

COUNTRY
ECONOMIC
REVIEW

INDIA

December 2001

CURRENCY EQUIVALENTS

(as of 31 December 2001)

Currency Unit – Rupee/s (Re/Rs)

Re1.00 = \$.0208

\$1.00 = Rs48.18

ABBREVIATIONS

CPI	-	consumer price index
EFC	-	Eleventh Finance Commission
EXIM	-	export-import
FDI	-	foreign direct investment
FII	-	foreign institutional investment
GDP	-	gross domestic product
GFD	-	gross fiscal deficit
IDG	-	International Development Goal
IMD	-	Indian Millennium Deposit
MDG	-	Millenium Development Goal
NPA	-	nonperforming asset
PSU	-	public sector undertaking
QR	-	quantitative restriction
RBI	-	Reserve Bank of India
SEBI	-	Securities and Exchange Board of India
SSI	-	small-scale industries
WMA	-	ways and means advances
WTO	-	World Trade Organization
VAT	-	value-added tax

NOTES

- (i) The fiscal year (FY) of the Government begins on 1 April and ends on 31 March of the following year. 2000 is fiscal year 2000/2001.
- (ii) In this report, "\$" refers to US dollars.

CONTENTS

EXECUTIVE SUMMARY	i
I. RECENT ECONOMIC DEVELOPMENTS	1
A. Poverty Reduction and Progress Toward the Millennium Development Goals (MDGs)	2
B. Economic Growth – A Historical Perspective	8
C. Growth, Employment, Savings And Investment – Recent Trends	14
D. Fiscal Developments	20
E. Monetary Developments and Prices	24
F. External Trade and Balance of Payment	27
II. SHORT-TERM ECONOMIC OUTLOOK	28
III. CENTER-STATE FISCAL RELATIONS AND THEIR IMPLICATIONS FOR STRUCTURAL DEFICITS	30
A. Recent Trends in State Finances	30
B. The Specific Character of India’s Fiscal Federalism and the Principle of Comparative Advantage	33
C. Assignment of Revenues and Expenditures, Intergovernmental Transfers, and Their Impact on Structural Deficits	34
D. Softening of State Budget Constraints	37
E. Conclusion	39
APPENDIXES	
Table A.1 Key Economic Indicators	43
Table A.2 Indicators of Social Development	44
Table A.3 Gross Domestic Product at Factor Cost by Sectoral Origin (1993/94 Prices)	45
Table A.4 Gross Domestic Product at Factor Cost by Sectoral Origin (Current Prices)	46
Table A.5 Expenditure on Gross Domestic Product (Current Market Prices)	47
Table A.6 Summary of Central Government Finances	48
Table A.7.1 Central Government Finances	49
Table A.7.2 Central Government Finances (Percentage of Gross Domestic Product)	50
Table A.8 State Government Finances	51
Table A.9 Monetary Survey	52
Table A.10 Price Index	53
Table A.11 Summary of Balance of Payments	54
Table A.12 External Debt	55

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EXECUTIVE SUMMARY

The growth of the Indian economy has been decelerating since 1999, with the slowdown becoming more pronounced from the second half of 2000. The slowdown has been driven by sluggishness in the industry sector. The services sector, the prime engine of economic growth during the 1990s, has also shown a moderate decline. Agriculture growth will be high in 2001 compared with a very low turnout in both 1999 and 2000.

In 2000, the gross domestic product (GDP) grew at 5.2 percent. In the first quarter of 2001, GDP growth was a mere 4.4 percent over its level in the same quarter of 2000. In 2001, economic growth is expected to be around 5.0 percent.¹ While a disappointing outcome compared with India's high growth rates in the mid-1990s, this still makes the Indian economy—together with the People's Republic of China—one of the best performing economies in 2001.

Several factors may have caused below-expectations economic performance. The global economic slowdown affected the Indian economy, but its impact is, in our assessment, limited. This is because, despite achievements in trade liberalization under the post-1991 reforms and in compliance with World Trade Organization (WTO) commitments, India's openness remains relatively limited. This softens the impact on the economy of external shocks as the September 11 attacks on the United States, and of cyclical patterns in global demand. Of all possible transmission channels—trade, capital flows, and exchange rate—the first is the most likely to be hit by the deepening global slowdown. India's export growth—particularly software and related services—dropped in 2001; however, import growth has slowed even more sharply and the trade balance and current account deficit are unlikely to worsen in 2001. So far, there is no significant impact on foreign capital flows to India, which remain small. And the rupee is fairly stable in the context of a comfortable foreign exchange reserves position.

There were also some major domestic shocks, such as the devastating earthquake in Gujarat in January 2001. Economic losses caused by the earthquake have been estimated at roughly 1 percent of India's GDP. However, aid from the international community, supporting immediate efforts at reconstruction, has helped lessen the impact of the shock.

The main causes of the relatively poor performance of the Indian economy appear to be domestic structural factors. These can be traced back to the unfinished reform agenda.

First-generation reforms were designed, on the one hand, to rein in public finances in the medium term by redefining the role of the public sector and, on the other hand, to spur private sector growth. The three key areas covered by the reforms were industrial policy, trade and exchange rate, and the financial sector. A key element in the redefinition of the public sector role was an ambitious program of reform of center and state public sector undertakings (PSU), including restructuring, accompanied by decreasing reliance on the public budget and gradual divestiture. Trade liberalization involved eliminating export subsidies and reducing peak tariff rates, easing some quantitative restrictions on exports and imports, and allowing current account convertibility of the rupee. Steps were taken to facilitate foreign capital inflows by raising the limits on foreign equity holdings and giving tax concessions for foreign institutional investment. Finally, financial sector reforms pursued the objectives of strengthening and liberalizing the financial market and improving monetary management. They included measures to simplify and liberalize the interest rate structure; to align capital adequacy, accounting, and

¹ Staff estimate.

provisioning standards with international benchmarks; and to strengthen banking supervision and stock market regulation.

Progress made under first-generation reforms has been substantial. Most industries previously under state monopoly have been opened to the private sector. The role of industrial licensing and small-scale industry reservations has been substantially curtailed. The insurance business has been opened to the private sector. Import restrictions have been substantially liberalized with the abolition of import licensing, removal of quantitative restrictions (QRs) in fulfillment of WTO obligations, and lower tariff rates. Norms relating to ceilings in relation to foreign direct investment and foreign institutional investment have been substantially eased. However, more remain to be achieved, particularly in terms of (i) fiscal consolidation efforts, (ii) divestiture and privatization, and (iii) creating an enabling environment for private sector growth.

Postreform efforts at fiscal consolidation were eroded in the second half of the 1990s by the impact of increases in public sector salaries mandated by the Fifth Pay Commission and by the rapidly deteriorating fiscal position of the states. State finances and issues in center-state fiscal relations are given special emphasis in this country economic review, with the final chapter being dedicated to them.

In 2000/01 the consolidated fiscal deficit was back at the precrisis level of above 9 percent of GDP. This was accompanied by a worsening in the overall quality of public expenditures, with a decrease in the share of capital and development expenditures, and an increase in revenue deficits as a percentage of gross fiscal deficits. In the context of a slowing economy, tax revenues were low in 2001. Combined with efforts to pump-prime the economy this led to an acceleration of the Government's borrowing program for 2001 and created some concern that fiscal consolidation efforts may be further undermined.

Achievements under the Government's disinvestment and privatization program have been mixed. While there were some successes in privatizing the telecommunications sector, the vicissitudes experienced in the power sector, for example, are well known. Of a targeted disinvestment of Rs100 billion in 2000, only Rs25 billion was realized. Progress toward achieving the 2001 target of Rs120 billion has been limited.

Contrary to the expectations at the onset of the reform process, private sector investment did not effectively substitute for public sector capital expenditure. A significant gap emerged in the infrastructure sector, as the government's privatization program stalled and the expected private sector investment in the key infrastructure services did not materialize. The drop in public capital investment, combined with slow progress in pursuing restructuring and privatization of public sector undertakings, undermined the quality of the infrastructure base of the economy and created the infrastructure bottlenecks that constrain economic growth today.

The 1991 reform program had included a review of industrial exit policies aimed at easing existing barriers to exit such as laws and regulations on bankruptcy, labor retrenchment, and transfer of land. However, little if any progress has been achieved on all these accounts due to the complex political economy dynamics impeding the reform process. Small-scale industry reservation policies continue to undermine the efficiency of the productive sector.

The program of second-generation reforms articulated in the 2001 budget is comprehensive. The program covers fiscal consolidation, with efforts to contain growth in public expenditures and to rationalize the tax system. It extends reforms to the agriculture sector that

had largely been bypassed by first-generation reforms. The program focuses on improving quality in public expenditure with a focus on raising investment in infrastructure and making this investment viable through appropriate user charges. The program in particular addresses the reform of the power sector. Subsidies on nonmerit goods continue to be among the main causes of escalating revenue deficits and worsening state finances. Power sector subsidies are a large component of the total subsidy bill. Memoranda of Understanding between central and state governments, which several states have signed, include power sector reforms.

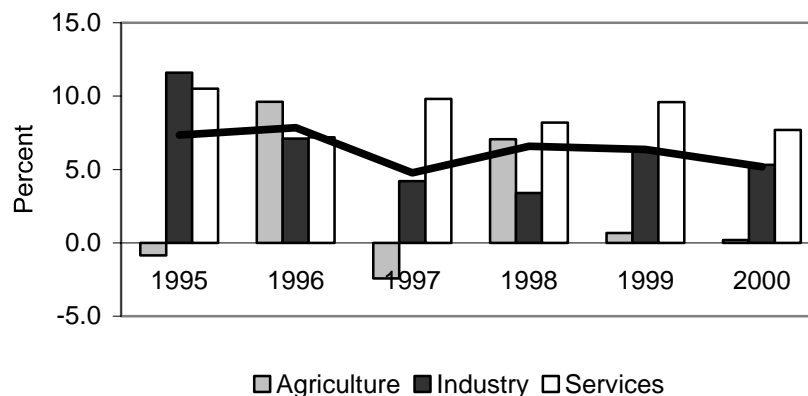
The budget also announced measures easing price control in key sectors. It further promoted financial sector reforms and continuing, progressive liberalization of the capital account. A supplementary plan of reforms to enhance competition, including reform of labor laws, was presented by the Prime Minister to the Council of Economic Advisors in September 2001.

India's prospects for the medium term will depend on the prompt implementation of these reforms, and key reforms of industrial exit policies. Substantial progress on the reform agenda should allow India to move to growth above 6 percent in 2002 and toward the higher growth path of 8 percent envisaged in the Approach Paper to the Tenth Five-Year Plan for the medium term.

I. RECENT ECONOMIC DEVELOPMENTS

1. The Indian economy has been experiencing a significant slowdown starting from the second half of 2000 (statistical tables are in the Appendix). Current official estimates¹ for 2000 place the growth of gross domestic product (GDP) at factor cost at 5.2 percent (Figure 1). Therefore, the economy was already at a low ebb at the time of the September 11 attack on the United States. The September 11 attack contributed to undermining the prospects for early recovery of the weak global economy, which is now expected to grow at only 2.6 percent in 2001.² The heightened uncertainty and dimmer prospects for a revival in global demand in the wake of September 11 may have an impact on the Indian economy, but this impact is likely to be fairly modest. India's economic problems are essentially homegrown. Large fiscal deficits, infrastructure bottlenecks, factor market distortions, and other obstacles to economic competition and to free trade are taking their toll on the economy. They need to be addressed through appropriate policy responses. In the first quarter of 2001, official estimates indicate that the GDP grew by a mere 4.4 percent over its level in the same quarter in 2000. Growth in the second quarter picked up to 5.3 percent. We project the Indian economy to be growing at 5.0 percent for the whole of 2001.

Figure 1: GDP Growth Rates and Components



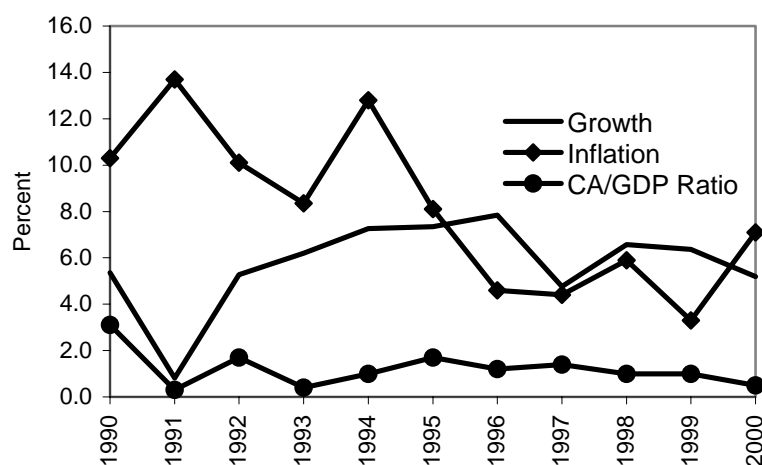
2. The economic slowdown, however, should not be seen in isolation. Despite the somewhat disappointing growth outcome vis-a-vis expectations, the Indian economy remains one of the best performing developing economies in 2001. This is a remarkable achievement, considering the weak external demand environment and the dampening impact on India's economic performance of shocks such as the devastating earthquake in Gujarat in January 2001. However, economic growth at 6 percent between 1998 and 2000, appears lackluster compared with India's strong economic performance in the mid-1990s. Following the introduction of a comprehensive policy reform program in the aftermath of the 1991 balance-of-payment crisis, the Indian economy grew at rates higher than 7 percent during 1994-1996. As economic growth slowed down in the latter part of the decade, inflation continued to beat a

¹ Cut-off date for data in the Country Economic Review 2001 is 31 December 2001.

² International Monetary Fund estimates.

downward path and current account deficits remained moderate, generally around 1 percent of GDP (Figure 2).

Figure 2: Real GDP Growth Rate, Inflation, and Current Account Deficit/GDP Ratio



CA = current account deficit , GDP = gross domestic product.

3. This country economic review examines India's economic performance in the 1990s and recent trends. In particular, it seeks to assess the structural factors behind the slowdown in recent years. It also has a special chapter on center-state fiscal relations, given the increasing role played by the states in exacerbating the perverse fiscal deficit dynamics.

4. At the outset, it may be useful to put India's economic performance into perspective by briefly assessing, the effect of faster economic growth on poverty reduction and improvement in the living conditions of people in the subcontinent.

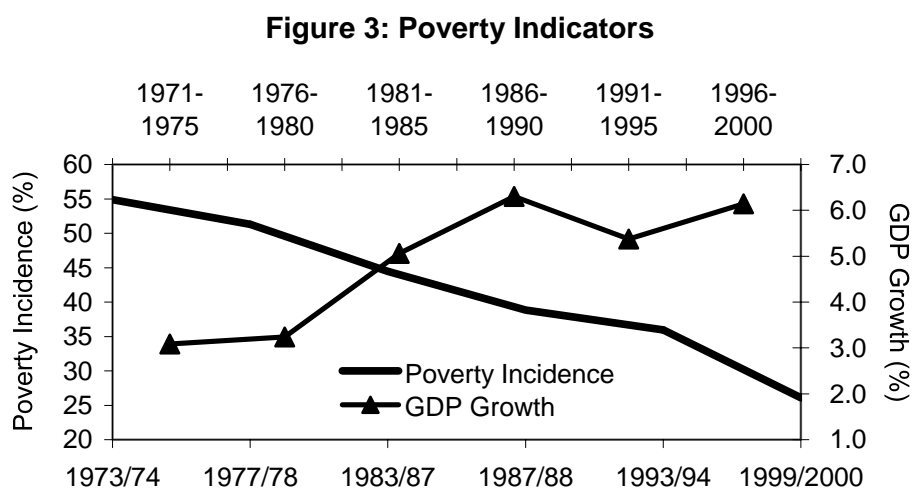
A. Poverty Reduction and Progress Toward the Millennium Development Goals (MDGs)

5. Throughout its postindependence planning experience spanning the last 50 years, India has considered economic growth as a tool to achieve wide and equitable access of its citizens to necessary economic and social resources rather than as an end in itself.³ Practical results, however, have been mixed. While poverty and social indicators have improved, they have done so at a slower pace than in other developing countries originally in a comparable position (e.g., People's Republic of China, East and Southeast Asian countries). Also, even within India,

³ In the words of Jawaharlal Nehru in front of the Constituent Assembly in 1947 (reprinted in Gopal. [ed.] 1983. *Jawaharlal Nehru: An Anthology*, Oxford University Press, pp. 76-77), a key challenge for India was "the ending of poverty and ignorance and disease and inequality of opportunity."

achievements have been widely divergent, with some states—e.g., Gujarat, Goa, Kerala—achieving substantial progress and others—e.g., Bihar and Orissa—being left behind.⁴

6. Overall, data clearly shows that poverty⁵ has been reduced the most, and at a more rapid pace, during periods of faster economic growth⁶ (Figure 3). For example, the post-1991 reform period, during which growth accelerated significantly, also exhibits a faster drop in poverty incidence.



7. However, reduction in income poverty may not have been accompanied by equal progress in alleviating other dimensions of human deprivation, because of a relative neglect of these key aspects of deprivation in public policy.⁷ For example, a recent report on poverty assessment for India,⁸ which, among others, incorporates and analyzes data from the latest National Sample Survey Organization Census (2001), observes that, despite the significant reduction in absolute income poverty—due to India’s rapid economic growth in the postreform period—some disturbing findings emerge from recent data:

- (i) With reference to the Asian Development Bank’s (ADB) focal states—Gujarat, Madhya Pradesh, and Kerala— Madhya Pradesh registered a deterioration in

⁴ For an assessment of India’s record in social development, see Dreze J. and A. Sen, 1995. *India Economic Development and Social Opportunity*, Oxford University Press.

⁵ The current poverty level in India is defined based on consumer expenditure. The per capita per month cut-off point was Rs327.56 in rural areas and Rs454.1 in urban areas in 1999-2000. The latest National Sample Survey has put the number of people below the poverty line at a level of 26 percent.

⁶ The poverty-reducing impact of economic growth is confirmed by several econometric studies. For example, a recent study by the International Monetary Fund (IMF), “Interstate Differences in Rural Poverty in India,” part of the IMF Country Report 01/181 (October 2001), finds that economic growth has helped reduce poverty in most Indian states over the last 20 years, except in the early years (1990-1992) of the reform period. The study attributes the widening poverty differential across states in the 1990s to nongrowth structural factors, such as policies on redistribution and expenditures for the development of human resources.

⁷ This is argued, for example, by Dreze and Sen (footnote 4).

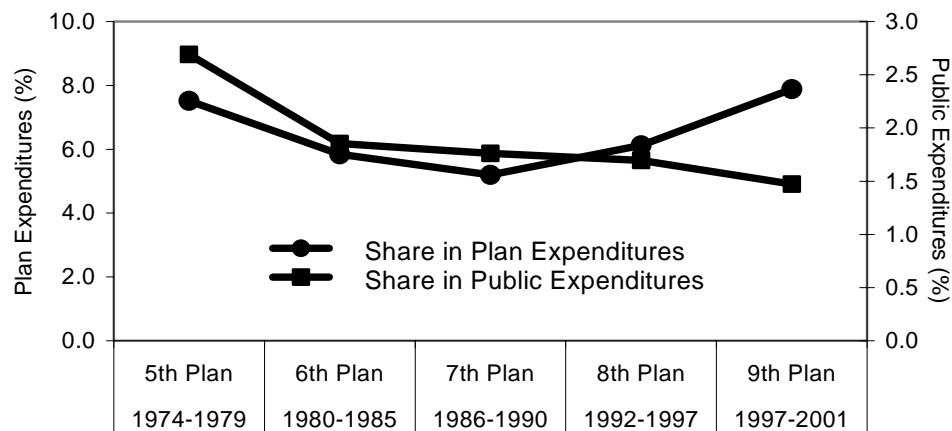
⁸ *Poverty in India: An Assessment and Analysis and Implication for Country Strategy and Program*, November 2001— Study carried out for the Asian Development Bank by K. S. and Suresh D. Tendulkar.

absolute (income) poverty. The other two states showed an improvement between 1993/94 and 1999/2000.

