INDIA'S ECONOMY AT THE MIDNIGHT HOUR:

Australia's India Strategy

EAST ASIA ANALYTICAL UNIT
Department of Foreign Affairs and Trade

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Long years ago we made a tryst with destiny, and now the time comes when we shall redeem our pledge, not wholly or in full measure, but very substantially. At the stroke of the midnight hour, when the world sleeps, India will awake to life and freedom. A moment comes, which comes but rarely in history, when we step out from the old to the new, when an age ends, and when the sould of a nation, long suppressed, finds utterance.

Pandit Jawaharlal Nehru, first Prime Minister of independent India, in his speech marking the achievement of Indian independence from Britain, on 14 August 1947.

EXECUTIVE SUMMARY

India's economic prospects have changed substantially. In the 1990s, India will attract international attention as it grows at a rate comparable to that projected for South-East Asia. At average annual growth rates of some 6 per cent per year, by the year 2000 India will have a GDP of around US$430 billion (in 1992 dollar terms). Based on this assessment, India, with a GDP less than that of Australia in 1992, would overtake Australia in economic size by the year 2000. Projected annual imports of US$49 billion (in 1992 dollar terms) by the end of the 1990s suggest that Australian firms should take India's potential into consideration as they formulate their trade and investment strategies. India's economic growth outlook could mean a doubling of Australian annual exports to the market by the year 2000.

The Indian economy is vast - a population of 866 million, a resource-rich land mass with established industrial capacity, the ninth largest manufacturing economy in the world, or the fifth largest if measured by Purchasing Power Parity. But hitherto India's role in world trade has been insignificant. This has been the result of pursuit of autarchic import-substitution policies since independence, continuing well beyond the period for which they may have been effective.

But the enormous strategic, political and economic upheavals around the world over the last few years have forced the pace of change in India too. As a consequence, India has embarked on a course of radical economic reform, restructuring the domestic economy to promote greater efficiency, productivity, and competitiveness, and opening up the economy to the forces of international competition.

Economic reform will bring the Indian economy firmly into international trade and investment considerations. The reform process appears sustainable if the pace and sequence of reforms is carefully modulated. In any case, there is no turning back. Past policies have failed, and now stand discredited. International trends favour liberalisation, and multilateral economic and financial institutions, as well as India's major trading partners, are exerting pressure on India to maintain the momentum for reform.

Although continuation of reform can be predicted with some confidence, the pace of reform is less certain. A projected average growth rate of 6 per cent per year for the rest of the 1990s is based on a relatively cautious assessment of the pace of reform - it is a base-case scenario. Those who believe a projection of average growth of 6 per cent a year for the 1990s to be excessively optimistic rather than cautious, are often unaware that India achieved average annual growth of 5 per cent during the 1980s. A cautious assessment is based on the lessons of India's recent economic performance, some concern over the financing of India's deficit and doubts over rapid reform in some key areas, such as the bureaucracy and the labour market, where predictions of smooth progress seem overly optimistic.

At growth rates of 6 per cent per year, India should be able to absorb its growing labour force and achieve an equitable distribution of the benefits of growth. This has been identified by the World Bank as a key element of success in the East Asian 'Miracle'.

Another key element of East Asian economic growth was the coincidence of reform from within and investment interest from outside. There is every indication that India will be able to attract international investment interest to fuel development and growth. Since 1991 there has been a sudden surge in inflows of foreign investment in response to the liberalised environment. In 1993/94 the total foreign capital inflow into India is expected to be US$5 billion compared to US$580 million in 1992/93. While historically based perceptions in the international community are ensuring a high degree of caution among investors, there is also evidence of a latent interest in India due to the sheer size of its population and the potentially large market it represents. India will face strong competition for international investment funds, particularly from China, but also from South-East Asia. Nevertheless, many international investors will feel unable to ignore India as an investment destination.

In the 1990s, world economic growth and the trading regime are unlikely to be as accommodating as they were during the 1980s, but the potential for India to capture the benefits of rapid technology transfer will help to sustain rapid growth and structural change. India's advantages in skilled labour will facilitate such change.

India's economic development is not likely to be deflected by major domestic political change. In the short term, the active and vocal constituencies opposed to reform - labour, some opposition parties, parts of the bureaucracy and the formerly protected corporate sector - may be able to capture a measure of popular support and ensure media attention. But so long as the government continues on its course, the benefits of reform should become apparent to an increasingly broad sector of the population, who will eventually form a much larger constituency in favour of reform. The political and bureaucratic environments, however, will ensure uneven patterns of development within India. Some States will reform faster and develop more rapidly than others. Similarly, some industry sectors will develop more rapidly than others. This growth pattern will present foreign investors, exporters and importers with a matrix of opportunities by sector and by State. Generalised statements about India's opportunities will not be enough for individual firms making pragmatic commercial decisions. The Indian market is complex. Opportunistic, ill-researched approaches bear high risks.

India will face some constraints in its efforts to industrialise. Infrastructure will need to be upgraded and developed rapidly to keep pace with economic growth. Many other parts of Asia have come up against this constraint as they entered the 1990s and there will be substantial competition for international capital to build and improve infrastructure. India's comparative advantage in skilled workers will be absorbed quickly as growth continues apace. Although India has higher education strengths, upgrading of general levels of education and wider coverage will be needed. Education levels and technical skills training will need significant attention if India is to maintain an advantage it currently has over many East Asian competitors.

Export growth will be dependent on markets for Indian products, which in turn will rely to a great extent on the strength of recovery in the world economy, and India's capacity not only to develop competitiveness and reliability but also to project it successfully to a cautious world. Stronger growth in the United States augurs well for Indian exports, particularly given recent strong US investment in Indian production, but slower growth in Japan and Europe may dampen export growth to some extent. India's past inability to lock into regional production and regional trade patterns developing in the rest of Asia mean that the self-reinforcing growth being enjoyed by countries in East Asia will not flow on to India in the shorter term. However, trends towards increased investment from Singapore and other regional countries may draw India into regional production and trade as the decade progresses.

Vast new markets will emerge in India as the reform process stimulates industrialisation and export capacity. India's imports are likely to more than double by the end of the century. Imports of capital and intermediate goods and infrastructure-related goods and services are expected to expand particularly strongly. The big, expanding middle class will add to the demand for imports of both goods and services and the sophistication of markets. The Indian middle class is conservatively estimated at 120 million, and is growing by around 20 million - more than the entire Australian population - each year. This does indeed suggest that opportunities in India deserve the attention of the Australian business community.

India's liberalisation comes at a fortuitous time for Australia. In many ways, Australia and India are going through a similar process. Of course the Australian economy has always been more dependent on world trade, and much less protected, than India's. But globalisation has had a similar impact in forcing Australia to drop remaining trade barriers and achieve international competitiveness. To attain this, Australia has had an agenda of macro and microeconomic reform, including deregulation of the financial sector, labour market reforms, restructuring of the public sector and government enterprises, and phasing down of tariffs. Australian business is now more outward-looking and export-oriented than at any stage in our history.

While relations between India and Australia have always been friendly, they have not been particularly close. Cricket has been the surest bond, and the only times Australia monopolised Indian attention was when it took to the crease. There have been waves of 'rediscovery' - in the early 1970s, and again in the mid-1980s - when attempts were made to establish more solid ties. But these foundered eventually on India's lack of interest in opening up in its dealings with the rest of the world. In those years, India still relied heavily on its mutually supportive relations with the former USSR and the countries of the Eastern Bloc in trade and in defence. Culturally, its focus was towards Britain, Europe and the United States, where a large number of Indians had emigrated, rather than to Australia or the rest of Asia.

