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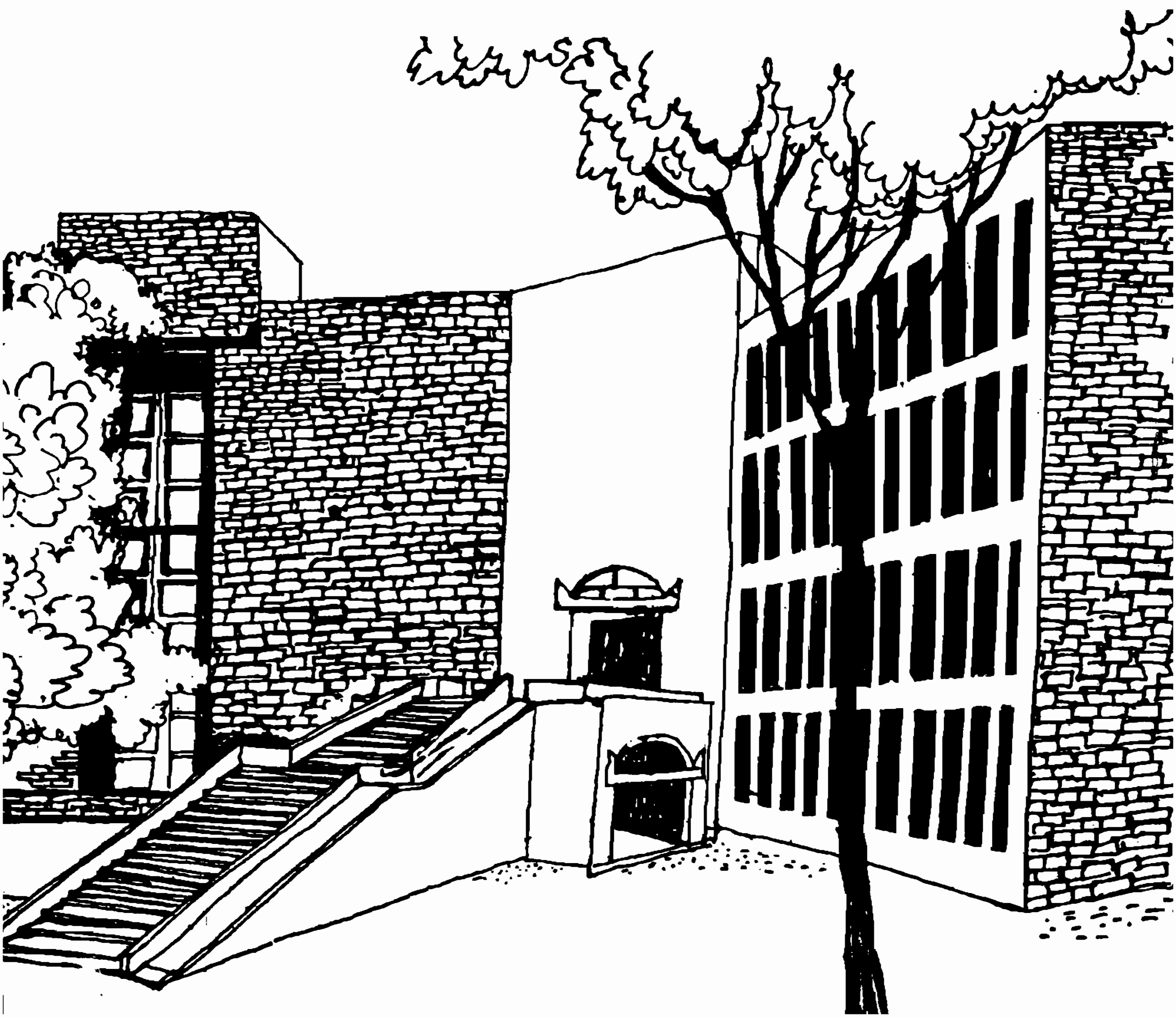

Indian Economic Forecast: Post Budget Analysis April 1994

A.B. Rastogi

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INDIAN ECONOMIC FORECAST : POST BUDGET ANALYSIS APRIL 1994

by

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ABSTRACT

The collective impact of a battery of reforms coming hard on the heels of one another. is still being felt in boardrooms and *chaupals*. The credibility of the reform dictates that consistent liberalisation policies should be followed. The last budget has introduced the changes in tax structure which are consistent with the liberalisation process. We are forecasting a growth rate of around 6% in 1994-95 and underlying rate of inflation of around 8% as unwinding of many administered prices take place in the first quarter of 1994-95. Current account may post a small surplus in the current fiscal year. Exports would rise by as much as 15% in dollar terms. Improving world trade volume and low crude oil prices are expected to give positive supply shock to the world economy which would benefit Indian exports. Total import value may not rise more than 5% in dollar terms due to a lower value of imports of petroleum products.

Dumping of 'exit policy' plans has put industrial restructuring process in the slow lane and therefore, generation of large number of permanent jobs in organised sector has got a set back for some time to come.

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1. Introduction

Macroeconomic management is the most critical policy problem in restructuring process. The external sector of the Indian economy has been well managed and its results are for everyone to see. However, rising fiscal deficits and inflation suggest that the government has lost grip on the domestic sector of the economy. But is this the result of restructuring process or bad management of the economy? Credibility and expectations play the central role in any major economic reform. When credibility is high, there are expectations of policy to continue and there are good chances for reforms to succeed. However, credibility should not be viewed as an exogenous variable, because it is affected by the strategy followed during the restructuring process. To establish credibility, internal consistency of the policies being pursued is essential. This inspires the degree of confidence among economic agents who make the reforms to succeed by taking required decision which has an effect on the economic structure.