- (ii) While there were increases in literacy rates in all states, the number of female illiterates in the state of Gujarat went up in 1994-2001. Gujarat also exhibited a deterioration in the juvenile sex ratio.
- (iii) Over the same period, school participation rates declined for urban males in all age groups and the gap in school attendance rates between the poor and non-poor widened. In contrast, school attendance and participation rates improved for urban females.

8. While health and education expenditures have increased as a proportion of total plan expenditures since the Seventh Plan, they have consistently decreased as a proportion of total public expenditures (plan and non-plan) (Figure 4). This has gone along with a reduction of plan expenditure as a percentage of total expenditure, and with the overall compression of development expenditures in public budgets. When evaluated against the needs of India's burgeoning population, expenditures on key basic services, while increasing in absolute amounts throughout plan periods (in constant prices), remain small. These trends and their underlying fiscal causes will be discussed more in detail in the context of public finance policy issues.

Figure 4: Share of Education and Health Expenditures in Plan Expenditures and Public Expenditures



Note: 9th Plan data for 2000 are revised estimates; those for 2001 are budget estimates.

9. Further, the record of interventions directly targeted to the poor has been disappointing (Box 1). Of the myriad of government programs directly targeted to the poor, few have actually benefited them. On the one hand, this testifies to a systematic difficulty in identifying and targeting beneficiaries. On the other hand, it reflects implementation shortcomings that could have been addressed through better design, management or monitoring.

Box 1: Poverty Reduction Programs

Poverty reduction schemes and subsidies to the poor absorb an inordinate amount of Plan resources. The 10th Plan provision for these items amounted to Rs320 billion, equivalent to almost 20 times the amount provided for basic infrastructure such as irrigation. These schemes have been plagued by substantial shortcomings, largely undermining their effectiveness in reaching the poor and improving their situation. For example:

Integrated Rural Development Program (IRDP)

- Nonviable projects, often at subcritical investment levels
- Lack of technological expertise in project design and implementation
- Unskilled beneficiaries, unable to manage projects
- Poor targeting and selection of non-poor as beneficiaries
- Inefficient delivery of credit by banks/credit diversion
- Lack of coordination with other complementary programs, such as training

Wage Employment Programs

- Inadequate employment generation
- Violation of material-labor (60:40) norms and fudging of muster rolls
- Contractors hiring outside labor at lower wages
- Violation of norms on earmarking 60 percent of funds for watershed and minor irrigation
- Siphoning off funds due to corruption—out of Rs60 currently earmarked for wages for each Rs100, only Rs10-15 actually reach the poor worker.
- Gender-based discrimination

Rural Housing

- Stronger dependence of poor on politicians and bureaucrats
- High incidence and depth of corruption (with 40 percent of approved subsidies not reaching the poor in some cases)
- Arbitrary/nontransparent selection of beneficiaries

Efforts have been made to address these shortcomings. For example, in April 1999, the Government launched the Swarna Jayanti Gram Swarozgar Yojana (SGSY). SGSY restructured and combined the IRDP with other poverty alleviation programs with the objectives of achieving better targeting and promoting microenterprises for self-employment of the rural poor. Similarly, the Antyodaya Anna Yojana, a scheme introduced to provide foodgrains to the poorest of the poor, aims to improve identification and targeting of beneficiaries.

Source: Approach Paper to the 10th Five-Year Plan

10. It may be useful to take a quick look at how these trends position India on the way to achieving the millenium development goals (MDGs)⁹. Table 1—which summarizes India's achievement and plans toward realization of the MDG—shows that while India has made some remarkable progress during the nineties toward achieving the MDG poverty target, it still lags behind and needs to accelerate progress on social indicators. On several counts, India's own targets—as reflected in the Approach Paper to the Tenth Five-Year Plan—are more ambitious than the MDGs. Such rapid progress on social indicators requires that more attention be paid to investment in health and education, and to reforms that may facilitate access of the poor to these essential services.

⁹ The MDGs are the goals contained in the Millenium Declaration, which was adopted by 191 nations in September 2000. The MDGs incorporate the international development goals (IDGs) and encompass agreed upon goals and targets for monitoring human development.

Table 1: Millennium Development Goals and India

Area/ Sector	Millennium Development Goals (MDGs)	Achievements	Targets in the Approach Paper to the Tenth Five-Year Plan (2002-2007)
Poverty and Hunger	<ul style="list-style-type: none"> Reduce by half the proportion of people in extreme poverty between 1990 and 2015. 	<ul style="list-style-type: none"> Poverty incidence was reduced from 35.97% in 1993/94 to 26.1% in 1999/2000. Population below \$1 per day (1993 purchasing power parity \$) was 52.5% in 1994 and 44.2% in 1999. Underweight children under age 5 were 64% in 1990 and 53% in 1995-2000. 	<ul style="list-style-type: none"> Reduce poverty ratio by 5 percentage points by 2007 and by 15 percentage points by 2012.
Labor and Employment		<ul style="list-style-type: none"> Growth rate of employment in the organized sector was 1.44% in 1991 and 0.4% in 1999. Labor force average annual growth rate was 1.9% in 1980-1990 and 2.3% in 1991-1999. 	<ul style="list-style-type: none"> Provide gainful high-quality employment to the addition to the labor force over the Tenth Plan period Reduction in gender gaps in wage rate by at least 50% by 2007.
Education and Literacy	<ul style="list-style-type: none"> Achieve 100% primary school enrollment by 2015. 	<ul style="list-style-type: none"> Primary net enrollment ratio was 65% in 1980 and 77% in 1997. Children out of school were 31.4 million in 1980 and 25.4 million in 1997. Proportion of pupils who reached grade 5 were 52% for female and 57% for male in 1980, and 55% for female and 61% for male in 1993. 	<ul style="list-style-type: none"> All children in school by 2003. All children to complete 5 years of schooling by 2007. Increase in literacy rate to 75% within the Plan period.
Gender Equality and Empowerment of Women	<ul style="list-style-type: none"> Eliminate gender disparities in primary and secondary education by 2005. 	<ul style="list-style-type: none"> In 1990, primary gross enrollment ratio was 84% for female and 110% for male in 1998, and 83% for female and 101% for male in 1998. In 1990, secondary gross enrollment ratio was 33% for female and 55% for male in 1990 and 39% for female and 59% for male in 1996. Adult literacy rate was 36% for female and 62% for male in 1990 and 44% for females and 68% for males in 1999. Youth female literacy rate as a proportion of male literacy rate was 74% in 1990 and 81% in 1999. Proportion of seats held by women in national parliament was 7% in 1992 and 8% in 1999. 	<ul style="list-style-type: none"> Reduction in gender gaps in literacy rate by at least 50% by 2007.
Population		<ul style="list-style-type: none"> Decadal population rate was 23.5% in 1981-1991 and 21.34% in 1991-2001. 	<ul style="list-style-type: none"> Reduction in decadal rate of population growth to 16.2% between 2001 and 2011.
Health	<ul style="list-style-type: none"> Reduce the mortality rates for infants by two thirds between 1990 and 2015 Reduce the mortality of children under 5 by two thirds between 1990 and 2015 	<ul style="list-style-type: none"> Infant mortality ratio (per 1,000 live births) was 80 in 1990 and 71 in 1999. Mortality of children under 5 (per 1,000) was 112 in 1990 and 90 in 1999. 	<ul style="list-style-type: none"> Reduction of infant mortality ratio to 45 per 1,000 live births by 2007 and to 28 by 2012.

	<ul style="list-style-type: none"> • Reduce the mortality rates for mothers by three fourths between 1990 and 2015 • Provide access to reproductive health services for all females of appropriate age by 2015. • Halt and reverse the spread of human immunodeficiency virus/ acquired immunodeficiency syndrome (HIV/AIDS) by 2015. • Halt and reverse the incidence of malaria and other major diseases. 	<ul style="list-style-type: none"> • Proportion of one-year-olds fully immunized against measles was 82% in 1990-1993 and 72% in 1999. • Maternal mortality ratio (per 1,000 live births) was 5 in 1980-1985 and 4 in 1990-1998. • Proportion of births attended by a skilled health personnel was 33% in 1983-1993 and 34% in 1990-1996. • Total fertility rate (births per woman) was 5 in 1980 and 3 in 1999. • Couple protection rate was 44% in 1991 and 46% in 2000. • Contraceptive prevalence rate was 41 in 1993 and 52 in 1999. • Adults living with AIDS (% age 15-49) was 0.82% in 1997 and 0.70% in 1999 • Total malaria cases were 260 per 100,000 people in 1991 and 275 in 1997. • Total tuberculosis cases were 122 per 100,000 people in 1994 and 115 in 1998 	<ul style="list-style-type: none"> • Reduction of maternal mortality ratio to 2 per 1000 live births by 2007 and to 1 by 2012.
Environment	<ul style="list-style-type: none"> • Implementing national strategies for sustainable development by 2005. • Reversing current loss of environmental resources globally and nationally by 2015. 	<ul style="list-style-type: none"> • Based on the proposed action plan and strategies for sustainable development cited in the State of Environment Report of India 2001, the following have been achieved: <ul style="list-style-type: none"> - Passage of the Biodiversity Bill in May 2000 - Drafted the revised National Water Policy Act - Restructured the National Land Use and Conservation Board - Created the National Afforestation and Eco-Development Programme • Adopted the National Action Program to Combat Desertification, in September 2001 • Forest area was 517 thousand square kilometers in 1990 and 650 thousand sq. km. in 1995. • Forest area as a percentage of total land area was 18.5% in 1990 and 21.9% in 1995. • Average annual deforestation was 0.6% in 1980-1990 and 0.0% in 1990-1995. • Freshwater resources were 2,243 cubic meters (m³) per capita in 1995 and 1,947 m³ per capita in 1998. • Access to safe drinking water in the rural areas was 73.9% in 1990 and 98% in 1999; 83.8 in 1990 and 90.2 in 1999 in the urban areas 	<ul style="list-style-type: none"> • Increase in forest and tree cover to 25% by 2007 and 33% by 2012. • All villages to have sustained access to potable drinking water within the Plan period. • Cleaning of major polluted rivers by 2007 and other notified stretches by 2012.

- Gross domestic product (GDP) per unit of energy use (PPP \$ per kg of oil equivalent) was 1.9 in 1980 and 4.3 in 1999.
- Carbon dioxide emissions per capita was 1.0 metric ton in 1990 and 1.1 metric tons in 1997.

Sources: World Development Indicators 2001 CD-Rom, World Bank; Key Indicators 2000, Asian Development Bank; World Development Report 2000, World Bank; Economic Survey 2000-01, Economic Division, Ministry of Finance, Government of India.

B. Economic Growth—A Historical Perspective

1. Economic Reforms and India's Economic Performance in the 1990s

11. Progress under “first-generation” reforms—introduced after the 1991 crisis—has been substantial.¹⁰ The reforms had the extremely difficult task of engineering a comprehensive move away from a mixed-economy model that had been adopted by postindependence India toward a market economy. In parallel to economic liberalization, deep institutional changes had to take place. To illustrate the magnitude of the shift, a brief historical discussion of the changing role of the Planning Commission is given in Box 2.

Box 2: Fifty Years of Economic Planning—A Retrospective

To better understand the liberalization process of the 1990s, it is necessary to see it against the backdrop of the evolution of India's mixed-economy system. Being at the center of the institutional setup of the mixed economy, the Planning Commission has played, especially in the early years, an important role in articulating the vision and objectives of postindependence India and establishing the parameters within which economic development would take place.

The Planning Commission was established in 1950 by a Cabinet resolution under the chairmanship of Prime Minister Nehru. As it did not have constitutional or legal existence, the Commission was uniquely dependent on the support of the Prime Minister. The influence of Nehru's moderate socialist vision was evident in an industrial policy that rejected nationalization of private enterprise, while, at the same time, endorsing an increasing economic role for the public sector. The instruments through which a dominant role for the public sector in the economy was to be achieved were (i) an acceleration of public sector investments in key sectors (particularly heavy and strategic industries); (ii) extensive regulation of private sector economic activities through a system of industrial licensing; and (iii) price and distribution controls. The small-scale industries reservation policy—also an important ingredient of the Indian approach to the mixed economy—was a concession to influential Gandhian elements.

This “asymptotic” or “gradualist” approach to the Marxist state¹ found expression in the Planning Commission's emphasis on the overall national investment goals (especially since the Second Plan) and the role of the public sector in mobilizing the required level of savings to finance the plan investment targets. In this context, rapid growth of the public sector was seen in the twofold role of a key objective in its own sake and an important instrument to influence directly the pattern of investment toward the directions endorsed by the plan. In this, it was complemented by plan industrial targets, which aimed at indirectly determining the pattern of private sector industrial growth and technological development by influencing the scale, location, import-content, and other key features of private investment decisions.

¹ Bhagwati J., and P. Desai. 1970. *India: Planning for Industrialization—Industrialization and Trade Policies Since 1951*, Oxford University Press, contains a fascinating historical account of the political and ideological underpinning of India's industrial policies.

¹⁰ The post-1991 reform agenda is discussed at length in the Country Operational Strategy for India (1996) and in various country economic reviews.

There are many analyses of the results of these planning efforts.² On the one hand, they are seen as having contributed to establishing the foundations for a diversified industrial base; on the other hand, they spurred inefficiencies in both the public and private sectors, and helped introduce those distortions that plague the Indian economy to this day. During the 1950s and 1960s, the economy grew at the slow rate of 3.5 percent. The main

successes in public policy during those years were that the tax/GDP ratio rose and the gross domestic savings rate doubled. However, the close and directed nature of the economy prevented the effective utilization of these resources. More fundamentally, the planning effort did not translate into an asymptotic approach to the Marxist state. Far from progressively being replaced by the public sector, the private sector grew both in size and influence thanks to the early emphasis on public, financial and physical, infrastructure investment and of opportunities for exploiting the web of regulations and control of the economy to its advantage. As the expected results did not materialize and ideological orientations started to change, the heyday of planning came to an end and was replaced by growing skepticism. Since the mid-1960s, efforts were made to change the nature of the planning process. Several factors influenced this change.

First, from the mid-1960s, the monolithic dominance of the National Congress party in the Indian political scene started to be eroded and regional parties started playing an increasing role both at the center and at the state level. This helped effect a substantial shift in the role of the National Development Council (NDC) vis-à-vis the Planning Commission. The NDC, which was established in 1952, had a key advisory and review function with respect to planning. It comprised the Prime Minister, the chief ministers of the states and the members of the Planning Commission.

For the first three plans, under the leadership of Nehru, the NDC behaved as a generally supportive sounding board for the proposals of the Planning Commission. However, progressively, as political equilibria started to change, the states became increasingly more vocal and actively used the NDC as a platform to promote their interests in the planning process.

Second, two consecutive severe droughts—in 1965 and 1966—dealt a severe blow to the agriculture sector and destabilized the economy, increasing India's dependence on external aid. Two positive consequences resulted from this critical situation. The first of these was the Green Revolution. The second was a first, if unsuccessful, experiment at liberalization in 1966.

Partly under pressure from aid agencies, India introduced limited import liberalization and devalued the rupee. However, these reforms were in a sense ill-timed, in that, while a correct response from an economic standpoint, they came at a time when their political viability was extremely uncertain. The Indian economy was already on the brink of industrial recession, and the dramatic fall in agricultural production caused by the two severe droughts was fueling inflationary tendencies. These independent developments came to be blamed on the devaluation and led to a surge of antireform pressures.

However, as India started to toy with economic liberalization and opening—again in the mid-1980s and, more comprehensively, in the nineties—the role of direct controls became increasingly questionable. Also in an open economy, macroeconomic objectives had to be more carefully weighed and plan targets calibrated to be consistent with these. The respective roles of the Ministry of Finance and the Planning Commission had to evolve in response to the requirements of a more open economy.

In the Eighth Five-Year Plan (1992-1997), the role of the Planning Commission was redefined:

"[...] We are gradually moving towards indicative planning. Through a clear prioritization of goals, efforts will be made to reduce the bottlenecks, making higher rates of growth possible. If each sector can clearly visualize what is expected of it, then it can gear up to meet the set target. Through the instrument of indicative planning, it will be possible to provide a clear picture of the effects on the entire economy of any change in governmental policy.

The Planning Commission will play an integrative role and help in the development of a holistic approach to policy formulation in critical areas of development. The Planning Commission will play a mediatory and facilitating role for managing the change smoothly and creating a culture of high productivity and efficiency in the Government." (Source: Eighth Five-Year Plan (1992-1997), Government of India, Planning Commission, Volume 1, p. [ij])

² Bhagwati and Desai, op. cit., for example made a severe assessment, particularly of the early Plan emphasis on physical target. They also criticize the lack of cost-benefit analysis, leading to wastage of public resources.

The Approach Paper to the Tenth Five-Year Plan further stresses the need for a shift from a “resource plan” to a “reform plan.” It characterizes the state as providing the enabling environment for private sector growth and playing a residual role in areas of “market failure.” This understanding of the role of the Government represents a 360-degree turn from the emphasis of the early plan efforts on the direct and primary role of the state in the economy.

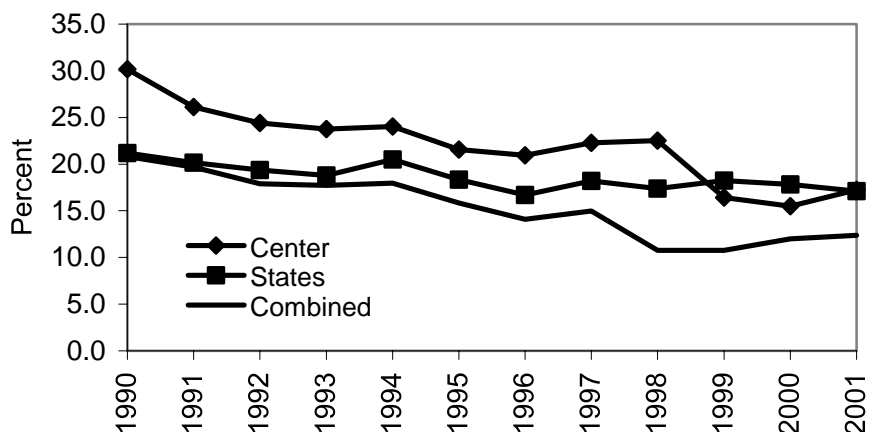
12. The liberalization of the economy under the “first-generation” reforms has been substantial. Most industries previously under state monopoly were opened to the private sector. The role of industrial licensing and small-scale industry reservations was curtailed. The insurance business was opened to the private sector. Imports were substantially liberalized with the abolition of import licensing, removal of quantitative restrictions (QRs) in fulfillment of World Trade Organization (WTO) obligations, and lower tariff rates. Norms relating to ceilings to foreign direct investment (FDI) and foreign institutional investment (FII) were substantially eased. However, a lot still remains to be achieved, particularly in terms of fiscal consolidation efforts, divestiture and privatization, and creating an enabling environment for private sector growth. The 1991 reform program had included a review of industrial exit policies aimed at easing existing barriers to exit such as laws and regulations on bankruptcy, labor retrenchment, and transfer of land. However, little if any progress was achieved on all these accounts due to the complex political economy dynamics impeding the actual reform process. Current economic woes experienced by the Indian economy can be traced back to the unfinished reform agenda.

13. One way to assess the success of first-generation reforms is by looking at the economic growth record before and after the reforms. However, an important qualifier in any such exercise is that many other factors beside the reforms may have played a role in determining the growth outcome and it is, therefore, difficult to isolate the impact of policy changes from other influences. A most significant such factor is the fiscal deficit dynamics observed after 1991.

14. In the postreform decade, the Indian economy recorded higher rates of GDP growth—on average, 5.7 percent—than in the 1980s (around 3.2 percent). Overall economic performance was remarkably more stable in the nineties, with fewer and milder cyclical downturns, and exhibited less dependence on agricultural outcomes. In the years immediately preceding the 1991 crisis, however, the economy had also recorded substantial growth of over 7.5 percent per year. Several factors had contributed to this growth performance. These included an exceptionally good agriculture output in 1988, but also pump-priming of the economy. Economic expansion in the late 1980s was financed through high levels of domestic and external indebtedness and the consolidated fiscal deficit of center and states reached 9.4 percent of GDP in 1990.