But given the shifts in the global environment India is now beginning to recognise the dynamic economic growth in East Asia. Gradually, it is also realising Australia's significance - as a key player in the Cambodian peace settlement, in the Cairns Group, and in APEC - in this regional context. So the climate is right for a new, and qualitatively different, wave of expanding economic relations.

In recent years, Australian business has seen the growth of the East Asian economies, and has reoriented itself to focus on opportunities presented in these countries. India has not been part of their horizons. Our report shows that India has an 'image problem' with Australian business. Even those who are running profitable business operations with India perceive the business environment in negative terms. India is currently considered to be more difficult in this respect than other Asian countries.

This negative image must be redressed. Although some difficulties remain, old stereotypes no longer reflect the realities of the Indian market. India is changing, and our competitors have been quick to realise this. Increasingly, India is becoming the focus of international attention. More and more, India is being hailed as the 'new tiger', and its economic prospects are being compared favourably to the other giant in the region, China. But India is less likely to experience the extraordinary growth rates of China. India's growth is also likely to be less volatile relative to China's 'boom-bust' cycles. India has maintained stable and respectable growth rates since independence (average annual growth of around 3.5 per cent until the 1980s and 5 per cent during the 1980s). In many ways future growth is building on that momentum with an added boost from major economic reform processes. India's growth performance may more closely resemble that experienced in much of South-East Asia as a result of liberalisation and economic reform in the 1970s and 1980s. It is incumbent on Australia not to let pass this opportune moment for establishing closer economic relations with India.

If Australia continues to neglect the Indian market, we stand to miss out on the opportunities that Indian economic liberalisation presents. And in a market approaching 900 million people, the opportunities are significant. India will not be the right market for all Australian firms, but it should not be dismissed on the basis of outdated information and perceptions. Our analysis of the Indian economy shows that the Indian economy today possesses a number of strengths which are not sufficiently well known or being taken into account. These include a large reserve of skilled labour, an established corporate sector and industrial base, thriving financial institutions, comparable legal and administrative systems, and widespread use of English. While numerous constraints also remain - a bloated and at times obstructive bureaucracy, poor infrastructure and labour market rigidities - these are being addressed. Change will be gradual, but this cautious approach may also enhance stability in the longer term.

This report highlights opportunities both in sectors where Australia has comparative advantage and an established trade record, as well as new areas. Recognising the diversity of India, the report also identifies the states Australian companies might target on the basis of superior infrastructure and complementarity. These are Gujarat, Maharashtra, Punjab, Haryana, West Bengal, Tamil Nadu and Karnataka.

For the 1990s, even if Australia's exports were to continue to grow at current rates, we would lose market share to our competitors. Although the value of our exports would increase in absolute terms in line with India's economic growth, there would be slower growth in imports from Australia than in total Indian imports, because our exports are concentrated in sectors where the rate of import growth is likely to be relatively low. To be successful will require increased efforts, as well as a

comprehensive rethinking of how best to pursue closer economic ties. In the final chapter of the report we map out a strategy for the future, for the mutual benefit of India and Australia. This encompasses suggestions for activities across a range of areas. Networks and linkages are a particularly important asset in doing business with India, and greater attention should be concentrated on developing these. The services of Australia's Indian community may be of value for this purpose.

Ultimately, while Governments can set in place a framework to facilitate business activity, companies have to be prepared to examine the Indian market on its merits. We commend it to them as a market of enormous potential.

PART I

INDIA TODAY

...India has all the material and human resources to be a front-ranking nation of the world. We are on the threshold of a new century, indeed a new millennium. There are tremendous opportunities, provided we have the wisdom and foresight to seize them. There are also immense dangers if we falter or appear indecisive. ...This then is a time for hard work, for recapturing the high noon of idealism which inspired our freedom struggle, for a firm determination to hold aloft, undimmed and untarnished, the bright torch of India which, as Jawaharlal Nehru was fond of saying, embodies her great and eternal spirit so that its light reaches every home and rekindles hope, faith and courage, and pride in being an Indian.

-Manmohan Singh, *Budget Address,* 28 February 1994

CHAPTER ONE

INDIA: REPOSITIONING ITSELF IN THE WORLD

The global environment of the 1990s is changing rapidly. Economies are becoming increasingly interdependent, as protectionist policies are abandoned in favour of competition based on comparative advantage. Production processes are spread over a range of countries, according to perceived national strengths, rather than located in the parent company's home base. Service exports are becoming increasingly 'footloose'. More and more, areas once considered matters of domestic policy, such as environmental protection, or rules of competition, are becoming subject to multilateral scrutiny. The successful conclusion of the Uruguay Round and the establishment of a new World Trade Organisation have provided further impetus for global economic liberalisation.

Politically and strategically, the end of the Cold War has meant a rethinking of traditional alliances, and a recalculation of which linkages are best suited to national interests in the future. Increasingly, the trend is to new regional arrangements, particularly covering trade but also security and defence.

In this context, India is on the move. The changes described above have jolted it out of old certainties and familiar patterns in its interaction with the world. India has seen its influence in world affairs wane in part because its economic clout has not been able to match the leading posture it assumed. It is now seeing its East Asian neighbours, always presumed by India to be lesser developing countries, surge ahead economically.

India now faces the challenge of repositioning itself in the world. The Indian Government is increasingly aware of the need for India to become world competitive in order to win a leading place in the global economy.

Until recently, India was striving towards self-reliance in a highly controlled, centrally planned and closed economy. India's trade with the rest of the world has been insignificant. Today, India is trying to break with the economic policies that underpinned Nehruvian socialism, and open itself up to world trade. This reorientation is strongly supported by international financial institutions and the major economic powers.

The rest of the world has not caught up with these changes. Prevailing images of India still tend to portray an overpopulated country mired in poverty and religious dissension. Images of modern India that encompass satellite dishes, a vigorous computer software industry, five-star hotels, or high technology industries, have not permeated our thinking.

The middle class is burgeoning. The resultant consumer market is conservatively estimated at around 120 million people - the size of Japan. Nonetheless, more than twice this number - an estimated 240 million people, the size of the United States - still live below the poverty line, and the satisfaction of basic needs for this segment of the

population will continue to be a major priority of the Indian Government. The potential for economic success is remarkable. But it will depend on a renewed commitment to resolving the daunting problems of the past - population increase, endemic poverty and environmental degradation.

India is a country of great regional diversity. Distribution of natural resources is unequal and the political capacity for smooth governance varies widely. Some states are clearly better placed than others to benefit from the opening up of the Indian economy. But the opportunities opened up by liberalisation present all states with the chance to improve their performance either through trade and investment, or concentration on provision of new services, such as tourism.

Economically

Since attaining independence in 1947, India has been characterised as having one of the world's most inward-looking economies. Between 1951 and 1993, India's share of world trade plunged from 2.4 per cent to 0.5 per cent. Virtually every aspect of business was controlled and licensed by the bureaucracy. There have been previous bouts of reform, but these did not change the essential orientation of the economy. Rajiv Gandhi's Government ushered in one such bout, from 1985. Barriers to entry in some sectors were reduced, the unprofitability of most public sector enterprises was recognised and the 'licence raj' system of controls was acknowledged to be stifling economic development.