The initial welcome response to the budget turned into a gloomy outlook as stock markets did not show a sharp gain. `Informational Cascading' effect has taken hold since then and there seems to be more pessimism about the Indian economy than optimism due to rising fiscal deficit and changes in tax structure.

2. Budget 1994-95

In a developing economy like India, factors that underlie success of a liberalisation process are:

a. Implementation of structural reforms like privatisation, trade liberalisation, deregulation and tax reforms.
b. Political will to go ahead with economic reforms and open markets.
c. Restructuring of foreign debt to restore credit worthiness.
d. Development of local capital market to encourage repatriation of `flight' capital.
e. Tap foreign capital markets for voluntary flow of capital.
f. To institutionalise reform process and move towards an independent central bank.

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* I am thankful to the participants of Macro-model seminar/presentation at the Ministry of Finance for their comments. This forecast was presented in the seminar on April 12, 1994.

Almost all these factors in India show a positive beginning except that privatisation and labour sector reforms would be done in a gradual way.

Success in the management of external sector of the economy can be gauged from the fact that India will not seek any fresh programme loan from international financial institutions during the financial year 1994-95. Nor will it plead for any fast-disbursing aid from bilateral or multilateral sources during the Aid India Consortium meeting scheduled to be held in Paris at the end of June. This is a direct result of the success of liberalisation programme. It is estimated that $ 5 billion will flow into India through portfolio investment by foreign institutional investors in the secondary capital market and the global depository receipts would be floated by Indian companies in 1994-95. Already India has withdrawn its request for capital market development loan of $ 250 million from the Asian Development Bank and the government is not keen to go on borrowing the second tranche of $ 125 million of the hydrocarbon sector loan. In the last fiscal year, out of $ 2.4 billion fast disbursing aid, India could use only $ 800 million because of a sharply reduced need for such resources.

The budget this time can be termed as a political budget as it seems to avoid hard decisions on the agricultural subsidies etc. and populist as it has sops for rural development etc. However, moving to a simpler tax system with moderate tax, but wider base and better tax administration, it is going to have a long-term impact on the economy. The reform process moved further in line with stated objectives of liberalisation by giving some autonomy to the RBI and convertibility of rupee on current account. Convertibility of the rupee on current account will remove procedural hassles for the exporter and end the black market in many current account transactions while retaining limits which will minimise capital account flows disguised as invisibles.

By showing a fiscal deficit of about 7.6 per cent of GDP in 1993-94 and projecting a fiscal deficit of 6 per cent of GDP, a political statement is made that the budget has been prepared by the Indian Ministry of Finance and not the International Monetary Fund as had been alleged by many political and economic commentators.

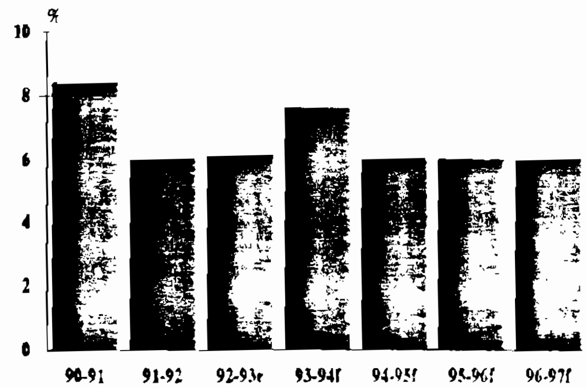
The Finance Minister has stated that he has designed the budget to achieve an accelerated growth. The economy is poised for a boom in investment and production. Indian companies raised Rs.20,000 crore from the capital market in 1993-94 and roughly $ 3 billion from the Euro-issues. In 1994-95, companies are expected to raise upto Rs. 25,000 to Rs. 30,000 crore from the capital market and $ 5 billion from Euro-issues. The public sector undertakings investment would also get a boost as the market for public sector bonds is much better. Hence, raising money for public sector undertakings is easier, though, some of the money raised has been used to sell off debts. The uncertainty of 1993-94 which prevailed before the assembly elections in the Northern states had spawned a significant deferral of investments. Investment is picking up and expansion plans are on the anvil.

What are the effects of fiscal deficits on the economy? Does deficit, or more precisely debt acquired by the public, matter? Of course, it matters. Government debt held by public represents postponed tax obligations and changes in debt held by public are associated with choices concerning the distribution of taxes over time. This point is often neglected when deficit induced inflation is placed on the centre stage.

No one would deny that even in a growing economy like India, fiscal deficit of 6 per cent - 7 per cent of GDP year-after-year is unsustainable as in long term it crowds out private investment and public debt grows to unmanageable proportions. In fact, in 1994-95, interest payments are budgeted to rise by nearly 23 per cent and it is a whopping 53.4 per cent of all the expected revenue receipts. Hence, there is an urgent need to reduce domestic debt.

The budget signalled that government has abandoned the path of austerity and has embarked upon a strategy of growth. But the question being raised now is that would the path living beyond their means would result in expanding the means or just raise the prices of existing means?

