Resilience of Indian Economy- A mid-term Appraisal

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< EXECUTIVE SUMMARY >

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The Budget 2003-04 raised hopes to push the economy into higher growth path thereby increasing production in both agriculture & industrial sector and Achieving targeted growth in organized sectors. The article below assesses the economy in various sectors.

Economic reform measures comprise a long-drawn and continuous process. The measures of economic reforms initiated by the Government of India since 1991 aim at accelerating the growth of the Indian economy by facilitating investment, spreading the spirit of competitiveness and securing progressively more and more private and public participation in various important sectors of the economy. Socio-economic problems like poverty, malnutrition, unemployment etc. also were sought to be eased by these measures.

No doubt, the process of reforms in the Ninth Five Year Plan (1997-2002) has resulted in an overall increase in the flow of foreign investment, restricted the rate of inflation, improved the balance of payment position, accumulated favourable foreign exchange reserves and registered current account surplus. However, towards the end of the Ninth Plan and in the first year of the Tenth Five Year Plan (2002-07) the country saw a dwindling rate of growth of Gross Domestic Product (GDP). GDP at Factor Cost which was 6.1 per cent in 1999-2000 plummeted to 4.4 per cent in 2000-01. There was a marginal 1.2 percentage point increase in the growth rate during 2001-02. However, during 2002-03 the growth according to Central Statistical Organisation's (CSO) Revised Advanced Estimates fell again to 4.3 per cent.

The fiscal year 2003-04 began on a happy note since the Indian economy witnessed a recovery of growth in various sectors like industry, services and the external sector. This recovery was accompanied by stability in major macro-economic indicators like low rate of inflation, enhanced foreign exchange reserves, increase in the growth rate of industry, etc. The Union Budget 2003-04 was presented at the time when the country was plagued by severe drought, swelling in global oil prices, slackened and depressed demand growth and the prevailing war tension in the Mid-East. Keeping in view the low rate of GDP growth registered in the year 2002-03, the Union Budget 2003-04 strove to revive the economy with active support of continued industrial recovery and a receding global recessionary phenomenon. The Budget assumed that a good monsoon season ahead would lead to a significant growth in agricultural production, thereby offsetting the impact of the drought on the economy. By rationalising taxes, an endeavour was made to raise the effective demand in the economy which in turn was supposed to enhance the performance of the various sectors of the economy. The Budget also advocated cut in the interest

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rates in order to encourage investments in the economy.

The monsoons have ensured a good amount of rainfall in the country during the fiscal year 2003-04 and the economy is expecting a bumper agricultural production which will have forward and backward linkages for other sectors in ensuring a higher GDP growth rate than obtained last year. The industrial sector has got over the depressionary phase and is set to improve its performance. Let us now have a glimpse of the performance of various sectors of the economy during the first four months of the fiscal year.

GDP Growth

The Tenth Plan has been rather too optimistic to target 8 per cent growth rate for the economy during the Plan period 2002-07. The first year of the Plan 2002-03 has witnessed a growth rate of only 4.3 per cent as per CSO estimates. This may have been due to the sharp decline of 3.2 per cent in the agricultural production. The Index of Agricultural Production (of 46 major crops including plantation) has shown a negative (-11.9 per cent) growth rate during this period due to the failure of monsoon and severe drought like situations in the country. The economy in the first quarter of the financial year has displayed a degree of buoyancy in the areas of industry, money and price. A better monsoon at the beginning and midst of the second quarter of the year may enable a GDP growth rate of 5.5 to 6 per cent during the second year of the Tenth Plan. The first two years of the Plan period, therefore, may achieve an average growth rate of 4.9 to 5.2 per cent which is well below the Plan target of 8 per cent per annum. In order to have an average of 8 per cent growth for the Plan period, the economy will have to grow at an average rate of 9.9 to 10 per cent per year during the remaining three years of the Plan Period which seems improbable. However, with a revival of industrial and services sector, healthy foreign exchange reserves, sustainable capital market and anticipated agricultural recovery in the coming years, the Tenth Plan may end up registering a growth rate of 5.5 to 6 per cent per year.

The Union Budget, therefore, rightly proposed a number of initiatives such as promoting infrastructure development by dovetailing public initiatives with that of private, enhancing private and public participation through promotion of private investment followed by measures aiming at fiscal consolidation.