The balance-of-payments problems of 1990-91 precipitated a crisis resulting in a process of radical economic reform, constituting a major break with past policies. The crisis led India to seek IMF assistance, which was only available on agreement to a program of economic restructuring. The Indian Government, led by Prime Minister Rao, accepted the need for reform. It has since pushed the reform process much further than most observers expected.

Major reforms such as the dismantling of the system of industrial licensing and the liberalisation of foreign investment regulations have had a beneficial impact on business opportunities in India and radically changed the business environment. Business is now free to capitalise on the strengths of the Indian economy: its wealth of natural resources, thriving private sector, high level of skilled labour and well established institutional framework, including stock exchanges and a developed legal system.

But there are still areas of reform that the Government has shied away from because of the hard decisions involved, particularly in policies relating to the public sector and labour market reforms. And India's inadequate infrastructure continues to constitute a bottleneck. While the power, transport and telecommunications sectors are being given priority they are still inadequate to allow rapid industrial or service industry expansion in many areas.

The telecommunications reform process may bring relief from the communications problems faced by business over the next few years, but the power sector is going to remain inadequate into the next century due to the lead times for new power projects.

Transport infrastructure is a major constraint on industry. The rail system's shortcomings are such that high-value freight is increasingly going to road transport, even though India's road system is incapable of supporting even the current traffic volume. Recent deregulation of the air transport sector is beginning to pay dividends with improvements in services and reductions in charges.

Another shackle on the Indian economy is the large number of highly regulated public sector undertakings that are prevented from becoming competitive by the legislative framework that has evolved over the four decades since independence. These companies are unable to shed labour, diversify, expand or sell surplus assets. Unless public sector reforms are implemented to give them a chance of competing they will remain a significant financial burden on the Indian government.

While many difficulties exist for business in India there are also increasing opportunities for companies that carefully assess the prospects. India is a very diverse country, where infrastructure, regulations, economic development, culture and attitudes to foreign companies vary enormously from region to region and from sector to sector. While India is not an easy market to enter, trade and investment prospects have never been better and will improve as the economic reform process continues.

Strategically

The end of the Cold War has forced India, like most other countries, to reconsider its position in the world: its international standing, its relationship to the major powers, its security and its economic well being have all been affected. The collapse of the Soviet Union eliminated India's security umbrella and economic and defence cushion.

India's foreign and security policies have only begun to adjust to the changed world order and continue to retain remnants of earlier, superseded thinking. India is slowly coming to grips with a competitive world in which it has to earn a place rather than be guaranteed one by others. There has been a recognition of the growing importance of economic diplomacy but this has yet to be fully translated into policy.

India's strategic preoccupations range through a web of interrelated issues, particularly Kashmir and nuclear weapons capability. The Kashmir dispute with Pakistan is the central issue preventing normal relations between the two countries. Two wars have been fought over this. Following the last war in 1971, India and Pakistan signed an accord - the 1972 Simla Agreement - which many governments, including Australia, recognise as a useful bilateral framework for the resolution of the dispute over Kashmir. However, growing international concern about the human rights dimensions of the situation has put increased pressure on the Indian Government to be more transparent about its role in managing the tensions within Kashmir.

The India-Pakistan relationship has a nuclear dimension. India has a nuclear weapons capability and an active missile development program which Pakistan seeks to match. Given the volatility of the relationship, the threat of escalation to a nuclear exchange is real, notwithstanding assurances to the contrary. China's links with Pakistan - the source of Pakistan's nuclear and missile capabilities - add further complexity to this triangular relationship. India justifies keeping its nuclear option open on the basis of

China's nuclear arsenal and the threat this poses to India's security. China, in turn, argues that it would never use nuclear weapons against a non-nuclear power, a declaration which has never satisfied India.

India has developed good or at least neutral relations with its neighbours (except Pakistan). Although predominantly a Hindu society, India has the second largest Muslim population in the world (after Indonesia). Because of this, relations between India and the Islamic world continue to be sensitive. Pakistan has been striving to fuel Islamic interest in Kashmir. For these reasons, as well as the need for stable sources of oil, India has worked hard to develop its bilateral relations with individual Islamic countries.

Despite strong ambivalence towards China, India has moved successfully to put its border dispute on hold while advancing the relationship on other fronts. India has created a new set of relations with the Central Asian Republics of the former Soviet Union and its relationship with Russia has been put on a different footing: its debt to Russia has been all but eliminated although a defence and technological dependency remains. Moving with the times, India has recognised Israel, restored diplomatic relations with South Africa and is looking to strengthen links with the countries of East Asia and Australia.

India's relations with the major economic powers - particularly the United States, Japan, United Kingdom and Germany - now loom much larger on its political and economic horizons. The United States is India's largest trading partner. Two-way trade is now of the order of US$7 billion and more foreign investment is flowing into India from the United States than from any other country. While from the United States' perspective India's strategic significance is essentially regional, there is a perception in India that the United States' efforts to provide international leadership on issues such as nuclear non-proliferation, human rights and free trade are prejudicial to India's national interests.

There is surprisingly little public debate in India on the economic underpinnings to political and military power and its role in conferring great power status. Big numbers - size of population, size of economy, size of defence forces - are readily and willingly confused with power, and the potential represented by big numbers is spoken of as if it were already fulfilled. Equity continues to play an important part in Indian thinking on international relations, including in economic relations, and underpins India's bid for permanent membership of the UN Security Council.

The recent opening up of South Africa is seen to be the basis of some hope. South Africa is being viewed from a number of perspectives: economically important in its own right with a useful Indian-origin community to generate trade; as a springboard into sub-Saharan Africa; and as one of the elements of an Indian Ocean rim economic grouping which could call upon the Indian communities of the rim.

The prospect for strengthening commercial links between littoral states of the Indian Ocean is now under examination in both India and Australia. The growing convergences of interest between Australia and India are being increasingly recognised as both countries reach out to participate more actively in the region.

But the question may be, which region? While the Indian Ocean is one where we could cooperate, India is also looking to consolidate its linkages with the Asia Pacific region. An ASEAN-India Business Council has been established, and India wants its recently initiated sectoral dialogue with ASEAN upgraded to full dialogue status. India also wishes to join APEC. Neither option needs to be ruled out, although given resource limitations, one or the other will have to be given priority.

Culturally

The global information revolution is also fuelling demand for economic change. The advent of satellite television into India and its rapid acceptance by the Indian population has ended cultural isolation and is radically altering economic expectations. These changes are concentrated on the increasingly affluent middle class, leading to rapid increases in demand for consumer products and additional pressure on the government to open up the Indian economy.

India is culturally rich and diverse and the impact of western culture will vary from region to region. In Bombay, for example, western influences are already strong as can be seen by the thriving, western-style entertainment industry (pubs, discos and nightclubs), although its film industry continues to be an extremely powerful popular medium for the dissemination of Indian entertainment and cultural values throughout the Indian diaspora.

The size of India's population offers scope for media services specifically aimed at meeting its demands. The services that cater for the tastes of the audience will obviously gain the largest share of the market. Programming specifically developed for, and in, India is gaining the greatest following and there are plans to increase the number of Indian language television channels and to develop more Indian production houses to provide the programming. But whether Indian viewers opt for material that is intrinsically Indian or whether they prefer to watch western programming, given the size of the Indian market the impact of the spread of electronic media will be immense.

