(ix) The figures of utilisation of outlays in the First Five Year plan show that in four of the six backward states, the percentage utilisation of the outlays provided has been less than the overall utilisation factors. The same pattern is observed in the figures of loans and advances given by the public sector financial institutions to the various states.

SUGGESTIONS TO REMOVE REGIONAL IMBALANCES

The following might help remove regional disparities:

- The first and the major thing to be done is to develop infrastructure facilities like water supply, electricity and transport.
- Planning needs to be decentralised. Multi-level planning facilitates people's participation in the decision making.
- Centrally collected resources must be progressively allocated to states.

The suggestions are only indicative but not the only ones.

QUESTIONS

1. What is balanced regional development?
2. How is backwardness determined? What are the causes for backwardness?
3. Suggest measures to remove regional disparities.
4. Why have the efforts to remove regional imbalances not been successful?

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CHAPTER 29

Price and Distribution Controls

CHAPTER OUTLINE

Objectives of Price and Distribution Controls

Control of Prices

- *Demand Management*
- *Supply Management*

Public Distribution System

- *Rationale of PDS*
- *Goods to be Included in the PDS*
- *Supplies to the PDS*
- *Form of PDS*
- *Success of PDS*
- *Measures to Strengthen PDS*
- *Revamped PDS*
- *Problems of Controls*

The Essential Commodities Act, 1955

- *Objectives of the Act*
- *Scope of the Act*
- *Essential Commodity*
- *Provisions of the Act*

LEARNING OBJECTIVES

After reading this Chapter, you should be able to:

1. *Understand the purposes why price and distribution controls are imposed*
2. *Understand that demand management and supply management are the two ways of enforcing price controls*
3. *Describe the functioning, pitfalls, and measures to improve PDS*
4. *Describe the objectives and bring out the provisions of the Essential Commodities Act, 1955*

Control of prices and the distribution of essential commodities is yet another component of economic environment. This chapter is devoted to a brief discussion of price and distribution controls.

OBJECTIVES OF PRICE AND DISTRIBUTION CONTROLS

The following are the objectives of price and distribution controls:

- Supply of essential commodities at reasonable prices;
- Prevention of hoarding and black-marketing;
- Maintain quality of goods and services;
- Prevent monopolistic, restrictive and unfair trade practices;
- Ensure supply of inputs to priority sectors;
- Ensure price stability; and
- Ensure minimum returns to producers.

CONTROL OF PRICES

Till 1961, there was not much urgency in price policy as the rise in prices was gradual and there was no public agitation against rise in prices. Since then, inflationary pressure was so great, that anti-inflationary measures were given priority by the government. A wide range of measures were adopted to ensure stable conditions as well as to prevent speculators from taking an undue advantage of the conditions of scarcity. Since the price situation was the outcome of shortages in basic supplies and a rapid growth in money supply and bank credit, various types of measures relating to money supply, pricing and distribution of commodities were pressed into service.

Demand Management

Demand management has been sought to be achieved through monitory and fiscal measures.

The accent of price policy since 1973-74 has been mostly to rely on fiscal and monetary measures with a view to check the demand of the general public for goods and services.

(i) *Fiscal Measures*: In July 1974, the Government of India promulgated three ordinances to limit the disposable money incomes in the hands of consumers through freezing wages and salaries on one side and dividend incomes on the other. In January 1984, the Government of India announced a package of programmes to curtail public expenditure, to postpone fresh recruitment to government jobs, etc., and thus attempted to reduce government expenditure. Instead, the governments-both Central and State Governments-have been spending tax-payer's money recklessly and wastefully. Besides, they have always adopted a policy of deficit budgeting. Thus, instead of checking prices, the government policy has actually pushed up prices.

It was only in the last three or four years that the Government of India has appreciated the importance of reducing fiscal deficit and bringing inflation under control. Government has been taking all measures to bring down fiscal deficit to around four per cent.

(ii) *Monetary Measures*: The monetary policy of RBI consists of the extensive use of general and selective credit control measures. The main thrust has been to restrict bank-credit against inflation sensitive goods and to influence the cost and availability

of commercial bank credit. The RBI relies heavily on selective credit controls on inflation sensitive commodities (such as foodgrains, cotton, oil-seeds and oils, sugar and textiles) so as to discourage speculative hoarding. The appx bank has frequently used the bank rate as an anti-inflationary weapon. Since July 1974, the RBI has frequently raised the bank rate from 7 to 12 per cent and has also raised the minimum lending rates on bank advances.

During the Sixth and Seventh Plan periods, monetary policy was essentially directed to prevent any excessive increase in liquidity and at the same time to ensure that the genuine credit requirements of the productive and the priority sectors are adequately met.

Reserve Bank took steps to tighten monetary and credit expansion in September 1981 when the cash reserve ratio (CRR) was raised from six to eight per cent in four stages. These steps resulted in a large measure, in mopping up excess liquidity in the economy, moderating monetary and credit expansion and consequently helped in bringing down the rate of inflation towards the end of 1981-82. Since 1990-91, money supply had accelerated considerably and there was continuous rise in inflationary pressure. Accordingly, RBI had to adopt monetary policies which would slow down money supply and reduce liquidity in the economy. When the inflationary pressure was reduced during subsequent years, RBI adjusted the monetary policy so as to stimulate production.

Supply Management

Supply management is related to the volume of supply and its distribution system. On the commodity front, the government has generally focussed its attention in securing greater control over the prices of rice, wheat, sugar, oils and other commodities of mass consumption. Through increase in domestic supplies, large releases from official stocks and widening and streamlining of the network of public distribution, the government attempts to prevent an undue increase in the prices of essential commodities. Let us touch some of the important aspects of this policy:

Supply management is related to the volume of supply and its distribution system.

(a) *Fixation of Maximum Prices*: For eliminating the incentives for hoarding and speculative activity in foodgrains, the state governments have been asked to fix the wholesale and retail prices of foodgrains. Further, the government also fixes minimum procurement prices for major crops on the recommendation of the Agricultural Prices Commission (APC). Prices of other important goods like cloth, sugar and vanaspati are also controlled.

(b) *The System of Dual Prices*: The government has adopted a system of dual prices in the case of goods like sugar, cement, paper etc. Under this system, the weaker sections of the community are supplied these goods through fair price shops, at controlled prices and the rest are allowed to purchase their requirements at higher prices from the open market. Dual pricing generally failed to serve the purpose; it created confusion in the market and led to erratic price movements.

(c) *Increase in Supplies of Foodgrains*: The government attempts to increase supplies of foodgrains and other essential goods in times of internal shortage through larger imports. During 1970s and 1980s, the Central Government

took advantage of the success of the green revolution and gradually built up large reserves of foodgrains; and at one time, reserves exceeded 30 million tonnes. It was strongly believed in government circles at one time that the intensive procurement drive, along with the fixation of wholesale and retail prices of foodgrains would compel hoarders to disgorge their stocks on the market, thereby releasing the pressure on prices.

(d) *Problem of Oilseeds and Edible Oils*: In recent years, the prices of oils along with those of pulses, tea and sugar have been responsible for rise in the general price level. The government has prepared medium and long-term plans to step up the production of oilseeds in the country. The Government has announced higher support prices for groundnut, soyabean and sunflower seeds-the last two crops offer the maximum scope for augmenting the supply of edible oils in the country. In the short period, the government has been relying on the imports of edible oils even though it has found out that imports do not necessarily bring down prices for the domestic consumers.

(e) *Public Distribution System and Consumer Protection*: An important aspect of the government's policy was the strengthening of the public distribution system. The government has set up a network of fair price shops numbering nearly 4,00,000 which cover a population of over 500 million and which distribute wheat, rice, sugar, imported edible oils (palm oil), kerosene, soft coke and controlled cloth. The public distribution system serves two purposes. Firstly, it helps to hold down prices. Secondly, it provides essential commodities to low income groups at relatively low prices. But whenever the public distribution is hard pressed due to inadequate supply, prices tend to rise.

(f) *Control over Private Trade in Foodgrains*: To check prices and to eliminate hoarding and speculative activity in foodgrains trade, wholesale dealers in foodgrains were licensed in many states. The government also enlisted the help of associations of foodgrains traders in regulating their activities and improving practices through voluntary sanctions. Steps were also taken to curb profiteering by traders by prescribing margins of profits. Limits were also fixed beyond which traders and producers could not hold stock without declaration. At the end of September 1977, Pulses and Edible Oils (Storage Control) Order was issued under the Essential Commodities Act to fix the maximum limits of stocks that could he held by wholesalers and retailers in respect of pulses, edible oils and vanaspati. The Food Corporation of India came in a big way to buy in surplus areas and sell in deficit areas and thus moderate the difference in prices.

(g) *Measures to Increase Agricultural Production*: Side by side with the measures for regulating prices and distribution, attention was also focussed on long-term measures to stimulate the production of agricultural commodities. Imports of fertilizers were increased substantially, measures were taken to increase output from indigenous fertilizer plants and also to set up new fertilizer plants. Pesticides and tractors are also of importance and attempts are being made to increase imports in the short run and establish additional capacity in the long run. Attention is being given to the multiplication and distribution of improved varieties of seed, speeding up the implementation of irrigation projects etc.[1]

PUBLIC DISTRIBUTION SYSTEM (PDS)

Rationale of PDS

PDS refers to the distribution of essential commodities through fair price shops.

The distribution of essential commodities through fair price shops at government-controlled prices has come to be known as the public distribution system. There are various reasons for the setting up of the public distribution system in India.

In order to maintain stable price conditions, an efficient management of the supplies of essential consumer goods is necessary. The demand for such commodities being largely inelastic, even a marginal fall in the production and supply often leads to a disproportionate increase in their prices. Moreover, as most of these commodities are agriculture-based, their prices are subject to large seasonal variations. Public distribution will, therefore, have to play a major role in ensuring supplies of essential consumer goods of mass consumption to people at reasonable prices, particularly to the weaker sections of the community.

As mentioned above, state trading and buffer stock operations on the one side, and public distribution on the other are essential in the case of agricultural products. A large proportion of agricultural products-both foodgrains and industrial raw materials-come to the market soon after the harvest when prices are depressed. It is necessary to devise a scheme to buy such commodities at prices which ensure a certain minimum profit to the producers. The Food Corporation of India (FCI) and other institutions have been set up to buy agricultural prices that also help in stabilising agricultural prices. At the same time, these goods would be supplied through public channels to consumers especially the weaker sections of the community-this would mean that in critical times, they would receive supplies of essential commodities at reasonable prices. The public distribution system has become a stable and permanent feature of India's strategy to control prices, reduce fluctuations in prices and achieve an equitable distribution of essential consumer goods.

The public distribution system is also required to operate the dual pricing system wherever it is applied. As explained above, a certain proportion of the output of the commodities involved is procured by public agencies for distribution through the public distribution system at reasonable prices to the vulnerable sections, and at the same time, the producers are allowed to sell the balance in the free market at higher prices and realise on the whole a fair price for their produce.

Goods to be included in the public distribution system

Most essential goods of mass consumption—cereals, sugar, kerosene, etc.—are routed through PDS.

Since distribution is a highly complex matter, only the most essential goods of mass consumption should be brought under the public distribution system, e.g., cereals, sugar, edible oils and vanaspati, kerosene, soft coke, controlled cloth, tea, toilet soap and washing soap, match boxes, exercise books for children etc. Even though all these goods are essential, there can be regional variations in preferences-rice in the South and West Bengal and wheat in North and Central India. Besides, different commodities may assume importance in the scheme of public distribution at different points of time. The main emphasis should be to cover the whole country and supply the essential goods through the public distribution system at reasonable prices only to the vulnerable sections of people in the country.

Supplies to the public distribution system

Both Central and state governments have made arrangements to procure essential commodities and supply them through the public distribution outlets. In the case of foodgrains, FCI undertakes the necessary operations. In regard to sugar, FCI undertakes the operations in some states and in others, civil supplies corporations or co-operatives undertake these operations. The State Trading Corporation(STC) has been entrusted with the responsibility of importing and distributing edible oils. The Department of Coal and Coal India Limited (CIL) handle soft coke. Kerosene is being handled by the public sector corporations like Indian Oil Corporation (IOC), Hindustan Petroleum and Bharat Petroleum. The production of controlled cloth has now been generally entrusted to the National Textile Corporation(NTC) and distributed through the National Consumers Co-operative Federation(NCCF). The NCCF also procures and distributes tea, while coffee is being supplied by the Coffee Board. In ordinary times, these arrangements have been functioning smoothly. But the government has to keep a continuous watch over these arrangements and strengthen the system and make changes as and when necessary.

Form of public distribution

At the state level, the distribution of essential commodities received from or through Central agencies is done through Food and Civil Supplies Departments, Civil Supplies Corporations and Essential Commodities Corporations. At the lowest level, there are fair price shops to sell essential goods ultimately to the consumers. The total number of fair price shops both co-operative and private, in the country was nearly 4.24 lakh as on 31 March 1994.[2]

Success of the public distribution system

Supply chain management is most crucial for the success of PDS.

