39	4 36	3 77	2 86
Exchange Rate	Rs/ US$	47 69	3 00	-1 00	-2 00	-4 00
As Percentage of GDPMP						
Fiscal Deficit of the Centre	%	6 14	5 93	6 04	5 81	6 12
Trade Balance	%	1 58	1 02	1 56	1 15	1 57
Current Account Balance	%	-0 29	1 45	0 03	-0 001	-0 17
Investment (Nominal)						
Public	%	5 91	6 10	6 15	6 12	6 19
Private	%	15 75	16 50	16 90	16 96	17 15
Total	%	21 66	22 60	23 05	23 08	23 35
Trade						
Exports	%	9 10	11 24	9 98	10 14	10 04
Imports	%	10 68	12 26	11 53	11 29	11 61

Medium-Term Perspective

The first quarter GDP growth for 2003-04 has been 5.7 per cent. Low inflation, an appreciating rupee, the bullish stock market, a robust industrial recovery, and the good monsoon have all helped brighten growth prospects for this year. In this section, we provide a medium-term perspective of the economy for the period 2003-04 to 2007-08. The perspective is useful from the point of view of comparison with the government's growth strategy of achieving an 8 per cent growth.

The medium-term perspective of the Indian economy should be viewed against the backdrop of the events of 2002-03. The severe drought last year not only reduced the agricultural GDP to (-) 3.2 per cent, it also pushed the overall growth down to 4.3 per cent. The low level of investment due to policy uncertainties also contributed to slow growth. Moreover, external factors such as rising oil prices and disturbances in West Asia played their role, as well.

However, there were a few good developments in 2002-03. First, the WPI inflation remained low for most of the year. Second, despite the hardening of the rupee (vis-à-vis the dollar), Indian exports grew by 19.2 per cent in dollar terms. In contrast, the world trade grew by less than 4 per cent. Services exports, led by ITES/BPO, pushed the current account into surplus for the second consecutive year ($3.7 billion). Exports of major commodities such as rice, ores and minerals, and handicrafts did well.

Net capital inflows increased to an average of $9.1 billion (Rs. 35,354 crore) per annum in the second half of the 1990s, up from $5.8 billion (Rs. 8,225 crore) during the second half of the 1980s. Net capital inflows were $12.6 billion in 2002-03. The RBI used sterilisation to counter the rising capital inflows through open market sales and repos. But this policy appears to have reached its optimum point and net domestic assets of the RBI have declined to 2.9 per cent of reserve money as on March 31, 2003. According to the RBI annual report 2002-03, the decline in net domestic assets to near zero as a proportion of reserve money focuses attention on the limits to full sterilisation and therefore, on

the future conduct of the monetary policy in the context of large and sustained capital inflows.

The surplus on the current account implies that the Indian economy is not being able to absorb the savings being generated in the economy and that India is financing the current account deficits of the US and other economies in the world. The decline in the investment rate below the savings rate is not very healthy. Certain reasons for declining investment rates are the persistent policy uncertainties and the investors adopting a wait-and-watch attitude. It is necessary to minimise uncertainties to encourage investment.

Basic Structure of the Model

Only some key features of the model are provided below. Agriculture and the manufacturing sector have a supply-side specification where the capital and labour productivity effect of enhanced health and educational attainment on production is incorporated. The actual output in the non-agriculture sectors is demand-determined. Price formation is sensitive to international price changes, as also variations in exchange rates. In the case of manufacturing, capacity utilisation also affects prices. Interest rates that affect investment are endogenously determined and are influenced by the fiscal deficit as well as the bank rate (policy determined). The exchange rate is considered as an exogenous variable in the model. Exports are sensitive to global demand conditions (price and income) and prices. Domestic economic activity determines imports. Government expenditure on health and education determines the health and education attainment of the population, and thus output.