Promotion of India's unique culture is being given priority by many State Governments in an effort to capture a slice of the international tourism market, although poor infrastructure at present limits their success.

Rediscovering Asia

Another important element driving India's reform process is the recognition that India is being left behind in development by some of its Asian neighbours, particularly China, Korea and the ASEAN countries. More recently the amount of foreign investment flowing into Vietnam has led India to scrutinise why it is not attracting more of this pool.

The 1980s should have been a bad decade for the East Asian developing countries. It started off ominously for the world economy: having just recovered from the first oil shock, further sharp rises in oil prices triggered another recession. This time round, the United States pursued tight monetary policy to combat inflation. This not only added to the initial severity of the recession but also resulted in a sustained rise in real US interest rates. Many heavily indebted developing countries failed to service their debt as a result.

Although some of the East Asian developing countries were among the big borrowers in the 1970s, all escaped relatively unscathed from the debt crisis. In fact, this experience prompted them to further restructure and liberalise their economies to pursue export-led growth. Many South-East Asian countries, in particular, began to dismantle import protection and actively promote manufacturing exports.

This effort was aided further when the sharp rise in the value of the yen since 1985 induced many Japanese manufacturers to shift their production base to other East Asian countries to take advantage of lower labour costs.

On another front, China started reforming its command economy in late 1978, first by introducing a new agricultural land tenure system. Reforms in the urban industrial areas followed. Although the restructuring of state-owned enterprises has not yet proved to be a great success, private enterprise flourished along the coastal strip of the country as a result of open-door economic policies and incentives granted to overseas investors. Notwithstanding numerous destabilising macroeconomic fluctuations, China has achieved an average annual economic growth rate of around 10 per cent since 1980. Many neighbouring economies, especially Hong Kong and Taiwan, have benefited from China's surge ahead.

From 1980 to 1992, the proportion of world exports accounted for by East Asian economies (excluding Japan) almost doubled from 8 per cent to 15 per cent. They also invariably achieved very fast economic growth by world standards. Significantly, while the developed economies went into recession in succession from 1990, the East Asian developing economies have been able to maintain their growth pace. In 1992, they achieved an average economic growth rate of 7.8 per cent, compared to 1.5 per cent for the OECD countries. A major reason for their resilience has been increased economic interdependence and the rise of East Asia as a force for economic growth in its own right.

The spectacular success of the East Asian economies has left India feeling uncomfortably marginalised. Accustomed to regarding itself as, in some senses, a

leader of these countries in forums such as the Non-Aligned Movement and the G77 developing country grouping in the United Nations, India has found it difficult to come to terms with the fact that developing countries in East Asia have overtaken it economically.

> ***I've often said that the world-is-in-a-recession attitude has created in our country a disastrous mindset. This is the by-product of the Soviet type thinking. If the world is in a recession, why are the Chinese exports booming? In 1973 our level of exports was the same as that of the Chinese. Where are the Chinese today, and where are the Indians?***
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> -Manmohan Singh, *India Today*, March 31, 1993

While Australia has been linked into the powerhouse that is East Asia (almost 60 per cent of Australia's exports go to East Asian markets), India has not been (only around one-quarter of India's exports go to East Asia). East Asia has also been slow to invest in India. Nevertheless, in the early 1990s many of the factors that ensured East Asian economic success are present in India: high savings, a well-educated workforce, and liberalising policies.

A comparison of India and China provides some useful insights and suggests that while East Asia and the world have already focused on China, India's era of neglect may also be near an end.

Figure 1.1

The Two Asian Giants Compared

SIMILARITIES

INDIA	**CHINA**
• Large sub-continent: 3.16 square kms	• Vast landmass: 9.6 square kms
• Second largest population size in the world: 866 million	• Largest population in the world: 1,180 million
• Planning commission and five-year plans which are losing relevance under economic reforms	• Communist Party mandated five-year plans aimed now at the 'Socialist market economy'
• Large public sector dominates infrastructural services and strategic industries but limited disinvestment and privatisation is occurring	• Pervasive public sector still controls the 'commanding heights' of the economy and much of foreign trade and investment
• GDP per capita US$270	• GDP per capita US$370
• Annual private consumption growth rate, 1980-91: 5.3 per cent	• Annual private consumption growth rate, 1980-91: 7.3 per cent

DIFFERENCES

INDIA	CHINA
• Constitutional democracy	• Communist one party state
• Federal parliamentary republic: strong central powers but growing devolution to 25 States and 7 union territories	• Highly centralised state: increasing strength in 22 provinces, 5 autonomous regions and 6 coastal special economic zones
• GDP growth, 1980-91: 5.4 per cent per annum	• GDP growth, 1980-91: 9.4 per cent per annum
• GDP, 1992: US$237.6 billion	• GDP, 1992: US$431.7 billion
• Adult literacy 1990: 48 per cent	• Adult literacy 1990: 73 per cent
• Food self sufficiency in grains based on Green Revolution breakthroughs	• Not self sufficient in grains: continues to import large quantities
• Strong labour unions	• Non-unionised labour
• Pluralistic policy-making process: free press, political parties and NGOs	• Little widespread public participation in the policy-making process
• Inflation rate, 1992/93: 9.6 per cent	• Inflation rate, 1992/93: 20 per cent
• Industry as share of GDP, 1991: 27 per cent	• Industry as share of GDP, 1991: 42 per cent
• Services as share of GDP, 1991: 41 per cent	• Services as share of GDP, 1991: 32 per cent
• Gross domestic savings as ratio of GDP, 1990: 21 per cent	• Gross domestic savings as ratio of GDP, 1990: 39.2 per cent
• Foreign exchange reserves, end-1993: US$10.2 billion	• Foreign exchange reserves, end-1993: US$22 billion

Sources: *Business India*, August 16-29, 1993, Economist Intelligence Unit Country Profiles, 1993-94, World Bank, and *The Economist*, 19 February, 1994.

CHAPTER TWO

THE INDIAN GIANT

Although India has to date failed to become an economic giant, it is a giant in many other respects. It has a vast population and a huge workforce, including large numbers of highly educated and highly skilled professionals. It is the world's largest democracy and encompasses great diversity.

Demographic Trends

India, with a population of 866 million in 1991, is the second most populous country in the world.[1]

India's population is projected to exceed the one billion mark by the year 2000. Population growth has always been one of the major problems facing the Indian economy. The average rate of population growth over the decade 1981-91 was down to 2.1 per cent, only a marginal improvement on the previous three decades. But fertility rates are dropping, owing largely to family planning programs, increased female literacy and a rise in the average age at marriage. East Asian countries have been more successful in containing population growth (see Table 2.1).

Table 2.1
Comparative Population Growth and Projections, 1988-2000

	Population (millions)		Average Annual Population Growth (per cent)		
	1988	**2000**	**1965-80**	**1980-88**	**1988-2000**
India	816	1007	2.3	2.2	1.8
Thailand	54	64	2.9	1.9	1.3
Philippines	60	75	2.9	2.5	1.9
Pakistan	106	154	3.1	3.2	3.1
Mexico	84	105	3.1	2.2	1.9
Indonesia	175	213	2.4	2.1	1.7
Australia	17	20	1.8	1.4	1.4

Source: MacIntyre, A., *Indonesia*, Asia-Australia Institute, Asia-Australia briefing papers, Vol.2 No.9, 1993.