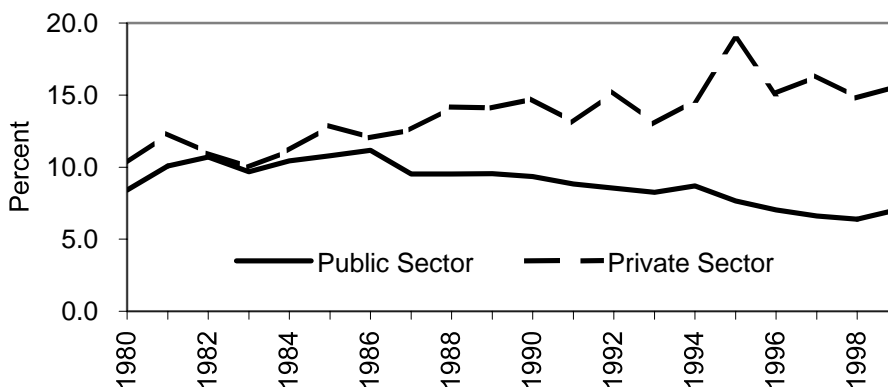
15. Between 1990 and 1995, efforts were made at fiscal consolidation, mainly at the center. During this period, the combined fiscal deficit of center and states declined by 2.9 percentage points. Fiscal discipline helped to free resources for investment, and, together with the positive impact of trade and industrial reforms, contributed to the rapid economic growth of the mid-1990s. Unfortunately, in the latter half of the decade, these initial accomplishments in fiscal consolidation were quickly eroded by the impact of government salary hike under the Fifth Pay Commission and by the rapidly deteriorating fiscal position of the states. As public savings turned negative, the overall quality of public expenditure worsened, with a decrease in the share of capital expenditure (Figure 5) and an increase in revenue deficits as a percentage of fiscal deficits. These negative developments in public finances and a slowing down of the reform process are the main structural factors behind the subdued economic performance in of the second half of the 1990s.

Figure 5: Capital Expenditure as a Share of Total Expenditure



16. Widening fiscal deficits and high interest rates contributed to a mounting debt stock. In turn, the high interest payments on outstanding debt, combined with rising current expenditures on salaries, pensions, and subsidies, narrowed the fiscal room for public capital expenditures. During the 1980s, the public sector was contributing a fairly stable portion of gross capital formation, even though its relative share vis-à-vis the private sector dropped during the latter half of the decade (Figure 6). In the 1990s, following the reforms, the contribution of the public sector to gross capital formation in the economy ebbed as the private sector's rose. This was partly the deliberate result of the liberalization process, which encouraged the public sector to withdraw from economically viable productive sectors. Partly, it was the result of the narrowing fiscal space for public capital expenditure. However, private sector investment did not effectively substitute for public sector capital expenditure, in both type and sector composition. A significant gap emerged in the infrastructure sector, as the government's privatization program under the first-generation reforms stalled and the expected private sector investment in key infrastructure services did not materialize. The drop in public capital investment combined with lack of progress in restructuring and privatizing public sector undertakings (PSUs) seriously undermined the quality of the infrastructure base of the economy during the 1990s. This created the infrastructure bottlenecks that constrain economic growth today.

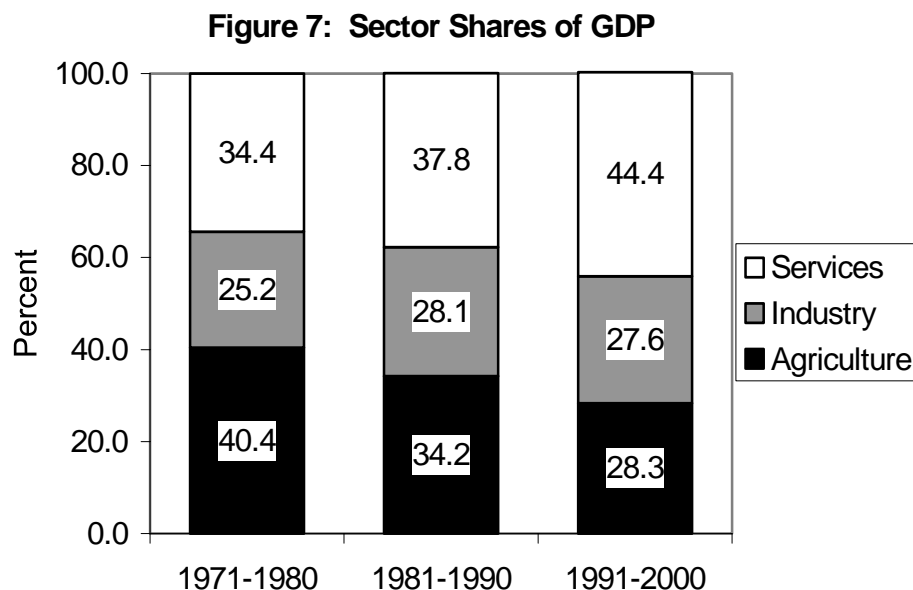
Figure 6: Sector Gross Capital Formation as a Share of GDP



2. The Changing Sectoral Structure of the Economy

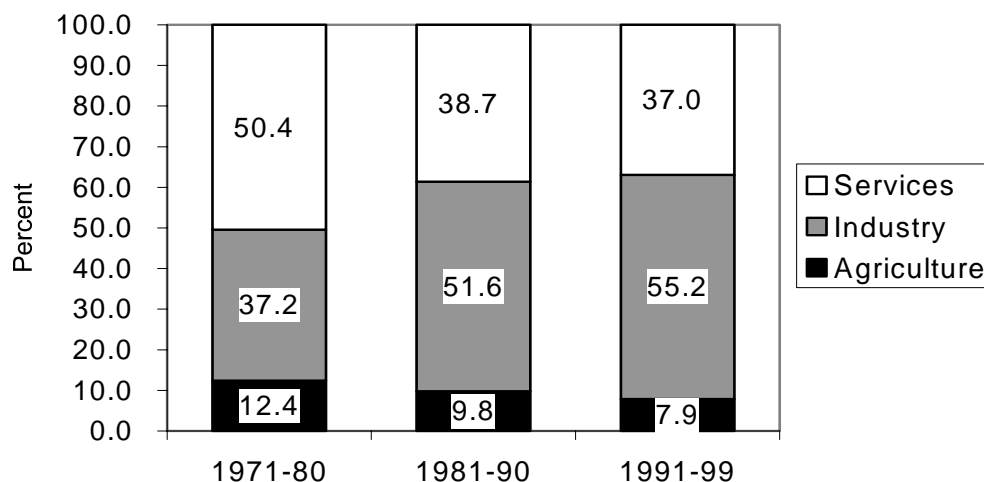
17. The speed and depth of the reform process during the 1990s also contributed to effect significant changes in the structure of the economy. Most notably, during the 1990s, the sector composition of output changed substantially due to a divergence in the performance of the various sectors of the economy (Figure 7). The services sector became the prime engine of economic growth. It averaged a decadal growth rate of 7.3 percent in the 1990s, with growth around 8 percent, on average, in the postreform years (1992-1999). The increase in the share of services to GDP almost exactly mirrored the decline in agriculture share. Agriculture accounted for over 40 percent of GDP in the 1970s. Its share dropped to only 28.3 percent in the 1990s.

18. The decreasing contribution of agriculture to GDP reflected the low productivity of the sector and its highly volatile performance, registering a very modest average growth of 3.2 percent in the 1990s. Reforms had largely bypassed the agriculture sector, where prices and distribution controls continued to prevail. Trade in agricultural products, in particular those labeled as essential commodities, continued to remain heavily restricted. At the same time, investment in agriculture modernization and rural infrastructure—as reflected in the share of agriculture in total capital formation—declined during the 1990s, as opposed to substantial increases in capital formation in the industry sector¹¹ (Figure 8).



¹¹ In addition to being a response to the improved investment climate resulting from the reforms, the high rates of capital formation in the industry sector may have been the reflection of the continuing distortionary impact of existing policies, particularly labor policies, on factor markets.

**Figure 8: Sector Shares of Gross Capital Formation
(Constant Prices)**



3. Openness of the Indian Economy

19. The reforms improved the management of the external sector and opened new opportunities for Indian producers in export markets. Trade liberalization led to exports surging to double-digit levels in the late 1990s, and trade as a percentage of GDP went up from around 15 percent in the late 1980s to over 25 percent in the late 1990s. On the capital account, the softening of FDI and FII norms led to increasing and relatively stable foreign capital flows. In an environment of relatively moderate inflation, these positive trends contributed to an increasingly comfortable foreign exchange reserve position.

20. Despite these achievements, the degree of openness of the Indian economy remains limited. India together with other South Asian countries is still at the bottom of the spectrum in terms of conventional indicators of external openness (trade, FDI, protection). As for the implementation of capital account convertibility, since the early 1990s, gradual steps have been taken in relation to more liberal norms for FDI and FII and repatriation of funds by foreigners and NRIs. However, of the three preconditions laid down by the Tarapore Committee in 1997 for full capital account convertibility, i.e., fiscal consolidation, low inflation rate, and a stronger financial sector,¹² progress has been made on the latter two accounts. Fiscal profligacy still remains a problem.

¹² The three preconditions set by the Tarapore Committee are (i) fiscal consolidation marked by a phased reduction in central Government fiscal deficit from 4.5 percent in 1997/98 to 3.5 percent by 1999/2000; (ii) adoption of a three-year mandated average inflation rate of 3.5%; (iii) stronger financial sector, including full deregulation of interest rates and further reduction in cash reserve ratio and level of nonperforming assets of banks.

21. In summary, first-generation reforms, while certainly making a dent, have not been able to fully address the key structural problems of the Indian economy. As significant public finance imbalances remain at both the center and state levels, dwindling public sector investment in economic infrastructure has led to growing infrastructure bottlenecks. The slow progress of privatization, persisting factor (labor, capital, land) market distortions, and a still limited role for trade and foreign capital flows continue to hamper economic performance. These structural factors are the long-term and perhaps the main causes of the economy's performing below potential. With the waning growth impulses of reforms, business confidence has deteriorated significantly, leading to the current sluggish investment environment. The relatively poor growth performance of the Indian economy since 2000 is also dependent on cyclical factors on both the demand and supply sides. These cyclical elements—that will be discussed next in the context of an analysis of recent economic trends—may, however, play a lesser role.

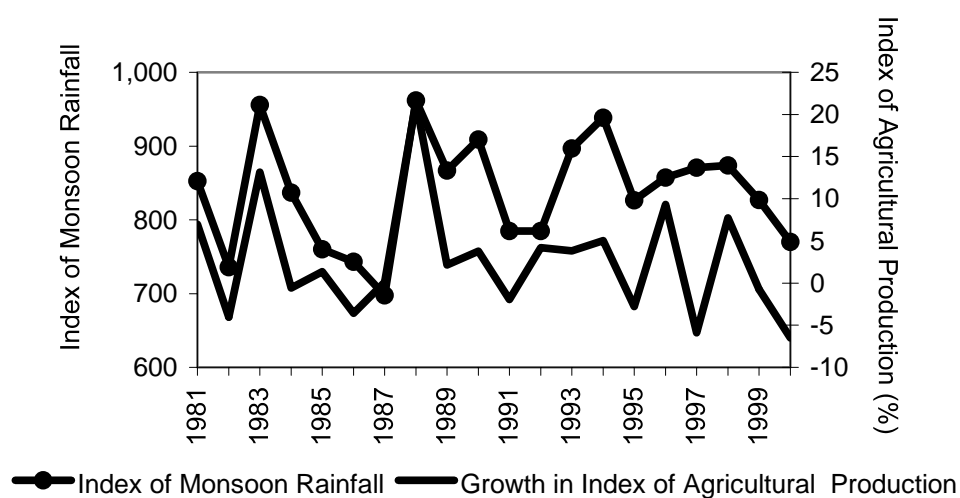
C. Growth, Employment, Savings and Investment—Recent Trends

1. Sector Growth

a. Agriculture and Allied Sectors

22. The year 2000 was the second consecutive year in which agriculture output witnessed a decline, giving way to negative growth in the GDP originating from agriculture. Agriculture growth decelerated from 0.7 percent in 1999 to 0.2 percent in 2000. During 2000, both foodgrains and nonfoodgrains crops witnessed a decline. However, the prospects for 2001 are good and the agriculture sector is already showing signs of recovery. During the first quarter of 2001 the agricultural GDP increased by 2.3 percent as compared with 0.6 percent in the corresponding quarter of the previous year. During the second quarter of 2001, the agriculture sector posted a higher growth of 3.4 percent as compared to 0.5 percent in the same quarter of 2000.

Figure 9: Agricultural Production vs Monsoon Rainfall



23. As shown in Figure 9, the correlation between agricultural performance and rainfall—even without taking into account the important factor of spatial and temporal anomalies in rain distribution—is striking. Growth of agricultural output in India is highly dependent on the outcome of the yearly monsoon. A good monsoon is equated with strong agriculture performance, a bad monsoon with stagnation or contraction. Agricultural production in 2001 is expected to record a robust growth on account of well-distributed monsoon rainfall in both the South-West and North-East. The *kharif* foodgrains output in 2001 recorded a new peak at 105.6 million tones on account of an increase in the production of rice and pulses. Similarly, the *kharif* nonfoodgrains output also witnessed an increase due to rise in the production of oilseeds and cotton. The prospects for *rabi* agricultural production are also considered to be bright on account of good North-East monsoon rainfall and comfortable position of water storage in major reservoirs in the country. It is expected that there will be a bumper wheat crop during 2001 on account of favorable conditions.

24. Infrastructure bottlenecks, particularly in irrigation, rural electrification, and shortage, but also in transport and telecommunications, undermine the prospects for higher and sustained agricultural performance. India has one of the largest agricultural research infrastructures in the world; nevertheless, diffusion of high-yield varieties is limited and postharvest technologies are poor.

25. Further, several policy-induced distortions affect agriculture sector development: administered input and output prices, a targeted public distribution mechanism for food grains that has largely outlived its usefulness and imposes large costs on the budget and the economy (Box 3), small-scale industry (SSI) reservation policies affecting agro-processing and related sectors, and trade restrictions. Many of these issues are being addressed as part of the National Agriculture Policy announced in 2000 and several 2001 budget measures.

26. With a view to securing a minimum 4 percent annual growth rate in the sector, the new agricultural policy consists of a package of measures to improve the terms of trade for agriculture; dismantle restrictions to the movements of agricultural products across the country in a progressive manner; improve the supply of and access to rural credit, especially through micro-credit; remove infrastructure bottlenecks, notably in rural electrification; widen the coverage of the futures markets to agricultural commodities; and provide insurance to farmers. The policy also addresses postharvest management and marketing issues by encouraging private sector participation. These measures were reinforced by initiatives in the 2001 budget, particularly with respect to improving the provision of rural credit and development of rural infrastructure. These included a tax holiday for enterprises handling, transporting and storing foodgrains, credit-linked subsidy schemes for construction of cold storages, use of resources from the Watershed Development Fund under National Bank for Agriculture and Rural Development (NABARD) to enable water users' associations to implement, operate and maintain irrigation schemes; and initiatives to improve the power distribution systems in rural areas.

Box 3: Targeted Public Distribution System (TPDS)

Originally motivated by the need to provide the poor with food security and cheap access to basic foodstuff, the TPDS has also worked as a price-support system for agricultural producers. The scheme distinguishes between below-the-poverty-line (BPL) and above-the-poverty-line (APL) families. BPL families can buy grains at a substantially subsidized price, while APL can obtain them at a price that covers the cost of procurement to the government. Since the government procurement price is high, reflecting subsidy to the farmers, APL price is above-market. This leads to low off-take from the program and limited impact on the nutritional status of the poor. Further, food stocks are now about twice as large as what would be needed based on food security considerations, and, given the high cost of storage, this enormously increases the food subsidy cost for the government.

The Approach Paper to the Tenth Five-Year Plan proposes several measures to address shortcomings in TPDS. They include measures that will eliminate legal and policy distortions in agriculture markets and encourage private sector participation, such as

- making the Essential Commodities Act an emergency provision to be enacted for limited periods only, as and when necessary;
- banning controls on movements of agriculture products within and between states;
- phasing out of monopoly purchases;
- removing licensing controls and de-reserving agri-based and food-processing industries, including milk processing;
- introducing a policy that eliminates export restrictions on agricultural commodities and agri-products; and
- removing sugar from TPDS and decontrolling the sugar industry.

To implement these measures, it was proposed in the Union Budget 2001-02 to decentralize the procurement, storage and distribution operations under the Targeted Public Distribution System (TPDS) so as to reduce the carrying cost of foodgrains. The Union Minister for Agriculture announced in August 2001 that the Government is implementing a scheme to reduce losses of foodgrains during the postharvest period. Several new initiatives have been launched including creation of additional public storage capacity and of new facilities for bulk handling, storage and transportation of foodgrains through private sector participation. These measures are expected to reduce the fiscal burden on the central government by way of decentralizing the TPDS operations as well as increasing the off-take under the same.

Source: Approach Paper to the Tenth Five-Year Plan.

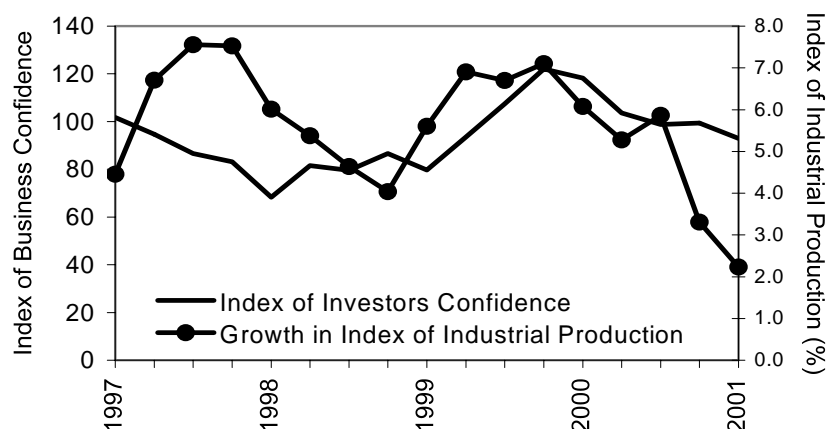
b. Industry Sector

27. Overall, industry grew at 5.3 percent in 2000. The slowdown in sector performance began in the latter part of 2000, with last quarter growth at 2.7 percent. Manufacturing, which alone accounts for roughly 65 percent of industrial output, grew by 3.5 percent in that period, less than half the rate of growth during the same quarter in 1999. Nonmanufacturing grew by around 1.4 percent compared with 7.2 percent in the same period in 1999. The lackluster industry performance has extended into 2001, with change in the index of industrial production at 2.2 percent in the first seven months of the current fiscal year. During this period, manufacturing continued to slow down with growth of only 2.3 percent over that in 2000. All other subsectors have decelerated substantially, with virtual stagnation in the mining subsector.

28. Various factors may have contributed to the lackluster outcome in 2000 and 2001. On the supply side, infrastructure bottlenecks, as a consequence of the low levels of public investment in infrastructure and limited success in privatization efforts, are a binding constraint on industrial performance. Pervasive factor and product market distortions, the slow pace of

policy reforms, and vicissitudes experienced by the Indian capital markets have played a key role as well. On the demand side, low agricultural incomes and the waning of the initial surge in the demand for consumer durables due to payment of arrears under the Fifth Pay Commission have reduced consumer demand. Low investor confidence, related to the supply-side factors just mentioned, coupled with the sizable excess capacity created at high interest costs in the rapid growth years of the mid-1990s, has been a key causal factor behind a depressed investment demand. Figure 10 shows the high degree of correlation between changes in the index of industrial production and the index of investor confidence.