Assumptions

The key assumptions for a medium-term forecast are as follows:

- Gross irrigated area will increase at 0.64 per cent per annum;
- Rainfall is assumed at 4.4 per cent above normal for 2003-04 and at long-term normal level till 2007-08;
- Procurement prices of food grains are assumed to grow at 5 per cent per annum;

- The rupee is assumed to appreciate vis-à-vis the dollar by 2 per cent in 2003-04 and depreciate by 1 per cent per annum till 2007-08;
- LIBOR is fixed at the 2002-03 level;
- World income will grow by 3.2 per cent in 2003-04 and 4 per cent thereafter (*World Economic Outlook*, IMF, April 2003);
- World prices of manufactured products and primary articles will grow by 2 per cent and oil prices by 5 per cent;
- The bank rate will decline by 25 basis points per annum till 2007-08;
- The Centre's capital expenditure on health and education will increase by 10 per cent and other capital expenditure by 15 per cent per annum;
- The Central subsidies will grow by 17 per cent per annum;
- Public investment in agriculture, manufacturing, mining and construction will remain the same as at the 2000-01 level and in infrastructure and services will increase by 5 per cent per annum;
- The revenue parameters are assumed to follow the trend experienced in the last five years;
- Disinvestment proceeds will be Rs 7,000 crore per annum.

Results

Since agriculture and services are major drivers of growth, the GDP is estimated to grow at 7.13 per cent in 2003-04 (Table 8.5). Agriculture is estimated to grow at 7.05 per cent over last year's negative growth of 3.2 per cent. The services growth (trade, financial services, business services, and public administration) is expected to be 8.01 per cent. Infrastructure (electricity, gas, water supply, transport, storage and communication) is expected to grow at 6.54 per cent. Manufacturing is expected to grow at 6.21 per cent and mining and construction at 5.89 per cent. The average GDP growth for 2003-04 to 2007-08 is expected to be 7.05 per cent. The GDP growth in 2004-05 is expected to decline from

Table 8.4: Average Growth of Macro Variables (2003-04 to 2007-08)

Variable	2002-03 (Actual)	Growth during 2003-04	Average Growth during 2003-04 to 2007-08
Gross Domestic Product (Real, Rs Crore)			
- Agriculture	292310	7 05	4 06
- Mining and Construction	99500	5 89	6 96
- Manufacturing	225985	6 21	7 24
- Infrastructure	147643	6 54	7 50
- Services	554876	8 01	8 37
- Total	1320314	7 13	7 05
Inflation (%)			
- WPI All Commodities	3 29	4 26	4 56
- WPI Manufactured Products	2 64	4 16	4 43
- WPI Primary Articles	3 33	4 36	5 05
- WPI Energy, Fuel and Light	5 43	4 49	4 38
- Based on CPI	3 97	4 41	4 73
GFCF (Real, Rs Crore, 2001-02)			
- Total	324549	10 96	10 20
- Private	244377	13 34	12 02
- Public	80172	3 87	3 95
Trade (Rs Crore)			
- Merchandise Exports	252790	9 85	10 54
Merchandise Imports	296597	20 61	13 45
Money Supply (Rs Crore)	1727877	12 61	13 39
Fiscal Deficit (Centre Rs Crore)	145466	12 46	11 32
Percentage of Current GDP at Market Prices			
Government Expenditure (Centre)	16 4	16 3	16 7
- Interest Payments	4 7	4 2	4 2
Government Revenue			
Receipts (Centre)	10 5	10 0	10 5
Fiscal Deficit	5 9	5 4	5 3
Trade Balance	-1 6	-3 8	-3 9
Current Account Balance	0 7	-0 6	0 2

its level in 2003-04, as agriculture growth would decelerate. Agriculture is estimated to grow between 3.2 per cent to 3.4 per cent during 2004-05 and 2007-08. However, services, infrastructure and manufacturing will be main drivers of growth after 2003-04.