[1] World Bank, *India: Progress and Challenges in Economic Transition,* World Bank Report No. 11761-IN, Washington, May, 1993.

Life expectancy has increased considerably: from 32 years in 1951 to 59 years in 1990. Nonetheless, Indian age distribution continues to be 'young', with children under the age of fifteen forming about 40 per cent of the population in 1987-88.[2]

The trend towards urbanisation is an important new development. Although still slow when compared to other Asian countries, 25.7 per cent of the population were urban dwellers in 1991.[3] This trend will exacerbate the problems of towns and cities, which already suffer from overcrowding and attendant problems of housing shortages, lack of power and over-stretched infrastructure.

Income distribution remains very uneven. It is estimated that there are as many as 10,000 $US millionaires in India.[4] But despite this, India still has to grapple with the problem of mass poverty. About one-third of the world's 'absolute poor' live in India. According to the Indian Government's own definition of poverty, approximately 30 per cent of the population (240 million people) live below the poverty line.[5]

Poverty alleviation has always been one of the major goals of the Indian Government. But it is difficult to say whether the decline in the proportion (although not in absolute numbers) living in poverty has been due to economic development and increased per capita GDP or to any specific poverty alleviation programs. Poverty alleviation programs have not always been carefully targeted.

Regional differences are significant: Bihar, Uttar Pradesh and Madhya Pradesh have the highest percentage of poor; Haryana, Punjab and Jammu and Kashmir the lowest.[6]

Labour Market

India's labour force was estimated at 310 million in 1991, constituting about 38 per cent of the population. Wage levels vary from State to State. Low productivity is a common feature of the Indian labour market. This is at least partly because the large government sector, as a 'model employer', has provided job security with indexation of wages to inflation and with steady increases in real wages regardless of productivity.

Only 7 per cent of the total workforce is unionised, although union membership is high in many key industries. The most powerful unions are in the public sector and have political clout. They resist any changes that affect their vested interests. As a result, the workforce employed in that sector is much larger than warranted by technical or economic considerations and acts as a brake on the implementation of reform.

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[2] The 1991 census excludes population distribution by age. Visaria, P, 'Population' in Jalan, B. (ed) *The Indian Economy,* Penguin India, New Delhi, 1992, p.289. See World Bank, *op.cit,* p.108, table on distribution of population by age.

[3] According to the 1991 census.

[4] *Financial Review*, 7 Feb 1994.

[5] This rate is, however, an improvement over the 48 per cent of the population which fell into this category in 1977-78. See World Bank *op cit.*

[6] The Economist Intelligence Unit, *India, Nepal Country Profile*: *1992-93,* World Microfilms Publications Ltd, United Kingdom, 1992 and World Bank, *op cit*.

The number of person-days lost due to strikes and lockouts over industrial disputes was around 34.12 million in 1991-92. Most industrial unrest has been in the cotton and jute textiles and manufacturing industries and confined largely to the States of Andhra Pradesh, Maharashtra, West Bengal and Tamil Nadu.[7]

There are no reliable estimates of unemployment and underemployment for the Indian economy. The unemployed are not entitled to any unemployment benefits. The number of registered unemployed covers only the urban unemployed and does not fully reflect the situation. There were 30 million unemployed registered in 1986-88, including about 16.5 million educated and, within this group, about 2.8 million graduates. The problem of unemployment has worsened as population growth has exceeded the growth in employment.

Education and Workforce Skills

Despite an extensive education sector, India's literacy rates are among the lowest in the world. Adult literacy in 1991 was estimated at 52 per cent; female literacy was only 39 per cent, while male literacy was 64 per cent. Rural areas had a 45 per cent literacy rate, while that among rural females was as low as 30 per cent.[8]

Under the Constitution, the primary responsibility for education rests with each State Government, although the Central Government coordinates education planning and policy through the Department of Education. The majority of funding is supplied by the Central and State Governments, with additional funding from local authorities and private sources, including student fees. Expenditure on education in 1989 was 3.1 per cent of GNP.[9] This compares with expenditure by China and Indonesia of 2.3 per cent and 0.9 per cent of GNP respectively in 1981, although Indian spending was much more concentrated on higher education. The New Education Policy (NEP) introduced in 1986 envisaged a national system of education built around universal primary education. Additional funding was to be provided to allow increased opportunities for less privileged students involved in higher education. Funding for State universities largely comes from State Governments, supplemented by Central Government funds, with fees making up 11-12 per cent of total expenditure.[10]

India has an extensive higher education sector. In 1988, there were 164 universities and 6,597 colleges in India with an annual expansion rate of 3 per cent.[11] But the education system is characterised by a lack of resources and a high pupil/teacher ratio. There are immense variations in the quality of education offered by tertiary institutions. While qualifications gained from the more prestigious universities are of international standard, those from other universities and colleges are of a significantly lesser standard. Colleges are affiliated with universities, but most universities only prescribe curriculum and control examinations. The affiliated colleges, many of which

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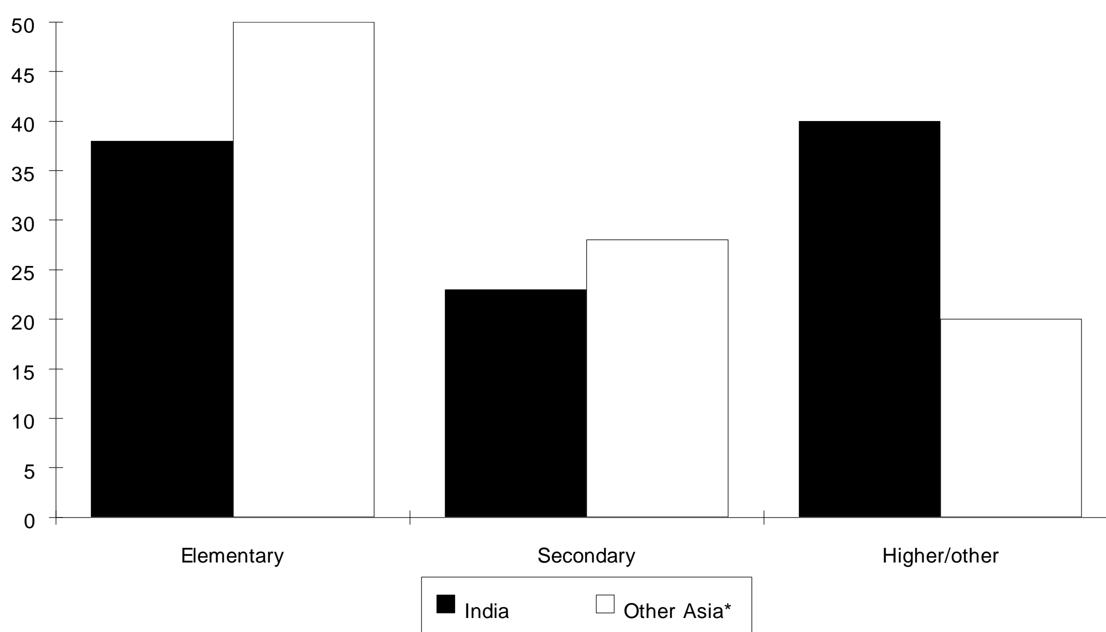
[7] Government of India, *Economic Survey, 1992-93*, New Delhi, 1993.
[8]Census of India,1991 (paper no. 2 of 1992).
[9]UNESCO, *Statistical Yearbook*, 1993.
[10]Department of Education, Employment and Training (DEET),*Country Education Profile*, *India*, AGPS, Canberra, 1992, p.6.
[11] *Ibid*, p.6.

are ill-equipped and inadequately staffed, are involved in teaching and preparing students for examinations.

