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India: Crisis, Reforms and Growth in the Nineties

by

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[ς] This paper was substantially completed during the authour's Spring 2002 visit to CREDPR as Senior Research Fellow. At the time he was a Professor at the Indian Council for Research on International Economic Relations (ICRIER), on sabbatical leave from his previous assignment as Chief Economic Adviser, Ministry of Finance, Government of India. The views expressed are strictly personal.

INDIA: CRISIS, REFORMS and GROWTH in the NINETIES [1]

The 1990s saw far-reaching changes in India's economic policy. A severe balance of payments crisis at the beginning of the decade triggered wide ranging reforms in economic policy during the early nineties. These reforms brought about a swift turnaround in India's external sector and catalysed an unprecedent spurt in economic growth during the five years 1992-97, coincident with the Eighth Plan period. Unfortunately, the programme of policy reforms lost momentum after 1995 and the early partial success with fiscal consolidation was reversed after 1996. Coupled with some deterioration in the international economic environment in the final years of the decade, these factors contributed to a clear deterioration in economic performance, especially growth, in the last four years 1997-2001.

This paper seeks to improve our understanding of the fascinating story of crisis, reforms and growth in India during the nineties.

A. 1991 Crisis and Policy Response

The deep-seated roots of the 1991 crisis in fiscal laxity, growing reliance on external borrowing, a weakening financial sector and heavy-handed regulation of trade and industry are well known.[2] The proximate trigger was the Gulf War in the second half of 1990-91, which jacked up international oil prices (and India's oil import bill) and reduced remittance inflows from the Gulf. This happened in the context of unstable coalition politics in India in the period between the end of the Rajiv Gandhi Congress government in late 1989 and the assumption of power by the Narasimha Rao Congress government in June 1991. The increase in doubts about India's ability to manage the current account pressures triggered adverse effects in the capital account, which compounded the external sector problem. By September 1990 net inflows of non-resident Indian (NRI) deposits had turned negative and access to external commercial borrowings was

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[1] Parts of this paper draw on the author's recent larger work on India's macroeconomic policies and performance, Acharya (2002).

[2] For detailed accounts, see the Government's *Economic Surveys* for 1991/92, 1992/93 and 1993/94, Ahluwalia (2000), Chopra et.al (1995), Government of India (1993) and Joshi and Little (1996).

becoming costly and difficult. By December 1990 even short-term credit was becoming expensive and elusive. Foreign currency reserves fell sharply and dipped below $ 1 billion in January 1991.

By March, the current account deficit in the balance of payments had touched a record level of nearly US$ 10 billion for the fiscal year 1990/91 or over 3 per cent of GDP. Exports were falling. The foreign borrowing spree had taken the ratio of short term external debt to foreign currency reserves to an astronomical 380 per cent. The debt service ratio soared to a new peak of 35 per cent. Foreign currency reserves skated close to a pitiful billion dollars throughout the spring and summer of 1991.

The initial responses to the mounting external payments crisis were "traditional". They included recourse to IMF financing ($ 1.8 billion was drawn in January 1991 under the Compensatory and Contingency Financing Facility and a First Credit Tranche arrangement) and a series of measures to reduce imports, including high and rising cash margin requirements, a surcharge on petroleum product prices, a surcharge on interest on bank finance for imports and a tightening of import licensing. The severity of import compression may be gauged from the fact that in 1991/92 imports fell by 25 per cent in dollar terms (Table 1). As the *Economic Survey* (Part I, p.8) for the year observes, "Import compression had reached a stage when it threatened widespread loss of production and employment, and verged on economic chaos".

Despite these harsh measures, NRI deposit outflows accelerated in the second quarter of 1991 and foreign exchange reserves continued to fall after a brief respite from IMF-financing. To quote the *Economic Survey* again, "By June 1991, the balance of payments crisis had become overwhelmingly a crisis of confidence – of confidence in the Government's ability to manage the balance of payments. … A default on payments, for the first time in our history had become a serious possibility in June 1991."

Faced with this prospect, the new Congress government of June 1991, with Manmohan Singh as Finance Minister, acted quickly to stabilize the macroeconomic situation and initiate long overdue structural reforms to restore economic health. In July 1991 the rupee was devalued by 18 per cent and the new Budget for 1991/92 cut the fiscal deficit by 2 per cent of GDP. The transition to a market-determined exchange rate system was begun through the induction of a system of tradable import entitlements called "Eximscrips". Industrial licensing was virtually

abolished and clearances under the Monopolies and Restrictive Trade Practices (MRTP) Act dispensed with. For the first time, foreign investment up to 51 per cent equity was automatically allowed in a wide range of industries. A programme of disinvestment of government equity in public sector enterprises was begun. To accommodate a revival in imports and industry, further multilateral, balance of payments financing was secured from the IMF, World Bank and Asian Development Bank.

Table 1: External Sector Performance

	Average of (1985-90)	1990/91	1991/92	1992/93	1993/94	1994/95
Export Growth (% in US$)	11.4	9.0	-1.1	3.3	20.2	18.4
Import Growth (%in US $)	9.4	14.4	-24.5	15.4	10.0	34.3
Trade Deficit (% of GDP)	3.0	3.0	1.0	2.3	1.5	2.8
Current Account Deficit (% of GDP)	2.2	3.1	0.3	1.7	0.4	1.0
Foreign Investment ($ million)	279.2	103	133	557	4,235	4,807
(a) Direct		[97]	[129]	[313]	[668]	[983]
(b) Portfolio (Flls+GDR & others)		[6]	[4]	[244]	[3,567]	[3,824]
Capital Account Surplus ($ million)	5,097.4	8,402	4,563	4,224	9,882	8,013
Foreign Currency Reserves ($ million)	5,022	2,236	5,631	6,434	15,068	20,809
Change in Foreign Currency Reserves ($ million)	-423	-1,132	3,395	803	8,634	5,741
Exchange Rate (Rs. / US $)	13.82	17.94	24.47	30.65*	31.37	31.40

*: The average official exchange rate for the year 1992-93 was 25.97.

Source: Reserve Bank of India, *Handbook of Statistics on the Indian Economy, 2001*.

Note: 1. Foreign currency reserves position from 1990-91 onwards is for end of the financial year i.e. 31st March of the respective year

2. Exchange rates are period average.

Other important reforms which ensued in the next twenty months included (see Table 2 for more details):

- Transition to a market-determined exchange rate by March 1993;
- Phased reduction of India's absurdly high peak custom duties (ranging up to 300 per cent in 1990/91) with a view to reducing the heavy anti-export bias in the trade policy regime;
- Virtual abolition of import licensing controls for capital goods, raw material and intermediates;
- Reduction in and strict controls over short term external borrowing and imposition of prudential caps and minimum maturity requirements for medium term external commercial borrowing;
- New policies to attract foreign portfolio investment into Indian stock markets;
- Legislative empowerment of the capital market regulator, Securities and Exchange Board of India (SEBI) and removal of government controls over capital issues;
- Establishment of a new, state-of-the-art National Stock Exchange.
- Phasing in of Basle prudential norms in the banking sector with regard to income recognition, capital adequacy, provisioning, etc.
- Reduction of reserve requirements, especially the statutory liquidity ratio (SLR);
- Gradual freeing of interest rates.

Table 2: Main Economic Reforms of 1991-93

Fiscal

- Reduction of fiscal deficit.
- Launching of reform of major taxes.

External Sector

- Devaluation and transition to a market-determined exchange rate.
- Phased reduction of import licensing (quantitative restrictions).
- Phased reduction of peak custom duties.
- Policies to encourage direct and portfolio foreign investment.
- Monitoring and controls over external borrowing, especially short-term.

- Build-up of foreign exchange reserves.
- Amendment of the Foreign Exchange Regulation Act (FERA) to reduce restrictions on firms.

Industry

- Virtual abolition of industrial licensing.
- Abolition of separate permission needed by "MRTP houses".
- Sharp reduction of industries "reserved" for the public sector.
- Freer access to foreign technology.

Agriculture

- More remunerative procurement prices for cereals.
- Reduction in protection to manufacturing sector.

Financial Sector

- Phasing in of Basle prudential norms.
- Reduction of reserve requirements for banks, notably the cash reserve ratio (CRR) and the statutory liquidity ratio (SLR).
- Gradual freeing up of interest rates.
- Legislative empowerment of the Securities and Exchange Board of India (SEBI).
- Establishment of the National Stock Exchange (NSE).
- Abolition of government control over capital issues.