Figure 10: Indices of Industrial Production and Business Confidence ^a



^a The business confidence index developed by NCAER “captures both future expectations (through responses on macro-level factors such as ‘overall economic conditions, and ‘investment climate’) and the current conditions of firms (through responses to micro-level factors, namely, financial provision of the firms and capacity utilization.” (NCAER, Business Expectations Survey No. 38, October 2001, p. 2).

29. Initiatives in the 2001 budget, if implemented promptly, should help create the right environment for industry sector revival and more rapid growth in the medium term. In particular, power sector reforms, together with other reforms aimed at easing infrastructure bottlenecks—e.g., in roads and telecommunications—are urgently needed. Reform of exit policies, such as the Sick Industrial Companies Act (SICA), will facilitate layoffs, retrenchment, and closure of non-viable businesses and ensure higher efficiency economy-wide. The impetus of SSI de-reservation—which had been boosted in 2000 with de-reservation of the garment sector—needs to be renewed.

c. Services Sector

30. After growing at an average rate higher than 8.5 percent in the postreform 1990s (1993-2000), service sector growth slowed down to 7.7 percent in 2000, and appears set for below-expectations performance during 2001 as well. Despite this slowdown, the relative contribution of the services sector to overall GDP growth increased to about 71 percent and the sector share in GDP to roughly 49 percent. The sustainability of the high growth rates recorded by the sector in the face of the industrial slowdown has been questioned. From the early to mid-1990s, growth

in services and industrial performance appeared to be highly correlated. But since 1997, growth in services has been largely independent of industry sector performance. This may open to question the genuine buoyancy of the sector, as price effects (related, among others, to the impact of the Fifth Pay Commission) may be more significant than quantity effects.

2. Employment

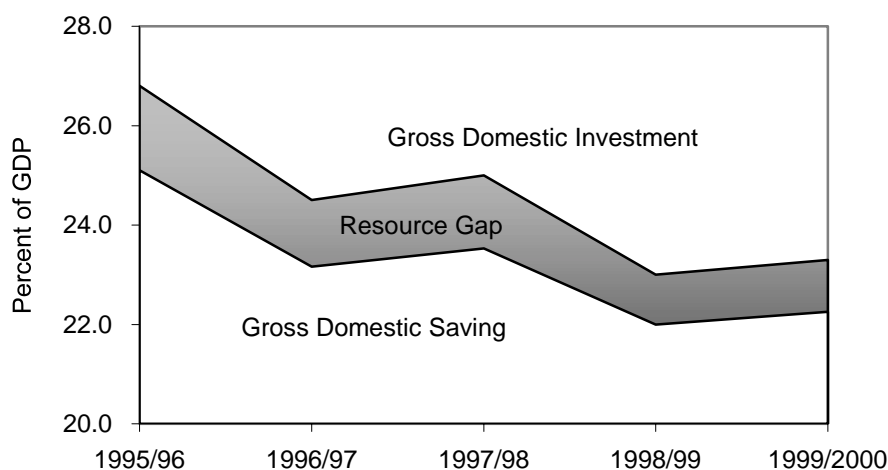
31. The organized sector¹² absorbs less than 5 percent of the 600 million working-age population. In the postreform years, most of the employment generated in the organized sector was from the private sector. Despite this, the public sector continues to be the largest employer in the organized sector, with a share of 70 percent. Employment growth in the private sector was an average 1.5 percent during 1992-2000 period compared with 0.13 percent in the public sector. In 2000, employment in the private sector expanded by 0.92 percent, as public sector employment stagnated. While low growth in public sector employment is a positive trend and should be reinforced—given the need to downsize the huge public bureaucracy and to rationalize PSUs—the relative modest growth of employment in the organized private sector raises some concerns. These may be mitigated by indications that most of the new employment opportunities are being created in the unorganized sector, of which the fast-growing services sector is a part.

32. Certain labor market reforms have been announced in the Union Budget 2001-02. These would provide increased labor market flexibility by enabling employers to lay off labor during periods of output decline and providing them with incentives to hire additional labor during periods of increased output. However, the hike in the severance package envisaged as part of these measures would avoid indiscriminate lay offs. The proposed labor market reforms would protect the interests of workers even during periods of contractual employment, and would provide an insurance cover in case of retrenchment. Once adopted, these measures will promote investment in labor-intensive activities while at the same time safeguarding the interest of workers.

3. Savings and Investment

33. In 1999/2000, the gross domestic savings rate—at 22.3 percent of GDP—showed a modest improvement as compared with that in 1998/1999 (Figure 11 and Table 2). Household savings grew marginally, reflecting a decline in consumer demand. The savings rate of the corporate sector stayed the same. The continued deterioration of public finances was mirrored in the negative public sector saving rate for the second consecutive year, with the rate of public savings dropping from -0.8 in 1998/99 to -1.2 percent of GDP in 1999/2000. The consistent decline in public sector savings explains the drop in gross domestic savings from the peak level of 25.1 percent in 1995/96 to the current levels of around 22 percent.

¹² The organized sector in India is defined as comprising enterprises and factories either operated by power and with more than 10 employees, or not operated by power and with more than 50 employees. All other enterprises and factories constitute the unorganized sector.

Figure 11: Savings and Investment

34. The drop in gross savings has been mirrored in the decline in gross domestic investment. Even though gross domestic investment increased marginally to 23.3 percent of GDP in 1999/2000, it is still significantly below the peak of 26.8 percent of GDP reached in 1995/96. The rate of gross capital formation was 23.3 percent of GDP in 1999, recording a modest 30 basis point increase over the 1998 figure. However, its composition changed significantly with a substantial decrease in corporate sector investment in fixed assets, from 6.6 to 5.9 percent of GDP, being offset by an equivalent increase in household fixed investment, from 8.3 to 9 percent of GDP. Public sector fixed investments went up slightly from 6.3 to 6.4 percent of GDP. The drop in private corporate sector investment for the second consecutive year is attributable to the existence of large excess capacity accumulated during the mid-1990s.

**Table 2: Savings and Investment Rates
(percent of GDP)**

Fiscal Year	Gross Domestic Saving				Gross Domestic Investment				
	Total	Household	Corporate	Public	Total	O F	Gross Fixed Capital Formation		
							Household	Corporate	Public
1993/94	22.5	18.4	3.5	0.6	23.1	W H I C H	7.5	6.0	8.0
1994/95	24.9	19.7	3.5	1.7	26.0		7.3	5.9	8.8
1995/96	25.1	18.2	5.0	2.0	26.8	8.5	8.2	7.7	
1996/97	23.2	17.1	4.5	1.7	24.5	7.3	8.6	6.9	
1997/98	23.5	17.9	4.2	1.5	25.0	7.3	8.1	6.4	
1998/99	22.0	19.1	3.7	(0.8)	23.0	8.3	6.6	6.3	
1999/2000	22.3	19.8	3.7	(1.2)	23.3	9.0	5.9	6.4	

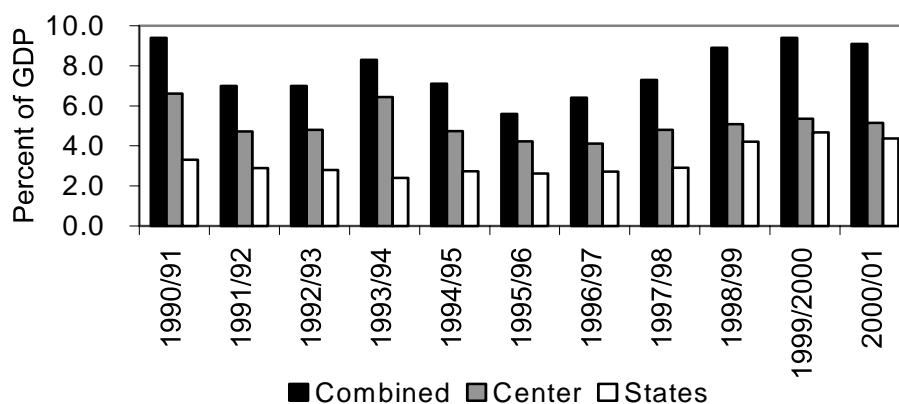
Source: Economic Survey 2000-01, Economic Division, Ministry of Finance, Government of India; Central Statistical Organization website; and National Income Statistics (December 2000), Center for Monitoring the Indian Economy.

D. Fiscal Developments

35. The program of second-generation reforms articulated in the 2001 budget is fairly comprehensive. It covers fiscal consolidation, with efforts to contain growth in public expenditures and to rationalize the tax system. It extends reforms to the agriculture sector that had largely been bypassed by first-generation reforms. It stresses improving quality in public expenditure, with a focus on raising investment in infrastructure and making this investment viable through appropriate user charges. The budget also announced measures easing price controls in key sectors. It further promoted financial sector reforms and continuing, progressive liberalization of the capital account. A supplementary plan of reforms to enhance competition, including the reform of labor laws, was presented by the Prime Minister to the Council of Economic Advisors in September 2001.

36. The economic slowdown has had an immediate repercussion on the fiscal balance. In the first half of 2001, revenue receipts fell short of expectations. In particular, revenues from the corporation tax and customs duties dropped by 13 and 16 percent, respectively. At the same time, expenditures were accelerated in an effort to pump-prime the economy. This led to a situation where roughly three fourths of the total borrowing program of the national Government was completed in less than half of the fiscal year. Maintaining the current expansionary fiscal stance will undermine the Government's effort at fiscal discipline and the achievement of the target for the gross fiscal deficit of the center—4.7 percent of GDP—as set out in the 2001 budget document. When projected against the background of chronically high fiscal deficits and massive debt burden of the center and the states, the current fiscal situation appears all the more a cause for concern (Figure 12). The medium-term program of fiscal discipline captured in the Fiscal Responsibility and Budget Management Bill—which would allow the debt path to converge toward a more sustainable trajectory—is currently under discussion in the Parliament (Box 4).

Figure 12: Fiscal Deficits



Box 4: Fiscal Responsibility and Budget Management Bill 2000

The basic fiscal management principle upheld in the Fiscal Responsibility and Budget Management bill is that the central Government will take appropriate measures to eliminate the revenue deficit and fiscal deficit and build up adequate revenue surplus in a time-bound manner. In particular, starting from the fiscal year 2001/02, the central Government will:

- reduce revenue deficit by an amount equivalent to 0.5 percent or more of the estimated gross domestic product at the end of each financial year;
- reduce revenue deficit to nil within a period of 5 financial years;
- build up surplus revenue and utilize it for discharging liabilities;
- reduce fiscal deficit by an amount equivalent to 0.5 percent or more of the estimated gross domestic product at the end of each financial year;
- reduce fiscal deficit for a financial year to not more than 2 percent of the estimated gross domestic product for that year, within a period of 5 financial years;
- not give guarantee for any amount exceeding 0.5 percent of the estimated gross domestic product; and
- ensure within a period of 10 financial years, that the total liabilities at the end of a financial year do not exceed 50 percent of the estimated gross domestic product.

The bill also mandates that

- the Medium-Term Fiscal Scenario be submitted to the Parliament;
- trends in receipts and expenditure in relation to budget targets be reviewed by the Ministry of Finance on a quarterly basis and reported on to both Houses of Parliament;
- deviation from budget targets be explained to Parliament by the Finance Minister and appropriate remedial measures be identified;
- direct borrowings from the Reserve Bank of India by the central Government be prohibited after three years, except by way of advances to meet temporary cash requirements; and
- suitable measures be introduced to ensure greater transparency in fiscal operations and minimize secrecy in budget preparation.

Source: Economic Survey 2000-01 and Fiscal Responsibility and Budget Management Bill 2000.

37. The fiscal situation has clear implications for the performance of the economy and for overall development. First, the large component of relatively rigid, current expenditures—interest payments, subsidies, and public sector salaries and pensions—has gone up during the past twenty years and now accounts for a disproportionately large portion of the gross fiscal deficits both at the center and the state levels (Figure 13). Revenue deficits as a percentage of gross fiscal deficits have increased substantially in the last decade thus worsening the “quality” of the overall fiscal deficit (Figure 14). Consequently, little money is left for development and capital expenditures in physical and human infrastructure. Over the same period, gross budgetary support for plan activities (i.e., development-oriented and capital expenditures) has gone down from 7 to 3.85 percent of GDP.

Figure 13: Current Expenditure as a Share of Total Expenditure

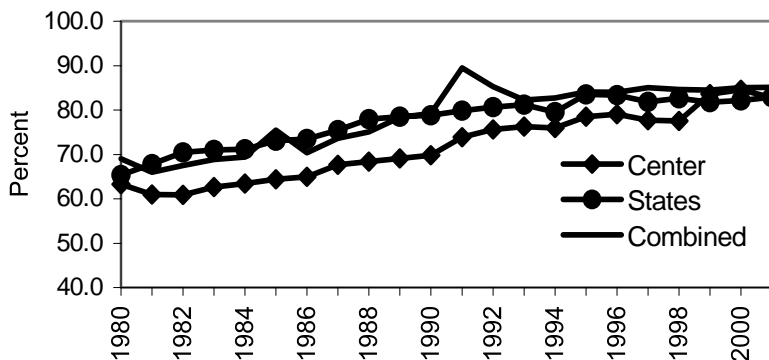
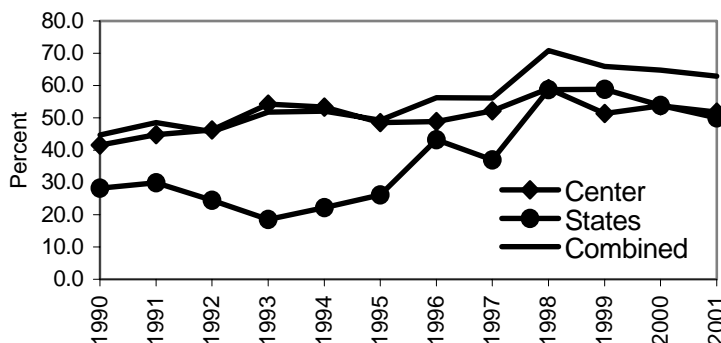


Figure 14: Revenue Deficit as a Share of Gross Fiscal Deficit



38. Fiscal adjustment at center and state government levels will need to be accompanied by efforts to improve the quality of public expenditures. Cutting the costs of the bureaucracy through retrenchment, containing the growth of salary expenditure, and pension reforms, is one important component of this effort. Another critical component is reducing the subsidy bill shouldered by the Government. This issue, while broader in scope, is fundamentally linked to that of commercialization, divestiture, and privatization of PSUs. The implicit subsidy burden that PSUs impose on public finances is huge. For example, some estimates indicate that the onus cast on state finances by power sector subsidies and losses is equivalent, on the average, to 50 percent of state deficits. According to estimates by the Ministry of Finance,¹⁴ the hidden subsidies on nonmerit goods amount to almost 10 percent of GDP, a figure roughly equivalent

¹⁴ Cited in the Approach to the 10th Five-Year Plan.

to the combined center-state fiscal deficit. Clearly, reforming the PSUs decisively would go a long way toward improving fiscal performance.

39. The privatization program has been progressing at a slow pace. In 2000, disinvestment receipts amounted to Rs25 billion against a target of Rs100 billion. In 2001, limited progress has been made toward achieving the target of Rs120 billion. To provide renewed impetus for the disinvestment program, in a Cabinet reshuffle, the Minister of Disinvestment was elevated to a Cabinet position in September 2001.

40. Alongside adjustments in expenditures, fiscal correction will require improvement in revenues as well. For direct taxes, greater revenue efficiency will require abolition of exemptions and improved compliance. The latter may be better achieved through modernization of the tax administration system and the use of information systems and technology. But with fairly large efficiency gains having already been achieved by lowering direct tax rates, the most substantial increases in revenue collection will have to come from indirect taxes. After the introduction of the central value-added tax (CenVAT), launching of the value-added tax (VAT) in major states is now planned for 1 April 2003 (Box 5).

Box 5: Value Added Tax in India

The government of India introduced CenVAT under the provisions of the 2000/01 budget. CenVAT largely replaces the system of union excise duties and credit for input duties known as Modvat. It covers all commodities—with the exception of diesel, petrol, and matches. In addition to the single rate of 16 percent at which CenVAT is generally applied, there are three special excise duty rates (SED) of 8, 16 and 24 percent for specified (mostly final) products. The impact of CenVAT could be maximized through better administration, including

- a shift from physical controls to self-assessment of the duty,
- computerized registration and a central database accessible throughout the country to minimize fraud, and
- coverage of all commodities.

The states are now in the process of preparing for the introduction of VAT by 1 April 2003 for general category states and by 1 April 2004 for special category states.¹ The VAT will address shortcomings of the existing sales tax system such as cascading (no credit or set-off on input taxes), multiple rates, uncontrolled incidence, and lack of neutrality. The current VAT proposal comprises a three-rate structure, with the following floor rates:

- 4 percent on an agreed upon list of essential items
- 12 percent on selected, high-value goods
- a revenue neutral rate with a floor of 10 percent on all other commodities

Petroleum products and alcohol will not be covered by VAT. Instead they will be subjected to a nonrebtable excise with a floor rate of 20 percent. A small number of commodities will remain outside VAT. A committee is examining the issue of whether states might be allowed to tax services under VAT. The central Government has tasked another committee with evolving a compensation package for possible revenue losses to the states due to the introduction of VAT.

A plan to put in place the legislative and administrative requirements for the launch of state VAT has been prepared by the empowered committee of state finance ministers. The plan covers mechanisms for effective administration such as procedures for registration, information technology requirements, and public information.

¹ General category states are Andhra Pradesh, Bihar, Goa, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh, and West Bengal. Special category states are Assam, Arunachal Pradesh, Himachal Pradesh, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, and Tripura.

E. Monetary Developments and Prices

1. Monetary Policy

41. During 2000, monetary policy continued to aim at providing sufficient liquidity to the system to accommodate economic growth and a revival of investment demand while keeping inflationary tendencies at bay. The global economic slowdown and a low-inflation external and domestic environment, a comfortable foreign exchange position, and relatively stable flows of foreign capital have provided room for monetary easing and lower interest rates.

**Table 3: Selected Monetary Indicators
(end-March)**

Item	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01	2001/02 ²
	Percent change						
Monetary Aggregates							
M3	13.6	16.2	18.0	19.4	14.6	16.7	--
Credit to Government	15.9	12.0	14.6	17.0	14.1	16.1	--
Credit to Commercial	17.7	9.2	15.1	14.5	18.3	14.8	--
Sector							
	Percent						
Cash Reserve Ratio (CRR)	14.0	10.0	10.0	10.5	9.0	8.0	--
Bank Rate	12.0	12.0	10.5	8.0	8.0	7.0	--
91-Day T-Bill Yield	13.0	8.0	7.3	8.75	9.2	8.7	7.2
Interest on Deposits (maximum) ¹	12.0	13.0	12.5	12.5	11.0	10.5	9.0
Prime Lending Rate (minimum) ¹	16.5	14.5	14.0	12.0	12.0	10.0	10.0

M3 = money supply, T-bill = treasury bill.

¹ Public Sector Banks.

² Period up to December 2001.

Source: Reserve Bank of India Annual Report 2000-2001 and Reserve Bank of India Bulletin, various issues, Reserve Bank of India.

42. Broad money (M3) grew by 16.7 percent in 2000/01 (Table 3). Net of inflows under the India Millennium Deposit Scheme (IMD), M3 expanded by only 14.4 percent, a figure comparable with monetary growth in 1999 and well within planned monetary aggregates. Bank credit to the government rose by 16.1 percent, while bank credit to the commercial sector increased by 14.8. Nonfood bank credit was high during the first three quarters of the year, but decelerated considerably in the last quarter on account of low demand for investment which mirrored the slowdown in industrial activity. In the first nine months of 2001, broad money went up by 10.5 percent as against 13.2 percent in the comparable period of the previous year. On an annual basis, growth of M3 was at 13.9 percent, well within the range of 14.5 percent projected for the full year but lower than that of 16.2 percent recorded in the previous year. This was accompanied by a surge in bank deposits, whose relative attractiveness has increased in the context of an uncertain financial market environment.

