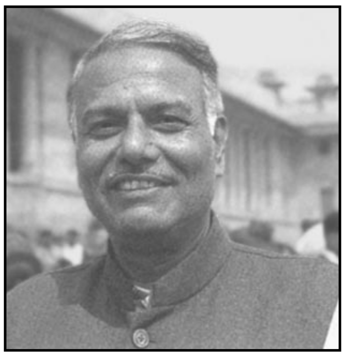
INDIA
ECONOMIC NEWS
50th Anniversary of India's Independence
Volume IX, Number 5-6 May-June 1998

INSIDE:

The ruling . . . Bharatiya Janata Party . . . used its first budget . . . to push certain economic reforms, such as selling or closing state firms and opening the nationalized insurance industry to private competition.
— **Wall Street Journal**

Union Budget for 1998-99 Presented to Parliament



Yashwant Sinha
Finance Minister

The Finance Minister presented a $64.2 billion budget on June 1, 1998 for the financial year 1998-99. The budget sharply increased public works spending to revive growth. The following major initiatives have been taken in the budget: concrete steps to wind up terminally ill public enterprises, scrapping of the Urban Land Ceiling and Regulation Act, ending public sector monopoly in insurance and a decision to give up the majority stake in Indian Airlines. The fiscal deficit is to be contained at 5.6% of GDP as compared to 6.1% in 1997-98. The following are some of the main features of the budget.

One of the key objectives of the budget is to supplement a higher rate of domestic savings with greater foreign investment.

Private investment, both domestic and foreign, will continue to play a major role in spurring industrial growth. The government aims at minimizing bureaucratic and procedural hurdles and create an investor friendly environment. Industrial licensing was abolished in most industrial sectors as part of the economic reforms. On reviewing the remaining handful of licensed sectors, the government has further decided to delicense coal and lignite and petroleum products.

Foreign investment flows have increased substantially and were estimated to be $3.1 billion in 1997-98. About 60% of investment approvals are in the energy and infrastructure sectors. The government hopes to double the inflow of foreign direct investment within two years. Foreign investors are frequently inhibited by lack of familiarity with Indian systems and statutes and particular problems at the State level. To reduce such problems, the government will implement a system

(Continued on page 2)

whereby, an officer of the administrative Ministry would be designated as a monitoring officer to help in processing and implementation of the project in conjunction with Central and State authorities for every foreign investment proposal exceeding $25 million. It will be the personal responsibility of the monitoring officer to ensure that a decision on the foreign investment proposals shall be taken within a period of 90 days.

The plan outlay for the key infrastructure sectors of Energy, Transport and Communications have been stepped up by 35%. This steep increase in investments will trigger industrial activity and revive rapid economic growth.

The government is providing $125 million for the National Highways Authority of India to catalyze new road projects including four-laning of existing National Highways. The corpus of NHAI is being augmented by levying an additional tax of 3 cents per litre on petrol. The concessions presently available to import of equipment for construction of National Highways is being extended to other road construction projects.

Foreign institutional investor (FII) debt funds have till now been allowed to invest only in listed debt securities. The government has allowed them to invest in unlisted domestic debt securities also. In non-strategic state-owned corporations, government stake will be brought down to 26%. This will increase the availability of quality scrips that FIIs can invest in.

In order to augment the flow of long-term resources for financing infrastructure, the government has ***opened the insurance sector to competition*** from private Indian companies. The Insurance Regulatory Authority will also be converted into a statutory body.

Non-Resident Indians

The government believes that NRIs constitute a huge, untapped potential for India's development. The following steps have been proposed to increase NRI inflows into the country: Increase in the limits for ***purchase of shares in Indian companies*** in the secondary market to 5% from 1% for individuals and 10% from 5% in the aggregate; launch of a new ***India Millennium Scheme*** by the Unit Trust of India which will be open for subscription in dollars only by NRIs; launch of a new ***Resurgent India Bond*** by the State Bank of India denominated in foreign currencies for subscription by NRIs.

The government has decided to draw up a scheme for issuance of a ***Persons of Indian Origin (PIO) Card*** for those living abroad and having foreign passports. The PIO Card, which would be extended to persons of Indian origin settled in countries to be specified by government would besides introducing a visa-free regime, also confer some special economic, educational, financial and cultural benefits.

Financial sector reforms

There is now a greater urgency for financial sector reforms in the light of the South East Asian Financial Crisis. To strengthen the underlying health of Indian banks, Reserve Bank of India is raising the minimum required ***Capital Adequacy Ratio*** for banks from the present 8% to

(Continued on page 3)

Union Budget *(Continued from page 2)*

9% by March 31, 2000 and to 10% by as early as possible thereafter. RBI will also announce certain other enhancements of prudential norms in regard to asset classifications, income recognition, risk weights, etc.