Prices are expected to increase in 2003-04 by 4.3 per cent and 4.4 per cent, respectively, for WPI and CPI. Inflation in 2003-04 is expected to be higher, as compared to 2002-03. During 2003-04 to 2007-08, it is expected to be around 4.5 per cent. Exports are expected to grow by 9.85 per cent in rupee terms, consistent with the present year's target as far as the medium-term export strategy is concerned. However, an upturn in industrial activity is expected to increase imports, and imports are likely to grow by 20.61 per cent in 2003-04 in rupee terms. This will result in a current account deficit (0.6 per cent of GDP) in the year 2003-04 after two years of current account surplus. However, in the medium term, on an average, the current account might turn positive.

Government finances may improve slightly in terms of the ratio of GDPMP. On average, during 2003-04 to 2007-08, the fiscal deficit of the Centre is expected to grow by 11.32 per cent. But due to a higher GDP growth, the average fiscal deficit to GDP ratio may decline to 5.3 per cent, as compared to 5.9 per cent in 2002-03.

Comments on the Review by the Discussants

Dr Alok Ray

The mid-year review of the Indian economy for the year 2003-2004 prepared by Mr. Bery and his team is well-written, competent and fairly comprehensive. I would try to complement the picture by giving a slightly different perspective-somewhat wider, longer-term and more qualitative. It is heartening to learn from the Chairperson that Dr Malcolm Adiseshiah would have liked it this way.

Before I give my perspective, a few specific comments on the Review on a quick reading.

1) On p.3 the Review says: 'Easing of the constraints in terms of availability of power, procedural bottlenecks, cost and availability of credit, and road and port facilities will further facilitate the industrial recovery.' Is there any solid evidence on that or is it an 'if-then' kind of statement?

2) In the Money and Capital Market chapter, the Review talks about low credit disbursement. As for solutions, it suggests a further cut in CRR (p.73). I doubt it. The major problem today is that the PLR (the prime lending rate) is still in the range of 10-12% for all banks, though the Bank Rate is only 6% and several rounds of CRR cut have already taken place. Banks are flush with excess liquidity and a further cut in CRR would be irrelevant. Today the blue chip companies can borrow at sub-PLR rates or can borrow abroad at much lower interest rates or can even raise capital directly from the market. The same facility is not available for less reputed small and medium enterprises which have to borrow at PLR plus a suitable risk premium which often

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comes to 15% or above. Banks are playing safe by investing in risk-less government securities. Moreover, falling interest rates are raising the value of bonds held by banks. These capital gains are improving the bank's bottom lines and as a result they are under less pressure to lend to new private businesses.

3) There is no information or projection for employment growth. Are we going for 'jobless growth'? Though this is an important question, there is no discussion on that in the Review. Nor is there any mention of the need and urgency for labour market reforms for both higher growth and employment generation.

Regarding the high growth rate of GDP in 2003-04 projected by several agencies (like CII, IMF, CMIE) including NCAER, three points need to be noted. First, the projected 6.5% to 7% growth rate of India's GDP in 2003-04 (as against 4.3% in 2002-03) is almost solely due to a good monsoon this year, combined with a bad one last year. In other words, it basically reflects the effect of returning to normal after starting from a low base. For example, according to CMIE estimates for 2003-04, growth in Agriculture would be 10.7% (as against -3.2% in 02-03), whereas growth in Industry would be 5% (as against 6% in 2002-03) and Services would be growing at 7.3% (as against 7.1% in 2002-03). Clearly, the credit for the substantially higher GDP growth rate in 2003-04 should go to the weather gods. In fact, according to CMIE both Industry and Services would be growing at a lower rate than last year.

Second, even this high (around 7%) growth rate, assuming that it eventually turns out to be the case, is not unprecedented. We had more than 7% growth rate in 3 consecutive years in 1994-95, 1995-96 and 1996-97 and then the growth rate came down. So, one should not be too elated.

Third, the chances of a turnaround in US economic growth seem brighter now. Japan is also showing signs of a rebound. The Eurozone, however, is still lagging. All considered, a global recovery, though somewhat unbalanced, seems likely. If so, India would gain through higher exports of goods and services. On the flip side, if the huge current account deficit of the US and the falling dollar prompt in-

vestors to shift money away from the US, the interest rate may rise there, choking off the nascent recovery. Which way it would go is anybody's guess at this moment.