43. The Reserve Bank of India (RBI) employed the liquidity adjustment facility (LAF) flexibly. During the first half of 2000, considerations relating to foreign exchange stability required tightening of the monetary policy with the use of repo operations to absorb liquidity and signal the monetary stance. As conditions on foreign exchange markets began to ease in September

2000, due also to \$5.5 billion inflows under the IMD scheme, RBI progressively softened the monetary policy stance to help reverse the economic slowdown. While it continued to use a blend of repos and reverse repos operations for day-to-day liquidity management, RBI eased interest rates. It reduced the cash reserve ratio (CRR) to a level of 7.5 percent by May 2001 and softened the bank rate to 7 percent level by the end of FY2000. In October 2001, in the context of the mid term monetary policy review, RBI announced a new series of measures aimed to revive the slowing economy. RBI lowered the bank rate by a further 50 basis points to 6.5 percent and reduced the CRR to 5.5 percent by December 2001. This augmented the pool of lending resources by Rs80 billion.

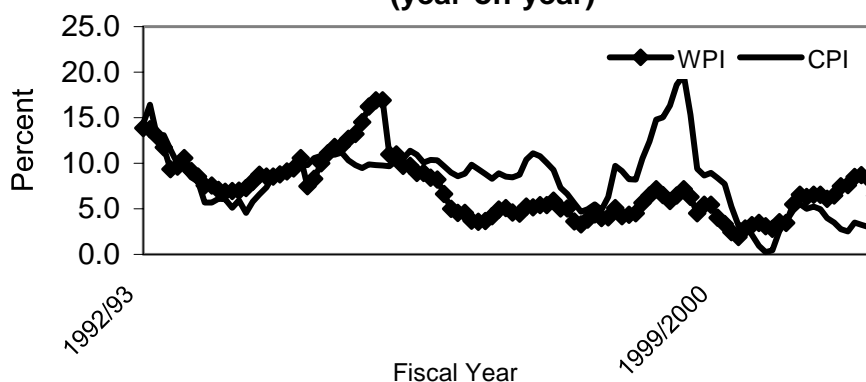
44. In the face of the persistent sluggishness of industrial performance, monetary policy has been at the center of the debate on appropriate policy responses. Some commentators feel that, with real interest rates in India still higher than those prevailing in international markets, monetary easing can facilitate economic recovery. Others, however, stress that in a situation characterized by low business confidence and investment demand, monetary easing mostly benefits the government which is able to borrow at lower cost. In general, there seems to be a fairly broad consensus that cost of borrowing and crowding out of private investors are not a concern in the short term, given the current slackness in investment demand. Despite lower interest rates during the current year, industrial credit has not picked up. Slow industrial growth and lack of investment demand may be better explained by factors such as low consumer demand, the existence of substantial excess capacity from the high-growth period of the mid-1990s, structural bottlenecks, and the slow pace of reforms. The cost of borrowing will, however, become a more significant factor as economic recovery gains momentum in response to positive shocks such as a good monsoon and stronger agriculture performance and their repercussions on consumers' demand. In the medium term, effective monetary management must go hand in hand with credible fiscal adjustment.

2. Prices

45. Inflation—as measured by the year-on-year variations in the wholesale price index (WPI)—was above 6 percent for the first half of 2000 (Figure 15). After easing marginally in August, inflationary trends picked up in the second half of the fiscal year, driven by the hardening of international crude oil prices. As higher oil prices drove administered fuel prices up, inflation reached a peak at 8.8 percent in January 2001. With the softening of oil prices, inflationary tendencies moderated and inflation fell below 5 percent by the end of 2000. In the absence of demand-related pressures, the consumer price index (CPI) exhibited a marked downward trend for the most part of the year.

46. Inflation has continued to decline well into 2001. On 29 December 2001, WPI inflation was 2.0 percent, less than one fourth of the inflation rate in the same period in 2000. However, annual inflation as measured by the year-on-year variations in CPI for industrial workers was at 4.9 percent in November 2001, as compared to 2.7 percent in the corresponding period a year ago. This reflected an increase in prices of some primary articles items such as fruits and vegetables, pulses and oilseeds. However, as food stocks are very high and expectations are of a good agriculture output, inflationary tendencies are likely to be kept at bay.

**Figure 15: Inflation
(year-on-year)**



CPI = consumer price index, WPI = wholesale price index.

3. Financial, Banking, and Capital Markets Reforms

47. Financial sector reforms continued to focus on developing and strengthening the regulation and supervision of financial markets. Recent measures, particularly the amendment to the Securities Contract (Regulation) Act of 1956 which were brought into effect in March 2000, have better defined the supervisory and regulatory role of RBI with respect to the Government, the money market, and gold-related securities and related derivative transactions. The development of the Government securities market has been an important component of this reform process and has made it possible to carry through the large Government borrowing program without compromising the efficiency of monetary policy. Government securities-related reforms include a scheme for automatic invocation of the undrawn refinance/liquidity support from RBI by a subsidiary general ledger (SGL) account holder, and the planned introduction of an electronic negotiated dealing system (NDS).

48. Banking sector reforms have continued to emphasize strengthening of prudential norms and supervision in line with international standards and improving asset quality. RBI participates in various forums to develop international financial standards (together with Government of India), and to assess the applicability of international standards to the Indian financial system. Among the specific reforms, a move was made towards the adoption of international norms for classifying loans as performing and nonperforming by 2004. In July 2000, guidelines were issued for the recovery of dues relating to nonperforming assets (NPAs) for all public sector banks with outstandings up to Rs50 million. The NPA guidelines provide simple and transparent norms for the recovery of NPA in all sectors through compromise settlements. In addition, banks were mandated to include the risk-weighted assets of their subsidiaries in their consolidated balance sheets on a notional basis. Valuation norms for investment portfolios of banks were modified, with investments for sale or trading being periodically marked to market. Limits to levels of bank exposure to individual/group borrowers and to capital markets were made more conservative and are being reduced to 15 percent and 40 percent of the bank's capital funds, respectively, with effect from 31 March 2002. At the same time, transparency and disclosure

with respect to equity investments by banks were enhanced. Prudential norms introduced for banks were, in many cases, extended to financial institutions as well, in the context of a move toward consolidated supervision of the whole banking sector. Norms were set for entry of new private sector banks and for eligibility criteria of banks and nonbanking financial companies (NBFC) to enter the insurance business.

49. Prudential norms and strengthening of risk management systems continued to be a mainstay of capital market reforms. The Securities and Exchange Board of India (SEBI) tightened entry norms for primary issues. SEBI also allowed introduction of new stock market products and tightened disclosure norms and market surveillance systems. Following turbulence in the equity markets in March 2001, SEBI announced in May a series of capital market reforms including among others, the banning of deferral products in the cash segment such as badla¹⁵, expansion of rolling settlement system and introduction of international practices on modernizing systems as well as price bands.

F. External Trade and Balance of Payment

50. In 2000, the balance of payment recorded a surplus for the fifth consecutive year. Exceptionally strong export growth, together with a stable capital account, spearheaded the performance of the external sector. Export growth accelerated to 19.6 percent in 2000 with contributions from all main export categories. In contrast, import growth dropped to 7.0 percent, resulting in a lower trade account deficit in 2000 (3.0 percent of GDP) than in 1999 (4.0 percent of GDP). As the invisible account continued to record a substantial surplus (2.5 percent of GDP), the current account deficit dropped from 1.0 percent in 1999 to 0.5 percent of GDP in 2000. Current receipts financed 96 percent of current payments.

51. In the context of the protracted global economic slowdown, export and import growth have decelerated dramatically in recent months. From April to November 2001, exports grew by 0.5 percent compared with 21.0 percent during the same period in 2000. Imports, on the other hand, decelerated to 1.2 percent in April-November 2001 relative to the 7.4 percent increase for the same period in 2000. The deceleration in imports—even after controlling for cyclical factors—should help assuage concerns about the impact of the removal of quantitative restrictions (QRs), in compliance with WTO commitments, on the trade balance. The removal of QRs appears to have been neutralized by alternative mechanisms for protection, such as restrictions on imports of some basic products and increase in customs duties on some agricultural commodities and cars, which are admissible under WTO guidelines.

52. For the first eight months (April-November) of 2001, the trade deficit was at \$5.8 billion compared with \$5.6 billion in the same period in 2000. As subdued industrial growth continues to dampen imports, under the assumption of a stable invisibles account, the negative impact of the global slowdown on export growth could be largely neutralized and the current account deficit contained within 1 percent of GDP in 2001 as well.

53. The Government announced a new export-import (EXIM) policy in March 2001 with the objective of accelerating export growth to achieve 1 percent of global trade by 2004. This will require double-digit export growth rates. Several export promotion measures were announced, including proposals to formulate an agriculture export policy and establish agricultural export

¹⁵ Carrying forward of transaction from one settlement period to the next without effecting delivery or payment is called 'badla'.

zones. State governments were given a key role in identifying these zones. Additional measures encompassed assistance to be provided for research and development; market research; warehousing and marketing infrastructure; and market promotion. In addition the EXIM policy supports an enhanced role for special economic zones (SEZ). Special SEZ measures include permission for FDI under the automatic route for all manufacturing sectors, exemption from licensing for items under SSI reservation, duty-free procurement of goods from domestic tariff areas, and permission to subcontract part of the production process abroad.

54. However, high, sustainable export growth, which is necessary to achieve the 1 percent target in the EXIM policy, will also require the removal of economy-wide distortions in factor and product markets. By raising costs of production and lowering productivity, such distortions hamper the ability of Indian suppliers to compete effectively on international markets. Factor market distortions include archaic labor and land laws. Product market restrictions include small-scale enterprise reservation policies.

55. Foreign investment, at \$4.6 billion (less than 1 percent of GDP), exhibited a moderate decline in 2000. Capital flows remained stable during the first quarter of 2001, with a marginal decrease in FDI at \$609 million, being balanced by higher foreign institutional investment at \$632 million. Overall, India's FDI levels remain low compared with those of other Asian countries. This may be due to the persistence of bureaucratic hurdles and to the slow reform process. Foreign investment inflows have been exhibiting less volatility in 2001 despite the industrial downturn and a stock market scandal in March.

56. By the end of 2000, foreign exchange reserves were at a comfortable \$42 billion level, equivalent to nine months of imports. As of 10 August 2001, foreign exchange reserves were at the level of \$44.1 billion. After falling below the psychological threshold of Rs47/\$ in May 2001, the rupee hit a new historic low of Rs48/\$ in the aftermath of the September 11 attacks and has been fluctuating moderately around this level.

57. Total external debt outstanding is provisionally estimated at \$100 billion as of March 2001, up from \$98 billion in 2000. The composition of the debt has, however, improved with short-term debt at \$3.5 billion (or 8 percent of reserves) in March 2001 compared with \$3.9 billion (or 10 percent of reserves) in 2000. About 32 percent of the total debt as of March 2001 was concessional.

II. SHORT-TERM ECONOMIC OUTLOOK

58. Given the increased uncertainty of the global economic scenario (Box 6), we are projecting India's GDP growth at 5.0 percent in 2001. This depends on a positive performance of the agriculture sector, and a moderate pickup in industrial activity in the second half of the year. In a generally depressed demand environment, inflation will be at around 5.0 percent and the current account deficit, reflecting both the export slowdown and the decline in imports, is likely to be less than 1 percent of GDP. For 2002, GDP growth is projected at around 6.0 percent as industry and services growth gain further momentum. Improved performance in 2002 will, in part, depend on a more favorable global environment. Most significantly, however, it will be conditional on the Government's accelerating the pace of economic reforms. In a domestic environment characterized by stronger fiscal discipline, inflationary pressures might be managed effectively. Under this assumption, inflation would remain moderate at around 5.0 percent in 2002. The current account deficit would be at 1 percent of GDP in 2002.

59. Reforms will need to focus on fiscal consolidation and on creating an enabling environment to revive industrial growth. The needed reforms are highly interdependent. For example, without fiscal adjustment, the availability of public funds for key physical and social infrastructure will remain severely constrained. Without reforms in PSUs, it will be difficult to address fiscal consolidation. This suggests that, to be successful, the reform process must address all these aspects in a well-coordinated and comprehensive manner. Only if this is done will India be able to move onto the higher growth path of 8 percent GDP growth envisaged by the Approach Paper to the Tenth Five-Year Plan.

Box 6: Impact of September 11 on the Indian Economy and the Outlook

The September 11 attacks on the United States have had a significant negative impact on the global economy. They compounded uncertainty and affected business confidence worldwide. The expectations of a prolonged global economic slump and a softer rebound in 2002 than previously anticipated have potential implications for India's economic outlook as well. As the still relatively limited openness of the Indian economy suggests, however, these implications are likely to be fairly limited. The investment climate in India was already bleak prior to September 11. And it is impossible to distinguish quantitatively the impact of September 11 from the influence of preexisting factors, which had caused global and domestic demand to be at a low ebb. Therefore, an analysis of the impact of September 11 must necessarily be general and qualitative in nature. There are essentially three potential transmission channels of potential impact:

- international trade
- capital flows
- exchange rate

With the United States as India's major trading partner, which accounts for almost one fifth of India's total exports, the impact of September 11 on India's exports is likely to be significant. Software services are likely to suffer the most from the drop in external demand. The National Association of Software and Service Companies (NASCOM) has revised the growth rate for software services exports downward to below 20 percent. Software services exports have been a major driver of export performance and have played an important role in sustaining the current account. A decline in software exports could deprive the Indian economy of a buffer mechanism to counterbalance external shocks such as sharp increases in oil prices. Worker remittances from the Gulf countries may also be negatively affected. International tourism will experience some negative impact.

Further, political uncertainty in the region could deter foreign capital flows. This, however, has not happened so far, and foreign direct investment and foreign institutional investment have maintained their levels. The stock market, which took a dip in the immediate aftermath of the attacks, appears to have stabilized and recovered most of the post-September 11 loss, but further turbulence cannot be excluded as events unfold. These factors may contribute to further weakening of the rupee, which crossed the Rs48/\$1 threshold in the aftermath of the attacks and has been fluctuating around that value since.

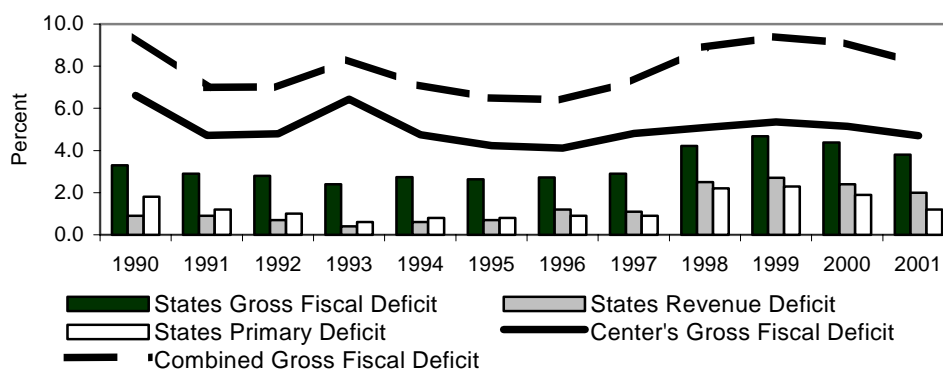
Given the still limited degree of openness of the Indian economy, however, the possible negative impacts on the balance of payment are not likely to be very significant, especially when considered in the present context of a comfortable foreign exchange reserve situation and low current account deficits. A possible depreciation of the rupee could help contain any negative impact on exports. Further, the dampening effect of the deeper and more prolonged global slowdown on external demand is likely to agriculture sector materialize. As a large portion of the employed population still works in the agriculture sector, the multiplier be counteracted by a pickup in domestic demand if expectations of a strong performance of the effect of increased demand from rural households is likely to be significant and could counteract the negative fallout of a drop in global demand.

III. CENTER-STATE FISCAL RELATIONS AND THEIR IMPLICATIONS FOR STRUCTURAL DEFICITS

A. Recent Trends in State Finances

60. In the context of this review, frequent reference has been made to issues of fiscal consolidation. The second half of the 1990s has seen the fiscal position of the states deteriorate significantly. Their gross fiscal deficit (GFD) as a percentage of GDP has risen from 2.6 in 1995 to 4.4 in 2000 (Figure 16). Fiscal profligacy has been accompanied by a significant deterioration in the quality of state-level public expenditure. The increase in state GFD has, in fact, been primarily driven by burgeoning revenue (current) deficits, which surged from 0.7 to 2.3 percent of GDP during the same period. This lackluster financial performance of the states has substantially undone the gains in terms of fiscal consolidation, which were achieved at the center during the mid-1990s and brought the aggregate (center/states) fiscal deficit figure back to its pre-1991 crisis level of over 9 percent of GDP. It is, therefore, important to take an in-depth look at the causes of this negative performance.

Figure 16: Measures of Government Deficit as a Share of GDP



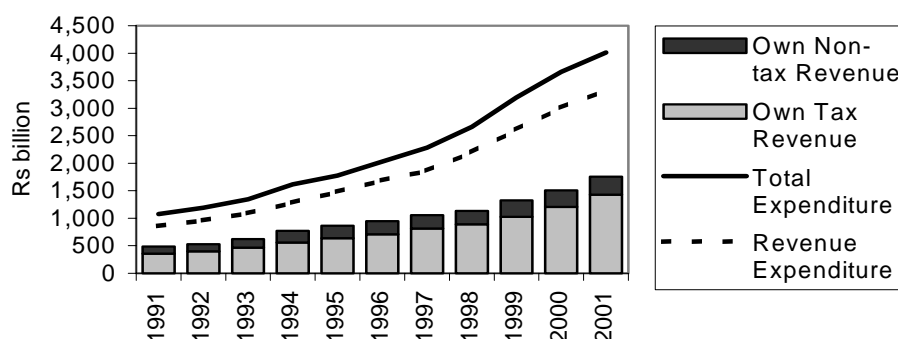
Note: Figures for 2000 are revised estimates; those for 2001 are budget estimates.

61. There are several proximate causes of this rapid increase in the size and deterioration in the quality of fiscal deficits. On the expenditure side, the Fifth Pay Commission inflated the salaries and pensions of state employees. Since the Fourth Pay Commission, the states have adopted de facto parity with the center in the remuneration of their employees and severed the link with ability to pay. This practice has proven particularly burdensome for the poorest states. Further, decreased transfers and subsidies from the center have implied a higher recourse to debt. A widening debt stock and high interest rates in the liberalized environment have translated into a rising interest burden for the states. In 1990, interest payments due from the states accounted for 46 percent of GFD. By 2000, interest payments had risen to 57 percent of GFD.¹⁶

¹⁶ The rise in revenue deficits could partly be a consequence of current accounting practices. Since 1992, as mandated by the 73rd and 74th amendments to the Constitution of India, states must increasingly devolve functions and transfer of funds to local bodies. By current accounting norms, these transfers are classified in the

62. On the revenue side, the tax/GDP ratio has been dropping due to poor compliance and to the fact that an increasing portion of GDP originates from the services sector, which is not taxed by the states. This has contributed to a widening gap between revenue receipts and expenditures (Figure 17). Cyclical factors have also had a negative impact on tax buoyancy since the second half of 2000. Lack of financial viability of PSUs has heavily burdened the state budgets.

Figure 17: States' Own Revenue Receipts and Expenditure



63. To address these proximate causes of fiscal imbalances at the state level, several measures are being enacted. States are increasingly focusing on expenditure management and restructuring, including rationalization of public sector employment and voluntary retirement schemes. On the revenue side, the Eleventh Finance Commission has highlighted three areas of focus for the states' efforts at fiscal consolidation: tax compliance, user charges, and reprioritization and phasing out of nonmerit subsidies. Efforts are being made to simplify and rationalize the tax structure, which encompass the introduction of the VAT by 2002. Improvements in tax compliance are expected to result, thanks to, among others, the enhanced use of modern information and communication technologies (ICT).