For the success of the public distribution system, the maintenance of the supply line of commodities selected for distribution is of crucial importance. Even a temporary interruption in supplies would create great hardship to the people. This necessitates forward planning i.e., suitable programmes to increase the production of essential commodities of mass consumption and timely imports when domestic supplies are anticipated to be inadequate to match the internal demand.

Another factor for the success of the public distribution system is the necessary link between production, procurement, transportation, storage and distribution of the selected commodities. In the past, responsibilities for these were fragmented and this contributed to the weakness and inefficiency of the public distribution system. The Sixth and Seventh Plans had followed an integrated approach and paid attention not only to production and procurement, but also to storage and the transportation of the selected commodities.

For the public distribution system to be really useful, it is necessary to expand it quickly to cover all areas in the country, particularly the backward, remote and inaccessible areas. Special attention has to be given to rural areas as the system is relatively less developed in such areas. The public distribution system is extremely weak in inaccessible areas inhabited by the tribals and weaker sections of the community because of the non-viability of operations there.

In the states where a strong cooperative movement exists, the apex body of consumer co-operatives and marketing societies may take up the responsibility of procurement, storage, movement and the distribution of essential commodities. In other states, however, it would be necessary to set up Civil Supplies Corporation or Essential Commodities Corporations to undertake these operations.

Measures to Strengthen PDS

In recent years, the government has taken the following measures to strengthen public distribution and make it more effective and useful:

(a) Steps to reduce the cost of distribution by taking advantage of the economies of bulk handling and building up a network of rural godowns;

(b) Measures to strengthen co-ordination and linkage between the consumer and marketing co-operatives so that the former could procure farm products directly from farmers;

(c) Steps to expand the storage capacity of co-operatives to enable them to play a larger role in the public distribution systems;

(d) Measures to increase the usefulness of the public distribution system through horizontal linkages with the plan programmes, e.g., organisation of mobile fair price shops at centres where rural works were in progress and the setting up of regular fair price shops in areas where large-scale employment was being generated under the plan projects and programmes;

(e) Steps to supply production inputs to the tribals, besides supplying essential consumer goods to them and also arranging to procure the products of the tribals at reasonable prices so as to eliminate their exploitation by the middlemen;

(f) Launching a scheme from January 1992 to revamp the PDS in about 1,700 blocks falling in the drought prone, desert, integrated tribal development project areas and certain designated hill areas; in these areas, additional commodities like tea, soap, pulses and iodised salt are also to be distributed[5] ; and

(g) Better targeting is another measure suggested for improving the PDS. Better targeting implies making the commodities available only to the needy. Right now rations are not explicitly targeted. The general belief is that, due to their characteristics, they will get implicitly targeted. However, when most of the population uses the system, there is a wastage associated with such subsidies in the sense that the non-targeted population also receives part of the subsidy due to the absence of direct targeting. On the other hand, a part of the deserving classes may be left out of the scheme due to various reasons, such as, the absence of a proper address (ration cards are issued only to households with registered residential addresses), lack of enough money at a single time (for workers on daily wages) to buy the rationed goods sold for a minimum period of a week, a fortnight or a month and the inability to make purchases on a regular basis (for migrant workers). Hence, explicit targeting assumes relevance.

Targeting is most crucial in PDS.

Revamped Public Distribution System

From June 1992, a special scheme to revamp the PDS (RPDS) was introduced where additional items like tea, soap, pulses and iodised salt began to be supplied by state governments to serve tribal, hill and arid area populations in 1775 blocks located in backward and remote areas characterised by poor infrastructure. Additional quantities of 3.1 million tonnes of foodgrains (rice and wheat) for RPDS, over and above the normal allocations to states, are assured for distribution in these *'revamped'* FPSs at a price which is lower than the central issue price (CIP) by Rs.50 per quintal as compared to normal PDS elsewhere. The state governments are also advised to ensure that the retail prices at the *'revamped'* fair price shops are not higher than CIP more than 25 paise/kg. Besides, the existing 17.75 RPDS blocks, government has identified additional 409 blocks for inclusion under the RPDS scheme.

In 1997, the Government of India introduced the Targeted Public Distribution system. This is a system which makes a distinction between Below Poverty Line (BPL) and Above Poverty Line (APL) households. It also introduced a pricing system.

In his 2000-2001 budget, the Finance Minister has announced steep price increases for rice and wheat supplied through fair price shops. Specifically, Central issue prices will be set at half the 'economic cost' incurred by the Food Corporation of India (FCI) of BPL households and at the full 'economic cost' for APL households. The economic cost comprises the procurement price of grain, costs related to procurement price of grain, and costs of distribution. Wheat will now be available at Rs.8.40 (against Rs.6.82) a kg and rice at Rs.11.70 (against Rs.9.05) per kg for APL families. BPL families will be charged Rs.4.20 (against Rs.2.50) per kg of wheat and Rs.5.85 (against Rs.3.50) per kg of rice.

Problems of Controls

The problems associated with price and distribution controls are many. In the first place, it often happens that the controlled prices fixed by the government are above the free market level. For instance, when there is a glut in the market due to the heavy supply of a particular commodity, its price would crash, resulting in heavy losses to the producers. The losses may be too much for the producers to bear. The controlled prices fixed are above the market level to avoid such losses. But the controlled prices would result in waste, inefficiency and the misallocation of resources.

Administered prices are often above market rates or below market prices.

Secondly, the controlled prices often will be fixed below the free market price. This happens when there is a short supply of a commodity. Being forced to sell below the market price, producers will be denied profits they would have earned had they sold their produce in the open market. This discourages fresh investments, expansion, modernisation and the setting up of new enterprises.

Thirdly, price control is inevitably followed by distribution control. In essence, rationing implements price control. Theoretically, distribution control ensures equitable distribution of essential commodities. But the success of rationing depends on civic consciousness and public trust in the system both of which are difficult to come by.

Price controls lead to corruption, inefficiency, hoarding and black-marketing.

Fourthly, price and distribution controls, like any other control, leads to corruption, inefficiency, hoarding and blackmarketing. It is rightly said that the price control is *'the father of blackmarketing and carries with it an insidious threat to public morality...a means to expose every citizen, everyday of his life, of a temptation to break the law or the organised conventions of the society.'*[4]

Fifthly, while fixing prices, authorities take into consideration the 'fair return' that the producers would get. A study of different reports made from time to time to fix a *'fair return'* and to decide a price will only show that the task is an extremely difficult one. First of all, the selection of representative units (when there are a large number of units); secondly, calculation of capital employed or other reasonable basis; thirdly, the expenditure that is to be covered by the *'fair'* rate of return; and fourthly, special allowances or problems typical to any industry, if any, are the issues to be tackled while deciding a price. Apart from covering the cost of raw material, labour, depreciation etc., cost of capital employed is also important and whether a particular cost (e.g., managerial remuneration or bonus to workers) is to come under the cost itself or to be covered by the *'fair rate of return'* is the problem that has been dealt with differently. Determination of a fair rate of return on capital depends on the definition of *'capital'* as well as on the judgement of what constitutes a fair or appropriate return in the context of the stage of economic development at a time.[5]

Sixthly, the system of price and distribution controls, the use of much manpower and other economic resources merely in working controls, and exposing the public services to a strain which may in the end prove unbearable.[6]

Seventhly, controls, particularly the PDS, have been a heavy drain on the nation's exchequer as shown in Table 29.1.

Table 29.1

Drain on Exchequer

[illegible]	[illegible]	*Subsidy paid to FCI (Rs.crore) Rs.*	[illegible]
1981-86	[illegible]	3,995	[illegible]
1986-91	[illegible]	10,326	[illegible]
1991-95	[illegible]	18,900	[illegible]

(**Source**: *The Hindu*, dated June 15, 1995).

Arguing that the subsidy is targeted to benefit the poor, our PDS seems to have failed in reaching the really poor. During 1992-93, UP, Bihar and Madhya Pradesh, which account for 34.5 per cent of total population and 42.2 per cent of the poor in the country were allocated only 13.7 per cent of the food grains distributed by the PDS all over the country. On the other hand, Andhra Pradesh, Kerala, and Delhi, which account for not more than 11.4 per cent of the total population and only 10.5 per cent of the poor in the country, had received 28.7 per cent of the total quantity of foodgrains distributed. Inequities in the distribution of foodgrains are most glaring in the cases of Delhi and Bihar. Delhi, which has a population of not more than one per cent of the total population of the country, and that too of the richest in the country, had received

5.3 per cent of foodgrains. Whereas Bihar, the poorest among all states and with population exceeding 10 per cent of the total, had received only 4.01 of the total foodgrains distributed.[7] (See also Table 29.2).

That PDS supports farmers is also not correct.

Finally, the claim that the PDS provides support to farmers is also not true. Hardly any coarse grain is ever purchased from farmers. For building up its rice stocks, the PDS mostly depends on levies realised from the rice mills. Even for wheat purchases there is a growing dependence on middlemen. In fact, support to farmers has transformed into support to rice millers and other middlemen. In any case, the minimum support prices take every factor into consideration, except the level of prices, which farmers have to pay for their own requirements (See also box 29.1).[8]

Box 29.1

Indictments

1985: Planning Commission Study

Beneficiary households were not drawing the ration even for one out of 11 commodities because of their irregular supply and poor quality.

1994: Kirit Parikh Report

In Punjab, Haryana, Uttar Pradesh, Bihar, Orissa and Madhya Pradesh, more than 90 per cent of the people do not buy any cereals from the PDS.

1995: Planning Commission Report

Out of the 64 villages sampled ration cards were not provided to all the selected households in 30 villages.

1997: World Bank Study

The impact of the PDS on poverty and the nutritional status was minimal. A sum of Rs.4.27 was spent to transfer one rupee of income to the poor.

1997: Radhakrishna & Rao

Access to PDS is very limited and it is particularly weak in the states with the highest incidence of poverty.

2000: CAG Report

The benefits of subsidized price have not reached BPL households and income transfer through the PDS is poor.

2005: Planning Commission Study

In 2003-04, 16 states were issued 14.07 mt of foodgrain of which only 5.93 mt reached BPL families. More than 5 mt leaked out in transit and over 3 mt was diverted from the system.

Whatever may be the problems, price and distribution controls have been resorted to and have come to stay in our country.

Measures of Improve PDS

1. It is essential that coarse grains are introduced into the PDS. Half of the food grains allocation under the PDS should be of coarse grains, and in states where

Table 29.2 *Who Benefits from Public Distribution System?*

	Wheat lifted from FCI % of country total, 1986-1996	Proportion of Poor % of country '93-94	Proportion of poor who do not buy any ration	
			Urban	Rural
Andhra Pradesh	1.86	4.90	40.80	48.60
Assam	3.91	3.00	76.40	57.00
Bihar	7.38	18.70	98.80	92.90
Gujarat	8.25	3.20	55.50	68.00
Haryana	1.37	1.30	96.90	93.90
Himachal Pradesh	1.57	0.50	71.80	74.70
Jammu & Kashmir	1.72	0.60	76.70	21.40
Karnataka	6.98	4.90	38.10	37.90
Kerala	4.24	2.50	12.30	19.00
Madhya Pradesh	4.34	6.50	90.80	82.60
Maharastra	14.43	9.30	52.30	58.20
Orissa	3.27	4.90	95.30	86.20
Punjab	0.37	0.70	99.90	95.40
Rajasthan	10.87	4.00	91.20	[illegible]
Tamil Nadu	2.78	6.50	46.50	44.60
Uttar Pradesh	8.09	18.70	92.90	[illegible]
West Bengal	13.74	7.90	78.10	[illegible]

(**Source**: Indira Gandhi Institute of Development Studies; Lakdawala Committee Estimates)

the staple diet of the poor is coarse grains, no other grains should be distributed.

2. Sugar to be removed from the PDS. Instead gur (jaggery), which is a substitute for sugar in many places, may be introduced into the PDS. Most families in cities keep ration could and buy sugar and if this incentive is withdrawn, ABL households will not buy ration at all. This will make the PDS largely different for the rich and the middle class.
3. Government should open ration shops at the places where poor people live. Bihar, UP, MP, Orissa and Rajasthan have pockets of poverty and it is at these pockets that ration shops need to be opened. It is only then that the real purpose of PDS, *viz*, removing poverty, will be realised.
4. In order to discourage traders from diverting foodgrains from PDS stream to the open market, panchayats may be involved in the system of distribution. Services of panchayats may also be used to identify the rural poor.
5. It may also be stated that PDS alone will not solve the problem of food security. Apart from higher economic growth, a mix of policies such as effective implementation of anti-poverty programmes, including PDS, controlling inflation, improving health facilities is needed for increasing food security in the country.

THE ESSENTIAL COMMODITIES ACT, 1955

Most of the controls over price and distribution of consumption goods have been resorted to under the provisions of the Essential Commodities Act, 1955. Hence, a brief discussion of the Act follows:

Objectives of the Act

The objectives of the Act are laid down in its Preamble. The following are the three important objectives:

- Control of production, supply and distribution of essential commodities;
- Check inflationary trend in prices and
- Ensure equitable distribution of essential commodities.

Scope of the Act

The Act extends to the whole of India. The Act came into force on 1st April, 1955, repealing the Essential Commodities Ordinance No.1 of 1955 which was promulgated by the President on 26th January, 1955.