Public Sector

- Disinvestment programme begun.
- Greater autonomy / accountability for public enterprises.

B. Bust to Boom in the External Sector

The fruits of these policy thrusts soon became apparent in the external sector accounts (Table 1). Export growth zoomed up to 20 per cent (in US dollar terms) in 1993/94 and the two years thereafter as exporters responded to the substantial depreciation of the real effective exchange rate (see Figure 1), the reduction in anti-export bias of the trade policy regime and the

deregulation of domestic industry. Largely in response to the new exchange rate policy, inward remittances by non resident Indians quadrupled from $ 2 billion in 1990/91 to $ 8 billion in 1994/95 and rose further to exceed $ 12 billion in 1996/97. The current account deficit in the balance of payments came down and stayed well below 2 per cent of GDP. Portfolio foreign investment responded smartly to the new initiatives and climbed quickly to $ 3.8 billion in 1994/95. Direct foreign investment rose more slowly but steadily and by 1994/95 foreign investments totalled almost US $ 5 billion compared to hardly US $ 100 million in 1990/91.

Foreign exchange reserves climbed steeply from the precarious levels of 1991 to over US $ 25 billion at the end of 1994/95. The debt service ratio and the debt stock to GDP ratio both improved quickly (Table 3). The critical ratio of short term external debt to foreign currency reserves plummeted from the stratospheric height of 1991 to a very safe 20 per cent by March 1995.

Figure 1 A

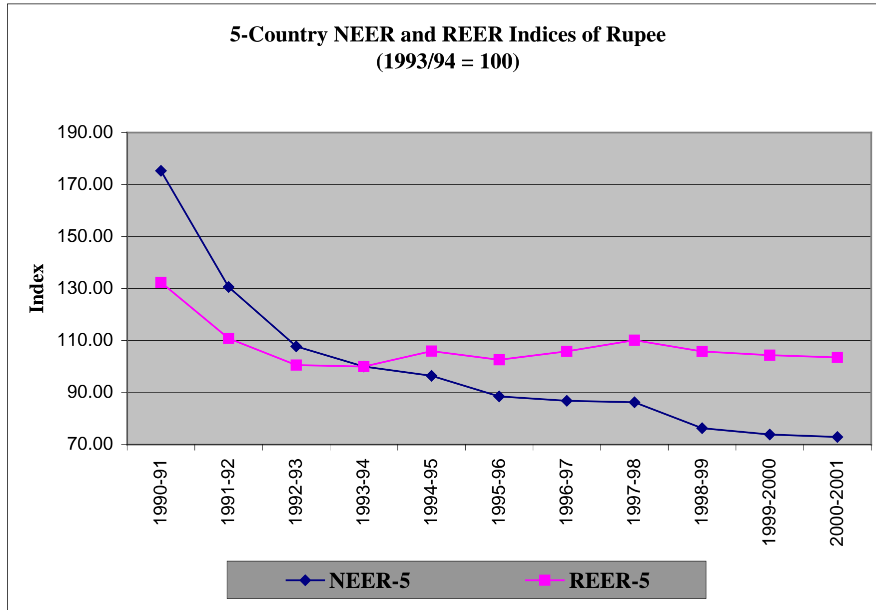

Figure 1 B

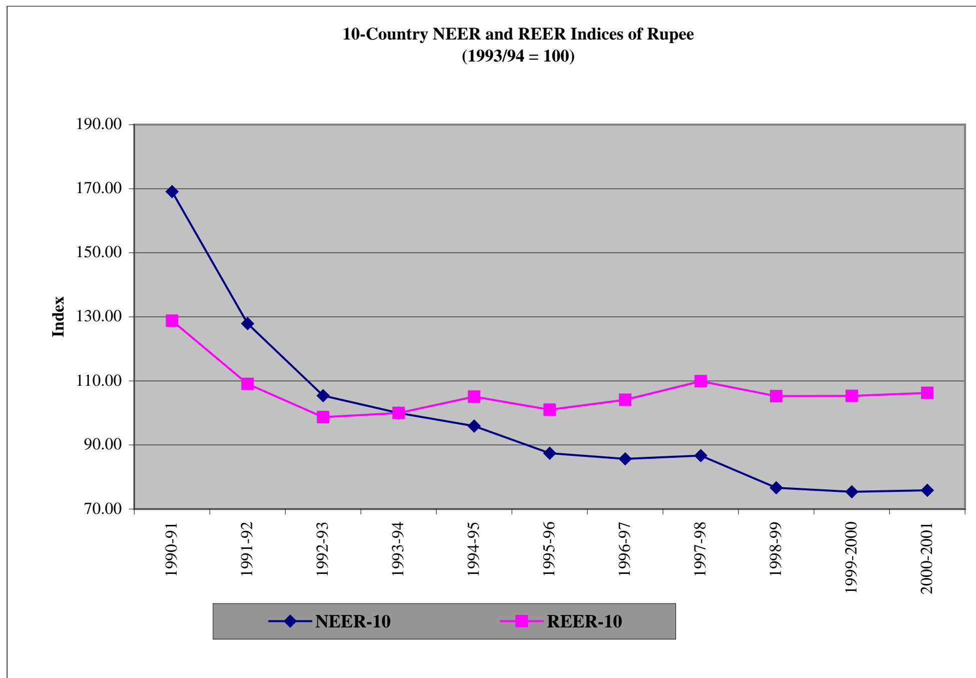

Table 3: External Debt Indicators

(percent)

	Debt Stock-GDP Ratio	Debt-Service Ratio	Debt-Exports Ratio	Proportion of Short Term Debt to Total Debt	Proportion of Short Term Debt to Foreign Currency Reserves
1990/91	28.7	35.3	491.7	10.3	382.3
1991/92	38.7	30.2	563.0	8.2	141.6
1992/93	37.6	27.5	512.7	7.1	98.3
1993/94	33.8	25.6	408.2	3.9	24.1
1994/95	30.9	26.2	369.6	4.3	20.4
1995/96	27.1	24.3	295.7	5.2	28.5
1996/97	24.7	21.2	277.1	7.2	30.1
1997/98	24.4	19.0	278.6	5.4	19.4
1998/99	23.5	18.0	287.0	4.5	14.8
1999/2000	22.0	16.0	258.6	4.1	11.5

Sources: RBI, *Handbook of Statistics on Indian Economy, 2000* and *India's External Debt, A Status Report,* Government of India, Ministry of Finance, Department of Economic Affairs, May, 2000.
Note: Flows relate to fiscal year indicated; stocks pertain to the end of the year indicated.

Taken as a whole, the first half of the nineties saw a remarkable turn around in India's external sector. This was attributable to the range and depth of reforms pertaining to the external sector. Indeed, the rapid turn around in external sector fortunes posed an unexpected new problem of a surge in foreign capital inflows. While this released external sector constraints and led to swift build up of foreign exchange reserves, it also fuelled rapid monetary growth and kept inflation close to double digits in the first half of the decade.

Although merchandise export growth performance slackened after 1995/96 and foreign investment flows plateaued after 1997/98, the continued strength of remittance inflows and the boom in software exports in the second half of the decade helped to keep the current account deficit well below 2 per cent of GDP and facilitated a sustained build-up of foreign exchange

reserves throughout the decade (Annex Table 1). Even the contagion effects of the 1997-98 Asian financial crisis caused only temporary stress to India's external finances.[3]

C. Partial Success with Fiscal Consolidation

It is widely agreed that a series of large fiscal and revenue deficits is detrimental to macroeconomic performance. Such deficits tend to crowd out private investment, increase inflationary potential, weaken the balance of payments, render financial sector reform more difficult and impose a serious burden of adjustment on future generations. The series of high fiscal deficits in the late eighties were clearly a major cause of the 1991 economic crisis in India.

The efforts at fiscal consolidation met with partial success in the first half of the nineties. Tables 4, 5 and 6 and Figure 2 present time series for fiscal, primary and revenue deficits of Centre-States consolidated, the Centre (separately) and States (separately), respectively. The following trends are noteworthy regarding the consolidated picture:

- The gross fiscal deficit increased significantly from an average of 7.2 per cent in the 5 years 1980-85 to 8.9 per cent in the next quinqennium, 1985-90, and even further to 9.4 per cent in 1990/91.