64. Power sector reforms are a critical component of fiscal consolidation efforts, given the enormous burden that this sector alone imposes on public finances. During FY1999/2000, distribution losses and subsidies to the power sectors were estimated at 1.4 percent of GDP. Several states have signed Memoranda of Understanding (MOUs) with the central Government, which commit them to undertake power sector reforms, including rationalization of electricity

state budget as revenue expenditures independent of the use for which they are employed by the recipient local body. This practice does not reflect that a significant portion of these funds may be in fact used for development and capital expenditures.

This argument of course only applies to those states that have actually devolved functions to third-tier governments. For these, it may significantly overestimate the revenue deficits. However, it does not affect the size of GFD, but only its composition. In the case of Kerala, for example, transfers from the state to the local governments amounted to Rs10.5 billion in 2000. Of these, 50–70 percent is estimated to have been employed by the local bodies for capital expenditures. Taking the low-end estimate, the revenue deficit of the state would be roughly 20 percent lower, were the corresponding transfers to be classified as capital expenditures in the state budget.

tariffs and progressive elimination of distribution losses. For other PSUs, states are stepping up efforts to wind up loss-incurring enterprises, and, where feasible, privatize and merge them.

65. To provide further incentives to address imbalances, the Eleventh Finance Commission established an incentive fund under the state fiscal reform facility. The structure and targets of this fund are described in Box 7.

Box 7: Incentive Fund

The Incentive Fund comprises two parts. The first part is financed by withholding 15 percent of the Eleventh Finance Commission yearly grant to the states to cover the deficit on the nonplan revenue account. The second part is financed by a matching contribution of the central Government. The fund is to be apportioned to states over a period of five years (2000/01 to 2004/05) based on their performance in terms of a single, monitorable fiscal target, i.e. the ratio of revenue deficit to revenue receipts. To qualify for an allocation from the fund, a state must have attained a minimum 5 percent improvement in this ratio during the applicable fiscal year. Amounts that are not allocated to a state in any particular year will be rolled over and be available to the state in the following years. However, any amount not apportioned to individual states by the fourth year will flow into the common pool to be allocated among the performing states in the fifth year of the fund.

66. So far, we have discussed the proximate causes of the fiscal imbalances observed at the state level and the policy and administrative measures that the Indian Government and the states are putting in place to address such imbalances. However, it is important to examine whether there are structural factors in a decentralized, federalist setting that contribute systematically to the creation of macroeconomic imbalances or preempt macroeconomic stabilization efforts by the central Government. In developing countries where certain ideal preconditions for its optimal working are not in place, decentralization may be a contributing factor to structural—as opposed to cyclical—fiscal deficits. Ideal conditions for the optimal working of fiscal federalism are as follows:

- (i) the assignment of responsibilities to each tier of government that broadly reflects their comparative advantage in providing specific public goods (paras. 68-70);
- (ii) a contract between the central, state, and local governments detailing the expenditures responsibilities of each tier of government and assigning each level adequate resources to finance these mandates in a way that minimizes moral hazards (paras. 71-79);
- (iii) a hard budget constraint for second- and third-tier governments (paras. 80-85);
- (iv) accountable, transparent and participatory governance structures at all levels;
- (v) a reasonably uniform (and high) quality of the bureaucracy at the center, state, and local levels; and
- (vi) good public expenditure management and accounting systems.

67. To keep this report within an acceptable length, the rest of this chapter will focus on the first three conditions, which have a more immediate and direct bearing on the macroeconomic impact of decentralization. It will provide a brief description of the federal system of government in India against these conditions and point at some features that may contribute to the observed structural fiscal imbalances by promoting moral hazards in state fiscal management.

B. The Specific Character of India's Fiscal Federalism and the Principle of Comparative Advantage

68. Historically, India remained a two-tier federal structure until the early 1990s, driven by strong centripetal tendencies. This was consistent with the country's mixed-economy model, where allocation of resources was guided by the central plan and enforced through pervasive administrative and economic controls. Such a model necessarily constrained the role of the states. The liberalization drive, carried out by the first-generation reforms in the early to mid-1990s, required, however, a redefinition of the institutional relationship between central and state governments, and an increasing role for the latter, particularly with respect to the regulation of the economy. In parallel, political equilibria had progressively altered—with the regional parties coming to play an increasing role not only in the states, but also at the center as members of coalition governments. These elements contributed to further decentralization and a deepening of the federalist structure. While local bodies, such as *panchayats* in rural areas and municipalities in urban areas, had been in existence since the early years of the federation, they were not substantially empowered with self-government prerogatives. In 1992, however, with the 73rd and 74th Amendments to the Constitution, local governments obtained constitutional status and a shift was made toward a three-tier federal structure.

69. Within this broad historical context, attribution of powers across jurisdictions follows loosely a notion of comparative advantage based on spatial characteristics of the public goods.¹⁷ The key responsibilities of the center include all functions related to the money supply and external borrowing; international relations, defense, atomic energy, and space; and national highways, airways, international waterways, and transport networks entailing substantial scale economies. States are assigned functions with statewide implications, such as public order and police; local government; public health, water, and sanitation; and agriculture, intrastate communications and transport, and trade and commerce. The states can devolve some of these functions to the local governments. Central and state governments have concurrent responsibility for functions with strong development potential and benefits that spillover across the states. These are economic planning, energy, education, health, and family welfare.

70. The Constitution assigns tax powers exclusively to the central or to the state governments based on the principle of separation. With respect to direct taxation, the central Government has the power to levy taxes on personal and corporate income from nonagricultural sources, while the states can tax incomes from agricultural sources. For indirect taxes, from an economic standpoint, an important exception is made to the principle of separation with respect to the taxation of goods traded domestically. For these goods, the center levies an excise tax and the states a sales tax. Even though legally these taxes fulfill the principle of separation, as they apply, respectively, to the production and sales of goods, their economic burden falls on the same tax base, i.e., in practice they overlap. In addition to excise taxes, the central Government is assigned customs duties and a tax on railway fares. The states levy sales taxes, an excise on alcohol, *octroi*¹⁸, electricity duty, entertainment tax, and taxes on passengers and goods conveyed by road or inland waterways. Local bodies are not vested constitutionally with the power to impose taxes. States delegate to local bodies some taxes, such as octroi and property tax, but retain control on the structure of these taxes. Residual taxing powers are

¹⁷ See Oates, W., 1972, *Fiscal Federalism*, New York: Harcourt, Brace Jovanovich, Inc.

¹⁸ Octroi is a tax levied on the entry of goods into a municipality or any other specified jurisdiction for use, consumption or sale. Octroi is levied at the time when the goods enter the municipal limits where the goods are to be ultimately sold, used or consumed. Generally, octroi is borne by the purchaser. Goods in transit are exempted from octroi.

vested with the central Government. Under the constitution, taxes on services have not been assigned to either level of Government. As such, they have fallen among the residuary powers of the central Government, which has exercised the power to tax services only selectively. However, with the introduction of VAT, taxation of services should go along with taxation on goods.¹⁹

C. Assignment of Revenues and Expenditures, Intergovernmental Transfers, and Their Impact on Structural Deficits

71. An aggregate fiscal imbalance has emerged in India because the system of taxation just described has not been able to generate sufficient resources to finance the mandates of the public sector. Therefore, recourse to debt has become a systemic feature of public finance. It is not possible here to detail all the causes of this aggregate fiscal imbalance, but just to point to some that are more closely and specifically related to federal institutional arrangements.²⁰ For example, the separation of the income tax base into personal and corporate, to be taxed at the center, and agricultural, reserved to the states, has opened opportunities for tax avoidance and evasion. Further, the states have found it politically difficult to tax agricultural income and wealth, and have so substantially renounced an important revenue source.²¹ The system of center/state indirect taxation of consumption, through excise and sales taxes, has generated considerable inequities and economic distortions. It has also acquired increasing complexities during the years, compounding tax uncertainty and the cost of compliance and enforcement. As a result, buoyancy of indirect tax is low. An increasingly important contributor to economic growth—the services sector—has substantially slipped through the taxation net both at the center and state levels. All these factors have contributed to a progressive erosion of the tax base and of the tax/GDP ratio. While these elements are not a necessary feature of fiscal federalism per se, they have been an integral aspect of the way center-state fiscal relations have evolved in India. And they can be said to have contributed to macroeconomic imbalances.

72. The attribution of responsibilities and revenue sources to central and state governments mandated in the constitution has further resulted in an asymmetric distribution of expenditures and revenues across the three tiers of government, i.e., into a vertical fiscal imbalance. Based on the findings of the Eleventh Finance Commission Report, the central Government raises roughly two thirds of the revenues and the States one third, but each tier of government—including local bodies—carries out one third of total public expenditures.²²

¹⁹ See Chelliah, R. J., et al., 2001, *Primer on Value Added Tax*, National Institute of Public Finance and Policy.

²⁰ The prohibitive rates of taxation on income, for example, had been definitely a major cause of low compliance and low revenues for direct taxes, but this paper does not discuss this issue because it is not directly related to the federal structure. With the reform of direct taxation, income tax rates were brought broadly in line with internationally prevailing levels, leading to substantial improvement in tax buoyancy. Also, on the expenditure side, the enormous growth of the bureaucracy has led to huge public sector costs and contributed to the emergence of structural deficits.

²¹ See also Rao, M. G., “Fiscal Decentralization in Indian Federalism”, paper presented at the *Seminar on Fiscal Decentralization*, IMF, 20-21 November 2000.

²² There are, of course, basic rationales for fiscal transfers from the center to the states other than filling vertical fiscal gaps. An important one is that of horizontal equity. Issues pertaining to equalizing transfers and their actual impact in the case of India are discussed in papers prepared under TA 5902-REG: *Intergovernmental Fiscal Transfers for Equitable In-Country Growth*. In particular, see Srivastava, D. K., 2001. *Intergovernmental Fiscal Transfers for Equitable In-Country Growth*, National Institute of Public Finance and Policy, New Delhi, 5-6 September.

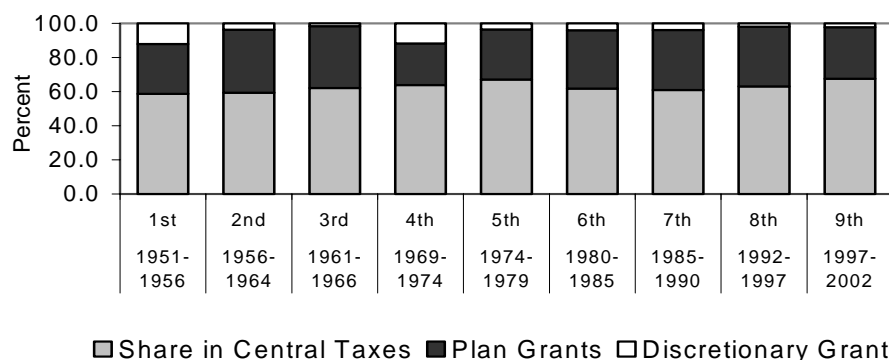
73. The gap between revenues and expenditures of lower tier governments is financed by intergovernmental transfers. Three main types of transfers take place between the center and the states: (i) Finance Commission transfers, (ii) Planning Commission transfers, and (iii) transfers for central sector schemes and shared-cost programs. Some specific features of this system of transfers provide the states with perverse incentives to fiscal profligacy.

1. Finance Commission Transfers

74. The Finance Commission uses two main channels of transfers: devolution of central taxes, and grants. With the 18th amendment to the Constitution (May 2000, but effective retroactively from 1996), the net proceeds of all union taxes and duties, with the exception of the central sales tax and consignment tax, are shareable with the states.

75. Based on its analysis of non-plan expenditure needs and resources of both center and states, the Finance Commission distributes the assigned²³ and shareable tax base to the states, and fills the postdevolution gap between non-plan expenditures and revenues with the use of grants²⁴ (Figure 18). The EFC's formula for inter se distribution of tax transfers to states is strongly guided by the equity principle, and attempts to compensate states for resource deficiencies.²⁵ This is reflected in the larger weight in the formula of factors that capture divergence in incomes and capacities across state, compared with those that are based on fiscal discipline. This creates an incentive to perpetuate the resource deficiency, rather than address it.

Figure 18: Composition of Revenue Transfers to States by Plan Period



²³ Assigned taxes included excises on sugar, textile and tobacco products and the grant in lieu of taxes on railway fares. These were tax rental arrangements whereby the power to tax, originally bestowed to the states, had been transferred to the center to assure uniformity across states, and replaced by a system of transfers. Constitutional Amendment has withdrawn the separate identity of these arrangements, and these tax powers can now be returned back to the states.

²⁴ Historically, tax devolution has accounted for the largest share of Finance Commissions transfers to the states, averaging at around 20 percent in terms of Gross Revenue Receipts of the Center since the Sixth Five-Year Plan. Finance Commission Grants averaged 4.5 of Gross Revenue Receipts by the Center up to the Seventh Five-Year Plan. They accounted for less than 2 percent of GRR in the Ninth Five-Year Plan.

²⁵ The Eleventh Finance Commission's formula for inter se distribution of tax transfers to states is based on six criteria: population, distance of the per capita income of a state from the highest per capita income, area, index of infrastructure; tax effort, and fiscal discipline. The latter two criteria, which carry a combined weight of 12.5 percent, attempt to incorporate an incentive to fiscal discipline. The Tenth Finance Commission used a similar formula, with some differences in weights and in the methodology to compute the criteria.

76. But perhaps the greatest structural disincentive to performance is provided by the way the Finance Commission uses grants-in-aid to fill the gap between non-plan expenditures and state revenues, including own revenues and shares in central taxes. Finance Commissions have largely determined grants on the basis of historical expenditures rather than of normative criteria. The EFC has made some effort to introduce normative elements in calculating grants. However, while growth parameters for both revenue and expenditures were guided by some normative restrictions on growth levels, the calculation of base year magnitudes for these variables still reflected predominantly historical trends. This bias toward historical determination of grants in the gap-filling approach can be again seen as another important structural cause of fiscal imbalances at the state level, as it encourages states to maximize their expenditures.²⁶

2. Transfers Allocated by the Planning Commission

77. Center's assistance is also allocated to the states through the Planning Commission. The Planning Commission determines the amount of transfers to be distributed among the states to finance their development plans. The way state shares are calculated contributes to the emergence of structural fiscal imbalances. Since 1969, these resources are allocated on the basis of the so-called Gadgil formula. Under this formula, 30 percent of plan funds are set aside for the special category states and distributed to them, based on their plan size and past history of expenditures, with 90 percent of the assistance being given as grants and the balance 10 percent as loans. The remaining 70 percent of funds is apportioned among the general category states, with only 30 percent going to them as grants and the balance as loans.²⁷ These funds are distributed among states based on a formula including variables such as population, income, and performance. Fiscal performance, measured as tax effort and fiscal management, weighs 5 percent in the formula. Population weighs 60 percent.

78. The subsidy element on plan loans has been decreasing over time, and effective real interest rates are high. As states have an incentive to maximize the plan size to capture a sizable grant element, the grant-loan formula has translated into increasing State indebtedness and so contributed to macroeconomic imbalances.²⁸ In addition, for special category states, the earmarking of 30 percent of total plan transfer has far exceeded their absorptive capacity, and, despite the fact that 90 percent of these transfers are grants, has resulted in high debt-gross state domestic product (GSDP) ratios. On the other side of the equation, there has been limited oversight on the quality of state plan expenditures. State projects are articulated in broad terms and are not accompanied by a thorough economic analysis. As a result, the ex-post return on investment has been low, which undermines the sustainability of the debt.

²⁶ See Srivastava, *op. cit.*

²⁷ The 30-70 ratio of grants to loans is explained by the expectation that about 30 percent of state expenditures would have been revenue (current) expenditures and 70 percent capital expenditures. The intent was that there should not be any capital grants and that capital expenditures should be financed either by borrowing or by revenue surpluses. The 30-70 ratio is, however, out of line with actual historical shares of revenue and capital expenditures for general category states, particularly in recent years. For special category states, the intent was to have 60 percent capital grants in addition to 30 percent grants to cover revenue expenditures. In practice, a large portion of what were intended to be capital grants for the special category states has been used to finance revenue expenditures.

²⁸ In the context of a reexamination of center-state fiscal relations, proposals to move to a more favorable, 50-50 grant-to-loan ratio are being made.

3. Special-Purpose Transfers

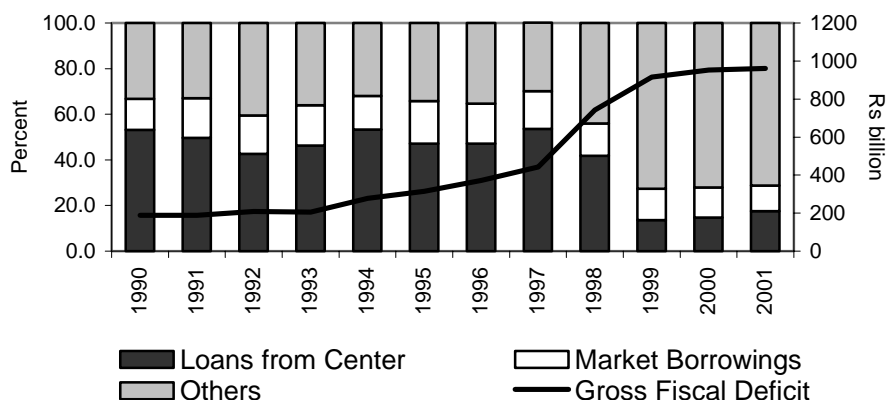
79. Finally, the third category of center-state transfers is transfers made to the states to finance the implementation of specific center schemes or shared-cost programs. These have been increasing in number, essentially providing the states with a tool to soften their budget constraint.

D. Softening of State Budget Constraints

80. The discussion so far has pointed at several elements in both the constitutional attribution of fiscal responsibilities and the structure of intergovernmental fiscal transfers that may be contributing to structural fiscal imbalances in India. In particular, incentives to fiscal discipline are weak. In fact, in many cases, the gap-filling approach guiding center-state relations provides disincentives to the states' exercise of fiscal restraint. This has resulted in state borrowings in excess of prudentially sound limits. In the latter half of the 1990s, the growth of the debt stock was, on average, 18 percent. This is significantly above the 11 percent growth rate of state revenues. With an increasing interest burden, it has translated into a deteriorating fiscal position of the states.

81. Decentralization will not contribute to fiscal imbalances if lower-tier governments are bound by a hard budget constraint. In theory, subnational governments are bound by a hard budget constraint. States need the endorsement of the central Government to borrow from the market. The Ministry of Finance, in coordination with the Planning Commission and RBI, sets the overall borrowing ceiling for the states—inclusive of all sources, i.e., center, market, small savings and provident funds—based on the annual plan submitted and on already existing liabilities (Figure 19).

Figure 19: Financing of States' Gross Fiscal Deficit



82. In practice, however, states have softened their budget constraints through various means:²⁹

- (i) Borrowing from public accounts, including small savings collections (80 percent of all collections accrues to the states in the form of loans) and provident funds.
- (ii) Through contingent liabilities in relation to
 - (a) The creation of separate corporations to implement major special projects, which then borrow from the market. This is becoming an increasingly widespread practice.
 - (b) Guarantees on PSU borrowings and borrowings by local governments, particularly municipal corporations.
- (iii) Overdrafts from RBI.