The Indian Government has recognised the need for continuous development of the education sector, and has embarked on an ambitious literacy program, with the aim of achieving a rate of 70 to 75 per cent by 1997.

When compared with expenditure on education in most other Asian countries, India's resources have been skewed in favour of secondary and higher education (see Figure 2.1).

Figure 2.1
Government Expenditure on Education
(percentage shares by level)



Source: World Bank, *op cit.*

Because of its concentration on higher education, India has a large pool of highly skilled labour, including an estimated 2 million engineers and scientists, and 10 million university graduates. Almost 50 million are educated to higher secondary level. India thus has a strong comparative advantage in supply of skilled labour, given that skilled wage rates are also much lower than in other Asian countries.

Political System

India is the world's largest democracy. Indians at all levels are conscious of their political rights, and combine to exercise them and influence the process of government. Consequently, the government is frequently obliged to act cautiously in order to balance competing interests. The Indian system of government has some similarities to the Australian system: it is a federation with power shared between the Central and State governments and it has a bicameral parliament at the Centre. The degree of power vested in the Centre is far greater than under the Australian system, as revealed by its ability to bring renegade state leaders to book for indiscipline and even to dismiss them in extreme cases in the course of the constant jostling for power that goes on between the Centre and the States.

Prime Minister P.V. Narasimha Rao is the head of government, and President Shankar Dayal Sharma the constitutional head of state. National elections are held every five years. Rao was elected in June 1991, and his Congress Party ruled as a minority government until the beginning of 1994 when defections from a minor party enabled it to achieve a majority in the Lok Sabha (lower house). Before this, Rao's Government had depended on the support of minority parties, facing frequent resistance to many of its policies by the main opposition parties. Nevertheless, it enjoyed the bipartisan support of the largest single opposition party, the Bharatiya Janata Party (BJP), for its economic reforms during its first year or so in office. The Rao Government has faced considerable political instability, including violent outbreaks of communal unrest at frequent intervals, at times diverting it from its priorities of economic reform and liberalisation. Nevertheless, the Government persevered with its policies in spite of the difficult political climate.

The diversity of the States in terms of resources, geography, culture, history and language, as well as the differing policies pursued by State governments of different political hues, have given rise to considerable disparities in the investment climate and the speed of application of reform from State to State. India's federal system of government has meant that the success of these measures is very much reliant on the States' commitment to implementation.

In a period of change, the electorate has been even more than usually vulnerable to manipulation by politicians keen to consolidate their power bases at the cost of exploiting traditional enmities. Widespread poverty, low literacy levels and strong nationalist sentiment have assisted the process. India has one of the lowest rates of literacy in the world and a poor record on most other indicators of human resource development. The economic liberalisation process and the entry of foreign companies have made easy targets for politicians to exploit longstanding problems of religion and caste through popular uncertainty and unease over the potential effects of the reforms.

The main opposition party, the BJP, used Hindu nationalism to increase its popularity during the first two years of the present Government's term. It succeeded in generating a wave of religious support and at times it seemed unlikely that the Government would see out its term in office as the BJP's apparent popular mandate grew rapidly for a time. Hindu nationalist sentiment peaked in December 1992, when BJP supporters demolished the Babri mosque at the Hindu pilgrimage site of Ayodhya and only began to wane by the time elections in the northern States took place in

November 1993. The BJP is now debating internally whether to distance itself from extreme (anti-Muslim) policies and move towards the political centre. It is equivocal in its support for economic liberalisation. The BJP is committed to making India a nuclear weapons state.

A daunting aspect of Indian political life is the continuing problem of communal tension which from time to time leads to large-scale disruption and violence of the type witnessed in the aftermath of the destruction of the mosque in Ayodhya in December 1992. The conflict had a spiralling effect throughout the country and saw its most extreme expression in violent Hindu-Muslim riots in Bombay in January 1993, a conflict exploited both by Hindu extremist elements and powerful Muslim underworld interests. An after-effect of the January riots was a sophisticated terrorist bomb attack on the city in March 1993, which targeted the Bombay stock exchange among other sites, highlighting how directly communal unrest can impact on the economy.

Government reaction to communal problems and sectarian violence has sometimes led to harsh measures to reinstate control. This was particularly the case during sectarian violence in Punjab and remains so in the struggle against the separatist movement in Kashmir. The Government's actions have at times led to concerns amongst international organisations and other governments about alleged human rights violations by the police and military. In response, the Indian Government has now set up a Human Rights Commission to investigate these allegations, although the military are exempt from its jurisdiction.

Factors contributing to political instability are not endemic to India, being regionally limited in the case of insurgency, and sporadic rather than perennial in the case of communal problems.

The unevenness of the distribution of the benefits and costs of India's economic reform process is placing the Government under pressure from those who are bearing, or perceive that they are, the pain from reductions in subsidies and other reform measures. The mass of rural producers feel particularly marginalised from the benefits of liberalisation and are directly affected by the reduction in subsidies. Early benefits are going to States with better infrastructure and resources and to people in the higher socio-economic groups. But the potential for stronger economic growth to ensure wider benefits in the longer term is a convincing one in the light of recent East Asian history.

Traditionally India has had strong trade unions and they are a potential impediment to the reform process. However, when a general strike was called in 1993 to protest the direction of economic reform the response was lukewarm. The Government is in the process of formulating improvements to its National Renewal Fund, a mechanism designed to compensate workers retrenched through changes envisaged in the labour sector which would enable employers to dismiss employees without government permission. Thus far the labour movement has not been a general impediment to reform, though in some important sectors, such as banking, railways and telecommunications, union pressure has prevented major restructuring.

All in all, the Government has succeeded in keeping the reform process on track in a climate of political upheaval, resisting pressure to jettison the process because of populist suspicion of and opposition to any short-term adverse effects. The reforms are beginning to take hold and are now widely regarded as irreversible. The Congress party seems well positioned to see out the rest of its term in office to face the next general elections in 1996. Its chances of winning the election depend on a number of factors: internal cohesion within the party, whether the BJP succeeds in orchestrating its resurgence, and whether other lesser political formations, currently most active on a regional basis, succeed in submerging their many differences and uniting to form a viable political force at the Centre.

The challenge in the next century for whichever party succeeds in winning power at the next elections will be first and foremost to make economic reforms work, to raise the growth rate, and to spread the benefits of growth as widely as possible. In addition, it will have to balance the containment of insurgency with international pressure regarding its human rights record, to maintain its electoral advantage without exploiting caste and communal differences that ultimately undermine internal stability and economic progress, and finally to balance the demands of economic progress with social development and environmental management - the latter important from the point of view of avoiding the stresses on infrastructure which could eventually represent a severe cost to the nation. In spite of inevitable adjustment problems, the prospects for the sustainability of the reforms are positive.