The Finance Minister stated that the relatively high level of ***Non-Performing Assets*** (NPAs) in Indian public sector banks is a cause for concern and that net NPAs, averaging 9% in 1996-97, must be brought down to below 5% by the year 2000-2001. As one way of reducing NPAs, Debt Recovery Tribunals will be strengthened and more Tribunals will be set up to cover all States.

Other Initiatives

The budget also provides for substantially higher allocations for education (50% increase), rural development and other ***social sectors*** like health, women and child development. Ministry of Welfare budget allocation has been increased by 91% and that of the Ministry of Agriculture by 58%. NABARD has been asked to greatly extend the scope and coverage of the Self Help Group (SHG) scheme so that 200,000 SHGs covering 4 million families can be assisted over the next five years through micro-credit.

The ***defense budget*** has been increased in nominal terms by 14% (same as the nominal budget estimate for 1998-99 over revised estimate for 1997-98) but in real terms it will go up by 7%. As a percentage of GDP, however, it remains constant at the last year figure of 2.54% which is much lower than that of Pakistan or China.

Provident funds are a potentially important source of funding for private sector infrastructure projects. The present pattern of investment prescribed for provident funds does not permit any investment in securities of private sector infrastructure projects. The government has allowed up to 10% of the new accretion to provident funds to be invested in private sector securities which have an investment grade rating.

The budget also attempts to ***simplify tax procedures*** and clear litigation-locked funds which will help industry and the exchequer.

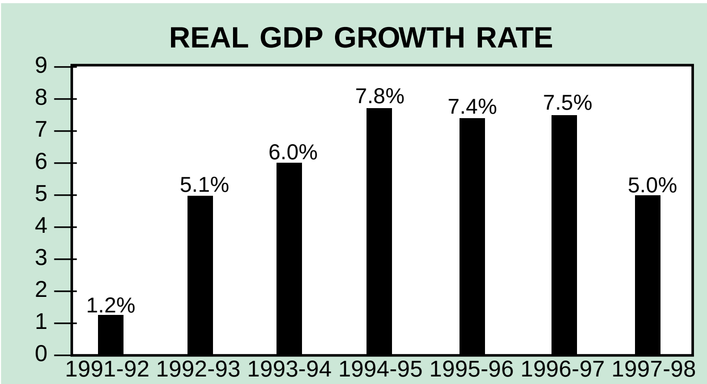
The full text of the Union Budget is available at the Ministry of Finance website at: http://www.nic.in/finmin

First Private Basic Telephone Service Launched

The launch of the first private basic telephone service, by Bharti Telenet in Indore, Madhya Pradesh, on June 4 marks the beginning of a new era in Indian telecommunications. It signals the first fruit of the National Telecom Policy of 1994 which invited private participation in basic services.

Economic Survey 1997-98: Some Highlights

Economic Survey is the basic economic document of the Government of India that provides a review of developments in the preceding and current years, highlights the prospects for the succeeding year and underlines the policy imperatives. The Economic Survey 1997-98 was released on May 28, 1998. The Indian financial year starts from April 1 and ends on March 31.



Recent years have seen a big step-up in economic growth. The average rate of growth of the economy rose from 6% per annum in the Seventh Plan period (1985-90) to 6.8% in the Eighth Plan period (1992-97). Growth averaged a high of 7.5% per annum in the last three years of the Eighth Plan (1994-95 to 1996-97). However, economic growth in terms of GDP has decelerated significantly to 5% in 1997-98 from 7.5% in 1996-97. The growth slow-down in the past year can be traced to a combination of underlying supply factors and temporary demand factors. The former are associated primarily with the quantity, quality and cost of basic infrastructure services such as power, railways and roads. The demand slow-down is attributable to several factors including the sharp deceleration in exports since 1996-97, substantial uncertainty in domestic and international environments, and other cyclical factors. On the positive side, there has been a fall in the average rate of inflation during 1997-98 to less than 5% from 6.3% during 1996-97.

Production

Industrial production has grown by 4.2% in 1997-98. The slow growth of industry in 1997-98 followed growth of 7.1% in 1996-97, which was much lower than the 12.1% growth achieved in 1995-96. Deceleration in industrial growth could be attributed to several factors. One of the most important is the decline in investment as shown by the decline in capital goods production and the fall in the value of imports of capital goods during 1997-98. Among the reasons for reduced investment are domestic and international uncertainty and reduced confidence, and a somewhat lacklustre capital market, which made it difficult to raise equity. Other factors constraining industrial expansion were the sharp decline in growth of exports since 1996-97 and the persistence of high real interest rates.