Essential Commodity

Section 2(a) of the Act defines 'essential commodity,' meaning any of the following classes of commodities:

(a) Cattle fodder including oil cakes and other concentrates;
(b) Coal, including coke and other derivations;
(c) Components, parts and accessories of automobiles;
(d) Cotton and woollen textiles;
(e) Drugs;
(f) Foodstuffs, including edible oilseeds and oil;
(g) Iron and steel, including manufactured products of iron and steel;
(h) Paper, including newsprint, paperboard, strawboard;
(i) Petroleum and petroleum products;
(j) Raw cotton whether ginned or unginned and cotton seeds;
(k) Raw jute and
(l) Any other commodity which the Central Government may notify as an essential commodity.

Provisions of the Act

Section 3 of the Act is most crucial. Under this section, the Central Government, whenever it is of the opinion that it is necessary or expedient to do so for maintaining or increasing supplies of any essential commodity or for securing an equitable distribution and the availability at fair prices of the essential commodities and for securing an essential commodity for the defence of India or the efficient conduct of military operations, may by order, provide for regulating or prohibiting the production, supply, distribution and trade and commerce in essential commodities as maybe specified in the order.

The sub-sections of Section 3 are supplementaries to Section 3. Sub-section (1) empowers the Central Government to issue an order as mentioned above. Sub-section (2) enumerates various categories or orders which can be made in exercise of the powers conferred by sub-section (1). Sub-section (3) provides for the fixation of price to be paid to a person who sells any essential commodity to the government or any other person or authority specified by it under an order. Sub-section (3-A) enables the Central government to control the rise in prices and to prevent the hoarding of any foodstuff in any locality. Under sub-section (4), the government, if it is of the opinion that it is necessary for maintaining or increasing the production and supply of an essential commodity, may appoint an authorised controller to exercise powers of control with respect to any undertaking engaged in the production and supply of the essential commodity.

Other Provisions

The Act makes it obligatory on the part of the government to exercise powers conferred on it by Section 3 in the interest of the general public and not in the interest of dealers.

It is also provided in the Act that the powers conferred by Section 3 are generally exercised by the Central Government unless delegated to the state governments.

Section 6 of the Act declares the orders of the Central Government passed under Section 3 to be effective, notwithstanding the said orders being inconsistent with other enactment.

Section 7 of the Act provides for imprisonment and fine for the contravention of Section 3. Section 7 lays down that if any person contravenes any order made under Section 3, he shall be punishable with fine and imprisonment with a term which may extend to one year.

QUESTIONS

1. What are the objectives of price and distribution controls?
2. Bring out the mechanisms of price and distribution controls.
3. Enumerate the problems of price and distribution controls.
4. Bring out the provisions of the Essential Commodities Act.

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2. *Ibid.*, p.387.
3. *Ibid.*, p.388.
4. J.E.Meade, *Planning and the Price Mechanisms*, p.7.
5. D.Amanchand, *Government and Business*, p.147.
6. *Ibid.*, p.148.
7. Bhanu Pratap Singh, "PDS at Its Dead End", *The Hindu*, June 15, 1995.
8. *Ibid.*

CHAPTER

30

External Sector

CHAPTER OUTLINE

Foreign Trade
- *Foreign Trade and Economic Development*
- *Extent of Foreign Trade*
- *Significance of Exports*
- *Export Strategy*
- *Imports*
- *Regulation of Foreign Trade*

Trade-in Services
- *Determinants of Service Exports*
- *Promoting Service Exports*

Balance of Payments

Exchange Rate Management

LEARNING OBJECTIVES

After reading this Chapter, you should be able to:

1. *Understand the significance of foreign trade in economic development*
2. *Assess the status of India's overseas trade*
3. *Suggest an export strategy to boost India's exports*
4. *Understand how India's foreign trade is sought to be regulated*
5. *Appreciate the role of invisible exports in India's foreign exchange earnings and suggest ways of promoting them further*
6. *Define the term 'balance of payments'*
7. *Understand the mechanism of exchange rate management*

The external sector comprises India's foreign trade, trade-in-services, foreign capital flows, balance of payments and exchange rate management. Of these, the flow of foreign capital was covered in Chapter 4. The remaining components of the external sector are discussed in this chapter.

The external sector has been posing a major challenge in recent years, particularly since September 1997. In 1998-99, the East Asian crisis cast its shadow. In addition, the crisis which affected Russia in 1998 and Brazil in 1999 had affected global economic prospects considerably. The economic prospects of Japan as well as the economies of Europe remained uncertain. In addition to the unfavourable external situation, India faced other problems, *viz.*, the economic sanctions imposed by several industrial countries, the suspension of fresh multilateral lending, the downgrading by international rating agencies and the reduction in investment by foreign institutional investors. It goes to the credit of the Reserve Bank of India that it has managed the external sector reasonably well through its monetary policy measures.

FOREIGN TRADE

Foreign trade, also called international trade, is as old as history. Trade among countries is normal and desirable. It exists for different reasons. The fact remains that the natural resources of the earth are not evenly distributed. One country possesses product X in surplus and lacks in respect of product Y. In another country, the reverse may be true. It is mutually advantageous for both the countries to exchange their surplus stocks. Then there is the advantage of comparative cost. One country produces a particular commodity at less cost than does another country. Economically, the lowest cost producer should produce and satisfy the demands for that product. There is also the prevalence of technological gaps which make foreign trade relevant and desirable. Developed countries spend substantially on research and development and as a result, develop new products keeping in mind the global customer profile. In the initial stages, these countries enjoy virtual monopoly in the manufacture of new products. Other countries, particularly less developed countries, are forced to buy new products from the developed countries.

Foreign trade is as old as history.

Foreign Trade and Economic Development

Whatever the reasons for the existence of foreign trade, there is no gain-saying the fact that foreign trade is significant for the economic development of countries, particularly the developing ones. It provides the urge to develop the knowledge and experience that makes development possible, and the means to accomplish it. An economy which has decided to embark on a programme of development is required to extend its productive capacity at a fast rate. For this, imports of machinery and equipment which cannot be produced in the initial stages at home are essential. Such imports which either help to create new capacity in some lines of production or enlarge capacity in the other lines of production are called *developmental imports*. For instance, imports required for the setting up of steel plants, locomotives and hydro-electric projects are developmental imports. Secondly, a developing country which sets in motion the process of industrialisation at home

Imports that help create new capacity, or enlarge capacity in the other lines are called developmental imports.

> Imports made in order to make full use of the developed capacity are called maintenance imports.

requires the imports of raw materials and intermediate goods so as to properly utilise the capacity created in the country. Imports which are made in order to make full use of the productive capacity are called '*maintenance imports*'. These imports are vital for a developing economy as many of the industrial projects are also held up for the lack of maintenance imports. For a developing economy, developmental and maintenance imports set limits to the extent of industrialisation which can be carried out in a given period. Besides these imports, a developing economy is also required to import consumer goods which are in supply at home during industrialisation. Such imports are anti-inflationary because they reduce the scarcity of consumer goods. One example of such imports is the foodgrains imports in India in the post-Independence period which helped to arrest the rise of prices at home.

It is, therefore, inevitable that during the early years of development, imports have to be increased at a very fast rate. It is natural that the balance of trade in such a situation will turn heavily against the developing countries. This necessitates the enlargement of exports. External assistance can help share the burden of growth in the short-run, but in the long period, the developing country has to bear the burden of development itself. To meet the growing foreign debt in view of inelastic imports, a developing country must increase its exports.

The influx of foreign goods into the country and along with them the flow of technology, the skills, speed and feed of production, the tastes and the experiences will have considerable influence on domestic production, marketing, lifestyles and the levels of living of people. In order to pay for imports and to service earlier borrowings, developing countries have to export their goods and services. This is a challenging task; a challenge in terms of upgrading technology, increasing productivity, reducing costs, and improving quality of goods and services to meet international challenges. The challenge compels these countries to shed their ennui, spruce up and develop fast to survive in the global business scenario. Thus, international trade sets in a chain of events which help transform the less developed economies into developed ones. This was the reason why G.Heberler remarked that *"My overall conclusion is that international trade has made a tremendous contribution to the development of less developed countries in the 19th and 20th centuries and can be expected to make an equally big contribution in the future"*.

Extent of Foreign Trade

The value of foreign trade of our country has been rising from year to year. It rose from Rs.30,553 crore during 1985-86 to Rs.8,38,575 crore during 2004-05, representing an increase of six times.

The break-up of foreign trade in terms of exports and imports from 1985-86 onwards is shown in Table 30.1.

The volume of our foreign trade has been increasing, the trade to GDP ratio has gone up from 13 per cent in 1980 to about 20 per cent as of now. What is interesting to note is that there has been a sea change in the composition of our foreign trade. India is no longer exporter of primary commodities and importer of manufactured goods. It exports manufactured goods and imports raw materials, intermediate and capital goods. As far as the direction of trade is concerned, it may be stated that the USA and

Table 30.1

India's Foreign Trade

(Rs.Crores)

Year	Exports	Imports	Total value of trade	Balance of trade
1985-86	10,895	19,658	30,553	-8,763
1986-87	12,452	20,201	32,653	-7,749
1987-88	15,741	22,399	38,140	-6,658
1988-89	20,232	28,235	48,467	-8,003
1989-90	27,681	35,416	63,097	-7,735
1990-91	32,553	43,198	75,751	-10,645
1991-92	44,040	47,851	91,892	-3,810
1992-93	53,688	63,375	1,17,063	-9,687
1993-94	69,751	73,101	1,42,852	-335
1994-95	82,674	89,971	1,72,645	-7,297
1995-96	1,06,353	1,22,678	2,29,031	-16,325
1996-97	85,623	97,111	1,82,734	-1,488
1997-98	1,26,286	1,51,553	2,77,839	-25,267
1998-99	1,01,850	1,32,447	2,34,297	-30,597
2002-03	2,55,137	2,97,206	5,52,343	-42,069
2003-04	2,91,582	3,53,976	6,45,558	-62,394
2004-05	3,56,626	4,81,950	8,38,576	1,25,190

(**Source**:Govt.of India, *Economic Surveys*)

the UK continue to be our principal buyers. After the break-up of the erstwhile Soviet Union, our exports to Asia and Oceania markets have shown a sharp jump. Infact, the current boom in exports is sustained largely by an unexpected and healthy rise in exports to the Asian and Oceania countries, which include ESCAP countries like Australia, Iran, Japan, Korea, Malaysia, Singapore, Thailand, Hong Kong, Bangladesh and Nepal. The shift in favour of these countries is facilitated by lower freight costs. Further, the fact that India is honouring its commitment and repay back a total debt of the value of Rs.30,000 crore in hard currencies over a period of 12 years, beginning with 1993, should once again initiate exports to Russia.

Share of foreign trade [illegible] now.

We continue to buy significantly from the US and the UK. But our imports from these two countries have declined in recent years. Our sellers now include Canada, Belgium, France, Germany and Japan. The EU as a group accounts for about 24 per cent of our imports. Russia and East European countries also export to us, but together, their share is around two per cent of our total imports. The oil producing countries have emerged as significant purchasing centres for us. This has been caused largely by sharp increase in the unit value of petroleum and its products. The OPEC alone accounts for about 22 per cent of our total imports.

Oil producing countries import considerably from the US.

Analytically, India's foreign trade is highly concentrated. In 1996-97, for example, 53.4 per cent of our exports found their distination in the EU, the USA and Japan.

Likewise, about 41.5 per cent of our total imports originated from the EU, the USA and Japan.

It is because of the high stakes involved in foreign trade that the Government of India has assumed sweeping powers of control over our exports and imports.

It maybe stated that the relationship of the government to international trade is based on the concept of sovereignty, the concept which recognises that a nation has complete control over her international affairs as far as other nations are concerned. Accordingly, a nation becomes very much concerned about her nationals and their property once these have passed into the confines of another nation or are on the high seas. In a world of strict sovereignty, nations would probably have no relations with each other except to be at war. But sovereignty has been tempered by reciprocity; that is, there are treaties of friendship and commerce, and treaties covering many other situations and relationships that give the nationals of the signatories the right to travel, reside, trade, hold property and make investments in other countries. These treaties also provide for the interchange of diplomatic officials and consuls (representatives of business interests). Treaties also cover the treatment of ships, sailors, airplanes and cargo when in foreign jurisdictions.

The principle of sovereignty states that each country has complete control over her merchandise. But this principle is tempered by reciprocity.

It is also good to know that trade policies can be characterised as *outward-oriented* or *inward-oriented*. An *outward-oriented* strategy provides incentives which are natural between production for the domestic market and exports. Because international trade is not positively discouraged, this approach is often, although somewhat misleading, referred to as *export promotion*. In truth, the essence of an outward-oriented strategy is neither discrimination in favour of exports nor bias against import substitution. By contrast, in an inward-oriented strategy, trade and industrial incentives are biased in favour of domestic production and against foreign trade. This approach is often referred to as *import substitution* strategy. In some countries, the bias against foreign trade has been extreme.