1. Small Savings Schemes

83. The option of borrowing from small savings schemes, which carry central Government guarantee, is a major obstacle to the imposition of market-based discipline on the states. Introducing market-based discipline for State borrowings will help encourage fiscal prudence. Since 1999, RBI has been encouraging the states to raise a portion (5–35 percent) of their allocated borrowings through auctions in the attempt to encourage the establishment of a market for state borrowings.³⁰

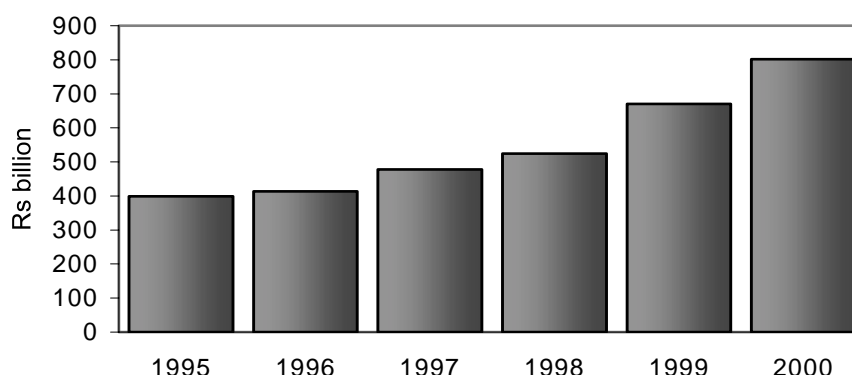
2. Contingent Liabilities

84. Additional concerns relate to contingent liabilities. These liabilities are not reflected in state budgets and are, therefore, difficult to monitor and limit. In view of this, several states recently placed statutory ceilings on guarantees. These include Gujarat, Karnataka, Sikkim, and West Bengal. Other states—such as Rajasthan and Assam—have introduced administrative ceilings. Data provided by RBI for guarantees shows increasing use of this instrument since 1996 (Figure 20).

²⁹ See Rao, M. G., op.cit. Also, Lahiri, A. K., 2000, "Sub-National Public Finance in India," in *Economic and Political Weekly*, April 29.

³⁰ Market borrowings currently finance about 13 percent of the gross fiscal deficit of the states. Since there is no real market for state borrowings, all states are charged the same interest rates irrespective of their financial position (except state specific options).

**Figure 20: Guarantee of State Governments
(Constant Prices)**



3. Ways and Means Advances, and Overdrafts

85. Finally, ways and means advances (WMA) are meant to help the states finance temporary cash-flow mismatches between receipts and payments. These WMA must be repaid by the states within three months. Amounts drawn in excess of WMA are overdrafts. Each state is assigned certain overdraft limits. Current norms prescribe that if a state is in overdraft in excess of 12 days, RBI will stop honoring its checks. However, since states are not required to vacate their WMA and overdrafts by the end of the financial year, these have been used as a means to finance fiscal deficits.

E. Conclusion

86. In conclusion, several institutional arrangements governing center-state fiscal relations impact on structural fiscal imbalances. This chapter specifically discussed:

- (i) Assignment of tax and expenditure responsibilities to the three tiers of government—for example, the mismatch between revenue capacities and expenditure responsibilities of subnational governments; and opportunities for tax evasion and low compliance;
- (ii) Specific features of the intergovernmental transfer system such as the “gap-filling” approach in Finance Commission transfers and the bias toward indebtedness induced by Planning Commission transfers; and
- (iii) Opportunities for softening the budget constraint of subnational governments.

87. While some policy action has been undertaken to address some of these areas, more remains to be done.

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Table A.1: Key Economic Indicators

Item	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01
Output Growth^a (% change)						
Real GDP	7.3	7.8	4.8	6.6	6.4	5.2
Agriculture	(0.9)	9.6	(2.4)	7.1	0.7	0.2
Industry	11.6	7.1	4.2	3.4	6.4	5.3
Services	10.5	7.2	9.8	8.2	9.6	7.7
Saving and Investment (% of GDP)						
Gross Domestic Saving	25.1	23.2	23.5	22.0	22.3	–
Gross Domestic Investment	26.8	24.5	25.0	23.0	23.3	–
Government Finance (% of GDP)						
Fiscal Deficit						
Center ^d	(4.2)	(4.1)	(4.8)	(5.1)	(5.4)	(5.1) ^b
States	(2.6)	(2.7)	(2.9)	(4.2)	(4.7) ^b	(4.4) ^c
Combined	(5.6)	(6.4)	(7.3)	(8.9)	(9.4)	(9.1)
Interest Payment (% of Revenue Receipts)						
Center	45.4	47.1	49.0	52.1	49.7	48.8 ^b
States	16.0	16.7	17.7	20.3	21.8 ^b	21.6 ^c
Monetary Supply and Credits (% change)						
Broad Money (M3)	13.6	16.2	18.0	19.4	14.6	16.7
Narrow Money (M1)	11.7	12.0	11.3	15.4	10.6	11.1
Nonfood credit	22.5	10.9	15.1	13.0	16.6	14.9
Investment in Gov't. Securities	12.4	20.2	17.7	19.4	24.8	22.1
Inflation (annual average, % change)						
WPI	8.1	4.6	4.4	5.9	3.3	7.1
CPI ^e	10.2	9.0	6.8	13.1	3.4	3.7
Balance of Payments						
Exports in \$ (% change)	20.3	5.6	4.5	(3.9)	9.5	19.6
Imports in \$ (% change)	21.6	12.1	4.6	(7.1)	16.5	7.0
Current Account (% of GDP)	(1.7)	(1.2)	(1.4)	(1.0)	(1.0)	(0.5)
Capital Account (% of GDP)	1.1	3.1	2.4	2.0	2.3	1.9
End-of-Year Reserves (\$ billion) ^f	17.0	22.4	26.0	29.5	35.1	39.6
(in months of imports)	4.7	5.5	6.1	7.5	7.6	8.0
Memorandum Items						
External Debt (\$ billion) ^g	93.7	93.5	93.5	96.9	98.3	100.4
Debt-to-GDP Ratio	27.0	24.5	24.3	23.4	21.9	21.5
Exchange Rate(Rupee/US\$)	33.5	35.5	37.2	42.1	43.3	45.7

– = not available, CPI = consumer price index, GDP = gross domestic product, WPI = wholesale price index.

^a Figures are in constant 1993/94 prices.

^b Revised estimate.

^c Budget estimate.

^d Excludes small savings to states.

^e CPI for industrial workers.

^f Excluding Gold and SDRs.

^g Figures are at end of March.

Table A.2: Indicators of Social Development

Item	Earlier Period	Latest Year
Life Expectancy at Birth (years)	63.1 (1997)	63.2 (1999)
Maternal Mortality Rate (per 100,000 live births)	460 (1980-1985)	570 (1999)
Total Fertility Rate (births per woman)	4.5 (1985)	3.3 (1995-2000)
Infant Mortality Rate (below 1 year; per 1,000 live births)	72 (1998)	70 (1999)
Adult Literacy (%)	41 (1981)	56.5 (1999)
Primary School Enrollment (% of school-age population)	96 (1995)	77 (1997)
Female	80 (1985)	71 (1997)
Secondary School Enrollment (% of school-age population)	37 (1985)	60 (1997)
Female	26 (1985)	48 (1997)
Child Malnutrition (% of under age 5) ^a	53.2 (1993)	45.4 (1997)
Population Below Poverty Line (%) ^b	44.5 (1983)	35.0 (1999)
Income Ratio of Highest 20% Level to Lowest 20%	5.1 (1980-1985)	5.7 (1997)
Population with Access to Safe Water (%)		
Rural	56.3 (1985)	98 (1999)
Urban	72.9 (1985)	90.2 (1999)
Population with Access to Sanitation (%)		
Rural	0.7 (1985)	9.0 (1999)
Urban	28.4 (1985)	49.3 (1999)
Human Development Index ^c	0.51 (1990)	0.57 (1999)
Human Development Ranking ^d	134 (1990)	115 (2001)
Population (in millions)	846 (1991)	1027 (2001)
Annual Population Growth Rate (% change) ^e	1.98 (1991)	1.14(2001)
Decadal Population Growth Rate (% change)	23.9 (1981-1991)	21.3 (1991-2001)
Employment Indicators (in millions)		
Total Employment	25.9 (1989)	28.1 (1999)
Agriculture	1.4 (1989)	1.4 (1999)
Industry	9.4 (1989)	9.9 (1999)
Service	15.1 (1989)	16.8 (1999)

^a Child malnutrition is the percentage of children under age 5 whose weight for age is less than -2 standard deviations from the median of the reference population, which is based on the children from the United States, who are assumed to be well-nourished. Weight for age is composite indicator of both weight for height (wasting) and height for age (stunting). Estimates of child malnutrition are from national survey data on weight for age.

^b Population below the poverty line is the percentage of population living below the poverty line deemed appropriate for the country by its authorities. National estimates are based on population-weighted subgroup estimates for household surveys.

^c The human development index (HDI) is based on the following indicators: longevity, as measured by life expectancy at birth; educational attainment, as measured by a combination of adult literacy (two-thirds weight) and the combined gross primary, secondary, and tertiary enrollment ratio (one-third weight); and standard of living, as measured by gross domestic product (GDP) per capita (purchasing power parity\$ (PPP)). The HDI is the average of life expectancy index, educational attainment, and adjusted real GDP per capita (PPP\$). The index is derived by dividing the 3 indices by 3.

^d Ranking is among 174 countries in the United Nations Development Program report of 2001.

^e Figure for 2001 is staff estimate.

Sources: World Bank, World Development Indicators 2001 CD -Rom; UNDP, Human Development Report 2001; Ministry of Finance, Economic Survey 2000-01; and Office of Registrar General, Census 2001.

**Table A.3: Gross Domestic Product at Factor Cost by Sectoral Origin
(1993/94 Prices)**

Item	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01 ^a
	Rs billion					
GDP at Factor Cost	8,996	9,701	10,163	10,830	11,519	12,117
GDP at Market Prices	9,955	10,674	11,149	11,819	12,667	–
Agriculture Sector	2,519	2,761	2,694	2,884	2,903	2,909
Agriculture	2,305	2,538	2,466	2,660	2,668	2,666
Industry Sector	2,524	2,703	2,818	2,914	3,101	3,267
Mining and Quarrying	233	234	257	260	264	274
Manufacturing	1,614	1,770	1,797	1,843	1,968	2,078
Registered	1,075	1,191	1,178	1,201	1,298	–
Unregistered	540	579	618	641	670	–
Electricity, Gas, and Water	222	234	252	268	282	296
Construction	455	465	512	543	587	619
Services Sector	3,953	4,237	4,651	5,032	5,515	5,941
Trade, Hotels, and Restaurants	1,259	1,355	1,458	1,560	1,684	2,702 ^b
Transport, Storage, and Communication	623	674	727	780	845	–
Financing, Insurance, Real Estate and Business Services	1,028	1,100	1,228	1,331	1,465	1,599
Community, Social, and Personal Services	1,043	1,108	1,238	1,361	1,521	1,640
	Annual Percentage Change					
GDP at Factor Cost	7.3	7.8	4.8	6.6	6.4	5.2
GDP at Market Prices	7.7	7.2	4.4	6.0	7.2	–
Agriculture Sector	(0.9)	9.6	(2.4)	7.1	0.7	0.2
Agriculture	(1.1)	10.1	(2.8)	7.9	0.3	(0.1)
Industry Sector	11.6	7.1	4.2	3.4	6.4	5.3
Mining and Quarrying	5.9	0.5	9.8	1.3	1.7	3.7
Manufacturing	14.9	9.7	1.5	2.5	6.8	5.6
Registered	14.7	10.8	(1.0)	1.9	8.0	–
Unregistered	15.3	7.3	6.8	3.7	4.5	–
Electricity, Gas, and Water	6.8	5.4	7.9	6.4	5.2	4.7
Construction	6.2	2.1	10.2	6.1	8.1	5.5
Services Sector	10.5	7.2	9.8	8.2	9.6	7.7
Trade, Hotels, and Restaurants	14.4	7.7	7.6	7.0	7.9	6.9 ^b
Transport, Storage, and Communication	11.0	8.2	7.8	7.3	8.3	–
Financing, Insurance, Real Estate and Business Services	8.2	7.0	11.6	8.4	10.1	9.1
Community, Social, and Personal Services	7.9	6.3	11.7	9.9	11.8	7.8

GDP = gross domestic product; – = not available.

^a Revised estimate.

^b Figure includes trade, hotels, and restaurants; and transport, storage, and communication sectors.

Sources: Central Statistical Organization, *National Accounts Statistics 2001; Revised Estimates of Annual National Income, 2000-01 (June 2001)*.

**Table A.4: Gross Domestic Product at Factor Cost by Sectoral Origin
(Current Prices)**

Economic Activity	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01^a
	Rs billion					
Agriculture Sector	3,031	3,626	3,870	4,599	4,842	5,004
Agriculture	2,778	3,340	3,535	4,232	4,439	4,569
Forestry and Logging	134	145	162	186	199	198
Fishing	119	141	173	181	204	237
Industry Sector	3,018	3,412	3,785	4,213	4,657	5,180
Mining and Quarrying	253	277	334	351	382	407
Manufacturing	1,938	2,207	2,320	2,518	2,746	2,993
Electricity, Gas, and Water	277	300	353	425	475	589
Construction	550	628	778	919	1,054	1,191
Services Sector	4,684	5,398	6,245	7,348	8,365	5,382
Trade, Hotels and Restaurants	1,463	1,717	1,945	2,247	2,470	4,213 ^b
Transport, Communication, and Storage	707	836	974	1,113	1,226	
Financing, Insurance, Real Estate, and Business Services	1,251	1,376	1,568	1,816	2,151	2,513
Community, Social, and Personal Services	1,263	1,469	1,758	2,172	2,519	2,869
GDP at Factor Cost	10,733	12,436	13,900	16,160	17,865	19,779
	Percentage of GDP at Factor Cost					
Agriculture Sector	28.2	29.2	27.8	28.5	27.1	25.3
Agriculture	25.9	26.9	25.4	26.2	24.8	23.1
Forestry and Logging	1.2	1.2	1.2	1.1	1.1	1.0
Fishing	1.1	1.1	1.2	1.1	1.1	1.2
Industry Sector	28.1	27.4	27.2	26.1	26.1	26.2
Mining and Quarrying	2.4	2.2	2.4	2.2	2.1	2.1
Manufacturing	18.1	17.7	16.7	15.6	15.4	15.1
Electricity, Gas, and Water	2.6	2.4	2.5	2.6	2.7	3.0
Construction	5.1	5.1	5.6	5.7	5.9	6.0
Services Sector	43.6	43.4	44.9	45.5	46.8	27.2
Trade, Hotels and Restaurants	13.6	13.8	14.0	13.9	13.8	21.3 ^b
Transport, Communication, and Storage	6.6	6.7	7.0	6.9	6.9	
Financing, Insurance, Real Estate, and Business Services	11.7	11.1	11.3	11.2	12.0	12.7
Community, Social, and Personal Services	11.8	11.8	12.6	13.4	14.1	14.5
Memorandum Item						
Gross Domestic Product at Market Prices	11,880.1	13,682.1	15,224.4	17,582.8	19,570.0	21,769.4

GDP = gross domestic product, – = not available.

^a Revised Estimate.

^b Figure includes trade, hotels, and restaurant and transport, communication and storage.

Sources: Central Statistical Organization, *National Accounts Statistics 2001; Revised Estimates of Annual National Income, 2000-01 (June 2001)*.

**Table A.5: Expenditure on Gross Domestic Product
(current market prices), Rs billion**

Item	1994/95	1995/96	1996/97	1997/98	1998/99 ^a	1999/2000 ^b
Consumption	7,728	8,946	10,494	11,470	13,530	15,169
Public	1,086	1,288	1,457	1,722	2,118	2,515
Private	6,642	7,658	9,037	9,748	11,412	12,654
Gross Domestic Investment^c	2,367	3,153	3,027	3,491	3,721	4,444
Gross Fixed Capital Formation	2,222	2,895	3,118	3,308	3,733	4,161
Public	889	916	943	971	1,103	1,246
Private	1,333	1,979	2,175	2,337	2,630	2,915
Corporate Sector	593	971	1,181	1,227	1,163	1,160
Household Sector	740	1,008	994	1,110	1,467	1,755
Change in Stocks	145	258	(91)	184	(12)	283
Exports of Goods and NFS	1,016	1,307	1,449	1,652	1,953	–
Less: Imports of Goods and NFS	1,047	1,450	1,610	1,843	2,247	–
Statistical Discrepancy	64	(76)	323	454	627	–
GDP at market prices	10,128	11,880	13,682	15,224	17,583	19,570
Net Factor Income from Abroad	(131)	(135)	(131)	(132)	(150)	(154)
GNP at market prices	9,997	11,745	13,551	15,092	17,433	19,416
Memo Item:						
Gross Domestic Investment adjusted^d	2,634	3,190	3,347	3,806	4,048	4,552
as percentage of GDP (%)	26.0	26.8	24.5	25.0	23.0	23.3

NFS = nonfactor services, GDP = gross domestic product, GNP = gross national product, – = not available.

^a Provisional estimates.

^b Quick estimates.

^c Refers to the gross capital formation unadjusted for errors and omissions.

^d Refers to the savings-based estimates of investment of India's Central Statistical Organization.

Sources: Central Statistical Organization, National Accounts Statistics 2001, *Quick Estimates of National Income, Consumption Expenditure, Saving and Capital Formation, 1999-2000 (January 2001)*.

Table A.6: Summary of Government Finances ^a

Item	1996/97	1997/98	1998/99	1999/2000	2000/01 ^b	2001/02 ^c
Rs billion						
Total Revenues	3,233	3,945	4,597	5,426	6,103	6,808
Of which:						
Tax Revenue	1,998	2,173	2,331	2,750	3,167	3,661
Nontax Revenue	466	535	546	688	807	873
Nondebt Capital Receipts	86	87	135	76	144	214
Recovery of Loans	79	78	71	59	119	94
Disinvestment Proceeds	6	9	64	17	25	120
Total Disbursement	3,435	3,924	4,633	5,458	6,130	6,836
Development	1,854	2,090	2,422	2,736	3,195	3,453
Nondevelopment	1,549	1,783	2,125	2,581	2,866	3,275
Others	33	51	86	142	69	108
Revenue	19	30	35	45	53	57
Capital	13	21	50	96	16	51
Gross Fiscal Surplus/(Deficit)	(872)	(1,107)	(1,571)	(1,848)	(1,996)	(2,037)
Percentage of GDP						
Total Revenues	23.6	25.9	26.1	27.7	28.0	27.5
Of which:						
Tax Revenue	14.6	14.3	13.3	14.1	14.5	14.8
Nontax Revenue	3.4	3.5	3.1	3.5	3.7	3.5
Nondebt Capital Receipts	0.6	0.6	0.8	0.4	0.7	0.9
Recovery of Loans	0.6	0.5	0.4	0.3	0.5	0.4
Disinvestment	0.0	0.1	0.4	0.1	0.1	0.5
Total Disbursements	25.1	25.8	26.3	27.9	28.1	27.6
Development	13.5	13.7	13.8	14.0	14.6	14.0
Nondevelopment	11.3	11.7	12.1	13.2	13.1	13.2
Others ^c	0.2	0.3	0.5	0.7	0.3	0.4
Gross Fiscal Surplus/(Deficit) ^d	(6.4)	(7.3)	(8.9)	(9.4)	(9.1)	(8.2)
GDP at current market prices	13,682.1	15,224.4	17,582.8	19,570.0	21,769.4	24,747.7

GDP = gross domestic product.

^a Central and state governments, combined.^b Revised estimates.^c Budget estimates.^d Gross fiscal deficit = total disbursement - other capital - tax receipts - nontax receipts - nondebt capital receipts.

Sources: Reserve Bank of India, RBI Bulletin, December 2001.