A number of initiatives were taken to increase the industrial growth rate during the year. During 1997-98, the number of industries subject to industrial licensing was reduced from 14 to 9. Fifteen items, hitherto reserved exclusively for manufacture in the small sector have been dereserved. Efforts continued to make foreign investment policy more transparent and simpler especially for the core sectors. In 1997-98, the list of industries eligible for foreign direct equity investment under the automatic approval route by RBI has been expanded. The existing ceiling of 24% for aggregate portfolio investment limit for Non Resident Indians (NRIs)/Overseas Corporate Bodies (OCBs)/Foreign Institutional Investors (FIIs) has now been raised to 30% of the issued and paid up capital of the company.

Policies to encourage investment in infrastructure included redefining "infrastructure" to cover telecommunications, oil exploration and industrial parks for the purpose of fiscal incentives. An Infrastructure Development Finance Company has been set up to encourage innovative means of financing. External commercial borrowing parameters for infrastructure projects were liberalized and fiscal incentives provided for infrastructure projects. The Telecom Regulatory Authority of India has been set up. The capital base of the National Highway Authority of India was expanded substantially to $125 million. The private sector was permitted to levy tolls on highways. The Tariff Authority for Major Ports was established. Ordinance for setting up a Central Electricity Regulatory Commission (CERC)

(Continued on page 5)

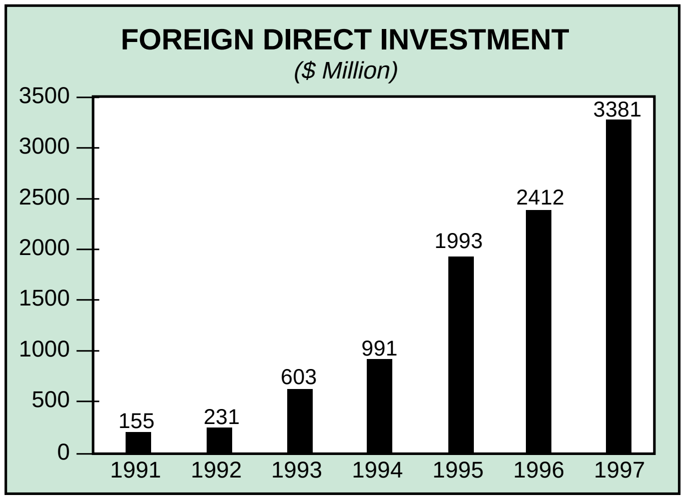
Economic Survey *(Continued from page 4)*

at the Center and State Electricity Regulatory Commissions (SERCs) in the States has been promulgated on April 25, 1998.

Balance of Payments

The balance of payments situation in 1997-98 remained sound. The current account deficit fell to about 1% of GDP in 1996-97, reflecting mainly the slow-down in industrial growth and investment and growth of net invisibles. In 1997-98, the current account deficit is expected to be about 1.5% of GDP, which is significantly less than the average deficit of about 2.3% of GDP during the Seventh Plan period (1985-86 to 1989-90).

In spite of the sharp deceleration in import growth, the trade deficit in 1996-97 widened by about $2.9 billion, because the growth of exports also decelerated sharply. Export growth, in US dollar terms, decelerated to 5.3% in 1996-97 and to 2.6% (provisional) in 1997-98, after three successive years of increase ranging from 18 to 21% per annum. The two most important factors responsible for a slowdown in export performance were probably the sharp decline in the growth of the value of world trade in 1996 and 1997, and the appreciation of the rupee vis-a-vis the currencies of India's major trading partners and competitors. The real effective exchange rate of the rupee has shown a gradually appreciating trend over the last few years, because of the appreciation of the US dollar against other major currencies and the low international inflation rates relative to ours. The dramatic depreciation of some East Asian currencies during 1997 has also been a contributory factor to our export sluggishness.



The capital account of balance of payments exhibited a handsome surplus in 1996-97, following sustained buoyancy in foreign investment flows and a surge in net inflow of non-resident deposits. During 1997-98, FDI amounted to US $3.4 billion. The surpluses in the capital account of balance of payment in 1996-97 and 1997-98 exceeded the deficits in the current account by a large margin, resulting in sizable accretions to foreign currency assets of the Reserve Bank. Total foreign exchange reserves (including gold and SDRs) at the end of March 1998 amounted to US $29.4 billion.