Foreign trade policy may be either outward directed or inward oriented. In the former, the government encourages exports but it is the reverse in the latter.

An *inward-oriented* strategy, usually, means overt protection. What is less obvious is that sheltering domestic industries puts exports at a great disadvantage because it raises the costs of the foreign inputs used in their production. Moveover, an increase in the relative costs of domestic inputs may also occur through inflation or because of an appreciation of the exchange rate as import restrictions are introduced.

In practice, trade policy contains elements of both approaches. Differences arise as much from the choice of instruments as from the absence or presence of intervention. Outward-oriented policies favour tariff over qualitative restrictions. These tariffs are usually counterbalanced by other measures, including production subsidies and the provision of inputs at 'free trade' prices. Governments aim to keep the exchange rate at a level that provides equal incentives to produce exports and imports substitutes. Overall protection is lower under an outward strategy than under an inward strategy; equally important, the spread between the highest and lowest rates of protection is narrower.

Inward strategies typically prefer quantitative restrictions to tariffs, and they involve a higher overall level of protection, together with greater variation across activities. Exchange rates are generally overvalued because of high protection and the use of quantitative restrictions. Industrial incentives are administered by an elaborate and expensive bureaucracy.

A major component of foreign trade is exports. It is, therefore, desirable to know about the exports, their direction, composition and prospects.

Significance of Exports

Exports are crucial for our economy for several reasons:

finance imports

1. We need export earnings to finance our imports. Imports would tend to grow as the economy grows further. We would be required to spend more foreign exchange earnings on the import of oil, investment-induced inputs and technology. This calls for massive export earnings.
2. It is not advisable to depend on external assistance to finance essential imports. It is necessary that we depend on our own feet, earn on our own, and use the same to buy essential items from the exporting countries.

Export earnings help service

3. We have huge debts and we need foreign exchange earnings to service the debts. It is bad policy to contract new loans to service old debts. Old debts must be liquidated hence we need more and more export earnings.
4. Exports would make our economy highly vibrant. Exports call for quality products produced at reasonable costs. Industrial establishments must be strong in fundamentals to achieve high productivity. Exposure to foreign markets would compel domestic industries to become more competitive.
5. Competitive firms would optimise resource utilisation. The consequence would be increased supply of goods and services. Added to this are the increased production capacities of plants resulting from upgraded technologies. As days go by, supply would outstrip domestic demand, leaving exportable surplus. Surplus would necessitate exports.

Our exports have increased by more than 200 times during the last 50 years, from Rs.606 crore in 1950-51 to over Rs.291,582 crore in 2003-04. The figures may look impressive, but what is essential is to study the relative position. Two approaches may be used to make a comparison: exports as a share of national income and India's exports as compared to the world exports.

The share of exports to GDP has increased over the years, from a mere 3.1 in 1965-66 to about 9.0 per cent in 2003-04 (see Table 30.2). This growth reflects the growing importance of exports to our economy.

But the percentage figures make poor comparison with those of high income countries whose exports account to 15 per cent of their aggregate GDP. Even low income economies show the figure at 18 per cent.

India's exports, as compared to the global exports, have been slow to grow. Infact, many developing countries have recorded export growth rates much higher than ours. Whereas our exports increased at an annual average rate of 5.9 per cent during 1980-92, the corresponding growth rates for other developing countries like China, South

Table 30.2

Exports as a Percentage of National Income

Year	Exports as % of National Income
1960-61	[illegible]
1970-71	[illegible]
1980-81	[illegible]
1990-91	7.2
1996-97	9.6
1997-98	[illegible]
1998-99	[illegible]
1999-00	[illegible]
2000-01	[illegible]
2001-02	[illegible]
2002-03	[illegible]

Korea, Malaysia and Pakistan, exceeds 11 per cent. Our ranking among the world's export-nation slipped from 16th in 1953 to 20th in 1983 and further to 30th as of now. This is inspite of our natural comparative advantages such as low wages, intelligent and educated workforce, raw cotton and preferential access to OECD countries.

Why are our exports lagging behind? Reasons are too many.

Shortage of supply hampers exports.

1. We face shortage of almost all products in the domestic market.When supply is not adequate to meet demanda of the home market, export becomes meaningless. Often, we curbed domestic consumption so as to have exportable surplus, just to earn foreign exchange. A classic example is sugar.

Besides, fast growing exportable goods now comprise new technology products. Our country has yet to make its mark as an exporter of such goods, except for some recent breakthrough in software exports.

2. There is the problem of quality of our goods and services. We have not been able to create an image as a supplier of quality products. Our tea, which holds a large market share, was found adulterated with cowdung.
3. Inadequate transportation and shipping facilities have stood in the way of export promotion. Though we have ports and ships, the average Indian port performs at one-third of the efficiency levels of ports in other Asian countries like Singapore and Hong Kong. We lose around $400 million every year on account of container delays, ship-waiting and poor feeder technology.
4. Lack competitive advantage when compared to other countries. The cost of production of our products is much higher than what it prevails in other countries. For example, the average cost of production in our country as a percentage of output value at world prices is 130 but it is 98 in Korea. The reason lies in the market conditions which prevailed before 1990s. Indian industries did not adequately feel the need for cost consciousness because of the sheltered market they enjoyed for a long time.

Further, the productivity of our industries is much lower than other countries. Lower productivity adds to the cost of production.

The industrial upgradation which should be taking place gradually, by learning from others' experiences made available through expanding trade relations with other countries, has not taken place due to limited foreign capital inflow.[1]

5. Our exports, like exports from other developing countries; are pitted against tariff and non-tariff barriers imposed by the developed countries.

Exports are also hampered by quotas under the Multi-Fibres Arrangement, ceilings under the generalised system of preferences, and '*administrative surveillance*', which enables the European side to initiate consultations followed by quantitative restrictions.[2]

Our sales to other countries are also saddled by emerging regional trading blocks like the EU, NAFTA and Asia Pacific Rim.

Regional trading blocks are also coming in the way of India's exports.

6. The so called export-promotion measures have failed in their objectives. Take the case of 100 per cent export-oriented units, for example. The scheme was launched with much fanfare in 1981 and bolstered time and again with the help of a variety of concessions. But the scheme failed to take off. Although, 569 units were given approvals since inception, only 99 have commenced production. In the five-year period (1981-85), the total foreign exchange earned by them was a meagre Rs.355 crore as against the target of Rs.5,000 crore. Those that were set up have virtually become 100 per cent import-oriented units, instead of functioning as 100 per cent export oriented units. And with regard to incentives offered to promoters, less said the better as Box 30.1 reveals.

Box 30.1

Incentive Scams

Starting with R.Chidambaram in 1991, a succession of commerce ministers has gone into overdrive to boost India's exports, offering generous incentives to exporters. With unscrupulous exporters only abusing such schemes, incentive schemes became incentive scams and have cost the exchequer Rs.10,000 crore between 1991 and 1999. A third of the losses may have been due to the controversial Value-Based Licensing (VABAL) Scheme alone.

Announced under the 1992-97 Exim Policy, and scrapped in April 1997, the VABAL Scheme allowed exporters to import inputs upto a specified value without restrictions. But the exporters gave wrong figures to the government and the latter had no mechanism to check the irregularities. Of the 10,758 licences allowing duty-free imports of Rs.5,380 crore, irregularities were noticed in 2,487 cases, entailing a loss of Rs.3,632.20 crore. Of these irregularities, 278 had not made any exports while they had imported inputs valued at Rs.292.49 crore. The scams came to light thanks to the audit (for the period 1992-98) done by the Comptroller and Auditor General of India.

(Reported in *Business Today*, April 7-21, 2000).

7. Exporters are subject to severe foreign exchange controls, reforms notwithstanding. Their travel abroad is limited to stipulated allowance in foreign exchange determined by the Reserve Bank of India (RBI). Exporters still need permission to spend foreign exchange in exhibitions and trade fairs. They still cannot retain their foreign exchange earnings in dollars indefinitely, and meet expenses out of their earnings.

8. Reform of export incentives shows a lack of clear direction and stability. International Price Reimbursement Scheme was abolished and then reintroduced. In every budget, there is a threat of abolition of 100 per cent exemption of export profits (80 HHC), which creates considerable uncertainty in the minds of exporters.

9. The process of trade liberalisation began in high gear-abolition of CCS in one stroke, introduction of the negative list for imports and partial convertibility of rupee. The pace then slackened somewhat and at present, there is again some tinkering with the finer points of export incentives:expansion of items under Special Import Licence, reduction of a few canalised items, reduction in minimum export price for rice, extension of items under Export Processing Zone schemes, extension of EPCG-Schemes for the service sector, expansion of EPCG schemes for merchant exporters and the expansion of the category of '*deemed exports*'. These changes bring back memories of liberalisation of the past through licensing.

10. There has been anti-export bias. For example, while import controls for raw materials and capital goods have been removed, they still have to go through the process of obtaining licences and fulfilling obligations monitored by officials (Advance Licence System and EPGC scheme which is also a licence). Duty drawback computations have been simplified but payments are not automatic and are still subject to delays as compared to international standards. Transport costs of exports, especially by air, are considerably higher than those charged by competitors. Other infrastructural problems are more acute than in the competitor countries. Indian exporters and importers face a series of complicated procedures and a large number of approvals while exporters and importers in other countries obtain approvals instantaneously with one signature. Further, there is a need to view the whole industrial sector in India as a potential export sector. Thus, while existing exporters get duty free imports of raw materials and machinery, the rest of the industrial sector still pays considerably higher duties. This acts as a *drag* in expanding the narrow export base.[3]

Anti-export bias is another hindrance.

11. An efficient trade information system is essential for success in the dynamic global market. But our marketing infrastructure as well as the marketing techniques are neither effective nor efficient. We do not have any machinery to keep prompt track of business information overseas, as is done by JETRO in Japan, KOTRA in Korea, CETDC in Hong Kong and STDB in Singapore with a wide network of offices abroad. These organisations have evolved an efficient system which helps them get information pertaining to tenders and the like much before these are released officially. In India, we get these details, at times, after the expiry date. India has, no doubt, a plethora of organisations - government, semi-government and non-government - engaged in this task in one way or another. Yet we do not have an easy access to market intelligence and information.[4]

Efficient trade information system is non-existent.

12. By and large our exports comprise goods and services which do not represent technological advancements except some gains in software. Across the globe

new technology goods formed about half of the world trade in 1980; two decades later these constitute more than two-thirds. India's technology intensive exports constitute just 3 per cent of her total exports as against 40 per cent in the case of Singapore.

Export Strategy

In the coming years, we need to step up our exports drastically. Need for increased export earnings stems from several reasons: (i) Imports will increase and to finance them, we need higher export earnings; (ii) it is not advisable to depend on external assistance to finance imports and (iii) debt-servicing burden is ever mounting, necessitating increased export earnings.

Coupled with the above stated causes for increased export earnings, there have developed, in the recent past, certain factors which are conducive to expand our exports. The favourable factors are-

- Emergence of China, Zimbabwe and Pakistan as new customers.
- Possible acceleration in world output and trade in the wake of economic growth picking up in most developed market-economy countries.
- Opulence of Gulf countries.
- Greater scope for exports of turn-key and construction projects and consultancy services in Asia and African countries.
- Multilateral trade negotiations.[5]

In order to encash on the above stated favourable factors and to promote our exports considerably, we need an appropriate strategy. Such a strategy shall proceed on the following lines:

a. Strategic planning for exports can be the key to achieve quantum jump in our exports. This has to be undertaken at the national level.

b. Separate administrative set up on the lines of JETRO of Japan and KETRO of South Korea maybe considered.

Export strategy should focus on key strengths of India's economy.

India has competitive edge in turnkey and construction projects, BPO, and consultancy services and there are several takers of these services in Asia and African countries. Most of the newly independent countries are also keen to launch such projects and are keen to use India's help. India should take advantage of these opportunities.

c. The debate on large-scale sector *vs.* small scale sector must go. We must take advantage of the synergy between the two.

d. Build up a viable and stable export production base and supportive infrastructural facilities.

e. Parallel to building up of production capacity, appropriate technology needs to be developed.

Olympic approach is needed to identify products which can be exported.

f. Olympic approach-picking up the best of our products, procedures and markets-needs to be considered immediately. Table 30.3 contains India's top export markets along with products. Such exports must be given all facilities to increase their exports.