- There was a reduction of over 2 per cent of GDP in the gross fiscal deficit in 1991/92, brought about essentially by the Central budget of that year (Table 5) and in the context of an IMF loan programme initiated to help cope with the balance of payments crisis of 1991.

- This correction was largely negated by a very large Central government fiscal slippage (relative to budget targets) in 1993/94, timed, perhaps not coincidentally, with the end of the IMF programme in spring 1993.

- The lost ground was quickly recovered and further consolidated in the next three years, with the lowest consolidated fiscal deficit for the decade of 6.4 per cent of GDP recorded in 1996/97. This coincided with and was largely a result of the Centre's achieving its lowest deficit in the decade (indeed in 20 years) of 4.1 per cent of GDP.

- This was also the year in which the consolidated primary deficit achieved a nadir of 1.3 per cent of GDP, thanks mainly to the only year of primary surplus achieved by the Centre in the last 20 years.

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[3] For a detailed account of external sector challenges and policy responses, see Acharya (1999).

Table 4: Consolidated Deficits of Central and State Governments

(As percent of GDP at current market prices)

	Fiscal Deficit	Primary Deficit	Revenue Deficit
1980/81	7.5	5.4	0.4
1981/82	6.3	4.1	-0.6
1982/83	5.9	3.4	0.2
1983/84	7.3	4.8	1.1
1984/85	9.0	6.2	2.1
1985/86	8.0	4.9	1.9
1986/87	9.9	6.5	2.4
1987/88	9.2	5.5	2.9
1988/89	8.5	4.6	2.9
1989/90	8.9	4.6	3.3
1990/91	9.4	5.0	4.2
1991/92	7.0	2.3	3.4
1992/93	7.0	2.1	3.2
1993/94	8.3	3.3	4.3
1994/95	7.1	1.9	3.7
1995/96	6.5	1.6	3.2
1996/97	6.4	1.3	3.6
1997/98	7.3	2.2	4.1
1998/99	9.0	3.7	6.3
1999/2000	9.5	3.9	6.3
2000/2001	9.7	3.6	6.3
Averages			
1980/81-1983/84	**6.8**	**4.4**	**0.3**
1984/85-1990/91	**9.0**	**5.3**	**2.8**
1991/92-1996/97	**7.1**	**2.1**	**3.6**
1997/98-2000/01	**8.9**	**3.4**	**5.8**

Source: Reserve Bank of India (RBI) Annual Reports

Note: For 1998/99 onwards the RBI data have been adjusted for revision of GDP estimates published by the Central Statistical Organisation (CSO) in January 2002. For 2000/01 the Central Government fiscal accounts have been used.

Table 5: Deficits of Central Government

(As percent of GDP at current market prices)

	Fiscal Deficit	Primary Deficit	Revenue Deficit
1980/81	5.4	3.6	1.4
1981/82	5.2	3.3	0.2
1982/83	5.6	3.6	0.7
1983/84	6.3	4.1	1.2
1984/85	7.1	4.7	1.7
1985/86	7.9	5.2	2.1
1986/87	8.5	5.5	2.5
1987/88	7.6	4.5	2.6
1988/89	7.3	3.9	2.5
1989/90	7.3	3.7	2.5
1990/91	6.6	2.8	3.3
1991/92	4.7	0.7	2.5
1992/93	4.8	0.6	2.5
1993/94	6.4	2.2	3.8
1994/95	4.7	0.4	3.1
1995/96	4.2	0.0	2.5
1996/97	4.1	-0.2	2.4
1997/98	4.8	0.5	3.1
1998/99	5.1	0.7	3.8
1999/2000	5.4	0.7	3.5
2000/2001	5.7	0.9	4.1
Averages			
1980/81-1983/84	**5.6**	**3.7**	**0.9**
1984/85-1990/91	**7.5**	**4.3**	**2.5**
1991/92-1996/97	**4.8**	**0.6**	**2.8**
1997/98-2000/01	**5.3**	**0.7**	**3.6**

Sources: *Economic Survey* (various issues), and Budget documents.
Note: Deficits are uniformly computed net of small savings transferred to states.

Table 6: Deficits of State Governments

(As percent of GDP at current market prices)

	Fiscal Deficit	Primary Deficit	Revenue Deficit
1980/81	2.6	1.7	-1.0
1981/82	2.4	1.6	-0.8
1982/83	2.6	1.7	-0.5
1983/84	2.9	2.0	-0.1
1984/85	3.3	2.3	0.4
1985/86	2.7	1.6	-0.2
1986/87	3.0	1.7	-0.1
1987/88	3.2	1.8	0.3
1988/89	2.8	1.4	0.4
1989/90	3.2	1.7	0.8
1990/91	3.3	1.8	0.9
1991/92	2.9	1.2	0.9
1992/93	2.8	1.0	0.7
1993/94	2.4	0.6	0.4
1994/95	2.7	0.8	0.6
1995/96	2.6	0.8	0.7
1996/97	2.7	0.9	1.2
1997/98	2.9	0.9	1.1
1998/99	4.3	2.2	2.5
1999/2000 P	4.7	2.4	2.8
2000/2001 RE	4.5	2.0	2.5
Averages			
1980/81-1983/84	**2.6**	**1.8**	**-0.6**
1984/85-1990/91	**3.1**	**1.8**	**0.4**
1991/92-1996/97	**2.7**	**0.9**	**0.8**
1997/98-2000/01	**4.1**	**1.9**	**2.2**

Source: RBI, *Handbook of Statistics on the Indian Economy, 2000* and RBI *Annual Report, 2000-01* for state fiscal data and CSO for GDP estimates