Central Government Fiscal Deficit (% GDP)



There is no doubt that the mathematics of Dr Singh's budget exercise went awry. The mathematics of blooming fiscal deficit in 1993-94 is like this. There was a shortfall of Rs.8,300 crore in revenue due to various political factors which were set in motion by the Ayodhya event, roughly Rs.1,000 crore shortfall in disinvestment, Rs.5000 crore on plan account and Rs.8000 crore on non-plan which include the Prime Minister's give away on the eve of State Assembly elections last year.

It is well recognized that presumptive tax has not gathered as much revenue as expected but this is due to the failure in gathering information. As tax administration improves, through computerisation, such loopholes will get plugged. The failure of presumptive tax has been attributed to the fact that according to the Law Ministry, traders cannot be forced to pay certain amount as tax as it would violate the constitutional and legal requirements. Still the extension of presumptive tax on building contractors and truck owners is done to broaden the base.

A simple explanation of high inflation of the late eighties in terms of high fiscal deficit has boomeranged on the government. Many equate high fiscal deficits with high rate of inflation. They ignore that when economy is not operating at its full potential there would be revenue shortages and fiscal deficit would increase. Hence the explanation given by the Ministry of Finance that the present fiscal deficit would jump start the economy without raising prices is not believed. What is ignored in the debate is that it is the monetised fiscal deficit which gives rise to inflation and the fiscal deficit funded by market borrowing raises output more than the increase in prices. But this raises domestic debt, and with it, the total interest liabilities it bears. Interest payments being rigid, pre-empt an increasing share of the Central Government budget. Therefore, government has very little room to cut revenue expenditure in medium term.

Elections are due to be held in Gujarat, Goa, Maharashtra, Andhra Pradesh, Karnataka, Orissa, Manipur, Arunachal Pradesh and Sikkim by the winter of 1994. It is believed that soft budget options are designed to win some votes in these states. So long as the state elections do not increase fiscal deficits further, one need not worry about it. If there is no slippage in the quarterly targets of expenditure, economy may grow well. Otherwise, corrective action must be taken in time. Restoration of fiscal discipline is essential to continue with structural reforms. Once fiscal indiscipline sets in there is a real danger of India's reforms to go haywire like that of Latin American countries and then all the gains on external front would be lost in a very short period of time.

The changes in tax structure emanate from the policy of economic liberalisation and introduction of measures which give freer hand to markets and international trade. To achieve this it is necessary to get rid of complex indirect tax structure and cascading which obstruct efficiency and trade. However, new sources of revenue are required to fill up the gap left by falling trade taxes (import duty) and yawning fiscal deficits.

The effects of the budget would be felt in the long-term as many anomalies in the punitive and intricate tax structure have been removed. The lowering of import duties will reduce the cost disadvantage faced by Indian industry. As expected the reduction in the number of rates is in line with the recommendation of the Chelliah Committee report. This will increase the transparency of the system, and hopefully at the reduced rate of duty, incentive to evade duties would be less and therefore, it would improve tax revenues.

Table 1: Impact of Tax Changes on Indian Companies

	Favourable (%)	Neutral (%)	Unfavourable (%)
Excise Duty	17.5	6.8	7.5
Import Tariff	15.0	5.1	8.0
Corporate Taxes	15.8	1.2	1.2
Capital Goods	1.7	0.8	-.-
Lending Rates	2.5	0.8	1.2
Other Provision	3.9	2.0	0.8
No Effect	-.-	7.0	0.8
Total (%)	56.4	23.7	19.5

To improve excise tax collections excise rules have been simplified and notifications are being sent to trade and industry in this regard. This is to ensure that the tax payer accepts the new tax structure and by making life simpler of the tax-payer it is hoped that he would not indulge in creative tax evasion practices.

It is envisaged that there will be no loss of revenue as a result of the reduction in personal income tax. Revenue from corporate taxes, too, is unlikely to fall as profits are improving. Excise tax changes are expected to see higher revenue from this quarter and only custom duties cut would entail loss of revenue. It is widely believed that revenue from excise has been underestimated.

The buoyancy in revenue calculation has not been taken due to the switch-over in the excise tax system from specific rates to ad valorem rates. It is widely believed that it may provide some breathing space to the government and it needs it as there is no provision of contingency fund in the budget.

The Finance Minister's contention that budget would be growth oriented is supported by a study which analyses the impact of tax changes on Indian companies. How the tax changes and other provisions would affect the companies are tabulated in Table-1. In the study a sample of 300 private and public sector companies were taken.

Personal and corporate income tax cuts would bolster corporate earnings in the coming year and extension of MODVAT to capital goods are expected to spun capital spending in as many as 57% of companies. On the other hand, reduction in component duties to 25 per cent would make the capital goods industry competitive. The introduction of countervailing duty (CVD) would ensure that the products would be able to compete with imported capital goods. The countervailing duty effectively makes it more expensive to import.

In transition, this year will hurt some segments of the economy but Finance Ministry is in no mood to deviate from its chosen path even if it is painful in the short run. The small scale industrial units (SSI) which are going to be affected by 1994-95 budget proposals - especially changes in excise duties - are up in arms. They would like the pre-budget exemptions to be restored but it is unlikely. In their frenzy, many good points of the budget have been overlooked. In order to claim MODVAT credit even small units can pay duty, if they choose, irrespective of their income. To get this benefit, they have to fill in a declaration, get registered and maintain records - something which small units do not do as the units are mostly a one man show. The SSIs feel that there is a psychological barrier to grow vertically as those units which have resources would like to float fresh units, thereby continuing to remain out of excise and sales tax net. This is what the changes in tax structure want to remove to enlarge tax base and catch as many profitable enterprises as possible in the tax net.