Table 30.3

India's Top Export Markets

Exports: Five Fastest Growing Sectors

Items	*2003-2004($bn)*	*2004-2005 ($bn)*	*(%) Change*
Petroleum crude & products	3.57	6.79	90.34
Software	13.30	17.9	34.09
Gems and jewellery	10.57	13.71	29.61
Machinery and instruments	2.78	3.49	25.52
Drugs, pharmaceuticals, fine chemicals	3.31	3.71	12.14

Top Five Exports, Then and now

1994-1995($bn)	[illegible]	*2004-2005($bn)*	[illegible]
Gems and jewellery	4.50	Software	17.20
Readymede garments	3.28	Engineering goods	14.58
Cotton yarn, fabrics, made-ups	2.23	Gems and jewellery	13.70
Marine products	1.18	Chemicals & related products	12.57
Leather(excluding footware)	1.06	Textiles	12.01

Five Fastest Growing Export Destinations

Country	*2003-2004($bn)*	*2004-2005 ($bn)*	*(%) Change*
Singapore	2.12	3.80	78.68
China	2.96	4.59	55.20
United Arab Emirates	5.13	7.10	38.48
US	11.49	13.27	15.45
Hong Kong	3.26	3.65	11.94

Top Five Fastest Growing Sectors

1994-1995($bn)	[illegible]	*2004-2005($bn)*	[illegible]
US	5.02	EU	17.25
Japan	2.03	US	13.27
Germany	1.75	UAE	[illegible]
UK	1.69	China	[illegible]
Russia	0.81	Singapore	3.80

(**Source**: ***Business Today,*** **Nov. 6, 2005, p.109).**

g. A strong push should be given to free trade zones to bring about an expansion of export production.

h. Exporters must change their mindset. Exporters should get dedicated to 'marketing' which is the exchange of 'satisfaction' for money, as distinct from 'trading' which is the exchange of goods for money. The former can be described as *sadhana*, while the latter is *pooja*. Marketing needs perseverance.

Exporters should develop export-oriented mindset [illegible] approach.

i. As national economies are getting integrated, the share of foreign components in manufactured products is increasing considerably. For example, of the $20,000 for General Motors automobile, $6,000 goes to South Korea for routine labour and assembly operations, $3,500 to Japan for advanced components and electronics, $1,500 to Germany for design engineering, $800 to Taiwan and Singapore for small components, $500 to UK for advertising and marketing seminars and $100 to Ireland and Barbados for data processing and about $800 to strategists in Detroit, banks and insurance in the US. India should carve a niche for herself in this emerging scenario.

j. Warehousing facilities need to be provided at important commercial centres abroad, particularly for fast-moving consumer goods. Importers are reluctant to keep heavy inventories. It is the responsibility of the exporters to maintain stocks at convenient locations to enable importers to buy even in small quantities.

k. A well-directed foreign trade policy should be based on accurate trade information supported by reliable data which are to a large extent lacking. Trade related data are new compiled on the basis of the information supplied by Export Promotion Councils. The information supplied by these councils is biased and inaccurate.

l. There are a large number of export promotion councils, commodity boards and other similar agencies-all in the name of promotion. Existence of multiple agencies has, instead of increasing exports, resulted in confusion and they seem to be working at cross purposes. In order to make them effective, they need to be reorganised with clearly defined roles and functions.

m. India should adopt a four-pronged approach to meet the joint challenge of a united Europe and opening up of East Europe. The approach should consist of four elements: (a) restructuring of the corporate sector; (b) better quality products; (c) revaluation of General System of Preferences (GSP), and (d) linkages in industrial products.

n. Standards and standardisation, quality systems, certification and inspections, measurement systems, testing laboratories, their accreditation and calibration services and production and supply of standard reference materials, are all important building blocks. Quality control through the agency of the Export Inspection Council leaves much to be desired. It is often alleged that the agency plays a retrograde role, albeit inadvertently. This needs to be rectified.

o. We need to realise that a healthy export sector can be built up only on a strong and efficient domestic economy. A strong economy is a must if we want to have a self-sustained buoyant export sector.

We must build up our own brands internationally and not depend upon artificial supports (provided in the form of permission to use internationally known brands, e.g., the use of UK brands).

We too have several agencies, bodies and departments exclusively meant to promote exports. Prominent among them are EOUs, and SEZs. An Export Orient Unit (EOU) can be located anywhere in the country and is entitled for duty-free import of capital goods, raw materials and components. The unit is exempt from paying excise duty on domestic purchases.

SEZs would be treated as utilities and hence are free from strikes and disputes

Special Economic Zones (SEZs) are a recent convert from Export Processing Zones (EPZs). Each zone provides to the units located therein,

basic infrastructural facilities like developed land, factory buildings, roads, power, telephone exchanges, water supply and drainage, in addition to a whole range of fiscal incentives. SEZs would be treated as public utilities and hence are saved form labour strikes.

There is also centrally sponsored Export Promotion Industrial Park Scheme (introduced in August 1994) under which state governments would be involved in the creation of infrastructural facilities for export oriented units.

Imports

As with exports, our imports too have been increasing from time to time. The value of imports has increased from Rs.608 crore in 1950-51 to Rs.3,53,976 crore in 2003-04. While exports have been mainly dependent on world demand and availability of exportable surplus, imports have largely been a matter of government policy.

In relation to national income, imports during the first 30 years of planning varied between 6.5 per cent and 8.5 per cent of the GDP, the variation being minimal. Again, since 1979-80, this percentage varied between eight and 12, signifying that the imports ratio to GDP has been fairly stable.

It may be observed that in planned economies, the development effort is likely to increase imports faster than national income, because investment as a proportion of GDP is stepped up and the import content of investment is high in the early stages of development.

Regulation of Foreign Trade

As was stated earlier, the government has enormous powers to regulate our foreign trade. The Foreign Trade (Development and Regulation) Act, 1992, empowers the government to regulate imports and augment exports. The act underlines the role of foreign trade in our economic development. Technology, investment and production are becoming increasingly interdependent upon each other, and foreign trade brings these elements together and sums economic growth.

The government announces its foreign trade policy once in five years. Popularly called the Exim Policy, the latest policy was announced in March, 2007 and is valid for five years - 2007. The principal objectives of the policy are-

Exim Policy 2002-2007

The Exim policy 2002-2007 has the following objectives:

- To accelerate the transition of economy to a globally integrated vibrant economy.
- To stimulate sustained economic growth by providing access to essential raw materials, intermediates, components, consumables and goods required for enhancing production.
- To improve the technological strength and efficiency of agriculture, industry and services, thereby improving their competitiveness, and encouragement of globally accepted quality standards.
- To provide consumers with good quality products at reasonable prices.

Highlights of Exim Policy 2002-07 (as amended upto 31.3.2003)

1. Service Exports

Duty free import facility for service sector having a minimum foreign exchange earning of Rs.10 lakhs.

The duty free entitlement shall be 10% of the average foreign exchange earned in the preceding three licensing years. However, for hotels, the same shall be 5% of the average foreign exchange earned in the preceding three licensing years. This entitlement can be used for import of office equipments, professional equipments, spares and consumables. However, imports of agriculture and dairy products shall not be allowed for imports against the entitlement. The entitlement and the goods imported against such entitlement shall be non-transferable.

2. Agro Exports

(a) Corporate sector with proven credential will be encouraged to sponsor Agri Export Zone for boosting agro exports. The corporates to provide services such as provision of pre/post harvest treatment and operations, plant protection, processing, packaging, storage and related R&D.

(b) DEPB rate for selected agro products to factor in the cost of pre-production inputs such as fertiliser, pesticides and seeds.

3. Status Holders

(a) Duty-free import entitlement for status holders having incremental growth of more than 25% in FOB value of exports (in free foreign exchange).

This facility shall however be available to status holders having a minimum export turnover of Rs.25 crore (in free foreign exchange). The duty free entitlement shall be 10% of the incremental growth in exports and can be used for import of capital goods, office equipment and inputs for their own factory or the factory of the associate/supporting manufacturer/job worker. The entitlement/goods shall not be transferable. This facility shall be available on the exports made from 1.4.2003.

(b) Annual Advance Licence facility for status holders to be introduced to enable them to plan for their imports of raw material and components on an annual basis and take advantage of bulk purchases.

(c) The Input-Output norms for status holders to be fixed on priority basis within a period of 60 days.

(d) Status holders in STPI shall be permitted free movement of professional equipments like laptop/computer.

4. Hardware/Software

(a) To give a boost to electronic hardware industry, supplies of all 217 ITA-1 items from EHTP units to DTA shall qualify for fulfillment of export obligation.

(b) To promote growth of exports in embedded software, hardware shall be admissible for duty free import for testing and development purposes. Hardware upto a value of US $10,000 shall be allowed to be disposed off subject to STPI certification.

(c) 100% depreciation to be available over a period of 3 years to computer and computer peripherals for units in EOU/EHTP/STP/SEZ.

5. Gem and Jewellery Sector

(a) Diamond and Jewellery Dollar Account for exporters dealing in purchase/sale of diamonds and diamond studded jewellery.

(b) Nominated agencies to accept payment in dollars for cost of import of precious metals from EEFC account of exporter.

(c) Gem and Jewellery units in SEZ and EOUs can receive precious metal i.e. Gold/Silver/Platinum prior to exports or post exports equivalent to value of jewellery exported. This means that they can bring export proceeds in kind against the present provision of bringing in cash only.

6. Export Clusters

(a) Upgradation of infrastructure in existing clusters/industrial locations under the Department of Industrial Policy and Promotion (DIPP) scheme to increase overall competitiveness of the export clusters.

(b) Supplemental efforts to be made under the ASIDE scheme and similar schemes of other Ministries to bridge technology and productivity gaps in identified clusters.

(c) 10 such clusters with high growth potential to be reinvigorated based on a participatory approach.

7. Rehabilitation of Sick Units

For revival of sick units, extension of export obligation period to be allowed to such units based on BIFR rehabilitation schemes. This facility shall also be available to units outside the purview of BIFR but operating under the State rehabilitation programme.

8. Removal of Quantitative Restrictions

(a) Import of 69 items covering animal products, vegetables and spices, antibiotics and films removed from restricted list.

(b) Export of 5 items namely paddy except basmati, cotton linters, rare earth, silk cocoons, family planning devices except condoms removed from restricted list.

9. Special Economic Zones Scheme

(a) Sales from Domestic Tariff Area (DTA) to SEZs to be treated as export. This would now entity domestic suppliers to Drawback/DEPB benefits, CST exemption and Service Tax exemption.

(b) Agriculture/Horticulture processing SEZ units will now be allowed to provide inputs and equipments to contract farmers in DTA to promote production of goods as per the requirement of importing countries. This is expected to integrate the production and processing and help in promoting SEZs specialising in agro exports.

(c) Foreign bound passengers will now be allowed to take goods from SEZs to promote trade, tourism and exports.

(d) Domestic sales by SEZ units will now be exempt from SAD.

(e) Restriction of one year period for remittance of export proceeds removed for SEZ units.

(f) Netting of export permitted for SEZ unit provided it is between same exporter and importer over a period of 12 months.

(g) SEZ units permitted to take jobwork abroad and exports goods from there only.

(h) SEZ units can capitalise import payables.

(i) Wastage for subcontracting/exchange by gem and jewellery units in transactions between SEZ and DTA will now be allowed.

(j) Export/import of all products through post parcel/courier by SEZ units will now be allowed.

(k) The value of capital goods imported by SEZ units will now be amortised uniformly over 10 years.

(l) SEZ units will now be allowed to sell all products including gems and jewellery through exhibitions and duty free shops or shops set up abroad.

(m) Goods required for operation and maintenance of SEZ units will now be allowed duty free.

10. EQU Scheme

(a) Agriculture/Horticulture processing EOUs will now be allowed to provide inputs and equipments to contract farmers in DTA to promote production of goods as per the requirement of importing countries. This is expected to integrate the production and processing and help in promoting agro exports.

(b) EOUs are now required to be only net positive foreign exchange earner and there will now be no export performance requirement.

(c) Foreign bound passengers will now be allowed to take goods from EOUs to promote trade, tourism and exports.

(d) The value of capital goods imported by EOUs will now be amortized uniformly over 10 years.

(e) Period of utilisation of raw materials prescribed for EOUs increased from 1 year to 3 years.

(f) Gems and jewellery EOUs are now being permitted sub-contracting in DTA.

(g) Wastage for subcontracting/exchange by gem and jewellery units in transactions between EOUs and DTA will now be allowed as per norms.

(h) Export/Import of all products through post parcel/courier by EOUs will now be allowed.

(i) EOUs will now be allowed to sell all products including gems and jewellery through exhibitions and duty free shops or shops set up abroad.

(j) Gems and jewellery EOUs will now be entitled to advance domestic sales.

11. EPCG Scheme

(a) The scheme shall now allow import of capital goods for pre-production and post-production facilities also.

(b) The Export Obligation under the scheme shall now be linked to the duty saved and shall be 8 times the duty saved.

(c) To facilitate upgradation of existing plant and machinery, import of spares shall also be allowed under the scheme.

(d) To promote higher value addition in exports, the existing condition of imposing an additional Export Obligation of 50% for products in the higher product chain to be done away with.

(e) Greater flexibility for fulfillment of export obligation under the scheme by allowing export of any other product manufactured by the exporter. This shall take care of the dynamics of international market.

(f) Capital goods upto 10 years old shall also be allowed under the scheme.

(g) To facilitate diversification into the software sector, existing manufacturer exporters will be allowed to fulfill export obligation arising out of import of capital goods under the scheme for setting up of software units through export of manufactured goods of the same company.

(h) Royalty payments received from abroad and testing charges received in free foreign exchange to be counted for discharge of export obligation under EPCG scheme.

12. DEPB Scheme

(a) Facility for provisional DEPB rate introduced to encourage diversification and promote export of new products.

(b) DEPB rates rationalised in line with general reduction in Customs duty.