Over a much longer haul, Goldman Sachs, the US-based investment bank, projects that India could be the third largest economy in the world in another 40 years or so. But this kind of projection, on the basis of continuation of current growth rates and exchange rate movements in different countries, is quite risky. If a similar projection had been made in the past, the Roman Empire would be expanding even today! So, one should not take such projections too seriously.

It is true that, in terms of the standard indicators, the Indian economy is in fairly good health. Inflation, in terms of WPI as well as CPI, has been falling over the entire financial year. The low inflation rate has helped to keep a nominal interest rate and the cost of borrowing by both government and the private sector low. Forex reserves are over $90 billion, enough to pay for 15 months of imports as against 15 days of import cover in 1991. Foodgrain stocks are somewhat down but still quite comfortable (40 million tones in June 2003). Overall food security is no problem. The latest sales and profit figures are above expectations for many companies ranging over both the 'old' (such as steel, cement, auto) and the 'new' economy industries (like IT and pharmaceuticals). The share market is bullish but not so bullish as to be a mere bubble. Of course, the daily ups and downs in the stock market have a lot to do with the inflow and outflow of FII money but the broad upward trend has more to do with the strong fundamentals of the economy and the earning potential of many companies. Offshore outsourcing by US and European companies are benefiting Indian industry and labour. The good monsoon and its effect on rural demand after a time lag should further increase the sales and profits of many companies. Non-oil and capital goods imports are up, indicating industrial recovery. Export growth is fairly high, at 10% in the first 6-months of 2003-04, despite the rupee rising against the dollar, though not against all major currencies. The Business Confidence Index-which measures the confidence of business people

about the future business prospects-is going up.

Despite a great deal of apprehensions, Indian industry is now competing fairly successfully with the Chinese even in many lines of manufacturing-not to speak of software and pharmaceuticals that are our globally acknowledged areas of strength. India is on the way to become a manufacturing hub for auto and auto components for several big global players. Many believe that India could well be a major technology and R& D centre in future, given the stock of rich intellectual capital available at low cost. This process would get a boost as India is going to have the same patent protection laws as in the developed countries. Medical services and higher education also offer great future opportunities for India. However, to seize the opportunities, we need to develop world-class infrastructure in some of our best hospitals and colleges. In other words, potentials, without supporting policies and infrastructure, will remain unrealized.

Can we hope to have a sustained economic boom? The current boom is largely consumption-driven. It should get a fillip as rural demand rises further as a result of good monsoons. However, a sustained boom has to rely on rising real investment expenditure (not purchase of existing shares in the stock markets). Data indicates that the investment to GDP ratio has declined significantly after 1997-98. Investment (both domestic and foreign) would depend on the quality of physical infrastructure (power, transport, communication, irrigation) where public investment is crucial. It would also depend on labour productivity and discipline, stability and transparency of government policies and the speed of implementation of policies, specially at the state government levels. Everyone knows how government policy is changing so often in the areas of telecom and civil aviation and how long it takes to get all kinds of clearances. Foreign investment would go where it would get a more favourable investment climate. Even Indian investors may find it easier and profitable to invest in other countries and supply the Indian market from those bases, specially as restrictions on movement of goods and capital come down in the aftermath of India signing so many free trade agreements with other Asian countries. So, a rising consumption demand in India

is no guarantee that an investment boom will follow. If investment goes abroad, so will potential jobs and tax revenue for the government.

Is a high fiscal deficit our number one problem today, as emphasized by the IMF, the World Bank and many economists? In my opinion, the composition of government expenditure rather than the size of fiscal deficit is the real villain. A better proxy is revenue deficit which is rising steadily as a percentage of GDP-a matter of grave concern. Governments (union and states) are borrowing to maintain even their consumption expenditures (on salaries and pensions, interest, subsidy and defence). As a result, less and less revenue is available for meeting productive public expenditure. New infrastructure (physical and social) is not being built-even the existing one is not maintained with negative consequences for growth and welfare.