Centre-State Relations

There are 25 States and 7 Union Territories in India. The Constitution of India provides for two tiers of government and has assigned responsibilities and functions to both the Centre and the States. The States enjoy a substantial degree of autonomy within the areas of responsibilities granted to them by the Constitution. However, their freedom of action is circumscribed by several provisions intended to ensure the national viewpoint prevails in important matters.

The Constitution assigns to the States several major responsibilities. These include the maintenance of law and order and administration of justice, some capacity for revenue raising, and other wide-ranging functions connected with the social sectors, agriculture, infrastructure, including water management, and the overall development of the economy.

Three lists assign functions between the States and the Central government: the Union list covers the Centre's responsibilities, the State list covers State responsibilities and the Concurrent list covers areas where both are involved. Despite this structure, the division of responsibilities has never been clear cut and, in practice, the Planning Commission has progressively strengthened the Centre vis-a-vis the States. The Centre currently has overwhelming control over investible resources in the economy. According to the Constitution, States are allowed to access resources through taxation and borrowing as well as through resource sharing with the Centre.

Centre-State relations at times result in conflict, owing to the Centre's control over fiscal, monetary and foreign exchange resources. The Centre has used the Planning

Commission as its means of gaining greater control. The Centre can intervene on the grounds of pursuing national objectives or achieving uniformity of standards of services across the States, and through its role in determining administered prices of many products produced by Public Sector Enterprises (PSEs).

All States have not shared equally in the fruits of economic growth. There has been a big variation in the economic performance of different States (see table 2.2). When comparing the Net State Domestic Product (NSDP) over the 1980s, Maharashtra contributed the most to India's net domestic product (12 per cent in 1988-89), closely followed by Uttar Pradesh (11 per cent in 1988-89). Andhra Pradesh and Tamil Nadu in the south and Gujarat in the west each contributed about 6 per cent to India's net domestic product. The eastern States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Orissa contributed the least to the country's net domestic product.

Comparing per capita NSDP, Punjab, Maharashtra and Gujarat were among the top five, and Bihar, Madhya Pradesh, Orissa and Uttar Pradesh were the bottom four. Uttar Pradesh, despite being the second biggest contributor to India's net domestic product, ranks near the bottom in per capita terms. This is due to its heavy dependence on agriculture, which has not benefited uniformly from technological change, and population pressure.[12] The disparity between the highest and the lowest states has increased. By 1988-89, the ratio of the highest per capita state domestic product was 2.75 times the lowest. These disparities are likely to increase as State economies are allowed greater freedom from central control.

[12] Uttar Pradesh is the most populous State.

Table 2.2

Socio-Economic and Geographic Characteristics of Indian States, 1991

	Pop. millions	**Area** '000 kms	**Pop. Density** per sq km	**Rural Pop.** millions	**Urban Pop.** millions	**Share of Pop. Rural** per cent
India	846.3	3088.7	274	628.7	217.6	74.3
Andhra Pradesh	66.5	274.8	242	48.6	17.9	73.1
Arunachal Pradesh	0.9	86.5	10	0.8	0.1	92.5
Assam	22.4	78.4	286	19.9	2.5	88.8
Bihar	86.4	173.8	497	75.0	11.4	86.8
Goa	1.2	3.8	316	0.7	0.5	59.8
Gujarat	41.3	195.8	211	27.1	14.2	65.6
Haryana	16.5	44.3	372	12.4	4.1	75.3
Himachal Pradesh	5.2	55.6	93	4.7	0.4	90.9
Jammu & Kashmir	7.7	na	na	5.9	1.8	76.4
Karnataka	45.0	191.4	235	31.0	13.9	68.9
Kerala	29.1	38.9	749	21.4	7.7	73.5
Madhya Pradesh	66.2	444.2	149	50.8	15.3	76.8
Maharashtra	78.9	307.2	257	48.4	30.5	61.3
Manipur	1.8	22.4	82	1.3	0.5	70.8
Meghalaya	1.8	22.5	79	1.4	0.3	78.9
Mizoram	0.7	20.9	33	0.4	0.3	58.0
Nagaland	1.2	16.6	73	1.0	0.2	82.7
Orissa	31.7	155.9	203	27.4	4.2	86.5
Punjab	20.3	50.3	403	14.3	6.0	70.5
Rajasthan	44.0	341.1	129	33.9	10.1	77.0
Sikkim	0.4	7.1	57	0.37	0.0	91.0
Tamil Nadu	55.9	130.2	429	36.8	19.1	65.9
Tripura	2.8	10.5	263	2.3	0.4	83.4
Uttar Pradesh	139.1	294.1	473	111.5	27.6	80.2
West Bengal	68.1	88.8	767	49.4	18.7	72.6

Source: *Economic Survey, 1992-93*, Economic Division, Ministry of Finance, Government of India.

CHAPTER THREE

THE NEW MIDDLE CLASS

The Indian middle class is conservatively estimated to be 120 million people and growing at about 20 million people per year. Overall improvements in education and living standards, coupled with the increasing benefits of more productive economic activity, have produced a rapidly expanding Indian middle and upper class. Linkages between this growing entrepreneurial and consumer middle class and the millions of Indians who reside overseas are helping to accelerate India's domestic reform drive. This development is, in turn, fuelling economic growth as the middle class exercises its increased purchasing capacity. As an indicator of the strength of the upper middle class and high income group, there are about 20 million Indian shareholders and mutual fund investors. In the past, quality consumer goods were categorised as luxury items and their production was accorded a very low priority. There is therefore an enormous pent-up demand for such goods, and it is only now that the economy is being liberalised that this demand is being met. Despite liberalisation, the Government of India has not yet lifted the prohibition on imports of most categories of consumer goods. Consumer items now on the domestic market have been produced mainly in India.

Over the past decade, India recorded its fastest rate of economic growth. Real per capita income rose by 40 per cent during the 1980s, compared with a rise of 30 per cent over the previous two decades. This produced a major improvement in living standards and halted the spread of India's poverty. Food consumption rose by 35 per cent, almost double the 19 per cent growth in population[13]. The new middle class forms the basis of a rapidly developing consumer market.

The 1980s were marked by the following developments in consumption:

- Annual sales of packaged consumer goods (excluding such items as unpacked food and garments) rose by 220 per cent to US$2.2 billion.

- The number of television sets soared from 2 million to 23.4 million. Sales in the early 1990s are running at about 6 million sets a year.

- Annual sales of new cars increased five-fold, while sales of scooters and mopeds expanded by more than 11 times.

- The number of telephone lines doubled between 1983 and 1992 and is expected to triple in the next eight years.[14]

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[13] This is according to the Indian Planning Commission.
[14] *Far Eastern Economic Review*, 13 January, 1993.

- Spending on clothing, kitchen utensils, refrigerators, stoves, watches, personal accessories and personal transport surged by 8 to 10 times the percentage rise in population.

Indian National Sample Survey data show a clear trend of increases in expenditure on services and manufactured consumer goods in both urban and rural areas during the 1980s. Expenditure on fuel and lighting increased in urban areas. Durables accounted for very modest proportions but showed dramatic increases. In absolute terms the highest increases were in manufactured consumer goods. Production of consumer durables also increased over this period (see Table 3.1).

Other developments which have contributed to the growth of the middle class are rising literacy levels (particularly among women), population growth within the middle and high income groups and reduction in average household size. The latter development has particular significance for marketing of durable goods. For example, a joint family household may now need two or three smaller refrigerators rather than one large refrigerator.