13. Advance Licence

(a) Standard Input Output Norms for 403 new products notified.

(b) Anti-dumping and safeguard duty exemption to advance licence for deemed exports for supplies to EOU/SEZ/EHTP/STP.

14. DFRC Scheme

(a) Duty Free Replenishment Certificate scheme extended to deemed exports to provide a boost to domestic manufacturer.

(b) Value addition under DFRC scheme reduced from 33% to 25%.

15. Reduction of Transaction Cost

(a) High priority being accorded to the EDI implementation programme covering all major community partners in order to minimize transaction cost, time and discretion. We are now gearing ourselves to provide on line approvals to exporters where exports have been effected from 23 EDI ports.

(b) Online issuance of Importer-Exporter Code (IEC) number by linking the DGFT EDI network with the Income Tax PAN database is under progress.

(c) Applications filed electronically (through website www.nic.in/eximpol) shall have a 50% lower processing fee as compared to manual applications.

16. Miscellaneous

(a) Actual user condition for import of second hand capital goods upto 10 years old dispensed with.

(b) Reduction in penal interest rate from 24% to 15% for all old cases of default under Exim Policy.

(c) Restriction on export of warranty spares removed.

(d) IEC holder to furnish online return of imports/exports made on yearly basis.

Assessment

The Exim Policy has both strengths as well as weaknesses.

Strengths

1. The policy envisages a massive role for state governments to participate in export promotion.
2. Extension of export obligation period for sick units is a welcome step in as much as it helps them recover from sickness.
3. The policy helps increase India's share in the international trade of agricultural products.
4. The policy's focus on development of SEZs, export houses, industrial clusters and EOUs would help in propelling economic activity and promoting exports.
5. The move to allow setting up of overseas banking units within the SEZs would encourage lending to units in SEZs at internationally competitive rates.

Weaknesses

1. The policy is silent on critical labour laws and infrastructural bottlenecks.
2. There are too many export promotion schemes leading to duplication and confusion. The policy should have provided for a combination of all the schemes into one comprehensive policy.
3. The policy is also silent on dumping and what the government should do to curb it.

TRADE-IN-SERVICES

Services encompass telecommunications, transportation, tourism, banking, insurance, construction, computer-related-services and professional services. World trade in services stood at a whopping $1320 billion in 1998. The lion share went to the U.S. ($240 billion) followed by the U.K. ($101 billion), France ($85 billion) and the like. India showed $11 billion worth of services, registering 24 per cent rise over the previous year. This rise is significant because all other global players registered negative growth or marginal rise, as shown in Table 30.4. Another interesting development is that India's share in world's exports of services is more than the share of India's merchandise exports in the world's total merchandise exports.

It is surprising that for a long time, the role of the services sector was not realised and the potential was not exploited to the advantage of our country. As the Box 30.2 reveals, it is only since 1980s that the services sector started receiving attention from statisticians and policy makers.

Composition-wise, our service exports generally consist of business services, tourist services, software, and transportation services. Direction-wise, India's service exports are widely transacted across the globe.

Country	1997	1998	[illegible]
U.S.	235	240	[illegible]
U.K.	92	101	[illegible]
France	80	85	[illegible]
Germany	[illegible]	79	[illegible]
Japan	68	62	[illegible]
Hong Kong	38	34	[illegible]
China	25	24	[illegible]
S.Korea	27	24	[illegible]
India	9	11	[illegible]

($ billion)

Table 30.1 *Global Players in Trade-in-Services*

(**Source**: *WTO Annual Report*, 1999)

Box 30.2

Growth Locomotive but not Recognised

At the beginning of the twentieth century, services were deeds performed by nameless hands in servitude or bondage. The end of this period has seen a redefinition of the term, giving it fresh economic potential.

Services are the latest group of knowledge-utilities that are deemed to be the core of the wealth of nations in the new age. This semantic evolution connotes the comprehensive transformation of an entire spectrum of economic mindsets, among thinkers as well as governments. Not so long ago, both regarded services to be insignificant. The guru of classical economics, Adam Smith, epitomised the archaic view. To him, the economic value of services was absolutely transient; something that would perish in the very instant of its performance. According to this viewpoint, services could never amount to anything much, and measured upto even less. This was no ancient myth; many national accounting systems till recently had no estimate for the services.

Accounting systems of the erstwhile Soviet Union mindfully attributed no value to services. Other communist countries too banished them from national economic assessments as being immaterial. Even today, data systems of China cannot give full measure to the value of its services sector. Official statistical systems in India started detailed accounting for this sector only in the mid-1970s.

Of course in the last 30-35 years of the past century, services came to acquire a vast range of positive economic attributes. Again, these were intellectual as well as statistical. Neo-classical economists drastically overhauled the tenets of Adam Smith and imbued services with the quality of transforming the economic capacity and capabilities of their recipients. Economic development was itself viewed as a linear evolution towards the dominance of services in value terms (over agriculture or manufacturing). By the mid-1970s, the national accounting systems of most industrialised nations gave prominence to presenting valuations of services. In these countries, the rise in the share of services in national income was associated with overall economic growth as well as improvement in the quality of life. By the beginning of the 1980s, Indian statisticians too were tracking the evolution of the organised services sector in detail.

Determinants of Service Exports

Following are the principal determinants of our service exports:[5]

- Receipts from travel depend on tourist facilities in the country.
- Transportation receipts depend on merchandise exports originating from the country.
- Insurance receipts depend upon exports of merchandise.
- Receipts of repatriation of international investment income depend mainly on the growth of world economy.
- Professional, technical and other services receipts depend on the development of expertise in the country.

Promoting Service Exports

World trade in services will expand considerably and it is in our interest that we must take advantage of booming exports, particularly because we have a competitive advantage in software. It should go to the credit of the Government that it has already initiated a number of steps to strengthen the infrastructure for electronic data interchange and electronic commerce in view of the changing mode of trade transactions (see Box 30.3 for details). Similarly, we have vast potential in tourism and business services. In order to realise this potential, we should learn in terms of flexibility, customised operations, technologies and global strategies from the service providers of the North.

BALANCE OF PAYMENTS

Before proceeding further, it is useful to distinguish between *'balance of trade'* and *'balance of payments'*. The balance of trade refers to the difference between merchandise exports and imports during a period, which is usually one year. When the exports exceed imports, a country is said to enjoy a favourable balance of trade. Balance of trade of the country becomes unfavourable when it buys more from other countries than what it sells to them.

The balance of payments (BoP) is broader in its scope and include trade in merchandise and services. It is a systematic record of all international economic transactions, visible and invisible, of a country during a given period, the period generally being one year. BoP, therefore, presents a better picture of a country's financial transactions with the rest of the world than the balance of trade.

The analysis of BoP can be done in terms of two major sub-divisions - *current account* and *capital account*. Transactions relating to goods, services and income constitute the current account. A surplus on current account leads to an acquisition of assets or repayment of debt previously contracted; and a deficit involves the withdrawal of previously accumulated assets or is met by borrowings. The capital account presents transfers of money and other capital items and changes in the country's foreign assets and liabilities resulting from the transactions recorded in the current account. The deficit on the current account and on account of capital transactions can be financed by external assistance (loans and grants), drawings from the International Monetary Fund (IMF) and allocation of the Special Drawing Rights.

Box 30.3

Electronic Commerce

Electronic Commerce (EC), in a general sense, refers to all forms of commercial transactions that are based on electronic processing and data transmission. EC is likely to emerge as the major mode of commerce in view of lower information and transaction costs.

EC, which spurted in the mid-nineties essentially through non-proprietary networks such as the Internet, is expected to expand rapidly in the coming years. Estimates of EC turnover for the period 2000-02 range from US $10 billion to US $1.522 billion [OECD (1998)]. Currently, about 80 per cent of the EC transactions are intra- or inter-organisation type with about 80 per cent of the global EC transactions taking place in the United States. India remains one of the forerunners in EC development among the emerging markets with the Union Ministry of Commerce designated as the nodal agency for implementation of Electronic Data Interchange (EDI) and EC in India. The United Nations' standard (UN/EDIFACT) has been accepted as the national standard for EDI while four bodies - EDI/EC Council, India EDIFACT Committee, EDI Working Group and Message Development Group - have been formed in order to facilitate the development of EDI/EC in India. Special steps have been taken to introduce EDI/EC in areas such as ports, airlines, banks, tax administration, information exchange between organisations and interface of the authorities with the private sector. Electronic trading of financial instruments such as equity shares has been implemented by the National Stock Exchange.

The global nature of EC results in cross-border transactions often in intangibles with EC based payment mechanisms which pose new challenges for tax administration. The present taxation laws, based either on business connection or permanent establishment, are difficult to apply as the physical location of given transactions loses its importance, making it difficult to determine their revenue jurisdiction. Furthermore, e-commerce through internet, by and large, results in a distinct change in the pattern of intermediation by banks and other institutions limiting the ability of authorities to rely on them to collect withholding tax. Taxes could be source-based or destination-based. While source-based taxes applied to electronic commerce have clear compliance and administrative cost advantages over their destination-based counterparts, problems of evasion still remain. Special types of taxation such as the "bit tax" on data transmission have been proposed. However, tax administration would need to strike a balance between maximising the potential "efficiency gains" out of technology and protecting the revenue base.

Revenue implications of EC for India are limited at this stage as it is possible to identify most forms of cross-border EC transactions (including those involving intangibles) from the banking channel due to the existing reporting norms relating to foreign currency transactions.

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Most developing countries start as debtor economies, i.e., they start with deficit BoP. This is so because such countries need to import more visible and invisible items than they can export. As the economy progresses, a developing country's debtor position is likely to become a balanced one in terms of BoP and, finally, becomes a creditor economy, exporting more than it imports. Thus, from being a net debtor in the beginning, it becomes a net creditor in the end and, infact, begins to invest abroad rather than have others lending to and investing in it.[6]

India had faced pressures on BoP from time to time either due to certain domestic compulsions or due to external factors, as shown in Table 30.5. Factors responsible for BoP deficits are many. Ever increasing imports, gradual decline in net receipts from invisibles and reduction in flows of concessional assistance to India are the major causes for deficits in BoP.

Table 30.5

Key Indicators of BoP

Year	*Exports*	*Imports*	*Net Invisibles*	*Trade Balance*	*(% of GDP) Current Account Balance*
1985-90 (Average)	5.10	8.30	0.90	-3.20	-2.30
1990-91	6.25	9.43	-0.08	-3.18	-3.26
1991-92	7.30	8.15	0.01	-0.85	-0.34
1992-93	7.80	9.80	0.20	2.40	-1.80
1993-94	8.80	9.70	0.60	-0.90	-0.20
1994-95	8.90	10.50	0.80	-1.70	-0.80
1995-96	9.90	12.60	1.10	-2.70	-1.80
1996-97	9.50	13.00	2.60	-3.50	-1.00
1997-98	8.36	12.28	2.42	-3.94	-1.52
1998-99	8.20	11.40	2.20	-3.20	-1.00
1999-00	8.30	12.30	2.90	-4.00	-1.10
2000-01	9.40	12.40	2.60	-3.00	-0.50
2001-02	10.36	13.28	3.24	-2.92	0.32
2002-03	9.00	13.00	5.27	-4.00	1.27

(**Source**: *RBI*, Annual Report)

Countries make use of their respective exchange rates while dealing with other countries.

The crisis reached its peak during 1990-91, when current account deficit touched 3.3 per cent of the GDP, as seen in Table 30.5. This crisis unleashed series of measures such as strict fiscal and monetary discipline to control aggregate demand; dual exchange rate system (introduced in the Budget for 1992-93); full convertibility on current account (introduced in the Budget for 1994-95); substantial deregulation of trade and industry, standby arrangement with the IMF; structural adjustment and social security net loans from World Bank and financial sector loan negotiated with the ADB.

The above measures yielded positive results. The BOP situation has undergone a dramatic change during the nineties. The foreign exchange reserves, which were just enough to pay for only a fortnight's imports in 1991, have grown ten times since then (from Rs.11,416 cr as on end March 1991 to Rs.125,446 cr as on 31st March 1999).

EXCHANGE RATE MANAGEMENT

Countries make use of their respective exchange rates while dealing with other countries. It is the endeavour of every country to maintain equilibrium exchange rate. An equilibrium exchange rate is the proper rate of exchange at which there are no disharmonies in the economic system and the demand for the currency is equal to its supply in the foreign exchange market. At this rate, the domestic currency is neither undervalued nor overvalued in terms of foreign currency and thus does not give stimulus either to export or to import. The main objectives of our exchange rate policy are:[7]

- Reduce excess volatility in exchange rates, while ensuring that the market correction of overvalued or undervalued exchange rate is orderly and calibrated.
- Maintain an adequate level of foreign exchange reserves.
- Eliminate market constraints with a view to the development of a healthy foreign exchange market.

As with other any other aspect of international trade, reforms were effected in our exchange rate over the years. Starting with a two-stage cumulative devaluation of the rupee by about 20 per cent in July 1991, there was the Liberalised Exchange Rate Management System (LERMS) introduced in March 1992, and there was also the United Exchange Rate System (UERS) brought into force in March 1992. The LERMS was characterised by the dual exchange rate system and this was replaced by the UERS which, as the term signifies, United Exchange Rate System. The result was an effective devaluation of the rupee by around 35 per cent in nominal terms and 25 per cent in real terms between July, 1991 and March 1993.