Notes: 1. Data for 1999/2000 are provisional.
2. RE: Revised Estimate

Figure 2A

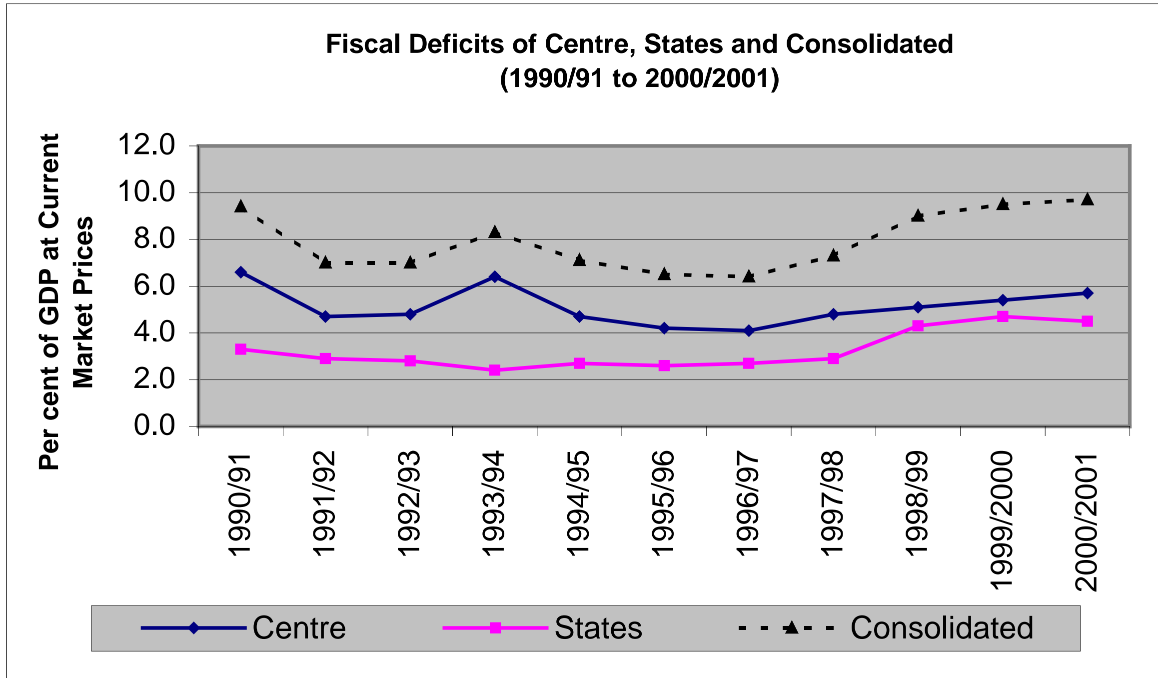
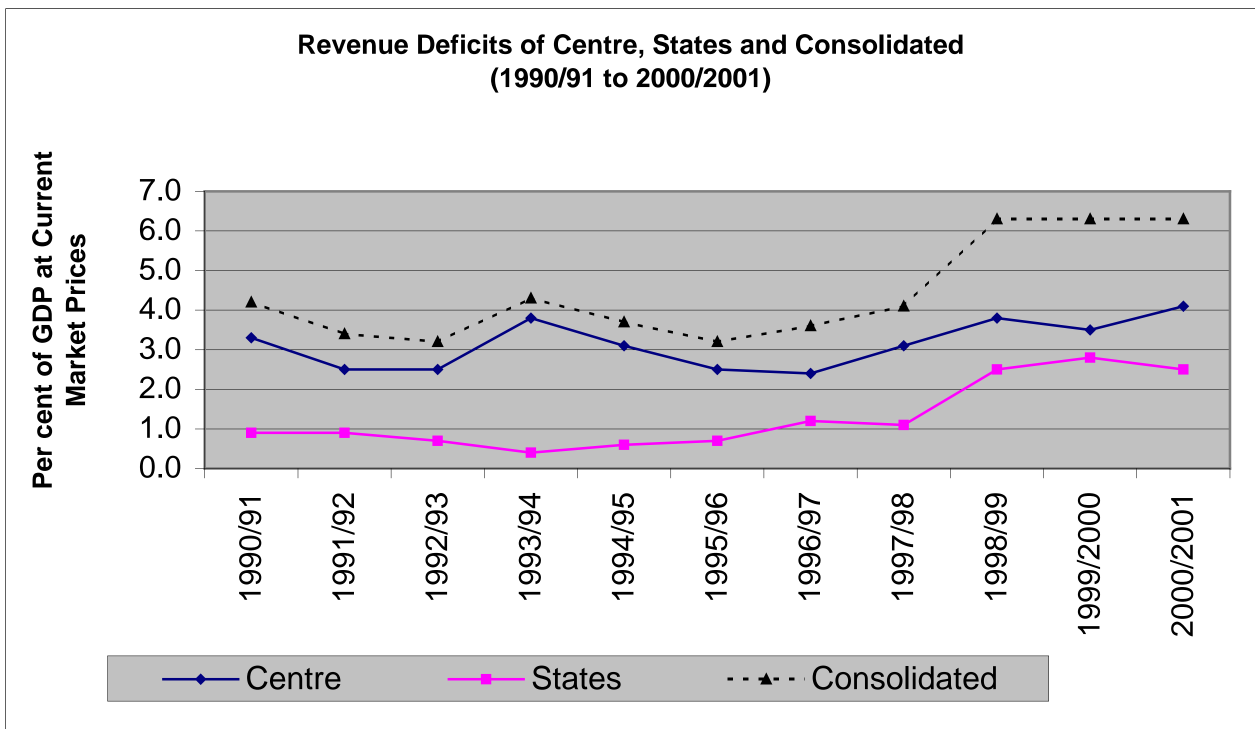


Figure 2B



This is not the place for a detailed decomposition of the factors explaining the trends in deficits over the decade of the nineties. However, tables 7 and 8 bring out a couple of broad points. First, revenue receipts (tax and non tax) did not contribute to the improvement in the Centre's fiscal position between 1990/91 and 1996/97. In fact there was some decline in the ratios to GDP. Of particular concern was a decline in the ratio of tax revenues to GDP. Second, the entire improvement in the Centre's fiscal situation up to 1996/97 is attributable to a reduction in the expenditure to GDP ratio from 17.3 per cent of GDP in 1990/91 to 13.9 per cent in 1996/97, with most of the reduction being concentrated in capital expenditure.

Table 7: Centre's Fiscal Position: A Summary View

(As percent of GDP at current market prices)

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/2001
1. Revenue Receipts	9.7	10.1	9.9	8.8	9.0	9.3	9.2	8.8	8.6	9.4	9.2
2. Tax Revenue (Net to Centre)	7.6	7.7	7.2	6.2	6.7	6.9	6.8	6.3	6.0	6.6	6.6
3. Non-Tax Revenue	2.1	2.4	2.7	2.6	2.3	2.4	2.4	2.5	2.6	2.8	2.7
4. Expenditure	17.3	16.2	15.8	15.9	14.9	14.2	13.9	14.2	14.7	15.4	15.6
5. Revenue Expenditure	12.9	12.6	12.4	12.6	12.1	11.8	11.6	11.8	12.4	12.9	13.3
6. Capital Expenditure	4.4	3.6	3.4	3.3	2.9	2.4	2.3	2.4	2.2	2.5	2.3
7. Revenue Balance (1-5)	**-3.3**	**-2.5**	**-2.5**	**-3.8**	**-3.1**	**-2.5**	**-2.4**	**-3.1**	**-3.8**	**-3.5**	**-4.1**
8. Fiscal Balance	**-6.6**	**-4.7**	**-4.8**	**-6.4**	**-4.7**	**-4.2**	**-4.1**	**-4.8**	**-5.1**	**-5.4**	**-5.7**

Sources: *Economic Survey* (various issues), and Budget Documents.

Table 8: States' Fiscal Position: A Summary View

(As percent of GDP at current market prices)

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/2001 RE
1. Revenue Receipts	11.7	12.3	12.2	12.3	12.1	11.5	11.2	11.2	10.0	10.6	11.4
2. Tax Revenue (Net to Centre)	7.8	8.1	8.1	8.0	8.0	7.8	7.8	8.0	7.3	7.5	7.9
3. Non-Tax Revenue	3.9	4.3	4.1	4.3	4.1	3.7	3.4	3.2	2.7	3.1	3.5
4. Expenditure	16.0	16.5	15.9	15.7	16.0	14.9	14.8	15.0	15.1	16.3	16.9
5. Revenue Expenditure	12.6	13.2	12.9	12.7	12.7	12.2	12.3	12.3	12.5	13.3	13.9
6. Capital Expenditure	3.4	3.3	3.1	2.9	3.3	2.7	2.5	2.7	2.6	2.8	2.8
7. Revenue Balance (1-5)	**-0.9**	**-0.9**	**-0.7**	**-0.4**	**-0.6**	**-0.7**	**-1.1**	**-1.1**	**-2.5**	**-2.7**	**-2.5**
8. Fiscal Balance	**-3.3**	**-2.9**	**-2.8**	**-2.4**	**-2.7**	**-2.7**	**-2.7**	**-2.9**	**-4.2**	**-4.7**	**-4.4**

Source: RBI, *Handbook of Statistics on Indian Economy 2001.*
Notes: RE: Revised Estimate

The improvement in the fiscal balances in the first half of the decade was significant, if partial. The decline in the consolidated fiscal deficit by 3 per cent of GDP between 1990/91 and 1995/96 made room for the investment boom of 1993-96, which, as we shall see, took aggregate domestic investment from a decadal low of 22.6 per cent of GDP in the crisis year of 1991/92 to a very healthy peak of 26.9 per cent of GDP in 1995/96. Of course, other factors, such as deregulation of industry and foreign trade, strong export performance and the overall reform momentum were also driving investment higher. But it does seem likely that the reduction in the fiscal deficit in the first half of the decade helped to nurture the rise in gross savings and investment, which, in turn, helped propel India's growth to 7 per cent plus for three successive years in the mid-nineties.

D. Strong Response of Growth and Investment

Against the background of improvements in external and fiscal balances noted above, the real economy responded strongly to the wide range of reform measures undertaken in the early nineties. GDP growth had collapsed to 1.3 per cent in 1991/92 as the balance of payment crisis of 1991 took its toll. In the subsequent nine years, 1992/93 to 2000/01, GDP growth averaged an unprecedented 6.1 per cent. The trend in decadal growth rates looks even better when we focus on per capita GDP growth, which accelerated to an average of 4.0 per cent in these nine years from under 1 per cent as recently as the seventies decade.

The strong growth of the 1990's, coming on top of the growth acceleration that occurred in the eighties, placed India among the ten fastest growing countries in the world in the final two decades of the twentieth century. Virmani (1999) ranks India sixth in the world growth league after China, Korea, Thailand, Singapore and Vietnam (Table 10). This is certainly a far cry from the conventional image of the Indian economy as a lumbering, shackled giant trailing far behind most significant emerging market economies in the growth race. Even more heartening is Virmani's finding that India retains sixth position when the ranking is redone in term of per capita GDP growth.