Money Supply and Interest Rate

The Monetary and Credit Policy, 2003-04, announced by the Reserve Bank of India (RBI) has appropriately taken note of the declined money supply (M3) and continued to advocate a softer interest rate structure. The Cash Reserve Ratio (CRR) and Bank Rate have been reduced with a view to increasing the money supply in the economy. The rate cuts would meet the resource gap by supplying additional credit in the hands of the financial intermediaries. The reduction in the Prime Lending Rates (PLR) would lead to an upsurge in the demand for food and non-food credits. The growth of the Money Supply has been within the range of 12 and 14 per cent during March to July 2003. The economic recovery in the first and beginning of the second quarters of the current financial year may augment both the food and non-food credit demand and would increase the money supply accordingly.

Monetary and Credit Policy 2003-04 of RBI provides various sops in order to create an economy with abundant liquidity with low interest rate regime. The PLR band of 10.50 to 11.0, Cash Credit Ratio of 4.5 per cent and Bank Rate of 6 per cent may lead to the reduction in the domestic interest rates on loanable credits. Keeping in view the low interest regime and prevailing marginal inflation rate, the off-take of credit may upsurge and fuel the economy to come to a comfortable growth trajectory.

Fiscal Deficit

The combined fiscal position of the Centre and the States reflects the seriousness of the problem of fiscal consolidation. Government at both levels have lost control over their respective expenditures and have been spending the bulk of the revenue earnings on wages, salaries and interest payments. The fiscal deficit for the year 2002-03 was 5.5 per cent (Budget Estimates) of GDP and the actual was 5.9 per cent of GDP (Revised Estimates). The high fiscal deficits were due to sluggish growth in revenue receipts and growing and unprevented public expenditure trends. The Union Budget 2003-04, therefore, acknowledged the necessity for fiscal consolidation for sustainable economic growth. Many fond measures like revenue enhancement through modern tax administration and expenditure rationalisation were advocated. But will these materialise? The budgeted fiscal deficit for the year 2003-04 (Budget Estimates) will be achieved only if the Government initiates various prudent measures like down-sizing the staff-strength of the 36 Ministries/Departments (as recommended by Expenditure Reforms Committee), rationalising the Indian tax structure, broadening service tax net, enhancing the quality of expenditure, effectively monitoring revenue and expenditure through better cash manage-

ment and pre-payment/re-payment or timely payment of high cost external and internal debt.

SUBSIDIES

Subsidies, if increased, will have a negative impact on capital expenditure and thereby could reduce the scope of effective saving and investment. The Central Government expenditure on major subsidies as a proportion of total expenditure has been at a comfortable level due to phasing out of subsidies and dismantling of the Administered Price Mechanism for Petroleum Products. The expenditure on subsidies as a proportion of total expenditure which was 74 per cent in 1994-95, declined to 7.1 per cent in 1995-96. The same was 11 per cent in 2002-03 (Revised Estimates). To rationalise subsidies and the expenditure thereof, the Government has to target subsidies, evaluate the socio-economic effects and eliminate those subsidies which do not have much of socio-economic validity and those which do not actually benefit the poor and destitute of the country.

EXTERNAL DEBT

The external debt stock of India was US $ 105 billion at the end of December 2002. However, the debt positions have shown considerable improvement vis-à-vis the positions in 1991-92. The incidence of external burden measured by debt-GDP ratio almost got reduced to half from 38.7 per cent in 1991-92 to 20.6 per cent in 2002-03 (end of December 2002). The details of external debt of the country and external debt to GDP ratio for the last three years are as follows: -

Table-1
Total External Debt and Debt to GDP Ratio (2000-01 to 2002-03)

Year	Total External Debt ($ million)	Debt to GDP Ratio
1	2	3
2000-01	101,132	22.4
2001-02	98,761	21.0
2002-03	104,987	20.6

Source: Ministry of Finance, Government of India

Taking into account the size of the Indian economy and the growth rate the Global Development Finance (GDF) published by the World Bank, India has been categorised as a 'moderately indebted' country. GDF 2003-04 has expressed that India has been transformed from 'moderately indebted' country to 'less indebted' category since 1999. As a part of its prudent debt management policy, the Government of India has prematurely repaid high cost loans owed to the World Bank (US$ 1,687.8 million) and Asian Development Bank (US$ 1,342.33 million) in February 2003. To improve further the external debt scenario in the country the Government should continue its efforts on prudent management of the liabilities due to external debt and liquidating relatively high cost items of the external debt portfolio, encouraging long-term maturity debt profiles and non-debt creating financial inflows.