The UERS has the following features:

- The rates of exchange are determined in the market.
- The freely floating exchange rate regime continues to operate within the frame-work of exchange control.
- Current receipts are surrounded to the banking system, which in turn meets the demand for foreign exchange.
- RBI intervention in the market to modulate the volatility and sharp depreciation of the rupee.
- The US dollar is the principal currency for the RBI transactions.
- The RBI effects transactions at a rate of exchange which could change within a margin of five per cent of the prevailing market rate.
- The RBI also announces a Reference Rate based on the quotations of select banks in Mumbai at 12 noon every day. The Rate is applicable to SDR transactions and transactions routed through the Asian Clearing Union.

Thus, with the introduction of UERS, our rupee has matured to a regime of the floating exchange rate from the earlier versions of a 'managed float'.

Along with the UERS, the rupee became fully convertible on current account with effect from August 20, 1994. Accordingly, several provisions like remittances for services, education, basic travel, gift remittances and donation and provisions of the Exchange Earners Foreign Currency Account (EEFC) have been relayed. In a further move, as announced on January 9, 1997, the RBI liberalised the existing regulations with regard to the payments for various kinds of feasibility studies, legal services, postal imports and the purchase of designs and drawings. With this, India has acquired IFF Article VIII Status. Under the status, IMF members undertake to refrain from imposing restrictions on the making of payments and transfers for current international transactions and from engaging in discriminatory currency arrangements or multiple currency practices without the approval of the IMF.

The Article VII status instils confidence among the international investing community, paving the way for further inflow of foreign capital. India is now committed to allowing free outflow of current account payments like interest, even if there is a serious foreign exchange crisis.

With regard to the capital account convertibility, it maybe stated that foreign exchange can be brought into the country with little or no restrictions, but it can be taken out only under specified conditions. There are exceptions however. For example, foreign institutional investors can bring in dollars to invest in the stock markets and take them out at will. In addition, NRIs can deposit funds in our banks, earn high interest rates and withdraw funds whenever they want. RBI has also expanded the scope of borrowing or raising funds abroad for resident Indians.

The reforms described above do not indicate that forex traders can make a quick buck in our country. Our forex market is restricted and is dominated by the Reserve Bank.

QUESTIONS

1. Bring out the role of foreign trade in a country's economic development.
2. Why are exports lagging behind targets? What can be done to promote exports?
3. How is foreign trade sought to be regulated?
4. What are trade-in-services? What is their role in our export earnings?
5. What is exchange rate management? Bring out the reforms in our exchange rate management?
6. What do you understand by balance of payments? Describe our balance of payments position over the years.

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CHAPTER 31

New Economic Policy

CHAPTER OUTLINE

Background to the New Policy

The New Policy

– *Evaluation of the Policy*

The Second Generation Reforms

LEARNING OBJECTIVES

After reading this Chapter, you should be able to:

1. *Understand the reasons why the New Economic Policy became a necessity*
2. *Describe the new policy and make a critical evaluation of it*
3. *List the second generation reforms*
4. *Assess the effects of 10 years of reforms*

Since July 1991, the government has initiated a series of radical changes in its policies relating to industry, trade, finance, foreign investments and fiscal aspects. The various changes, also called *structural* adjustments, when put together, constitute an economic policy which marks a total departure from the policy pursued earlier. This chapter is devoted to a brief discussion of the various aspects of the new policy.

BACKGROUND TO THE NEW POLICY

The new economic policy was necessitated by the worst economic crisis which was never witnessed by the country after Independence.

The new economic policy was announced in 1991, following the worst economic crisis that ever occurred in the country.

The most visible sign of the country's economic crisis was its extremely low foreign exchange reserves of Rs.2400 crore, which was reached in early 1991. The reserves were just enough to buy, from abroad, only three weeks requirements. The situation became even more precarious when international agencies lowered the country's credit rating.

The second major aspect of the economic crisis was the rapidly increasing burden of national debt, which exceeded 60 per cent of GNP in 1991. The fiscal deficit of the previous five years forced the government to borrow increasingly to meet shortfall in the revenue account. Borrowing added to the already prevailing debt burden.

Spiraling prices, dwindled forex reserves and heavy debt burden triggered the economic crisis which in turn resulted in the new economic policy.

The third and the most damaging feature of the 1991 crisis was the high price level. During 1985-90, the GDP grew at an average rate of 5.7 per cent but money supply increased at 15.7 per cent per annum. This excess liquidity led to high price rise which touched 17 per cent. (See Table 31.1 for more details about the price rise).

Table 31.1 *Trends in Wholesale Price Index and Consumer Price Index*

	1989-90	*1990-91*
(A) WPI (1981-82 = 100)		
All Commodities	8.1%	13.5%
(a) Primary articles	3.6%	18.9%
(b) Fuel, power and light	2.3%	19.2%
(c) Manufactured products	11.8%	9.6%
(B) CPI (1982 = 100)		
For Industrial workers	6.4%	13.7%

THE NEW POLICY

As part of the budget of 1991-92, through the latest one and also outside of the budgets, the government announced a number of economic reform measures. (It does not mean that attempts were not made earlier to reform the regulatory, trade and taxation regimes. It is just that their pace and frequency were slow).

The main objectives of the policy initiatives were:

(a) Reducing the government deficit to 6.5 percent of GDP in 1991-92 and five percent in 1992-93, with further reduction thereafter leading to containment of inflation;

(b) Reduction of the current account deficit in the balance of payments to 2.7 percent of GDP in 1991-92 and to 1.5 percent by 1995-96 as a result of export-growth and

(c) Raising GDP growth to around six percent by the mid-1990s

The new economic policy has four components, *viz*. (a) liberalisation, (b) privatisation, (c) globalisation and (d) stabilisation.

Four dimensions form the chunks of the new economic policy: liberalization, privatization, globalization and stabilization.

Together called the structural adjustment programme (SAP), the new policy envisages the measures as shown in Table 31.2.

Table 31.2

Model of Economic Management in India

Pre-reform strategies	Economic reform strategies
Closed economy	Open economy
Self reliance	Integrate with world markets
State-led economic growth	Market determined economic growth
Import substitution strategies	Export oriented strategies
Licence dominated regime	Delicensing, deregulation, debureaucratisation
Frequent state interventions	Selective and effective state interventions
Political administered prices	Market determined prices of large
Not much concern for deficits	Contain all kinds of deficits
Development by inflationary process	[illegible]
PSUs as engines of growth	[illegible]
Dominance of PSUs	[illegible]
Philosophy of natural monopoly	[illegible]
Restrictions of FDI and MNCs	[illegible]
Restrictions on currency movement	[illegible]
State controlled interest rates	[illegible]
State controlled credit	[illegible]
Underdeveloped capital market	[illegible]
Huge public sector budgetary resources (PSBR) liability on the government	[illegible]
High tax rates	[illegible]

The SAP has been forced on the economy because of several reasons. They are : *(i)* excess of consumption and expenditure over the revenue, resulting in heavy government borrowing; *(ii)* growing inefficiency in the use of resources; *(iii)* over protection; *(iv)* mismanagement of the firms and the economy, *(v)* distortions such as poor technological development and a shortage of foreign exchange and *(vi)* imprudent borrowing from abroad and mishandling and mismanagement of foreign exchange reserves.

Evaluation of the Policy

Two questions are relevant in the context of critical assessment of the new economic policy. They are: (i) Is the policy unavoidable? (ii) What are the achievements and failures of the policy?

> Economic policy should move towards free market. No reversal of the direction at all.

With regard to the first question, the answer is in affirmative considering the mire in which our economy was caught during the late 1980s and the early 1990s. A lasting solution to the crisis was not possible without the restoration of fiscal balance, infusing dynamism and competition and an increase in outward orientation.

As to the second question, it maybe asserted that the results have been quite encouraging. There has been a remarkable surge in the growth rate of the economy. After the crisis induced low growth of 0.9 per cent in 1991-92, the economy has responded smartly to the economic reforms to record a growth of 6.8 per cent in 1996-97. Industrial growth has registered around 8 per cent per annum.

Exports have grown comfortably and foreign investment inflow has been exceedingly good. Consequently, foreign currency reserves have stock piled. Price level too has been brought down to less than 8 per cent. And contrary to what the critics might say, poverty has come down (See Box 31.1).

> Thanks to new measures, economy has become vibrant.

In general, economy has become vibrant. Captains of industry are buoyant and are not deterred by the entry of MNCs. There is an overall increase in productivity, quality and competitiveness of Indian goods and services. For an economy which was under the grip of controls for nearly four decades, the new economic policy has not been a big jolt. It has absorbed the shocks of the structural adjustment with remarkable resilience and is looking ahead for more reforms. This has been realised by all political parties and hence the talk about the irreversibility of economic reforms.

There are problems nevertheless: (1) The pace of economic reforms, though fast during the first three years, slowed down from 1994 onwards. Reason is obvious. Elections to several state assembles were held in 1994. Two Rupees a kg of rice was the main promise in elections to the Andhra assembly. The promise was accepted by the electorate and the party which promised highly subsidised rice won the landslide majority. This opened the eyes of the rulers in the Central Government. Suddenly there was talk about subsidies and poverty and all attention was focussed on these issues. Economic reforms were sidelined and the trend continues till to date.

> Economic reforms are announced by Central Government, but it is the state governments which need to implement them.

(2) Though economic reforms are announced by the Central Government, their implementation is in the hands of state governments. For example, industries have been freed from investment and production restrictions. But basic infrastructure such as land, power, water needs are to be provided by the state governments. And except Haryana, Kerala, Orissa, Punjab, Rajasthan, West Bengal and Maharashtra (See Box 31.2) other states have not responded favourably to the economic reforms. Without active support from the state governments, it is difficult to carry out the reforms successfully.

(3) The Central Government's fiscal deficit continues to be high and this is reflected in continuing inflationary pressure. The borrowing requirements of a high fiscal

Box 31.1

Encouraging News About Poverty

For all those following the debate on poverty trends since the reforms of 1991, there is encouraging news from the National Council of Applied Economic Research (NCAER). It's latest consumer survey for 1993-94 shows that:

* The proportion of low income households has diminished after the economic reforms of 1991, a continuation of the declaiming trend evident since 1985-86 when it conducted its first survey. (See Table 31.3).
* Social mobility is substantial, and people are moving up the income ladder from the bottom to the middle, and from middle to the top. (See Table 31.4).

Table 31.3 Decline in Poverty

(Low income group%)

	Rural	*Urban*	*Total*
1985-86	73	42	65
1987-88	69	40	61
1989-90	67	37	59
1992-93	66	38	58
1993-94	65	37	57

Table 31.4 Up the Income Ladder

(% of households)

	Low income		*Lower middle income*		*Middle/high income*	
	Overall	*Rural*	*Overall*	*Rural*	*Overall*	*Rural*
1985-86	65	73	25	22	10	5
1987-88	61	69	28	25	11	5
1989-90	59	67	27	24	14	9
1992-93	58	66	25	23	17	12
1993-94	57	65	26	23	17	12

(Low income is defined as upto Rs.12,500 per year per household; lower middle income is Rs.12,500 to Rs.25,000 per year; middle/high income is above Rs.25,000 per year. All figures are at 1989-90 prices)

deficit are a source of pressure on interest rates and adversely affect the availability of resources for productive investment, especially at a time when a strong industrial recovery has resuscitated private sector demand for investible funds.

(4) Foreign exchange front may not continue to be comfortable for all the days to come. Unless fiscal restraint is observed and reforms in tax and trade policies continued, the recent improvements in international competitiveness and export growth could falter and thus bring the balance of payments under renewed stress. Moreover, in today's increasingly open and competitive international environment, perceptions

Box 31.2

Industrial Policy Reforms: Selected State Government Initiatives

Haryana

* Several steps taken to simplify procedures and ensure time bound clearances.
* Industrial Assistance Group as a single window services further extended to district level to ensure effective coordination among various government organisations.
* Powers to allot, transfer, lease and rent industrial plots/sheds; sanction/ disbursement of loans by Haryana Financial Corporation, sanction of electric load upto a certain limit-delegated to district level.
* Time bound clearance/sanctions encompassing all aspects - Project Approval (15 days), Registration as small unit (1 day), NOC (no objection certificate) by State Pollution Board (15 days), allotment of plots/shed (10 days) from receipt of application.
* All sales tax barriers through the state removed.
* High level coordination committee set up to ensure all clearances within the stipulated time. An Empowered Group (including representatives from various organisations) set up to revamp administration.
* High Powered Committee set up to take spot decisions on foreign investments, NRI projects and 100 per cent export oriented projects.
* A state level grievance committee set up to address problems faced by entrepreneurs.
* Visits of inspectors has been streamlined and rationalised.