Table 10: Growth Trends for Medium and Large Countries: 1980-2000

(percent)

	GDP		Per Capita GDP	
Country	**Growth Trend**	**Rank**	**Growth Trend**	**Rank**
China	10.1	1	8.8	1
Korea, Rep.	7.7	2	6.6	2
Thailand	7.1	3	5.7	3
Singapore	6.9	4	5.1	4
Ireland	5.3	10	4.9	5
India	**6.0**	**6**	**4.1**	**6**
Vietnam	6.2	5	4.1	7
Chile	5.6	9	4.0	8
Indonesia	5.7	8	3.9	9
Hong Kong	5.3	11	3.7	10
Malaysia	6.0	7	3.5	11

Source: Virmani (1999)

Notes:
1. Medium and Large countries are defined as those with population greater than 10 million and GDP greater than $ 40 billion.
2. The growth trend for 1980-98 is a log average of the growth trends for 1980-90 and 1990-98, from *World Development Report, 1999-2000.*
3. Population growth trends from *World Development Report, 1998-1999* and projections.
4. Forecasts of 1999 and 2000 are from *Asian Development Bank's Asian Economic Outlook 1999* and IMF *World Economic Outlook* where available.

Closer examination of growth trends during the decade reveals some interesting patterns, especially if we subdivide the nine years following the 1991 crisis into an initial high growth period of five years (corresponding to the Eighth Plan) and the subsequent four years up to 2000/01 (Table 11). First, comparing performance in the last nine years to the pre-crisis decade, it is interesting that the acceleration of GDP growth (from 5.6 to 6.1 per cent) is entirely attributable to the services sector where growth surged to 7.8 per cent from an already high 6.7 per cent in the eighties. Indeed, the growth of both agriculture and industry averages a little lower in the post-crisis nine years compared to the pre-crisis decade. Second, focussing now on the post-crisis quinquennium, the acceleration of GDP growth to 6.7 per cent from the pre-crisis

decadal average of 5.6 per cent is quite encouraging. Third, it is noteworthy that in this high growth Eighth Plan period all the major sectors (Agriculture, Industry, Services) grew noticeably faster than in the pre-crisis decade. The acceleration in the growth of agricultural value added is particularly interesting in the light of oft-repeated criticism that the economic reforms of the early nineties somehow neglected the agriculture sector.

Table 11: Growth of GDP and Major Sectors

	Share in Real GDP 1993-94 prices (%)	**Average Annual Growth Rates**			
	Average of 1994/95 - 1996/97	**1981/82 - 1990/91**	**1992/93 - 2000/01**	**1992/93 - 1996/97**	**1997/98 - 2000/01**
	(1)	(2)	(3)	(4)	(5)
1. Agriculture	28.9	3.6	3.2	4.7	1.2
2. Industry	27.6	7.1	6.4	7.6	4.8
3. Services	43.5	6.7	7.8	7.6	8.1
4. GDP (factor cost)	**100.0**	**5.6**	**6.1**	**6.7**	**5.4**

Source: Central Statistical Organisation

It is also interesting to note that, by the yardstick of overall economic growth, India's recovery from the 1991 crisis compares very favourably in international comparisons with other developing countries undertaking post-crisis reform programmes. As Table 12 shows, average economic growth in the first three years after the start of the reform / adjustment programme was over 6 per cent in India as compared to an average of only 2.2 per cent for thirty developing countries surveyed in one study.

Table 12: Average Economic Growth in First 3 Years after start of Reform/Adjustment Programme

(per cent)

India (1991-92)	**6.1**
Average of 30 Developing Countries	2.2
Kenya (1981)	2.4
Nigeria (1983)	2.1
Mexico (1983)	0.6
Thailand (1983)	5.1
Turkey (1980)	4.1

Source: CSO for India. For other countries, "Macroeconomic Performance under Adjustment Lending" in Thomas, Chhibber, Dailami and de Melo (eds). *Restructuring Economics in Distress, Policy Reforms and the World Bank*, Oxford University Press, 1991.

Note: Year in parenthesis indicates year reform or adjustment programme was launched.

These initial post-crisis years also witnessed a strong positive response from aggregate investment and savings. We have already noted the surge in gross domestic investment between 1991/92 and 1995/96. Gross domestic savings also increased significantly to attain a peak level of 25.1 per cent of GDP in 1995/96 (Table 13). It would be reasonable to infer that during this high growth period there was a mutually supportive interaction between economic growth on the one hand and aggregate savings and investment on the other.

Table 13: Savings and Investment

(As percent of GDP at current market prices)

	GDCF	GDS	Public Savings	Private Savings	Household Savings	Corporate Savings
Average 1985-90	22.7	20.4	2.4	18.0	16.0	2.0
1990/91	26.3	23.1	1.1	22.0	19.3	2.7
1991/92	22.6	22.0	2.0	20.1	17.0	3.1
1992/93	23.6	21.8	1.6	20.2	17.5	2.7
1993/94	23.1	22.5	0.6	21.9	18.4	3.5
1994/95	26.0	24.8	1.7	23.2	19.7	3.5
1995/96	26.9	25.1	2.0	23.1	18.2	4.9
1996/97	24.5	23.2	1.7	21.5	17.0	4.5
1997/98	24.6	23.1	1.3	21.8	17.6	4.2
1998/99	22.7	21.7	-1.0	22.6	18.9	3.7
1999/2000	24.3	23.2	-0.9	24.0	20.3	3.7
2000/2001 Q	24.0	23.4	-1.7	25.1	20.9	4.2

Source: *Economic Survey, 2001-2002*
Notes: Q: Quick Estimate
GDCF: Gross Domestic Capital Formation
GDS: Gross Domestic Saving

National accounts data on trends in gross fixed capital formation (at constant prices) also shows very strong growth of over 40 per cent between 1993/94 and 1995/96. The fixed investment surge is particularly strong in the industrial sector, especially manufacturing (Table 14).

What are the factors which explain the remarkable and broad-based growth surge in the period 1992-97? In the absence of authoritative research, we can suggest the following factors:

- Productivity gains resulting mainly from the deregulation of trade, industry and finance, especially in the sectors of industry and some services;
- Reform-assisted surge in export growth;
- The investment boom of 1993-96, which exerted expansionary influences on both supply and demand, especially in industry.
- The investment boom itself was probably driven by a combination of factors including unleashing of "animal spirits" by economic reforms, the swift loosening of foreign exchange bottlenecks, confidence in broadly consistent governmental policy signals and easier availability of investible funds (both through borrowing and new equity issues);
- The partial success in fiscal consolidation, which kept a check on government borrowings and facilitated expansion of aggregate savings and investment;
- Improvement in the terms of trade for agriculture resulting from a combination of higher procurement prices for important crops and reduction in trade protection for manufactures.
- Availability of capacity in key infrastructure sectors, notably power.
- A buoyant world economy which facilitated expansion of foreign trade and private capital inflows.

Table 14: Index of Gross Fixed Capital Formation (at 1993-94 prices), by Industry of Use

Base: 1993-94 = 100

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000
1. Agriculture etc.	**100.0**	**108.3**	**114.1**	**115.3**	**115.6**	**120.2**	**133.6**
2. Industry	**100.0**	**116.3**	**158.2**	**159.5**	**152.9**	**143.8**	**139.8**
2.a. Manufacturing	100.0	114.7	186.0	194.4	179.4	165.1	153.4
2.b. Mining and Quarrying	100.0	193.8	123.4	76.8	77.4	70.4	79.8
2.c. Electricity, Gas and Water	100.0	91.4	86.2	94.1	94.4	101.7	112.5
2.d. Construction	100.0	164.4	244.2	130.3	277.9	238.4	252.2
3. Services	**100.0**	**123.5**	**131.2**	**124.3**	**116.0**	**119.2**	**131.0**
3.a. Trade, Hotels and Restaurants	100.0	146.2	189.6	133.3	119.2	118.8	116.9
3.b. Transport, Storage and Communication	100.0	123.8	131.0	131.3	106.0	101.2	118.3
3.c. Financing, Insurance, Real Estate and Business Services	100.0	118.7	124.8	119.4	121.1	119.8	121.6
3.d. Community, Social and Personal Services	100.0	123.1	121.8	119.8	119.6	142.4	168.8
4. Total (1+2+3)	**100.0**	**118.5**	**143.9**	**141.9**	**135.2**	**132.1**	**135.8**

Source: Central Statistical Organisation

E. Post-1997 Deceleration : A Macro View

The year 1997 was a watershed, which rang in the end of the economic party. In particular, three marker events occurred within a six-month period to check the momentum of growth. In March, the instability inherent in coalition governments became manifest in the political crisis which ended the Deve Gowda government and ushered in the Gujral version of the United Front government. In July the Thai financial crisis raised the curtain on the Asian crisis saga, which dominated the international economic arena for next 18 months. Finally, in September, the Gujral government announced its decisions on the Fifth Pay Commission report, decisions which were to prove costly for both the fiscal and economic health of the country.