The stock market operators are quite agitated over the removal of 'Badla' system and hence have not bothered to look into 5 per cent tax on transactions as they believe that cost can be passed on to investors. From the failed experiments with securities - transaction taxes in places like Sweden, Finland and Malaysia (all of which have now abolished the tax), it is clear that the introduction of such a tax reduces stock prices. According to a study done by National Bureau of Economic Research, such a tax vandalizes financial markets by shifting trading to foreign markets or untaxed assets, or by reducing the volume of trade. Brokers and sub-brokers here are not worried about the tax amount but they are anxious about the fact that this tax is going to be collected by the Excise Department officials on monthly basis. Given the reputation of the Excise Department officials and some back dated deals which the brokers are able to do now, and which would not be possible under the new system have made the broker community jittery. How far this tax has affected the trading volume on Indian bourses is anybodys guess but certainly brokers have to revamp their back room operations.

In short, the budget was not revolutionary but it was evolutionary and as 75 per cent of the changes in tax structure have already taken place, the rest would be completed over the next two years. The calculated risk taken by the government in the given domestic and international setting is going to pay handsome gains in terms of good economic growth and average rate of inflation.

3. Forecast

Our growth and inflation forecast has not changed drastically but the current account scenario has changed as a result of commendable export performance and lower than expected crude oil prices in the medium term. The lower growth in agriculture and the industrial sector in 1993-94 meant that economic growth will be just 4%. Although world trade is suffering from recession-hit Germany and Japan, its effect on Indian economy is offset by low crude oil prices. The growth is expected to be 6% and the price level (WPI) is expected to go up about 8% in the current fiscal year.

4. Exogenous variables

4.1 World Interest Rates

The recent rise in the US short-term interest rates from 3 per cent to 3.25 per cent was the first upward movement in US rates for five years. It was more of a move designed to keep inflation under control and not an indicator that an upturn in inflation was imminent. The very robust growth seen in the final quarter of last year in the US was unsustainable but the factors which fuelled growth in 1993 will persist into 1994. Profits will continue to rise and interest rates will remain low. The Fed is likely to tighten its monetary policy further as the year progresses, but a 4 per cent interest rate by year-end would still be very low by recent historical standards. A year and a half of 3 per cent interest rates has not only re-capitalised the previously fragile banking system, but also reduced the debt burdens of both, consumers and business sufficiently for them to take on further credit and additional investments projects respectively.

Over the next year the prospects are that US interest rates and, later on, US inflation will move up, while German interest rates and inflation will continue to go down. German inflation is likely to fall below 2 per cent while the US inflation should edge above 3 per cent.

Table 2: Exogenous Variables

	1992	1993	1994	1995	1996
World					
Trade growth (%)	2.6	1.5	3.1	3.8	4.5
Real Short-term Interest Rate	3.1	2.7	1.5	2.2	3.2
Real Long-term Interest Rate	4.6	3.3	2.8	3.1	3.2
O.E.C.D. Inflation	3.0	2.8	2.2	2.6	2.9
Crude Oil($/barrel)	18.4	15.5	14.0	15.0	16.0
Domestic					
	92-93	93-94	94-95	95-96	96-97
Rainfall (% of normal rainfall)	93	101	100	92	92

Table 3: Forecast

	92-93e	93-94f	94-95f	95-96f	96-97f
GDP growth (%)	3.1	4.0	6.0	6.4	6.3
WPI (%)	9.5	8.1	8.0	7.9	7.6
CPI (%)	12.5	7.6	8.2	8.1	7.8
Exports (%GDP)	7.6	9.2	9.6	9.9	10.4
Imports (%GDP)	9.0	9.4	9.2	9.9	10.4
Current a/c (%GDP)	-2.1	-0.2	0.5	0.2	0.1
Current a/c ($ bill)	-4.9	-0.5	1.3	0.7	0.4
Exchange Rate (Rs/$)	31.5	31.4	32.6	33.4	34.0
Production (growth p.a.):					
Agriculture	3.6	1.2	2.2	2.0	1.9
Non-agriculture	3.0	4.5	7.6	8.2	8.2
Investment (% gdp):					
Private Sector	13.2	15.5	16.6	16.0	16.0
Public Sector	9.5	8.7	8.2	8.1	8.0
Govt. expdt. (%gdp) (Central + State + UTs)	31.5	31.2	31.0	30.8	30.7
Fiscal deficit (%gdp)	6.1	7.6	6.0	6.0	6.0

e - estimated figure   f - forecast figure

4.2 World Trade

Developing countries can look to World Trade Organisation (WTO)- successor to GATT - as an impartial referee of free world trade and a guarantor of small trading nations. Following the Marrakesh declaration and formation of WTO, Indian exporters would enjoy the most favoured nation status in as many as 117 nations. The agreement will result in substantial tariff cuts and bring in sectors such as textiles, agriculture and services which were previously not subject to GATT disciplines.

The world output growth is expected to be 2.6 per cent in 1994 against one per cent growth in 1993. There are several reasons for a good recovery. First, the industrialised nations have hit the rock bottom and from there they are expected to go up. Second, corrective policies in these countries are being pushed further. Interest rates are quite low and inflation is under control. European interest rates have started falling after the gradual easing of German monetary policy.

We have assumed a growth rate of 3.1% in the world trade volume in 1994. India would gain not only from the new trade organisation but also from growth in world trade also.