EXCHANGE RATES AND FOREIGN EXCHANGE RESERVES

The first quarter and the beginning of the second quarter of the current financial year have witnessed appreciation of the Indian Rupees against US Dollars. Rupee-Dollar exchange rate which was 47.47 in the month of March 2003 was 45.85 in the fourth week of August 2003. The appreciation of Rupee may be due to slow recovery of the US economy, aftermath of war tension, surplus current account of the country and presence of huge foreign exchange reserves backed by smooth inflow of foreign investments. Keeping in view the globalisation of the Indian economy and the on-going process of global financial integration, capital finds an easy movement into the economy both from individuals and corporates. In this context, the country has to be cautious enough to limit its short-term foreign investments because at the slightest fluctuation in the economy, there would be a risk of immediate transmission of a bulk amount of short-term investments by the investor.

The foreign exchange reserve which was $72.877 billion in February 2003 increased to $84.101 billion by July 2003. The prevailing interest rate structure in the economy, high investment inflows (both foreign institutional investment and foreign direct investment), improved industrial performance and recovery in the capital market may pave the way for further increase of foreign exchange in the country.

INDUSTRIAL GROWTH

There has been a favourable change in the global economic conditions. The recession of 2001 and the depressing effect of war efforts on trade and industry on global players have been receding. This has created buoyant and

vibrant trading conditions for developing countries like India. The international and domestic price of steel, zinc, aluminium and many industrial commodities have started moving upwards. The first quarter of the fiscal year also experienced a rise in the price of various manufacturing items like gems and jewellery, textiles, etc. In this situation, combined with an atmosphere of increasing domestic and international demand, the Indian industrial growth has started improving to 5.7 per cent in June 2003 in comparison with an average growth of 5.3 per cent in the April-June quarter. This is a quantum jump in comparison with that of last year's achievement (4.3 per cent in April-June 2002). The Index of Industrial Production grew at 5.7 per cent in June 2003 reflecting thereby growth of mining, manufacturing, basic goods, capital goods and consumer goods at 5.9, 5.8, 6.1, 5.3 and 6.3 per cent, respectively. The rising demand for Indian industrial products, receding global recessionary phase, optimistic budgetary measures, and favourable monetary policy of RBI are the major factors behind the upsurge in the growth of the Indian Industry.

Exports and Imports

The new EXIM Policy 2003-04 stresses on export of services, tax sops for stimulation of exports, creation of Special Export Zones, exports of agriculture and allied products, abolition of Quantitative Restrictions (QRs) in many agro products. The recovery in the global trade, world exports and external demand has caused Indian export growth by 11.95 per cent in June 2003 against 9.2 per cent in January 2003. This growth, however, was 1.6 percentage point lower than the growth of export in February 2003. This may have been due to the appreciation of the Rupee against US Dollars, increase in foreign exchange reserves and current account surplus. With the recovery in the US economy, enhancement of the global competitiveness, backed by demand growth, exports may grow in the coming months. During the first quarter of the fiscal year, exports were valued at US $ 13.1 billion. In Rupee terms, during this period, exports were 6.75 per cent higher at Rs.61, 868.77 crore.

The continuous appreciation of Rupee against Dollar followed by increase in the price of petroleum products and reduction in custom duties, have resulted in buoyancy in the growth of Indian imports. The country's overall imports have increased by 27.05 per cent during the first quarter of 2003-04 to US $ 17.3 billion, reflecting an increased demand for imports in the domestic market. During this period, oil imports increased by 17.94 per cent to US $ 4.8 billion and non-oil imports were estimated at US $ 12.5 billion, representing an increase of 31 per cent. In Rupee terms, during the first quarter the imports were of Rs. 8,153,237 crore, reflecting a growth of 22.09 per cent.

With the upsurge in imports vis-à-vis exports in the first quarter of the current fiscal year, the trade deficit widened to $ 4.2 billion from $ 1.8 billion against the same period during fiscal 2002-03.