Economic growth fell to 4.8 per cent in 1997/98, 4.3 per cent if the "Pay Commission effect" is netted out (see below). Agriculture recorded negative growth in value added, while the growth of manufacturing slumped to 1.5 per cent from 9.7 per cent in the previous year. Only services boomed at 9.8 per cent. Although industrial expansion remained subdued , GDP growth recovered smartly in 1998/99 thanks to a strong rebound in agriculture and continued buoyancy in services. Growth was sustained in 1999/2000 by a temporary recovery in industry. In 2000/01, renewed industrial deceleration and virtual stagnation in agriculture pulled GDP growth down to 4.0 per cent.

As a, result average GDP growth dropped to 5.4 per cent in the last four years, 1997/98-2000/01 (Table 11). Much more disquieting is the collapse of agricultural growth to 1.2 per cent (from nearly four times that rate in the Eighth Plan period) and the significant fall in industrial growth down to 4.8 per cent. Indeed, the drop in GDP growth in these four years would have been much steeper but for the extraordinary buoyancy of services which averaged growth of 8.1 per cent. This growth in services was much faster than industry, a pattern which is quite different and novel compared to India's past experience and, at the very least, raises questions of sustainability.

A part of the services sector growth in the last four years was “spurious” in the sense that it simply reflected the revaluation of the value added in the subsector “Public Administration and Defence” because of higher pay scales resulting from decisions on the Fifth Pay Commission. It is a peculiarity of national income accounting conventions that value added in non-marketed services is estimated on the basis of cost. These Pay Commission effects (including knock- on effects in States) were spread mainly over three years, 1997/98, 1998/99 and 1999/2000, when ‘real’ growth of ‘Public Administration and Defence’ soared to 14.5 per cent, 10.3 per cent and 13.2 per cent, respectively, compared to an average growth in the previous five years of less than 4 per cent. Subtracting the trend growth from the exceptionally high reported growth rates gives a measure of the “spurious” (or Pay Commission effected) growth in these years, which we also subtract from overall GDP growth in the relevant years. This adjustment reduces GDP growth by 0.5 per cent in 1997/98 and 1999/2000 and by 0.4 per cent in 1998/99. The adjusted (net of Pay Commission effect) GDP growth becomes 4.3 per cent in 1997/98, 6.1 per cent in 1998/99 and 5.6 per cent in 1999/2000. As a result of these adjustments, the average GDP growth in the last four years 1997/98 to 2000/01 drops to 5.0 per cent, which is noticeably below the 5.6 per cent average for the pre-crisis decade and substantially lower than the 6.7 per cent achieved in the post-crisis quinquennium.[4]

From a macroeconomic perspective, 1997 witnessed negative developments in three key areas of exports, investment and fiscal balance. Export growth in dollar terms dropped to 5 per cent from 20 per cent in the previous three years, partly because of the real appreciation of the rupee between 1993 and 1995 and partly because of the surge in Chinese exports to the world, which took away market share from all other Asian competitors. Industrial investment stalled for several reasons. First, the investment boom of the previous three years had built up large capacities, which discouraged further expansion. Second, real interest rates had risen in 1995/96 because of a sharp decline in inflation and a temporary rise in nominal interest rates, driven by Reserve Bank interventions in the foreign exchange market to stabilise a suddenly wobbly rupee. Third, the advent of coalition governance had probably heightened uncertainty and damped

[4] It could be argued that, for strict comparability, similar adjustments should be made to the growth in previous periods following previous Pay Commission decisions. However, the scale of the pay increases following the FPC is of a different order.

business confidence. Fourth, and related, the reform programme lost momentum and consistency after the mid-nineties.

On the fiscal front, after 1996/97, the consolidated fiscal and revenue deficits deteriorated steadily, with about half the worsening due to the phasing in of increases in government pay scales following the Fifth Pay Commission. Both the fiscal deficit and the revenue in deficit increased by about 3 per cent of GDP between 1995/96 and 1999/2000 (Table 4). This sharp widening in deficits was fully reflected in the decline of public savings from plus 2 per cent of GDP in 1995/96 to *minus* 1 per cent in 1998/99. This, in turn, largely explained the drop in gross domestic savings from its peak of 25.1 per cent of GDP in 1995/96 to 21.7 per cent in 1998/99. Over this period, there was a decline of similar magnitude in gross domestic investment, partly for reasons noted above and partly because of continued high real interest rates shored up by growing fiscal deficits.

From India's perspective the international economic environment also weakened after 1997. The Asian crisis of 1997-98 hurt exports and private capital inflows. The problems were compounded by the economic sanctions which followed the nuclear tests in May 1998. In the next two years the surge in international oil prices (much of it passed on after lags to Indian energy users) exerted negative effects. Finally from the last quarter of 2000 the global economic slowdown took its toll of India's economic performance.

Other, more structural factors influenced the deceleration of growth. This probably included the petering out of productivity gains from economic reforms, which clearly slowed after 1995. Although reforms continued throughout the decade, they never regained the breadth and depth of the early nineties. Key reforms in the financial sector, infrastructure, labour laws, trade and industrial policy and privatization remained unfinished or undone. Second, despite good intentions, the bottlenecks in infrastructure became worse over time, especially in power, railways and water supply, reflecting slow progress in reforms of pricing, ownership and the regulatory framework. Third, the low quality and quantity of investment in rural infrastructure combined with distorted pricing of some key agricultural inputs and outputs to damp the growth of agriculture. Fourth, the continuing decline in governance and

financial discipline in (especially, but by no means exclusively) the populous States of the Gangetic plain constrained growth prospects for over 30 per cent of India's population.

It is worth emphasizing that the coincidence of slowing economic growth and rising fiscal deficits is placing serious strain on public finances and highlighting issues of sustainability of public debt ratios. Between March 1991 and March 1997 the Central Government's debt-GDP ratio had fallen by almost 6 percentage points reflecting high growth and partial fiscal consolidation. In the next four years the ratio deteriorated (increased) by 7 percentage points, reflecting opposite trends in deficits and growth. Between March 1997 and March 2002 the ratio of the combined debt of the Centre and States to GDP increased by 13 percentage points from 56.5 per cent to 69.7 per cent. The need for reversing this trend is obvious.

F. Sectoral Perspectives

Problems in Agriculture

Much is being made of the strong growth of agriculture in fiscal 2001/02. According the Advance Estimates of National Income published in February 2002, the agriculture sector (broadly defined) is projected to grow by a very healthy 5.7. Indeed, without this buoyancy in agriculture, overall GDP growth would have been well below 5 percent. However, the current revival masks some worrying longer-term trends. For a start, it comes after two successive years of poor performance, including negative growth in 2000/01. In a somewhat longer perspective, in the nine years after the crisis of 1991/92 the growth of agricultural value added averaged 3.2 percent, slightly slower than the 3.6 percent achieved in the eighties. What's more, while the first five post-crisis years, 1992-97, saw agriculture boom at an average growth of 4.7 percent per year, the next four years, 1997-2001, recorded a dismal average of only 1.2 percent. Even if we add the very preliminary estimate for 2001/02, the Ninth Plan average annual growth is only 2.1 percent, less than half the Eighth Plan average of 4.7 percent. No wonder GDP growth in the Ninth Plan has averaged barely 5 percent per year, once we adjust for the "spurious" growth attributable to government pay increases. Experience from all over the world (and India's own

Eighth Plan experience) suggests that for a country to sustain economic growth at around 7 percent or higher, agriculture has to grow at 4 percent or more.