4.3 Oil Prices

The weakness in oil prices over recent months has helped in giving a further downward push to world inflation. Oil prices are currently around $ 14 a barrel, the lowest for about 5 years. The OPEC countries have left OPEC output at the current rate of nearly 25 million barrels a day for the rest of the year which implies that OPEC will over-produce one million barrels a day in the second quarter causing oil glut. Saudi Arabia does not want to be a swing producer and OPEC members do not want to concede market share to non-OPEC producers.

Cheap oil may be here to stay in medium term as evidence suggests that a fundamental shift downward is taking place in crude oil's pricing structure. New technology is helping in reducing exploration and production costs. The development of big Siberian oil fields by American companies of 'Russian' proportions has made OPEC members worried about the future of their oil revenue. They are following a strategy to supply cheap crude oil to the world to make the 'Russian' project unprofitable. Hence, low and stable energy prices are expected to give a positive supply shock to the world economy. As a result, crude oil prices are likely to remain in the range of $ 13 - $ 15 per barrel in 1994; about 20 per cent lower than 1993 prices. In 1995 and 1996 we have taken $ 15 per barrel and $ 16 per barrel as crude oil prices.

4.4 Domestic Rainfall

In India, a normal monsoon merits an average rainfall of about 88 cms. In 1993, the rainfall was 101 per cent of the average. Similarly, in 1992 it was 93 per cent. Over the last five years it appears that India has found favour with rain-gods. This year too initial indicators suggest that odds are 2:1 in favour of normal monsoon. Only by end May when all the indicators are available a prediction about monsoon will be made by Indian Meteorological Department. In this forecast we assume normal rains for 1994.

5. Output

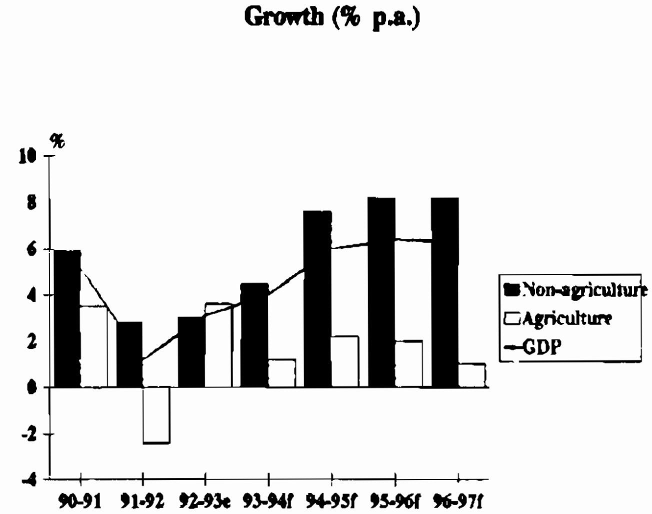
Official reports have started mentioning that in 1992-93 the growth rate was 3 per cent and is 3.8 per cent in 1993-94. World Bank had estimated that growth in agriculture sector in the last fiscal year would be around 4 per cent and 3.5 per cent in manufacturing sector. Assuming favourable monsoons, better growth performance is expected in fiscal year 1994. The Bank expects the Indian economy to enter a sustainable growth averaging more than five per cent over the next decade.

5.1 Agricultural Output

There were some surprises for farmers in the budget. Everyone had expected the prices on Urea to go up by 15 per cent to 20 per cent. In fact, Urea commanded premium in the market in February as farmers stocked it in anticipation of price rises. There is a sound logic behind the price increase. Besides saving on subsidy, the increased prices would have brought about a more balanced use of the three major crop nutrients namely, phosphatic, potassic and nitrogenous (urea) fertilisers. According to news report a last minute intervention by the Prime

Minister forced the Finance Minister to drop the move to increase urea prices in the last budget. There is a distinct possibility of increasing the urea prices during the course of the year.

Total foodgrains production during 1993-94 is estimated to be 181 million tonnes only. Non-foodgrains production which includes groundnut, cotton, jute, chillis, tobacco and sugar-cane is estimated to have shown a small growth this year. Earlier it was estimated that the total production of non-agriculture production may have declined by about 2 per cent. But non-crop agricultural production like marine products etc. which accounts for 30 per cent of total agricultural production has grown by 7 per cent or so in 1993-94. The total agricultural production in the last fiscal year is expected to be little over one per cent.



In 1994-95, on the basis of normal rainfall we expect a growth rate of about 2.2 per cent in total agricultural production. Non-foodgrains production is expected to show a healthy growth in 1994-95 along with non-crop agricultural sector as well, the reason being that this sector is being helped by exports of marine products etc. As a result of continuous good monsoon the agricultural growth rate is not as good as one would expect.

5.2 Non-Agricultural Output

Index of industrial production (IIP) showed a growth of 6.7 per cent in the month of December 1993. The manufacturing sector which was sluggish until November 1993, cloaked up a growth rate of 7.3 per cent in December 1993. In the later months of the fiscal year 1993-94 manufacturing activity picked up as can be seen by good production of automobile sector, textiles etc. which account for around 50 per cent of the total weight of the IIP. The spur in industrial production in the last quarter of 1993-94 should show the IIP growing little over 4 per cent in 1993-94. Service sector is estimated to have grown by roughly 5 per cent giving an increase in non-agricultural production of about 4.5% in the last fiscal year.