Inflation

Annual point to point inflation rate at the end of the second week of August 2003 has been registered at 4 per cent which shows a marked decline from April 2003-04 (6.15 per cent)

Table-2

Inflation Rates for April to August (2001-02 to 2003-04)

Month	2001-02	2002-03	2003-04
1	2	3	4
April	5.5	1.5	6.15
May	5.5	1.6	5.44
June	5.4	2.4	5.20
July	5.3	2.8	4.65
August	5.4	3.3	4.00*

* Second week of August
Source: Ministry of Finance, Government of India

The Wholesale Price Index (used for monitoring wholesale price movements of 435 commodities amongst the primary commodities, fuel and manufactured product groups) shows a continuous decline in the inflation rate as is shown in the table since April 2003-04. This decline may be due to the fall in the prices of primary articles, revival of the economy and reduction in the money supply growth.

Agriculture

Due to severe drought conditions in the fiscal year 2002-03, the agricultural production was negatively affected and hence had a negative impact on overall growth in the economy. This fiscal year 2003-04 has, however, raised a hope of a bumper crop due to good rainfall in the country. Indian economy, which is heavily dependent on the growth of agricultural output, is expected to grow at least one to one-half percentage points more than the previous year's growth rate. It has also been estimated that a growth rate of 7 to 7.5 per cent in agriculture may drive the

GDP growth to 6 to 6.5 per cent provided other sectors of the economy maintain their current momentum.

CONCLUSION

The Budget 2003-04 raised hopes to push the economy into a higher growth path thereby increasing production in both agriculture and industrial sector and achieving targeted employment growth in organised and unorganised sectors. The prospects of higher growth of agricultural production are bright as there has been a good amount of rainfall across the country. There is, therefore, no doubt that agricultural production in the kharif and rabi seasons will increase significantly and will push up the growth rate of the economy in 2003-04. Higher incomes in agriculture through its backward and forward linkage effects will boost the demand for industrial products and services, contributing in the process to an all-round acceleration in growth. The depression-ridden Indian industries and manufacturing sector are now trying to improve their overall performances. With the changing international economic scenario abroad and a booming capital market and conducive domestic monetary environment, the Indian business is expected to have a positive influence on the growth of the economy.

Considering the importance of fiscal consolidation, the Central Government should try out various prudent measures towards shrinking its various expenditure and also strive to raise its revenue from direct and indirect taxes significantly. As promised in the Budget Speech 2003-04, to encourage higher savings and investments the Centre has to take necessary steps for proposed public-private partnership for boosting public investment in infrastructure, the main growth initiative announced in the Union budget. The Centre should not bypass the socio-economic issues like education, health, employment and income of the poor. A clear-cut employment strategy keeping in view the optimistic goals set by the Tenth Plan must also be pursued. The renewed strategy should encourage growth of employment in the unorganised sector which contributes 92 per cent to the country's employment and enjoys more than 10 times labour intensity per unit of production as compared to the organised sector.

Keeping in view the emerging positive economic environment in the country, various economists from different institutions have forecast that the growth rate in 2003-04 fiscal year may reach 5.5 to 6.5 per cent. While the International Monetary Fund (IMF) projects growth of the Indian Economy at 5.5 per cent during 2003-04, the Governor of RBI, Shri Bimal Jalan has forecast the same to be between 6 and 6.5 per cent.

It is true that higher growth rate creates a competitive atmosphere in an economy through its linkage effects. However, the growth of an economy should be judged meticulously and qualitatively not only in an economic perspective but also a social one. While gloating over the revival of the Indian economy and projecting a higher rate of growth, we should also ask ourselves how much of the targeted 10 million job creation/employment generation per year contemplated by the Planning Commission during the Tenth Plan Period has been achieved; whether the growth is going to achieve distributive justice by distributing the growth benefits equitably to the country's multitude staggering under the burden of widened regional disparities and growing rural-urban divide?

Clearly the social perspective is daunting. There must be no complacency in this respect. The rise in growth rate has had only a minimal positive impact on additional employment generation in both the organised and unorganised sectors of the economy. And precious little has been done to arrest the growing rural-urban divide. How one wishes the Government to activate itself for meeting the needs of the hour and strives to fulfil its promise on "Panch Priorities" viz. Poverty Alleviation, Infrastructure Development, Accelerating reform process, creation of a conducive atmosphere for larger private investment and ensuring greater co-ordination with world economy, as envisaged in the Union Budget 2003-04.

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