Similar concerns emerge if we look at the growth of production and yield in principal crops which account for about 70 percent of value added in the "Agriculture and Allied" sector (the rest is attributable to livestock, dairying, fishing and forestry). Table 15 presents comparative data for the eighties and nineties. It is quite striking that the average growth rate of crop production has almost halved from 3.2 percent a year in the eighties to 1.7 percent in the nineties. And the decline is entirely due to the sharp fall in yield growth from 2.6 percent per year in the eighties to 1.0 percent in the nineties. Furthermore the deceleration in production and yield affect both foodgrains and nonfood crops (each accounting for about half of crop production). Foodgrain growth has dropped below the rate of population growth, while the nonfood growth rate has halved from 3.8 percent in the eighties to 1.9 percent in the nineties. Growth of foodgrain yields has halved and that of nonfood crops has plummeted to only a quarter of the eighties rate. Assuming (reasonably!) good correlation between the value added data and the crop production data, it would be reasonable to infer that most of the observed deceleration in the growth of production and yield has occurred in the period 1997-2001; indeed the Eighth Plan period may have seen some acceleration.

Table 15 : Principal Crops : Growth of Production and Yield

(% per annum)

	Production		**Yield**	
	1980/81-1989/90	**1990/91-2000/01**	**1980/81-1989/90**	**1990/91-2000/01**
Foodgrains	2.85	1.66	2.74	1.34
Non-Food Crops	3.77	1.86	2.31	0.59
All Crops	3.19	1.73	2.56	1.02

Source: Economic Survey, 2001/02

So what's amiss? Since agriculture accounts for 60 percent of India's labour force and a quarter of GDP, one might have expected intense scholarly research to yield an authoritative answer to this question. Although there has been a fair amount of research, the answers are still tentative.[5] In the absence of definitive answers to the puzzle of the agricultural slowdown, the following likely reasons can be put forward.

First, real public investment in agriculture (mostly in major and medium irrigation projects) has actually fallen by a fifth between 1994/95 and 2000/01. Over the same period there has been a 25 percent increase in real private investment (in mainly farm equipment and minor irrigation), taking the share of *private* investment in total to over three-quarters. The rise in total real investment has been modest, reflected in the fall in the ratio of agricultural investment to agricultural value added to a meagre 5 percent or so.

Second, the operation and maintenance (O&M) of irrigation systems in most states has deteriorated, partly because of very weak cost recovery as well as widespread entropy in the effectiveness of irrigation departments. The post Pay Commission pay increases have starved departments of funds for non-salary inputs for O&M. As a result, the management and distribution of the critical resource of water has probably worsened.

Third, in most states the rural roads and state highways programmes have not gone anywhere fast for much same reasons that bedevil irrigation departments. Yet the creation and sustenance of road linkages is crucial for the development of well-functioning agricultural markets.

Fourth, the systems of agricultural research, development and extension services (which played such a crucial role in the Green Revolution of the seventies and eighties) are generally perceived to have become bureaucratic, unaccountable (to farming needs) and unmotivated. The Pay Commission effect of starving non-salary inputs has also taken its toll.

[5] See, for example, Bhalla (2001), Gulati and Bathla (2001), Radhakrishna (2001) and Vaidyanathan (2000).

Fifth, although the terms of trade have remained favourable to agriculture as a whole, the natural and necessary diversification away from wheat and rice has been retarded by the pattern of inappropriately high procurement price increases for these crops (they have also created the costly food mountains in public godowns).

Sixth, there is growing evidence that high levels of urea subsidy for many years has distorted the use patterns of nitrogen-phosphates-potassium in a way which has been cumulatively detrimental to soil fertility.

Seventh, especially in the more populous states, agricultural productivity has been hurt by continuing fragmentation of land holdings arising partly from India's peculiarly slow shift of labour force from agriculture to non-agriculture. This peculiarity, in turn, is largely attributable to rigid labour laws (in the organized sector) and small scale industry reservations, which have seriously damaged the expansion of employment in manufacturing (we have only to compare with the much better experience of East Asian countries).[6]

If these are the right reasons, the solutions to the problems are implicit and clear. But they will not be easy to implement.

Industrial boom--shortlived

Industrial growth was very strong between October 1993 and September 1996, with annualized growth rates for manufacturing (accounting for almost four-fifths of the index of industrial production) close to or exceeding double digits in every quarter (Table 16). The deregulation of industry and foreign trade, combined with the momentum of overall reforms and good agricultural performance, clearly spurred strong growth of industrial production and investment during this triennium (Table 14). Growth faltered in September 1996, recovered in October and then suddenly plummeted in the last five months of fiscal 1996/97. What is worse,

[6] See Mohan (2002) for a persuasive account of the damage done by small scale industry reservations policy to growth of manufacturing output, exports and employment.

industrial growth remained sluggish throughout 1997/98 and 1998/99. Although there was some pickup in 1999/2000, it was shortlived and ran out of steam by the end of 2000.

Table 16 : Growth Rates for Manufacturing

(Figures in %)

Index of Industrial Production

	1993/ 94	1994/ 95	1995/ 96	1996/ 97	1997/ 98	1998/ 99	1999/ 2000	2000/ 2001
Q1	0.1	9.8	12.7	14.3	4.8	4.2	6.9	6.5
Q2	6.3	10.2	14.7	8.1	7.3	3.9	7.2	5.9
Q3	9.0	9.6	14.0	5.4	8.8	3.2	7.7	5.7
Q4	8.5	9.7	15.0	2.8	5.7	5.1	8.0	3.5

Source: Index of Industrial Production, CSO

It is quite remarkable that after August 1996 there has been only one solitary month (November 1997) in which either the overall index for industry or the component for manufacturing has registered double digit growth from a year ago. Moreover, except for the welcome partial recovery of 1999/2000, there is not one instance, since September 1996, of three successive quarters registering more than six percent growth.

What accounts for this dismal outcome after the manifest boom of the previous three years? A popular contemporary explanation among many industrialists was the "credit squeeze" of 1995/96. However, this mistook the unexpected and temporary tightening of liquidity in money markets, resulting from the large dollar sales by the Reserve Bank in support of a suddenly wobbly rupee-dollar exchange rate, as an expression of deflationary credit policy. As the Reserve Bank's annual report for the year was at pains to point out, monetary policy was steadily loosened from November 1995 onwards with successive reductions in the cash reserve ratio (CRR). With non-food bank credit growing by over 22 percent in 1995/96, it would be hard to reconcile this with any simple "credit squeeze" view.

We may be on firmer ground if we seek answers to the industrial slowdown puzzle in the sharp deceleration in 1996/97 in two major components of industrial demand, exports and investment. Export growth in dollars dropped to 5 percent from around 20 percent in the previous three years, partly because of the real appreciation of the rupee between 1993 and 1995 and partly because of the surge in Chinese exports to the world which took away market share from all other Asian competitors. The investment hiatus was equally pronounced, with real gross fixed investment in industry declining in each of the three years following 1996/97 (Table 14). Investment stalled for several reasons. First, the investment boom of the previous three years had built up large capacities, which discouraged further expansion. Second, real interest rates had risen in 1995/96 because of the drop in inflation and a temporary rise in nominal interest rates. Third, the advent of coalition governance had probably heightened uncertainty and damped business confidence.

If these were the reasons for the initial industrial slowdown, what explains its persistence for several years? Export growth remained low in 1997/98 and 1998/99 as the Asian crisis took its toll. That crisis and the post-nuclear-tests sanctions also depressed investor confidence. Even more damaging to business sentiments may have been the stalling of reforms in key areas such as infrastructure, labour laws and the financial sector and the continuing uncertainties of coalition governance. The somewhat ambivalent approach to reduction in trade protection may have also played a role.

In 1999/2000, fuelled by the strong rebound in agriculture in the preceding year, the recovery in exports and the budget for the year, industrial growth showed promising recovery. But it proved temporary as investment failed to revive and rising energy costs and the onset of global slowdown in late 2000 depressed both business confidence and industrial growth to new lows. By the spring of 2001 the global recession and India's financial sector problems were important new negatives weakening industrial performance.[7] Manufacturing production grew less than 3 per cent in 2001/02.

[7] In a recent paper, Bhattacharya and Patel (2002) argue that growing weaknesses in India's financial system have contributed significantly to the industrial slowdown of recent years.

Infrastructure Constraints

India's infrastructure problems are legendary. There is little doubt that past economic performance has been constrained by weaknesses in the availability and quality of infrastructure services, even if rigorous studies of the timing and severity of such constraints are hard to come by. There is some qualitative evidence to suggest that in key sectors such as electric power, roads and railways the situation may have worsened in recent years because of mounting fiscal pressure on budgets of public sector entities, continuing problems of chronic under-pricing and economically unsound cross-subsidization policies and insufficient progress with regulatory reforms. The real issue is what are the prospects for the medium-term?