Although industrial production did not pick up substantially between April-September 1993, gross profit margins of many companies improved. This suggests that companies have been busy in cost cutting exercise and are gearing up for domestic and foreign competition. Companies have saved a substantial expenditure by way of lower interest payments as a result of reduction in commercial lending rates which would definitely get reduced further this year. In fact, even for their working capital needs they mobilised capital through commercial papers which carry a smaller interest burden.

In the first eight months of 1993-94 the consumer durable industry grew by impressive 13 per cent and the 1994-95 budget - through excise tax cut - would further boost the growth of this sector. Consumer durables like refrigerators, washing machines, video cassette recorders have all benefited from the budget proposals.

According to a study carried out by Industrial Credit and Investment Corporation of India, sales grew by 13.6 per cent during this period. Interestingly, 'other income' of these companies grew by only 9.5 per cent which is the lowest in the last four years. As industrial production was not growing, most of the increase in sales has come about from running down the accumulated inventory. Therefore, this year must see a spurt in production figures.

The 246 public sector enterprises, with an asset base of Rs.135,000 crore, will be subject to pressure to perform without the protection and patronage which they have so far enjoyed. The government's current accent is on a management which has entrepreneurial skills and is capable of taking risk. Interestingly, the government wants to be serious about public sector undertakings can be gauged from the fact that in the budget government has taken credit of 8514 crore from dividends and profits in the budget; an increase of more than 300 per cent from the revised estimate of 2737 crore of the fiscal year 1993-94.

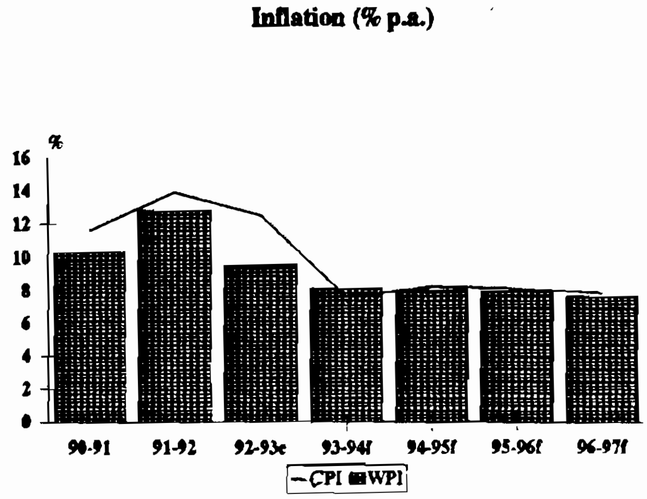
The present industrial index is outdated and does not fully reflect the movement in the overall industrial scenario. It tends to underestimate the contribution of the unorganised sector and within it of the fast moving exportable like garments, leather, gems and jewellery.

Keeping all these factors in mind a growth in non-agricultural sector to the tune of 7.6% is predicted for 1994-95. Our forecast is more optimistic than the National Council of Applied Economic Research (NCAER - March 1994) prediction of around 5.8%, the reason being that we are expecting a sharp pick up in industrial production and a substantial growth in service sector of the economy. It is expected that the non-agricultural sector would show some further increase in 1995-96 and 1996-97 as the changes in tax structure improve the long-term profitability of the industry and new investment go on stream.

6. Inflation

Through the 1994-95 budget, India made progress towards adopting legislative proposals to remove the Reserve Bank of India from government control, that is, making it independent. Empirical studies show that there is a negative correlation between the level of Central Bank independence and the rate of inflation and the studies have also found that the more dependent a central bank was, the greater was the variability in inflation. But the central bank's independence has no correlation between the average economic growth or the variability of growth. Thus, economic benefits to be gained from an independent central bank is in terms of stable prices, which for a country like India is quite beneficial.

Inflation is not like some mysterious disease, waiting to be triggered by some random event. We actually understand it. A growing economy pushes it up; and buoyant expectations push it up further. These expectations are formed by the mass of people observing the world around them. They observe their markets, their own needs and their government's incentives. Looking at that world they find a competitive world, but the signals from government are mixed. On one hand, it is committed to curb inflation, on the other, administered prices are being hiked. They conclude rationally that inflationary prices are here to stay.



Unless policy-makers remain on guard the inflation genie could come out of its bottle. To combat inflation there are three weapons at the government disposal, namely, large unutilised capacity, large food stock and high foreign exchange reserves. The stocks of foodgrains is an insurance against the rising inflation in the government's armour. Substantial foreign exchange reserves, too, would be used to import essential items like sugar and oil if there is any shortage of these items in the market, if monsoons are less than adequate this year. In fact import of sugar has already taken place on OGL and edible oils import on OGL is on the cards.

The immediate fall out of the budget proposals is that the Oil Pool Account deficits will swell forcing the government to increase the administered prices of petroleum product at the fag end of the fiscal year. Other administered prices of fertilisers, railways would also be raised. Procurement prices of Kharif agricultural production are expected to be raised in line with inflation and so would be the case with issue prices later in the year.