Finally, we should not suffer from 'growth mania'. Growth is not an end in itself. It is a means to a better life for the majority of the people. So, the question remains: how are the benefits of growth being distributed? To judge this, we need regular information on changes in such parameters like the ratio of people below the poverty line, income distribution among different classes, states and regions, employment growth, the cereal intake of the poor, some index of the popular perception on the quality of public services-not just a Business Confidence Index. Often, information on such things-unlike growth rates-is not readily available or become available after a long time lag.

To sum up, growth, to be meaningful for the common people, must be accompanied by two other things-productive employment generation and efficient delivery of basic public services at affordable prices to the targeted groups.

The latest available data shows that the growth rate of employment in the organized sector (public plus private) has been around1% per annum-much below the population or labour force growth rate. In fact, recession has caused a shakeout forcing firms to restructure, cut costs and improve labour productivity, often by shedding labour through Voluntary Retirement Schemes, etc. Falling interest rates have also helped through the replacing of high-cost loans by new

loans at low interest rates All these have improved company performance but by slowing down employment growth There is no clear evidence on how much meaningful employment is being created in the unorganized sectors to bridge the gap

Further, the really poor people have no choice but to depend on BPL ration cards for food, government schools for education, government hospitals for treatment and unfiltered ground water for drinking But what good is a BPL ration card if food is not available at ration shops in remote areas, or poor, dying patients are turned away from government hospitals as no bed is available or a family does not have enough money to get a patient admitted? What would all our talk of a 7% or 8% growth rate or Sensex rally mean to such people?

Dr Subir Gokarn

I would like to begin by congratulating Mr Bery and the NCAER team for a comprehensive and insightful review of the state of the Indian economy I will structure my comments around four themes, which emerged during the presentation

The first theme is the sustainability of the recovery that is currently under way The numbers show that the recovery in the manufacturing sector is currently into its fifth quarter, which suggests that the recovery is quite robust even if not spectacular But, any judgement about its sustainability ultimately rests on our understanding of what has been driving it In my view, the two most important drivers have been the decline in interest rates and the revival of public spending on capital formation, in the shape of the roads programme These two factors have created a boom in demand for a range of industrial sectors-cement, steel, commercial vehicles, automobiles and two-wheelers, and consumer durables-which are at the heart of the recovery

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Although interest rates are not likely fall very much more if at all, their current levels make housing finance as well as automobiles and durables more affordable to a much larger number of people. The demand for consumer non-durables should be boosted with the revival in the rural economy as a result of the bumper harvest that is expected. In short, the core drivers of the recovery are still in place and will be reinforced by the positive impact of a good monsoon. All things point to the sustainability of current trends.

The second theme is the absence of an investment revival despite the very favourable interest rate scenario. First, to continue with the argument made in the previous paragraph, let me emphasise that it is wrong to believe that interest rates have not had a positive impact; they have driven the demand for housing, automobiles and consumer durables. Yes, they have not had any discernible impact on traditional capacity expansion by firms. Based on some recent conversations with managers in assembly-oriented manufacturing businesses, it appears that such a spurt is still some distance away. The main reason for this is the tremendous use of outsourcing arrangements being made by large manufacturing companies.

One of the companies that I talked to has restructured itself to the extent that it has shed over half its workforce in the last few years and now manufactures only one of its three major product lines in-house. The two others are outsourced to a vendor network of several small and medium enterprises. The outsourcer only handles some final assembly and basically manages quality control among its vendors. The point is that the traditional view of "capacity" is no longer valid. This company, along with many others, is expanding capacity by exploiting slack in the small and medium sector. Its decision to expand in-house capacity is simply not sensitive to the prevailing macroeconomic scenario. If this is a widespread phenomenon, it is unlikely that new investment will take place in this segment of manufacturing. Process industries, however, are more constrained with respect to outsourcing arrangements and if the recovery continues, they should be looking at capacity expansions in the coming months. Of course, they could satisfy the rising de-

mand by continuous improvements in productivity, which leads me to my third theme.