India's external debt increased marginally by US $0.7 billion from US $92.2 billion at the end of 1996-97 to US $92.9 billion at the end of September, 1997. As a per cent of GDP, external debt declined to about 24% at end September 1997 from about 26% in 1996-97. Debt service payments declined from 24.3% of current receipts in 1995-96 to 21.4% in 1996-97, despite the bunching of repayments of India Development Bonds. In 1997-98, the ratio is expected to decline to about 18%.

Issues and Priorities

The sharp slow down in GDP and export growth following three years of high growth in each case, are two central areas of concern. The level of concern regarding the fiscal deficit and infrastructure problems continues to rise with each passing year. Higher growth is the best antidote for removing mass poverty and unemployment, and for generating revenues needed to supply public goods and other vital government services. Therefore, it is imperative to put back the economy on a higher growth path in the order of 7 to 8% per annum. This would necessitate raising of our savings rate to about 30% of GDP through a reduction of government dissavings, an improvement in the performance of non-traded infrastructure (energy, transport and communications) and restoration of export growth to respectable levels.

(Continued on page 6)

Economic Survey *(Continued from page 5)*

For maintaining balance of payments viability, it is essential to maintain a market-responsive exchange rate determined by fundamental demand-supply factors, while containing any excessive short-term volatility. Further, as FDI is the most stable form of capital flow, the share of FDI in total capital flows must be raised progressively. For this to happen, greater procedural simplifications are necessary in the area of FDI.

With the revival of economic growth, the demand for key infrastructure services such as power, telecom, railways, roads and ports, will press harder against existing supply constraints. The strategy to relieve infrastructure bottlenecks must encompass both the creation of additional capacity in various sectors as well as initiatives to induce much better capacity utilization. The strategy must also encourage both private and public provision of infrastructure services in a competitive environment and with an appropriate and transparent regulatory framework.

The full text of the Economic Survey is available at the Ministry of Finance website at: http://www.nic.in/finmin

United States defines Guidelines for Sanctions

Following India's nuclear tests in May 1998, sanctions as required by the Glenn Amendment of 1994 came into effect. Guidelines defining the scope of the sanctions were announced by the US Government on 18 June 1998. These are:

- Termination or suspension of foreign assistance under the Foreign Assistance Act, with exceptions provided by US law (e.g., humanitarian assistance, food, or other agricultural commodities).
- Termination of Foreign Military Sales under the Arms Export Control Act and revoking of licenses for the commercial sale of any item on the US Munitions List.
- Halting of any new commitments of US Government credits and credit guarantees by US Government entities (EXIM, OPIC, CCC).
- Continue to urge postponement of non-basic human needs loans to India by the international financial institutions.
- Suspension of most military-to-military programs, including certain on-going educational programs and official exchange visits.
- Prohibiting US banks from extending loans or credits to the Government of India.
- Denial of export of all dual use items controlled for nuclear or missile reasons. The US will consider on a case-by-case basis other transactions which do not support nuclear, missile, or inappropriate military activities.

The scope of the sanctions has been so defined as not to adversely affect humanitarian projects or hurt private business transactions. Only the prospective transactions of OPIC and EXIM Bank have been affected. Trade between the two countries will be affected only to the extent that export of goods and transfer of technology relating to nuclear and defence activities are involved.

It is expected that the sanctions will not impact on the promising on-going bilateral economic cooperation between the two countries. In fact, after the announcement of the sanctions there has been no slowing down in the pace of business activities by US companies in India. To give a few examples, in the seven weeks after the tests, oil exploration contracts were awarded to four US companies (Okland Oil Company, Samson International, Opesis Inc., Medallion Oil Company); a copper mining project awarded to Phelps Dodge; a software project by Oracle Corp. was approved by the state of Karnataka; American International Group announced that it would take a stake in Tata Airlines Ltd.; a mining venture of Reliance Industries with North American Coal Corp. finalized and approval given to Ford Motor Co. to raise its stake in the joint venture with Mahindras.

The US-India Business Council Annual Meeting

The USIBC Annual Meeting on 4 June 1998 at the US Chamber of Commerce, Washington DC was well attended by about 225 participants representing US trade and industry, US Administration and a FICCI delegation representing Indian industry.

The morning session began with a live video conference call with Mr. Jaswant Singh, Deputy Chairman of the Planning Commission. In his statement, Mr. Singh outlined the reasons why India had to undertake the nuclear tests and specifically clarified that India's action was not directed against any particular country. He added that there can be no doubt about India's intentions as the Prime Minister of India has announced a unilateral moratorium on nuclear testing and offered to sign a no-first-use pact with Pakistan.