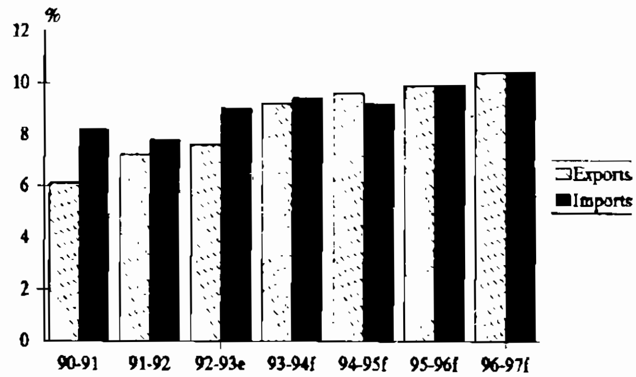
Prices of those items have gone up 10 to 15 per cent which have come under excise duty net. This is an indication of removal of the price advantage enjoyed by the small scale industries sector vis-a-vis large scale sector. Given the unwinding of administered prices and buoyant expectations of price rises, we forecast an average rate of inflation of 8% this year and only marginal reduction in the rate of change of prices next year.

7. Trade Balance

Exports during April 93 - February 94 recorded 21 per cent growth in dollar terms as compared to only 2.2 per cent growth in the corresponding period in 1992-93. Trade deficit declined to $ 500 million in April 93 - February 94 as against $ 3.5 billion in the corresponding period a year before. But, this has been achieved as a result of impressive growth in exports of agro-based products, marine products, textiles and handicrafts. These items have shown more than 40 per cent growth compared to little more than 30 per cent growth in engineering and electronics goods.

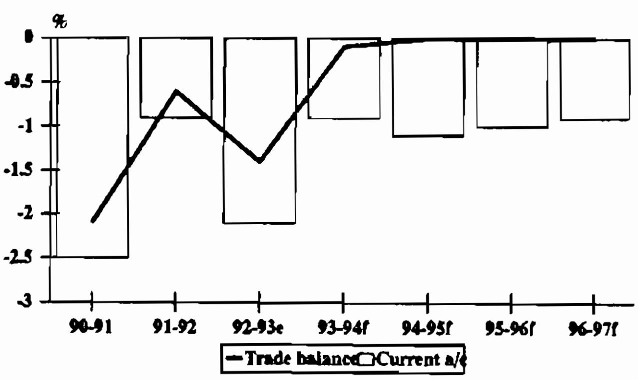
A 20 per cent growth in exports in 1994-95 can be achieved. The growth in agro-products holds the key to maintain this growth along with favourable world trade growth and major industrialised countries coming out of recession where gems and jewellery are exported from India. Government has not provided any new financial incentives this year to exporters but has provided better financing facilities for exports and strengthened infrastructure facilities.

Exports & Imports (% GDP)



The new trade policy, which essentially fine-tunes the existing long term policy, prunes the list of restricted or banned items for import and export. However, major gains in terms of time is to be achieved by simplified procedures. To boost exports, large scale exporters can use 'special import licenses' to import and sell specified consumer durables which were banned or restricted so far. It is estimated that about Rs.1500-2000 crore worth of special import licenses would be issued in the current fiscal year compared to Rs.1200 crore rupees in the fiscal year 1993-94. Exporters can retain 25 per cent of their export earnings in foreign currency which can be used for promotion of exports, travelling, market research and advertising products in foreign countries. The reduction in interest rates on bank lending would also help exporters.

Trade Balance & Current a/c (% GDP)



Export target for 1994-95 is being set around 25 per cent. It is an ambitious target but officials feel that it can be achieved. Areas like textiles, agriculture and allied products, leather and leather goods, gems and jewellery are expected to improve further their export performance this year. Many economists have suggested that to achieve 20 per cent export growth India must devalue as real exchange rate of rupee has appreciated with respect to June 1991 value by about 7 per cent. In our forecast, exports grow by 10.5% in real terms whereas real exchange rate appreciates by 2% in 1994-95. In dollar terms export growth turns out to be roughly 15% in the current fiscal year.

Table 2: External Trade of 216 Central PSU's

External Trade(Rs.crores)	90	91	92	93
Total Export Earnings	6329.72	7038.43	9156.21	9086.4
Total Imports	15516.41	14955.71	19144.26	19462.18
Net Export Earnings	-9186.69	-7917.28	-9988.05	-10375.76

Source : CMIE Corporate database

Import value of most items declined last year. Bulk imports like fertiliser recorded a fall of about 31 per cent in value terms in 1993. One other reason for lower import value in 1993-94 was that PSUs imports have been declining in real terms as their investments have been pruned. Table - 4 shows that in 1992 net imports rose by 26 per cent but in 1993 net imports increased by 1.7 per cent in nominal terms. These factors are likely to continue in 1994. Hence, imports as a percentage of GDP is likely to decline in 1994-95, mainly because of lower import value of petroleum products. However, in real terms a 2% and in dollar terms a 5% growth is expected.

8. Investment

Investment is going to pick up as the uncertainties about interest rates, taxes, exchange rates have been removed. As explained earlier companies have run down their inventories and rebuilding of inventories will take place now. Most of the cost cutting exercise is over and many public sector enterprises have raised funds in the past six months and they are investing these funds now. Some of the money which has gone in financial securities will come back as returns from 'other incomes' is falling and income from 'trading profits' is rising.

Both - Industrial Development Bank of India and Industrial Credit and Investment Corporation of India - financial institutions which lend long term capital to industry have reported surge in demand for loans in the second half of 1993-94. This is corrborated by NCAER Business Expectations Survey conducted in January 1994. According to the survey as many as 69 per cent of respondents have indicated that investment climate in the next six months is positive. Interestingly, firms with total sales of turnover of Rs. 50 - 100 crores and greater than Rs. 1000 crore turnover are even more positive about investment climate.