The answer probably varies substantially across the various infrastructure sectors. The outlook is most promising for the telecom sector, which has made the most progress in the transition from a public monopoly paradigm to a model where public and private service providers compete in the same market subject to an independent regulator. After a somewhat tortuous process of reform of the regulatory and investment framework, the telecom sector is now benefiting from substantial new investments and productivity gains from new technology and competition. This process should continue in the medium term, bringing widespread benefits from better tele-connectivity, including for the allied information technology sector.

Connectivity will also improve from growing investments in the national highway network, especially "the Golden Quadrilateral", although the old problems of maintenance and upkeep remain challenging. The outlook for state highways and rural roads is more problematic. There has been much less progress in railways, which remain a public monopoly, burdened by unrealistically low tariffs, massively uneconomical cross-subsidization of passengers by freight, insufficient investment in track and rolling stock and declining safety performance. Despite several high-level reviews and reports, the prospects for early corrective action are not bright.[8]

[8] The most recent comprehensive survey is provided by the report of the Expert Group on Indian Railways (2001).

Progress has been slowest in the sector of electric power, even though it is the sector in which it is most urgently needed.[9] The problems are well-known and include grossly inefficient State Electricity Boards (SEBs), a long history of massive under-pricing to agricultural users, very high levels of power theft, cross-subsidies which hit large and medium-scale industry, declining levels of investment in generation and transmission and widespread incidence of brownouts and blackouts. One recent survey of over a thousand industrial firms in India found the average cost of power to users (after allowing for blending from the public grid and private generators) to be over four rupees per unit, compared to less than two rupees in North America and around Rs. 2.50 in Korea and Taiwan.[10] Seventy percent of survey respondents had to resort to running their own generator sets! Although there has been some reform of the regulatory environment, the basic problems of inefficient, loss-making SEBS and unsustainable pricing and distribution policies remain far from being solved.

Taken together, the summary, medium-term outlook for the electric power sector is not promising. It is even possible that the constraints might get worse before they get better.

G. Concluding Remarks

At the beginning of the new millennium the Indian economy was at an intriguing juncture. Having notched up two decades of good economic growth there was genuine reason for satisfaction, especially when the performance is viewed in the context of international comparisons. At first glance the external sector also looked strong , at least in terms of the usual criteria of forex stockpiles, external debt ratios, current account deficits and so forth. Inflation was well under control. Despite the statistical controversies the incidence of extreme poverty was at its lowest point ever.

But the economic sky was darkening with clouds. Growth had clearly slowed in recent years both in aggregate and for all major sectors. The fiscal position had worsened substantially and was posing new problems of debt sustainability. Reforms continued but at an uneven pace. The financial sector was under renewed stress. Weak infrastructure, especially power, was taking

[9] For a recent survey of power sector problems, see Parikh and Parikh (2002).

its toll of economic performance. Agriculture had lost momentum. There were growing signs of weakness in international competitiveness, especially in the crucial segment of manufacturing. Export growth was weak. State finances were under exceptional strain, severely limiting the states' capacity to undertake productive development programmes, especially in the crucial areas of education, health and economic infrastructure. Regional disparities were sharpening. Good governance and administrative efficiency were at a premium.

Put simply and bluntly the outlook for sustained, broad-based growth was weak unless major corrective measures were put in place. It is easy to compile another list of what is often called "second generation reforms". Here I shall limit myself to five pressing priorities. First, the fiscal deficits of the central and state governments have to be reduced through a combination of higher tax yields, greater cost recovery (lower subsidies) and tight control of establishment expenditures. Second, the electric power sector has to be transformed through aggressive privatisation of power distribution. Third, the financial sector has to be overhauled, including privatisation of government-controlled banks and financial institutions. Fourth, to drive faster growth of industrial investment, output and employnent the announced reforms of rigid labour laws and bankruptcy provisions need to be implemented swiftly. Finally, trade policy reforms need to pursued resolutely through reductions in import duties in line with pronouncements made in recent budget speeches.

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[10] See Dollar, Goswami et.al (2002).

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Annex Table 1: Balance of Payments Indicators

(As per cent of GDP at current market prices)												
	1985-90 (Average)	**1990-91**	**1991-92**	**1992-93**	**1993-94**	**1994-95**	**1995-96**	**1996-97**	**1997-98**	**1998-99**	**1999-2000**	**2000-2001**
Exports, f.o.b.	4.8	5.8	6.9	7.3	8.3	8.3	9.1	8.9	8.7	8.2	8.4	9.8
Imports, c.i.f.	7.7	8.8	7.9	9.6	9.8	11.1	12.3	12.7	12.5	11.4	12.4	13.0
Trade Balance	**-3.0**	**-3.0**	**-1.0**	**-2.3**	**-1.5**	**-2.8**	**-3.2**	**-3.9**	**-3.8**	**-3.2**	**-4.0**	**-3.1**
Invisibles, net	0.79	-0.1	0.7	0.6	1.1	1.8	1.6	2.7	2.4	2.2	3.0	2.6
Current Account Balance	**-2.2**	**-3.1**	**-0.3**	**-1.7**	**-0.4**	**-1.0**	**-1.7**	**-1.2**	**-1.4**	**-1.0**	**-1.1**	**-0.5**
Capital Account Surplus	**2.2**	**2.3**	**1.5**	**1.6**	**3.5**	**2.8**	**1.3**	**3.0**	**2.4**	**2.0**	**2.3**	**2.0**
of which:												
Foreign Investment	0.10	0.03	0.05	0.23	1.55	1.53	1.38	1.60	1.31	0.58	1.17	1.11
External Assistance,net	0.68	0.70	1.13	0.77	0.69	0.48	0.28	0.29	0.23	0.20	0.20	0.10
Commercial Borrowings,net	0.57	0.71	0.58	-0.15	0.22	0.32	0.38	0.73	0.96	1.06	0.07	0.90
NRI Deposits, net	0.67	0.48	0.15	0.82	0.44	0.05	0.32	0.87	0.28	0.23	0.35	0.51
IMF, net	-0.26	0.38	0.32	0.45	0.07	-0.35	-0.48	-0.25	-0.15	-0.09	-0.06	-0.01

Annex Table 1: Balance of Payments Indicators (continued)

Memo Items

	1985-90 Average	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-2001
Forex Reserves, year end (US $ million)	5616.2	5834.0	9220.0	9832.0	19254.0	25186.0	21687.0	26423.0	29367.0	32490.0	38036.0	42281.0
Increase in Reserves (US $ million)	**-398**	**1872**	**3386**	**612**	**9422**	**5932**	**-3499**	**4736**	**2944**	**3123**	**5546**	**4245**
Forex Reserves as months of Import Cover	3.4	2.5	5.3	4.9	8.6	8.4	6.0	6.5	6.9	8.2	8.2	8.6
Exchange Rate (Rs / US $)	13.82	17.94	24.47	30.65*	31.37	31.40	33.45	35.50	37.17	42.07	43.33	45.68
Growth of Exports (in US$); %	**11.4**	**9.0**	**-1.1**	**3.3**	**20.2**	**18.4**	**20.3**	**5.6**	**4.5**	**-3.9**	**9.5**	**19.6**
Growth of Imports (in US$); %	**9.4**	**14.4**	**-24.5**	**15.4**	**10.0**	**34.3**	**21.6**	**12.1**	**4.6**	**-7.1**	**16.5**	**7.0**
Growth of Non-oil Imports; %	**12.3**	**3.4**	**-21.9**	**12.0**	**11.2**	**29.5**	**28.3**	**-0.2**	**14.5**	**8.0**	**3.2**	**-8.5**
Foreign Investment (US $ million)	**279.2**	**103.0**	**133.0**	**557.0**	**4235.0**	**4807.0**	**4805.0**	**6153.0**	**5390.0**	**2412.0**	**5191.0**	**5102.0**
Direct (US $ million)		97.0	129.0	313.0	668.0	983.0	2057.0	2841.0	3562.0	2473.0	2155.0	2339.0
Portfolio (US $ million)		6.0	4.0	244.0	3567.0	3824.0	2748.0	3312.0	1828.0	-61.0	3036.0	2763.0

* The average official exchange rate for the year 1992-93 was 25.97.

Sources: RBI, Handbook of Statistics on Indian Economy, 2000 , RBI Annual Report 2000-01, and DGCIS (for non-oil imports).