Table A.7.1: Central Government Finances
Rs billion

Item	1996/97	1997/98	1998/99	1999/2000	2000/01 ^a	2001/02 ^b
TOTAL RECEIPTS	1,878	2,330	2,795	2,972	3,329	3,752
Total Revenue (incl. Grants)	1,263	1,339	1,495	1,815	2,062	2,317
Tax Revenue (net of State's Share)	937	957	1,047	1,283	1,444	1,630
Tax Revenue (incl. State's Share)	1,288	1,392	1,439	1,719	1,983	2,266
Corporate Tax	186	200	245	307	387	442
Income Tax	182	171	202	256	353	406
Excise Taxes	450	480	532	619	707	817
Customs	429	402	407	484	498	548
Others	41	139	52	52	38	53
Nontax Revenue	326	382	447	531	618	687
Interest Receipts	221	253	301	339	380	416
Dividends and Profits	39	52	76	96	142	162
Foreign Grants	12	10	10	11	7	7
Other Receipts	54	67	61	86	89	102
Capital Receipts	615	991	1,301	1,157	1,268	1,435
Market Borrowing	200	325	690	703	759	729
External Assistance (Net)	30	11	19	12	6	19
Recovery of Loans	75	83	106	101	149	152
Small Savings and Provident Funds	176	289	388	156	165	185
Special Deposits and others (Net)	130	274	39	168	164	231
Disinvestment	4	9	59	17	25	120
Total Expenditure	2,010	2,321	2,793	2,981	3,355	3,752
Revenue Expenditure	1,589	1,803	2,165	2,491	2,835	3,106
Capital Expenditure ^c	421	517	629	490	520	647
Of which: Small Savings to States ^d	106	157	238	269	320	360
Nonplan Expenditure	1,475	1,731	2,125	2,219	2,493	2,751
Interest Payments	595	656	779	902	1,007	1,123
Defense	295	353	399	471	545	620
Subsidies	155	185	236	247	269	298
Other Nonplan	430	536	711	599	672	710
Plan Expenditure	535	591	668	762	862	1,001
Fiscal Surplus/(Deficit) w/ Small Savings	(668)	(889)	(1,133)	(1,317)	(1,440)	(1,523)
Fiscal Surplus/(Deficit) w/o Small Savings	(562)	(732)	(896)	(1,047)	(1,120)	(1,163)
Revenue Surplus/(Deficit)	(327)	(464)	(670)	(676)	(774)	(788)
Budget Surplus/(Deficit)	(132)	9	2	(9)	(26)	–
Primary Surplus/(Deficit) w/ Small Savings	(73)	(233)	(355)	(414)	(433)	(400)
Primary Surplus/(Deficit) w/o Small Savings	32	(76)	(117)	(145)	(113)	(40)

– = not available.

^a Revised estimates.

^b Budget estimates.

^c From 1999-2000, capital expenditure excludes small savings to states.

^d Small savings to states refer to the cost of interest and cost of management of states securities invested by the National Small Savings Fund.

Definitions:

Fiscal deficit = total revenue (tax + nontax + grants) + recovery of loans + disinvestment - total expenditure.

Revenue deficit = total revenue (tax + nontax + grants) - revenue expenditures.

Budget deficit = total receipts - total expenditures.

Primary deficit = fiscal deficit + interest payments (this, in effect, excludes interest payments from total expenditure).

Sources: Ministry of Finance, *Union Budget 2001-02*; Reserve Bank of India, *RBI Annual Report 2000-01*.

**Table A.7.2: Central Government Finances
(Percentage of GDP)**

Item	1996/97	1997/98	1998/99	1999/2000	2000/01 ^a	2001/02 ^b
TOTAL RECEIPTS	13.7	15.3	15.9	15.2	15.3	15.2
Total Revenue (incl. Grants)	9.2	8.8	8.5	9.3	9.5	9.4
Tax Revenue (Net of State's Share)	6.8	6.3	6.0	6.6	6.6	6.6
Tax Revenue (incl. State's Share)	9.4	9.1	8.2	8.8	9.1	9.2
Corporate Tax	1.4	1.3	1.4	1.6	1.8	1.8
Income Tax	1.3	1.1	1.2	1.3	1.6	1.6
Excise Taxes	3.3	3.2	3.0	3.2	3.2	3.3
Customs	3.1	2.6	2.3	2.5	2.3	2.2
Others	0.3	0.9	0.3	0.3	0.2	0.2
Nontax Revenue	2.4	2.5	2.5	2.7	2.8	2.8
Interest Receipts	1.6	1.7	1.7	1.7	1.7	1.7
Dividends and Profits	0.3	0.3	0.4	0.5	0.7	0.7
Foreign Grants	0.1	0.1	0.1	0.1	0.0	0.0
Other Receipts	0.4	0.4	0.3	0.4	0.4	0.4
Capital Receipts	4.5	6.5	7.4	5.9	5.8	5.8
Market Borrowing	1.5	2.1	3.9	3.6	3.5	2.9
External Assistance (Net)	0.2	0.1	0.1	0.1	0.0	0.1
Recovery of Loans	0.6	0.5	0.6	0.5	0.7	0.6
Small Savings & Provident Funds	1.3	1.9	2.2	0.8	0.8	0.7
Special Deposits and others (Net)	1.0	1.8	0.2	0.9	0.8	0.9
Disinvestment	0.0	0.1	0.3	0.1	0.1	0.5
Total Expenditure	14.7	15.2	15.9	15.2	15.4	15.2
Revenue Expenditure	11.6	11.8	12.3	12.7	13.0	12.5
Capital Expenditure	3.1	3.4	3.6	2.5	2.4	2.6
Small Savings to States	0.8	1.0	1.4	1.4	1.5	1.5
Nonplan Expenditure	10.8	11.4	12.1	11.3	11.5	11.1
Interest Payments	4.3	4.3	4.4	4.6	4.6	4.5
Defense	2.2	2.3	2.3	2.4	2.5	2.5
Subsidies	1.1	1.2	1.3	1.3	1.2	1.2
Other Nonplan	3.1	3.5	4.0	3.1	3.1	2.9
Plan Expenditure	3.9	3.9	3.8	3.9	4.0	4.0
Fiscal Surplus/(Deficit) w/ Small Savings	(4.9)	(5.8)	(6.4)	(6.7)	(6.6)	(6.2)
Fiscal Surplus/(Deficit) w/o Small Savings	(4.1)	(4.8)	(5.1)	(5.4)	(5.1)	(4.7) ^c
Revenue Surplus/(Deficit)	(2.4)	(3.1)	(3.8)	(3.5)	(3.6)	(3.2) ^d
Budget Surplus/(Deficit)	(1.0)	0.1	0.0	(0.0)	(0.1)	–
Primary Surplus/(Deficit) w/ Small Savings	(0.5)	(1.5)	(2.0)	(2.1)	(2.0)	(1.6)
Primary Surplus/(Deficit) w/o Small Savings	0.2	(0.5)	(0.7)	(0.7)	(0.5)	(0.2) ^d

– = not available; GDP = gross domestic product.

^a Revised estimates.

^b Budget estimates.

^c As per Union Budget Speech for 2001-02.

^d Worked out on the basis of the implicit nominal GDP underlying the budget estimates of Gross Fiscal Deficit/GDP ratio of 4.7% for 2001-2002.

Definitions:

Fiscal deficit = total revenue (tax + nontax + grants) + recovery of loans + disinvestment - total expenditure.

Revenue deficit = total revenue (tax + nontax + grants) - revenue expenditures.

Budget deficit = total receipts - total expenditures.

Primary deficit = fiscal deficit + interest payments (this, in effect, excludes interest payments from total expenditure).

Sources: Ministry of Finance, *Union Budget 2001-02*; Reserve Bank of India, *RBI Annual Report 2000-01*.

Table A.8: State Government Finances
(Rs billion)

Item	1996/97	1997/98	1998/99	1999/2000	2000/01 ^a	2001/02 ^b
Revenue Receipts	1528	1703	1764	2072	2496	2847
Tax Revenue	1061	1216	1284	1467	1723	2031
Own Tax Revenues	711	812	890	1026	1205	1427
Direct Tax ^c	84	65	108	131	147	158
Indirect Tax ^c	627	716	785	894	1049	1245
State Share in Central Taxes	350	404	394	441	518	604
Nontax Revenue	467	487	480	605	773	816
of which:						
Grants from Center	232	244	239	306	473	486
Revenue Expenditure	1689	1866	2201	2610	3009	3327
Developmental	1062	1138	1319	—	—	—
Social Services	603	683	820	—	—	—
Economic Services	458	455	498	—	—	—
Nondevelopmental	609	699	847	1051	1212	1430
Interest Payments	269	316	359	452	540	648
Other Expenditures	19	30	35	—	—	—
Revenue Surplus/(Deficit)	(161)	(163)	(436)	(538)	(513)	(480)
Capital Outlay	175	228	231	255	369	403
Developmental	168	218	223	—	—	—
Social Services	30	34	42	—	—	—
Economic Services	139	184	181	—	—	—
Nondevelopmental	7	10	8	—	—	—
Net Lending	38	51	80	122	70	77
Gross Fiscal Surplus/(Deficit)^d	(373)	(442)	(742)	(915)	(953)	(961)
GDP at Market Prices	13682	15224	17583	19570	21769	24748
<u>Financing</u>						
Market Loans	65	73	105	127	126	107
Loans from Center (net) ^e	175	237	311	124	140	168
Small Savings and Provident Fund	54	62	120	179	139	132
Others	80	70	208	485	548	553
<u>Memorandum Items (% of GDP):</u>						
Revenue Receipts	11.2	11.2	10.0	10.6	11.5	11.5
Revenue Expenditure	12.3	12.3	12.5	13.3	13.8	13.4
Capital Expenditure	1.3	1.5	1.3	1.3	1.7	1.6
Gross Fiscal Surplus/(Deficit)	(2.7)	(2.9)	(4.2)	(4.7)	(4.4)	(3.9)

— = not available, GDP = gross domestic product.

^a Revised estimates.

^b Budget estimates. Includes the 3 new states Chhattisgarh, Jharkand and Uttaranchal formed in November 2000.

^c Excludes state's share in central taxes as reported in central government budget documents.

^d Components do not add up to gross fiscal deficit due to inclusion of disinvestment proceeds of PSUs in 1996-97 and 1998/99.

^e From 1999-2000 onward, data excludes state's share in small savings.

Definitions:

Gross fiscal deficit = revenue receipt - (revenue expenditure + capital outlay + net lending).

Net lending = loans and advances by the state governments - recovery of loans and advances.

Sources: Reserve Bank of India, *State Finances: A Study of Budgets 2001-02*; *RBI Annual Report 2000-01*.

Table A.9: Monetary Survey ^a

Item	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01
	Rs billion					
Net Foreign Assets (NFA)	821	1,055	1,381	1,779	2,056	2,498
Net Domestic Assets (NDA)	5,171	5,905	6,832	8,031	9,185	10,618
Net Domestic Credit	6,024	6,649	7,639	8,827	10,279	11,856
Net Bank Credit to Government	2,578	2,886	3,306	3,867	4,414	5,124
Reserve Bank of India	1,213	1,242	1,352	1,525	1,483	1,539
Central Government	1,188	1,207	1,336	1,454	1,398	1,465
State Government	26	35	15	71	84	73
Other Banks	1,364	1,644	1,954	2,341	2,931	3,585
Bank Credit to Commercial Sector	3,446	3,763	4,333	4,960	5,866	6,732
Reserve Bank of India	69	62	82	122	153	133
Other Banks	3,378	3,701	4,251	4,838	5,713	6,599
Other Items (Net)	(854)	(744)	(807)	(796)	(1,094)	(1,238)
Reserve Bank of India	(323)	(352)	(433)	(605)	(702)	(793)
Govt's Currency Liabilities to Public	25	29	34	38	46	54
Other Banks (Residual)	(556)	(421)	(407)	(229)	(438)	(498)
Broad Money Supply	5,992	6,960	8,213	9,810	11,242	13,116
Narrow Money	2,148	2,406	2,678	3,091	3,418	3,798
Currency with Public	1,183	1,321	1,456	1,689	1,891	2,096
Deposit Money (total)	966	1,085	1,223	1,401	1,527	1,702
Time Deposit with Banks	3,844	4,554	5,535	6,719	7,824	9,318
	Annual Percentage Change					
Net Domestic Credit	16.9	10.4	14.9	15.6	16.4	15.3
Net Bank Credit to Government	15.9	12.0	14.5	17.0	14.1	16.1
Reserve Bank of India	19.6	2.3	8.9	12.8	(2.8)	3.8
Other Banks	12.8	20.5	18.9	19.8	25.2	22.3
Bank Credit to Commercial Sector	17.7	9.2	15.1	14.5	18.3	14.8
Broad Money Supply	13.6	16.2	18.0	19.4	14.6	16.7
Narrow Money	11.7	12.0	11.3	15.4	10.6	11.1
Memorandum Items: Velocity						
Broad Money	2.0	2.0	1.9	1.8	1.7	1.7
Narrow Money	5.5	5.7	5.7	5.7	5.7	5.7
Time Deposits with Banks	3.1	3.0	2.8	2.6	2.5	2.3

^a Data relate to the end of fiscal year (31 March).

Note: Monetary data have been revised from 1997/98 in line with the new accounting standards and consistent with the methodology suggested by the Working Group on Money Supply: Analytics and Methodology Compilation (June 1998)
Sources: Reserve Bank of India, *RBI Bulletin* (November 2001); *RBI Annual Report 2000-01*.

**Table A.10: Price Index
(1993/94=100)**

Indices	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01
Wholesale Price Index	Index Number of Wholesale Prices ^a					
All Commodities	122	127	133	141	145	156
Primary Articles	125	136	139	156	158	163
Food Articles	124	137	141	159	166	170
Food Grains	124	138	139	152	176	174
Nonfood Articles	138	134	138	152	143	147
Minerals	95	107	100	111	110	113
Fuel, Power, Light, and Lubricants	115	126	144	148	162	208
Manufactured Products	122	124	128	134	137	142
Food Products	118	125	135	150	151	146
Textiles	129	119	116	114	115	120
Chemicals and Chemical products	127	131	137	146	155	164
Basic Metals and Products	120	126	131	133	135	140
Machinery and Machine Tools	112	116	115	116	116	123
Consumer Price Index						
Industrial Workers ^b						
Food	337	369	388	445	446	453
General	313	342	366	414	428	444
Urban Nonmanual Employees ^c	259	283	302	337	352	371
Agricultural Laborers ^d	234	256	264	293	306	305
	Annual Percentage Change					
Wholesale Price Index						
All Commodities	8.1	4.6	4.4	5.9	3.3	7.1
Primary Articles	8.3	8.4	2.7	12.0	1.1	2.9
Fuel, Power, Light, and Lubricants	5.1	10.4	13.8	3.2	9.0	28.3
Manufactured Products	8.6	2.1	2.9	4.4	2.7	3.3
Consumer Price Index						
Industrial Workers						
Food	13.5	9.5	5.1	14.7	0.7	2
General	10.2	9.0	6.8	13.1	3.4	3.7
Urban Nonmanual Employees	9.3	9.3	6.9	11.3	4.5	5.6
Agricultural Laborers	10.7	9.1	3.4	11.0	4.4	(1.3)

– = not available.

^a On annual average basis.

^b Base: 1981/82=100.

^c Base: 1984/85=100.

^d Base: 1986/87=100.

Sources: Ministry of Finance, Economic Survey 2000-01; Reserve Bank of India, *RBI Annual Report 2000-01*, *RBI Bulletin* (November 2001)

Table A.11: Summary of Balance of Payments
(\$ million)

Item	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01
Current Account	(5,910)	(4,619)	(5,500)	(4,038)	(4,698)	(2,579)
(Percent of GDP)	(1.7)	(1.2)	(1.4)	(1.0)	(1.0)	(0.5)
Trade Account	(11,359)	(14,815)	(15,507)	(13,246)	(17,841)	(14,370)
(Percent of GDP)	(3.2)	(3.8)	(3.8)	(3.2)	(4.0)	(3.0)
Exports	32,311	34,133	35,680	34,298	37,542	44,894
(Growth Rate)	20.3	5.6	4.5	(3.9)	9.5	19.6
Imports	43,670	48,948	51,187	47,544	55,383	59,264
(Growth Rate)	21.6	12.1	4.6	(7.1)	16.5	7.0
Services (Net)	5,449	10,196	10,007	9,208	13,143	11,791
Nonfactor Services (NFS), Net	(197)	726	1,319	2,165	4,064	2,478
Factor Income, Net	(3,205)	(3,307)	(3,521)	(3,544)	(3,559)	(3,821)
Private Transfers, Net	8,506	12,367	11,830	10,280	12,256	12,798
Official Transfers	345	410	379	307	382	336
Capital Account	3,899	11,816	9,844	8,435	10,444	9,023
(Percent of GDP)	1.1	3.1	2.4	2.0	2.3	1.9
External Assistance (Net)	883	1,109	885	799	891	410
Disbursements	2,933	3,056	2,885	2,726	3,074	2,942
Amortization	(2,050)	(1,947)	(2,000)	(1,927)	(2,183)	(2,532)
Commercial Borrowings (Net)	1,275	2,848	4,010	4,367	333	4,016
MT and LT Loans	4,252	7,571	–	–	–	–
Amortization	(2,977)	(4,723)	–	–	–	–
Short-Term Credit (Net)	49	838	(96)	(748)	377	105
Foreign Investment	4,615	5,963	5,353	2,312	5,117	4,588
Nonresident Deposits, Net	1,103	3,350	1,125	960	1,540	2,317
Rupee Debt Service	(952)	(727)	(767)	(802)	(711)	(617)
Other Capital, Net ^a	(3,074)	(1,565)	(666)	1,547	2,897	(1,796)
Errors and Omissions	600	(594)	167	(175)	656	(588)
Overall Balance	(1,411)	6,603	4,511	4,222	6,402	5,856
Change in Reserves (Excl. Gold)	1,221	(6,793)	(4,511)	(4,222)	(6,402)	(5,856)
(– = increase)						
IMF (Net)	(1,715)	(975)	(618)	(393)	(260)	(26)
End-of-Year Reserves (excl. Gold)	17,044	22,367	25,975	29,522	35,058	39,554
(in months of imports)	4.7	5.5	6.1	7.5	7.6	8.0

GDP = gross domestic product, IMF = International Monetary Fund, LT = long-term, MT = medium-term,
– = not available,

^a Includes delayed export receipts, advance payments against imports, loans to non-residents and banking capital
Sources: Reserve Bank of India, *RBI Annual Report 1999-2000*; *RBI Bulletin (November 2001)*.

Table A. 12: External Debt
(\$ million)

Item	FY1995	FY1996	FY1997	FY1998	FY1999	FY2000 ^a
Multilateral	28,616	29,218	29,553	30,534	31,438	31,104
Government Borrowing	26,059	26,369	26,344	26,967	27,584	27,388
Concessional	17,576	17,636	17,836	18,596	19,269	19,066
Nonconcessional	8,483	8,733	8,508	8,371	8,315	8,322
Non-Government Borrowing	2,557	2,849	3,209	3,567	3,854	3,716
Concessional	0	0	0	0	0	0
Nonconcessional	2,557	2,849	3,209	3,567	3,854	3,716
Bilateral	19,213	17,494	16,969	17,499	18,175	16,624
Government Borrowing	15,535	13,652	12,998	13,447	13,966	12,730
Concessional	15,232	13,394	12,786	13,286	13,613	12,452
Nonconcessional	303	258	212	161	353	278
Non-Government Borrowing	3,678	3,842	3,971	4,052	4,209	3,894
Concessional	903	948	448	645	922	821
Nonconcessional	2,775	2,894	3,523	3,407	3,287	3,073
International Monetary Fund	2,374	1,313	664	287	26	–
Export Credit	5,376	5,861	6,526	6,789	6,780	5,838
Commercial Borrowing	13,873	14,335	16,986	20,978	19,943	24,203
NRI and FC(B&O) Deposits	11,011	11,012	11,913	11,794	13,562	15,432
Rupee Debt^b	8,233	7,511	5,874	4,731	4,406	3,693
TOTAL LONG-TERM DEBT	88,696	86,744	88,485	92,612	94,330	96,894
SHORT-TERM DEBT	5,034	6,726	5,046	4,274	3,933	3,462
as percentage of total debt (%)	5.4	7.2	5.4	4.4	4.0	3.4
TOTAL DEBT OUTSTANDING	93,730	93,470	93,531	96,886	98,263	100,356
As Percentage of GDP (%) ^c	27.0	24.5	24.3	23.4	21.9	21.5

NRI = Nonresident Indians, FC (B&O) Deposits = Foreign Currency (banks and others) deposits,
GDP = gross domestic product.

^a Provisional.

^b Rupee-denominated debt owed to Russia and payable through exports.

^c Derived using the debt figures in rupees. GDP figures are at current market prices from the Central Statistical Organiza
Sources: Ministry of Finance, India's External Debt: A Status Report, October 2001; Reserve Bank of India,
RBI Annual Report 2000-01.