Ambassador Naresh Chandra in his remarks highlighted the positive features of the Budget. He clarified that the defense outlay has been increased by 14% only in nominal terms and if adjusted for inflation, the increase is 7%. In any case, as a percentage of GDP, defense expenditure in India remains unchanged at only 2.5% which is much lower than both the neighbors. He drew attention to the significant increases in the budget outlay for agriculture, irrigation, education, women and child welfare and renewable energy sources.

Mr. George Munoz, President of OPIC, spoke about the impact of sanctions on OPIC's assistance to US companies for projects in India. He clarified that in respect of India, existing contracts would be abided by but there would be no new transactions.

After lunch, there was a live video conference call with Mr. Yashwant Sinha, Finance Minister of India. Mr. Sinha stated that spurring growth was his major concern in formulating the budgetary proposals as growth had fallen last year after being 7.5% for three years in succession. He is aiming at a 7-8% growth path and public investments have been raised in most of the key areas with this in view. Mr. Yashwant Sinha reiterated that his government welcomes foreign investment especially in key infrastructure sectors. The target is to double foreign direct investment in two years from the present level of $3.1 billion. To reduce delays in foreign investment clearances, Mr. Sinha said, a scheme of monitoring officers has been introduced. On the issue of additional customs duty, the finance minister clarified that this is not protectionist in nature and intended to be a countervailing duty as the domestic manufacturers were paying local taxes.

Mr. Frank Pallone, Congressman from New Jersey and leading member of the India Caucus, stated that the US industry could play a useful role in making the US administration understand the negative implications of the sanctions. Mr. Rodney Slater, US Secretary of Transportation, also spoke on the occasion.

At the end of the day there was a press conference and a communique was issued. Three significant observations have been made in the communique. First, sanctions may impose severe constraints on the ability of US companies to conduct business operations in India. Second, too often, business opportunities lost due to sanctions simply flow to other more opportunistic competitors. Third, government of the United States should continue to recognize the broader national interests that are engaged in India. "Democratic and pluralist, English speaking, committed to the rule of law, and increasingly oriented toward market liberalization, India's open society presents an attractive long-term opportunity for partnership at all level of relations with the United States".

NEWS BRIEFS

- The Confederation of Indian Industry (CII) has tied-up with ***Trade Access,*** a Boston-based IT firm, for providing electronic commerce facilities to its members. (Economic Times)

- Weizmann Ltd. has tied up with the US-based ***Western Union*** for speedy transfer of funds from anywhere in the world. Western Union is a wholly-owned subsidiary of First Data Corporation — a Fortune 100 company. The money transfer business is relatively new in India with the Reserve Bank of India allowing only inward remittances to be executed. It is expected to take off once full convertibility of the rupee is permitted. (Economic Times)

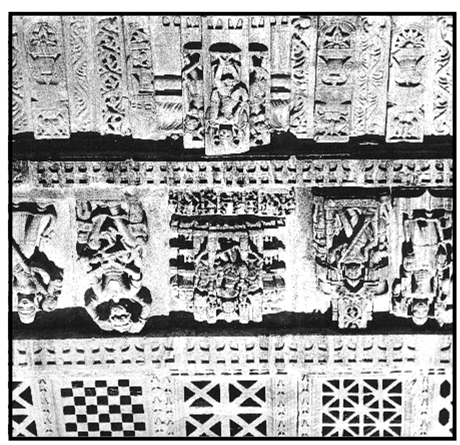
- ***Walt Disney,*** the US-based entertainment major, has firmed up plans for electronic media sector in the country. Bueno Vista Television India, a joint venture between K K Modi group and Walt Disney, has plans to popularize Walt Disney television products by dubbing them in regional languages and showing them on free-to-air channel. (Economic Times)

- ITC's new business division is forging ahead with its branded sports gear and fashion apparel by planning a tie-up with the $1.6-billion ***Russel Corp.*** of US and deciding to spread its retailing activities in high-profile Indian departmental stores. (Economic Times)

- ***Bechtel Enterprises Inc.*** of the US would be setting up a wholly-owned subsidiary in India for the development of infrastructure projects in sectors like petrochemicals, power, telecom, water supply, ports, roads and bridges. (Business Standard)

- ***AES Corporation*** has acquired 49% equity in the state-owned Orissa Power Generation Corporation (OPGC). Orissa is the first state in India to undertake comprehensive reforms of its power sector. The reform process is supported by the World Bank which is also providing financial assistance of $350 million to the project. (Business Standard)

NOTE: This newsletter can also be seen at:
http://www.indiaserver.com



First Class
U.S. Postage
PAID
Washington, DC
Permit # 1137

Embassy of India (Economic Wing)
Attn: Minna Radway
2107 Massachusetts Avenue, NW
Washington, DC 20008