During the presentation, the current macroeconomic situation was described as posing something of a puzzle. Specifically, accelerating growth, dormant inflation and low interest rates do not conform to a typical demand-pull recovery. Perhaps I am putting it a little too simplistically and thereby missing out on some of the nuances, but in my view, the current macroeconomic scenario is entirely consistent with a virtuous combination of demand and supply factors. Yes, a positive demand shock emanating from the factors I mentioned earlier could lead to accelerating growth, but it would be accompanied by rising inflation. However, this could be mitigated by a simultaneous positive supply shock, which would reinforce the growth stimulus, while dampening inflationary tendencies.

This positive supply shock has been generated by the tremendous increase in productivity that we are seeing in the corporate sector and, presumably by extension, in all segments of industry and services. At this point I have to say that I am somewhat suspicious of all the macroeconomic evidence pointing to limited, if any, productivity gains over the reforms decade. Perhaps there is some bias resulting from aggregation in this evidence. But, just looking around at what companies are doing suggests an enormous effort to streamline operations and lower costs. This appears to be paying off for those who survive the process in terms of being able to sustain margins while holding prices constant or even reducing them.

With respect to interest rates in particular, some recent research we have done shows that the efficiency of working capital management by the corporate sector has increased considerably. This has come about because of innovations induced by the extremely high interest rate regime that prevailed a few years ago. The demand for traditional bank finance by the corporate sector has declined considerably as a result of these improvements. Two points need to be made here. One, the significance of commercial credit growth as an indicator of recovery has become diluted. Two, a given amount of liquidity in the system can support a far larger

amount of activity. This is one reason why interest rates remain soft even as industrial activity continues to rise.

Finally, an important theme that emerged during the presentation was the problem of jobless growth. This is a structural problem and does not really have a place in a mid-year review, but since we have been talking about the sustainability of the recovery, there is naturally a concern about whether this will positively impact on employment. Clearly, the stagnation of employment opportunities is a major weakness in the otherwise extremely positive macroeconomic situation that we find ourselves in today.

A number of points can be made in this context. First, it is very clear that firms that are already in operation are more concerned with rationalising their workforces even in the midst of a recovery. A recovery may slow down the speed of downsizing, but will not reverse the trend. New jobs will only come from new firms, or at least with existing firms putting up new capacities. In this sense, the revival of employment prospects, at least in manufacturing, is dependent on the re-emergence of investment.

Second, the one sector in which employment appears to have been growing uninterruptedly is in services. We have an extremely weak handle on this sector because our data system just does not cover it well enough, but again, anecdotal evidence suggests a great deal of buoyancy in job growth. In my view, this demonstrates just how strong a deterrent job security regulations are to job growth. They are one of the factors making new investment in manufacturing a far more risky proposition than it should be in the current macroeconomic environment. Services, in general, are not subject to these restrictions and hence a rapid expansion in activity levels and employment is taking place in response to both domestic and external demand. A revival in employment in manufacturing will simply not happen without the removal of job security regulations.

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The India International Centre's annual Mid-Year Review of the Indian Economy is strategically timed to permit analysis of trends in the current fiscal year before budget preparations for the next year get underway. This year's Review comes at a time when both the Indian and the world economic scenario look distinctly more upbeat than a year ago.

The Indian economy is among the few large economies witnessing reasonable growth. As the Review shows, the GDP, after recording a growth of 4.3 per cent in 2002-03, grew at 5.7 per cent in the first quarter of 2003-04. The Manufacturing component of GDP grew at 6.4 per cent and the Services component at 7.4 per cent. With uniform and good rainfall, and with Agriculture and Services being the major drivers of growth, the GDP is expected to grow at 7.13 per cent in 2003-04.

Although it is clear that economic recovery is underway, the important questions are how durable the recovery is likely to be and what policy action can be taken in order to increase its longevity. The analysis presented in this Review suggests that the recovery reflects primarily domestic rather than international factors, although the international financial environment may have been crucial in facilitating economic reactivation.

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