India has been placed in the category of 'Big Emerging Markets' by the US administration. The US expects that India could provide significant commercial opportunities for US firms throughout the 1990s. The US Commerce Department estimates that India could spend as much as $100 billion on new infrastructure in the next six years. Furthermore, roughly $100 - $200 million would be spent on aircraft and air-traffic control equipment each year and about the same amount on telecommunications products and services. The US Commerce Secretary Ron Brown is likely to be in India to further trade relations between India and the US.

9. Labour

To make Indian industries competitive, political leadership would like to have a more flexible labour policy but they are against drastic changes in the labour laws as that will affect the interests of a large section of the people. Is this true? Although only four per cent of the 2.5 lakh sick units belong to the public sector, these public sector units enjoy budgetary support from the government budget. A large number of private sector sick units employ comparatively fewer people and do not get any budgetary support. A clear 'exit policy' would allow the government (central and state) to close some of these units. Number of people expected to be laid off in these units in next three years is estimated to be 1.1 million out of a labour force of 326 million and aggregate employment of 306 million. But such a policy would be opposed by the opposition tooth and nail and 'lung' power would be provided by trade unions. This would have more nuisance value than say, any substantial gain derived from a clear exit policy. Even from electoral politics point of view the governing party is unlikely to lose any seat.

The disinformation campaign fought by opposition parties over the GATT treaty and forthcoming elections in Gujarat, Maharashtra, Karnataka, Andhra Pradesh, Manipur etc. later this year has forced the government to quietly dump the 'exit policy'. The government in the name of 'middle path' has put all labour legislation except the amendment of the Trade Union's laws on the back burner. The proposed modifications to the Industrial Disputes Act to facilitate easier closure of units and retrenchment of labour will not be done. The government is more inclined to let the Board for Industrial and Financial reconstruction take its own time and would not force the pace of industrial restructuring by closure etc. Even the test case of economic reform process - the closure of NTH mills have been given a new lease of life through Rs.2005 crore modernisation plan. Incidentally, the budget does not provide this money. So it is not clear from where this money would come. It looks that it will turn out to be a case of false dawn and broken promises. Current line of political thinking is that 'rationalisation ' of surplus labour should be carried out in consultation with trade unions.

One wonders whether there is any hidden agenda here. Given the under-capitalisation of Indian industry and liberalised economic policies, it could be that labour can only be a sticky issue which can keep domestic and foreign corporate raiders away and keep restructuring process under political control.

The new Trade Union Act would allow a minimum of 10 per cent of the workforce of a unit to get registration for forming a union and 51 per cent of the workers would have the right to bargain during any negotiation. Outside leadership is to be discouraged so that problems between workers and management could be resolved amicably. However, what an employer wants is a change in Industrial Disputes Act, which will give him freedom to lay off workers in case he wants to exit from one sector and go to another. This has been recommended by the Goswami Committee report on industrial sickness. It seems that employers are in for a long wait.

Nevertheless, the industrial relations scenario has improved in 1993. This is reflected in the reduction of mandays lost due to strikes and lockouts which have reduced by half compared to 1992 figures. Now 'Exit Policy' is viewed coming at the end of reform process, when economy is competitive rather than a means to achieve a competitive economy. The thinking behind that is that in a growing economy job opportunities would exist to absorb not only new entrants but unemployed people also. Until then, reforms of labour sector must be seen as an economic and socio-political issue. The government has categorically mentioned that the government is not going to throw a lot of people out of work, whether it is in government or in industry.

Fortunately, industrial restructuring is going on. Many workers are ignoring their trade union's orders to avoid voluntary retirement scheme and accepting golden handshakes. This has provided a much-needed flexibility, which needs to be extended in some form into new labour laws.

Labour flexibility matters for foreign investment but it is not all-important. Investments in new units will minimise the use of labour intensive and contract out all essential business ensuring flexibility. The problem of flexibility relates to sick public sector undertakings and other companies and not to new comers. However, hope of high employment generation in the organised sector has been crucified on the altar of political convenience. Gradualism in labour reform is not therefore consistent with attracting foreign investment and it is delaying new job creation in the economy. But, reasonable political stability and the basic irreversibility of the reform process set in motion by the government are the two major factors that have convinced multinationals that during the turbulent 1990s, India is the place for them.

10. Conclusion

The collective impact of a battery of reforms coming hard on the heels of one another, is still being felt in boardrooms and *chaupals*. The credibility of the reform dictates that consistent liberalisation policies should be followed. The last budget has introduced the changes in tax structure which are consistent with the liberalisation process. The changes are going to be beneficial to many companies. However, some interest groups would be affected in transition as the new tax regime seeks to enlarge tax base as wide as possible. The governments' contention that loss of control of fiscal deficit in the year 1993-94 was due to specific circumstances and the aberration would be judged in the light of what happens to the present fiscal year deficit of 6% of GDP. If it can be contained this year and lowered slightly next year, the government would gain credibility and inspire confidence among foreign and domestic investors. Ballooning high cost domestic debt, however, is closing down not only this governments' but future government's options very rapidly. Only some well thoughtout measures to retire public debt either by selling PSU shares or from buoyant tax revenues, when economy is growing, would salvage future options. Otherwise, future generations would not be generous in their criticism of this postponement of tax obligations.

Exit policy and changes in Industrial Disputes Act has been quietly dumped by the government to win peace with labour on the issue of GATT treaty. Thus, hope of high employment generation in the organised sector has been crucified on the altar of political convenience.