Kerala

* Several steps are proposed/have been undertaken for attracting more investments and for procedural/rules simplification.
* State Industrial Development Committee will be formed for ensuring speedy clearance of applications of new SSIs, within prescribed time limit, review and maintenance of good industrial relations and monitoring of industrial development activities.
* District Development Committee to be formed in each district.
* Industrial Relations Committee to be extended to all existing and potential industrial areas.
* A new Green Channel Scheme will be introduced for expediting all clearances and all unneccesary licensing and clearances will be abolished.
* An Industrial Infrastructure Development Authority will be established.
* A special cell will be created to coordinate activities relating to central projects.
* New units will be exempted from all state taxes for the first seven years.
* Investment subsidy will be increased to 15 per cent, with certain ceilings.

Orissa

* A nodal committee constituted at the state government level of clearance of proposals for providing infrastructural facilities and government assistance, and to recommend measures for the rehabilitation of sick industrial units.
* The Foreign Investment Division in the Industrial Promotion and Investment Corporation of Orissa will act as a single window for investments by Non-Resident Indians and foreign investors.
* Nodal committees constituted at the district level to resolve local problems faced by entrepreneurs.

Punjab

* A new package of incentives to attract investments, avoid multiplicity of incentives and procedures, create new job opportunities and speedy clearance of new enterprises announced and made applicable from October, 1992. Steps undertaken/contemplated include:
* A committee constituted for providing land 'off the shell'.
* Udyog Sahayaka acting as a single window service for clearing projects.
* State government signed MoUs with selected industrial units to upgrade Industrial Training Institutes.
* Privatisation of Public Sector Units to be undertaken.
* Develop selected industrial corridors as part of infrastructural development. Use private initiative for infrastructure development, specially power.
* Procedures for providing credit by State Financial Institutions to be simplified. For promoting exports, foreign bank branches to be set up in Ludhiana.
* The state is formulating a policy to ensure granting of clearances for setting up industries within 24 hours of receipt of request.

Rajasthan

* Several steps taken for expanding and strengthening infrastructure, simplifying rules and procedures, ensuring speedy availability of inputs/clearances, increasing role of private sector, enhancing employment and investment.
* Power generation, telecom services, tourism and hotelling in the private sector encouraged.
* Enabling legislation put in place to allow private parties to collect tolls from roads/bridges constructed by them.
* Amendments made in rules relating to the conversion and allotment of land for industrial purposes.
* 155 SSIs exempted from obtaining No Objection Certificate from State Pollution Control Boards. Power to grant NOCs decentralised.
* Industries to be inspected under Factories Act reduced from 15 to three. Common inspection in accordance with a checklist prepared for the purpose. Even simpler procedure for the SSIs.

West Bengal

* State, wherever appropriate, welcomes foreign technology and investments.
* State recognises the importance and the key role of the private sector in accelerating growth.
* An Empowered Committee at the State level, under the Chairmanship of the Chief Secretary, to take quick decisions on investment proposals.
* The Single Window Agency of the West Bengal Industrial Development Corporation Ltd. strengthened to provide effective 'Escort Service' to new projects.
* Committees in each district formed under the Chairmanship of District Magistrates to ensure quick decisions on land, employment and other related matters.
* Private sector investment in power generation encouraged to meet increased demand.

(Source: Govt. of India, *Economic Survey, 1994-95*).

of weakness in macroeconomic policy of economic reforms could adversely affect the flow of foreign savings.

(5) Weakness in reforms is already visible. Not only the pace has slowed down, the process of reforms is not complete even though reforms are decade old. Many

areas need policy changes. For example, phasing out subsidies, reducing the number of agencies which give clearance for new projects, amending the Companies Act, 1956 to allow amalgamations and inter-corporate investments, and the like await government's clearance.

(6) The reforms have hit the labour hard. Emboldened by the new economic policy, both public and private sector enterprises have resorted to voluntary retirement schemes to get rid off surplus labour. Surplus may be the labour force, but removal is not the ideal solution. Excess labour could be retrained and redeployed instead of being asked to go home for good.

The labour is hurt on the employment front too. As pointed out by the mid-term appraisal document of the eighth Plan, "although employment growth was better in 1992-95 than during 1985-92, when the average rate of growth was only 1.78 per cent (equivalent to a net annual addition of about five million per year), it has been substantially lower than the Plan's target of an average employment growth rate of 2.6 to 2.8 per cent.

"Consequently, the growth in employment opportunities of six million in each of the three years 1992-95 have fallen short of the target envisaged in the Plan by about 2.5 million each year. It has also been smaller than the estimated growth of the labour force during the period. Therefore, the level of unemployment in the economy which was estimated at 17 million in 1992, is likely to have increased to 19 million in 1994". Obviously, economic reforms seems to have failed in generating additional jobs.

(7) The success of reforms is highly exaggerated. If one were to look into the economy closely, nothing seems to have changed from pre-reform days. The share of manufacturing in GDP for example, was 27.5 percent in 1989-90. It was slightly less at 27.3 percent in 1994-95. The share of agriculture fell from 33.7 percent in 1989-90 to 31.5 percent in 1994-95. (See Table 31.5)

(8) Contrary to what the Table 31.3 and 31.4 indicate, poverty during the ninetees has worsened as shown in Table 31.6. As seen from the Table, the progress achieved during the eightees in poverty reduction got reversed or ground to a halt during the Nineties.

All things considered, it maybe stated that the reforms are inevitable. Our economy cannot remain isolated from what is happening in the global business scenario. However, the policy makers do well to realise the past mistakes and correct them on the way to further reforms.

THE SECOND GENERATION REFORMS

What has been accomplished till now through SAP is significant. Yet much more needs to be done to reap the full benefits of what has so far been done. This calls for the implementation of the *second generation reforms*. The second generation reforms should help our firms grow and become strong MNCs, and offer greater opportunities to our vast pool of educated youth to realise their potential and alleviate the sufferings of people still languishing below poverty line.

Table 31.5

Unchanging Face of Economy

	1984-85	1989-90	1994-95
% share of agriculture in GDP	37.6	33.7	31.5
% share of manufactures in GDP	24.9	27.5	27.3
% share of banking, insurance and real estate	9.1	10.0	11.2
% composition of imports of crude oil, fertilizers, capital goods, iron and steel and chemicals	63.9 (1985-90)	-	63.8
% composition of exports of gems and jewellary	16.0 (1990-91)	-	17.1
% cotton yarn	6.34	-	8.41
% transport equipment	2.21	-	2.91

(**Source**:*Economic Times*, Jan 21, 1997)

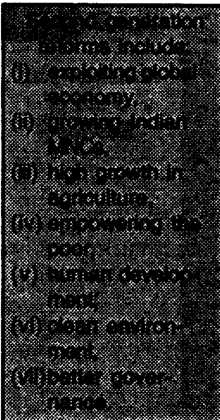
Table 31.6

Percentage of People below Poverty Line

Year	Rural	Urban	All-India	Number (million)
1983	45.6	40.8	44.5	322.8
1987-88	39.1	38.2	38.9	304.9
1989-90	33.7	36	34.3	276.0
1990-91	35.0	35.3	35.1	291.0
1992	41.7	37.8	40.7	348.0
1993-94	37.3	32.4	36.1	320.5
1994-95	38.0	34.2	37.0	329.5
1995-96	38.3	30.0	36.1	328.0
1997	38.5	34.0	37.2	348.8
1998	45.2	34.6	43.0	406.3

Estimates for only 1983, 1987-88 and 1993-94 are based on "Large Sample" data, all others on "Thin Samples". Estimates for 1998 are for six months.

(**Source**: *The Hindu*, Dec.30, 1999)



In brief, the second generation reforms comprise the following:

A. Exploiting the Knowledge-based Global Economy

(i) Revolutionising the telecom sector to help integrate India's economy into world economy.

(ii) Building institutes for higher education to turnout competent youth to take advantage of newer opportunities.

(iii) A system of intellectual property rights to reward innovations adequately.

(iv) Venture capital and 'private equity funds' to finance risk projects of the knowledge based economy.

B. Growing Indian Transnational Corporations

(i) Indian firms to enjoy flexibility in entry and exit. Freedom to diversify and to close down unsuccessful units helps Indian companies compete successfully with MNCs.

(ii) Bring in more trade reforms so that resources could be put to more productive uses.

(iii) Liberalise domestic trade, besides freeing international trade.

(iv) Liberalise and move towards capital account convertibility.

C. High Growth of Agriculture

(i) Free farmers from all domestic restrictions on storage, transport and sale of agricultural products.

(ii) State to ensure that adequate investments are made in irrigation, agricultural research and infrastructure.

D. Empowering the Poor

(i) Integrate and consolidate anti-poverty measures.

(ii) Set up a system for old age income security.

E. Human Development

(i) Knowledge industries require educated people. Make primary education compulsory.

(ii) Involve private sector to provide better primary education.

F. Clean Environment

(i) Arrest damage to environment.

(ii) Promote clean and healthy environment.

G. Improvements to Governance

(i) Reform of public finance.

(ii) Rationalise electricity prices.

(iii) Bring in legal reforms that ensure inexpensive and speedy justice and at the same time facilitate economic growth.

DECADE PLUS YEARS OF REFORMS[1]

We are into nearly 15 years of economic reforms. It is time that we take a look at the effect of economic reforms initiated in 1991. The following questions and their answers give us an objective assessment of the reforms. The questions raised are -

1. How fast the economy is growing?
2. How sustainable is our growth performance?
3. What are the prospects of the economy?
4. What is the state of poverty?
5. What is the access to clean water, and sanitation in rural India?
6. What is the state of health in India?
7. What have we done for social sector?
8. What is the role of new and emerging technologies?
9. What can we expect from new agricultural varieties?

Growth of the Economy

So far as rate of economic growth is concerned, expectation during the early 1990's was that it would be in double digits. The growth rate was 5.5 per cent since 1997-98 (though it was 7.5 from 1991 to 1997). It went up to 8 per cent in 2003-04. Development experts are of the opinion that India should have a growth rate of atleast 15 per cent sustained over a period of 10 to 15 years, if it were to become a developed economy. We fall short of this expectation considerably.

India needs a sustained growth rate of 15 per cent to become a developed one.

How Sustainable?

With regard to sustainability, the Indian economy exhibited considerable resilience in the recent past, inspite of several shocks it has received - Est Asian crisis, global depression, border tension, Iraq war, earthquake, tsunami, oil price fluctuations, and draughts (See also Box 31.3). The growth rate of 5.5 per cent against this backdrop is commendable by any standard.

Given the stable economic environment and better prospects lying ahead, sustaining the growth rate may not be difficult.

Economic Prospects

The economy seems to have everything going in its favour. Some instances are:

Economy seems to have everything going in its favour.

- Rate of inflation is slow and stable
- Abundant liquidity at low interest rates
- Exchange rate is stable under managed float regime
- Huge forex reserves
- Short-term external debt is low
- Stocks of foodgrains are comfortable

Box 31.3

Shocks Hitting the Economy after the mid-1990s

Incidents	Date	Details
Exchange rate Volatility	October 1995-March 1996	Sharp extended rise in interest rates and short-lived credit squeeze.
Asian currency crisis	1997	Heightened fear of volatility in currency markets and of capital flight.
India's bomb	11 May 1998	India conducts three nuclear explosions at its Pokhran nuclear test-site. These include a fission-device, a low-yield device, and a thermonuclear device.
	13 May 1998	India conducts tests of two sub-kiloton nuclear devices at Pokhran.
Sanction	13 May 1998	President Bill Clinton reported to Congress that he had imposed sanctions on India under Section 102 of the Arms Export Control Act, otherwise known as the Glenn Amendment.
Earthquake	29 March 1999	Chamoli UP.
War	31 May 1999-28 June 1999	Kargil war.
Cyclone	18-19 October 1999	Orissa, Andhra Pradesh, and West Bengal.
Global price shock	October 2000	Oil price hike.
US recession	Last quarter 2000-First quarter 2001	Triggers global slowdown.
Stock prices fall	Early 2001	Dotcom burst.
Scam	March 2001	SEBI restrains Anand Rathi from trading.
Earthquake	26 January 2001	Gujarat earthquake.
Scam	13 March 2001	Tehelka.com tapes released.
Scam	30 March 2001	Madhavpura Mercantile Cooperative Bank in trouble.
Enron dispute	May 2001	Work stops at Dabhol.
Financial crisis	May 2001	Software slowdown.
Scam	May 2001	Home trade CEO held for fraud.
Scam	August 2001	Arvind Johari, promoter of Lucknow-based Cyberspace Infosys Ltd. (CIL), held on the charge of misappropriating Rs.32.08 crores from Unit Trust of India (UTI).
International terrorism	11 September 2001	WTC bombing in New York.
War	November 2001	Afghan war.
Terrorism in India	13 December 2001	Bombing at the Parliament.
Price shocks	7 February 2002	Gold prices zoom to 5-year high.
Riot	27 February to 16 March 2002	Riots in Gujarat after Godhra Incident.
Tension	June 2002	Indo-Pak tension at the border.
Monsoon failure	June 2002	
Scam	July 2002	Worldcom scandal.
War	March 2003	Iraq war.
Epidemic	3 April 2003	SARS hits Asia.
Strike	3 April 2003	Truckers' strike.
Disaster	24 December 2004	Tsunami