Table 3.1
Production of Consumer Durables
('000 units)

Year to March	**1980**	**1984**	**1988**	**1991**
Televisions	369*	1560	5800	3980
Refrigerators	278	547	850	1322
Air Conditioners	44	55	77	80
Automobiles	31	64	175	165
Motorcycles	102	175	426	431
Scooters	210	297	630	770

Note: *Black and white only
Source: Economist Intelligence Unit, *India Country Profile*, January, 1993-94.

Lifestyles and habits are changing. Convenience goods such as instant coffee, noodles and tomato puree are popular. Households using washing machines instead of traditional laundryman services are increasing. Table 3.2 shows the number of households in different income groups owning selected consumer durables, and purchases of selected consumer products. From 142 million households, the number of wrist watches owned was 120 million, bicycles 60 million, and radios 54 million. Laundry soap was purchased at least once during the year by 133 million households, tea by 112 million, and soap by 124 million.[15]

[15] NCAER, *Consumer Market Demographics in India,* New Delhi, 1993, p.7.

Table 3.2
Ownership and Purchase of Selected Consumer Goods by Income Classes 1989/90
(by number of items)

	Low	Low-middle	Middle	Upper Middle	High	Total
B/W TV						
Owned	3794	7584	4696	1185	503	17762
Purchased	882	1878	917	202	115	3993
Transistor Radio						
Owned	23989	18727	7872	2202	10810	53870
Purchased	2635	1897	769	159	85	5545
Bicycle						
Owned	27434	20437	8486	1895	983	59236
Purchased	2484	2083	828	173	123	5692
Mechanical Wrist Watch						
Owned	33848	31391	16378	4658	2730	89004
Purchased	3899	4127	1953	577	303	10860
Digital Wrist Watch						
Owned	8902	10070	7245	3195	2176	31588
Purchased	1895	2355	1713	798	475	7236

Source: Rao, S.L., *Economic Reforms and Indian Markets*, Wheeler Publishing, Allahabad, 1992.

While overall per capita consumption of most goods may remain low, the absolute size of the market provides incentive for companies to invest and compete. For example, the market for hair-care products is estimated to be worth over US$150 million despite low average rates of consumption. Similarly, the detergent market is estimated to exceed 2 million tonnes per annum, higher than that of any single country in Europe.

Consumer orientation and innovation are fast becoming key ingredients to economic success. Packaging in smaller, affordable quantities has proved particularly successful. For instance, the introduction of shampoo in sachets has made a premium product readily affordable. Introduction of the traditional mouth freshener spice mixture *Pan Masala* in sachets, and a cheaper version of cassette tapes, have rewarded the entrepreneurs who brought these innovations to the vast Indian domestic market.

Advertising is a clear growth area. High profile billboards marketing domestic and foreign brands of consumer products have become a common sight in Indian cities. Sony, National Panasonic, Benetton, Colgate, Pepsi-Cola and Old Spice are among the scores of foreign brand names that are bombarding Indian consumers through advertisements in numerous magazines and newspapers and on television.

Size of the Middle Class

Estimates of the size of the Indian middle class vary between 100 and 250 million people. A commonly adopted but conservative estimate is 120 million - around 14 per cent of the population with incomes high enough to afford a lifestyle dependent on a growing range of consumer goods. Among the Indians in this group are those with sufficient disposable income to rent or own their residence, hold bank or credit card accounts, engage in holiday travel, own their own means of transportation, afford restaurant meals and work in white collar, increasingly service-oriented, jobs.

India's National Council for Applied Economic Research (NCAER), using a sample of around 500,000 households, completed one of the most comprehensive studies of household income in India over the four years 1986-1990. The objective was to determine the relative purchasing power of India's income groups (see Table 3.3). The NCAER classified income groups into five categories ranging from low, lower middle, middle, to upper middle and high. The estimated number of households in the middle income group with annual incomes of A$1,250 and above was 20.2 million, or around 100 million people. Around 10 million people are estimated to be in the high income group with annual incomes of above A$2,800.

Table 3.3
Household Income Distribution by Class*

Income group	Annual income (Rs	Annual Income (A$	Urban ('000)	Rural ('000	All India ('000)	No. of people (million)	Share of pop. (per cent)
Low	<12500	625	14,895	68,914	83,809	420	59
Lower Middle	12501-25000	625-1250	13,904	24,445	38,349	192	27
Middle	25001-40000	1250-2000	7,175	7,232	14,407	72	10
Upper middle	40001	2000-2800	2,591	1,191	3,782	19	2.6
High	>56001	>2800	1,505	552	2,057	10	1.4
Total			40,106	10,2335	142,441	713	

Note: *Estimated number of households by income group, 1989-90. Population figures are derived on the basis of an average household of 5 persons.

Source: National Council of Applied Economic Research (NCAER), *Consumer Market Demographics in India*, 1993.

Satellite television has exposed consumers to global advertising and fuelled higher consumer ownership aspirations amongst the middle class and high income groups. Since 1993, the introduction of the Hindi-language satellite channel 'Zee TV', telecast across India by the Hong Kong-based Star TV and watched by over 30 million people, has had an enormous impact.

> ***1993 was the year in which India got Star TV. This single occurrence will do more to influence the value set in young India than any other comparable event. It will change the attractiveness of India to investors, it will alter the expectations of the following generations of Indians and it will have a huge impact on the (Indian) consumer market. Its acceptance by young India is axiomatic of the changes in this country.***
>
> Roger Stone, Vice President, Unisys (Asia) Ltd, Hong Kong, 11 January 1994

Developing financial products (such as hire purchase and credit cards) will also extend the purchasing power of Indian consumers. Visa International estimates that at least 40 million Indians have an annual income sufficient to make them eligible to become cardholders.[16]

It is possible to get a false impression of affluence from cities such as New Delhi, Bombay and Bangalore, where the top income groups are concentrated. The NCAER points out that the incomes and purchasing power of the Indian middle class are not comparable with their counterparts in developed countries. 'Big ticket' items, such as washing machines, colour televisions and video cassette recorders are still beyond the means of most people in this group. Similarly, most middle class consumers are more likely to be able to purchase a motor scooter than a car. Nevertheless, absolute numbers in India's high income group represent a significant market for higher quality expensive items.

Income figures alone fail to capture the full purchasing power of the Indian middle class. A more useful indicator than income may be the pattern of consumption. India subsidises many basic needs: housing, primary health care, education, power, and transportation. A household that pays no rent and obtains its food from the land, or at heavily subsidised rates (as in the defence forces), has more disposable purchasing power than another household which has to live only on its income. When such state support is taken into account, the 1992 figure for per capita income of US$275, derived on a market exchange rate basis, quadruples to US$1,255 per capita on a Purchasing Power Parity basis.

The purchasing power of the middle class would also increase if 'black money' or undeclared income and wealth were taken into account. Most of the black money is in the hands of the middle and upper income groups, who have a savings rate of over 20 per cent, much of which is invested in gold or the domestic capital market. The amount of gold held by Indians is estimated to be about 8,000 tons.

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[16] *Asia Inc,* January 1994.

Table 3.4
Share of Consumer Goods Purchased by Low and Lower Middle Income Households

Proportion of purchase by households with annual income up to A$1,250	Expendables	Durables
>75 per cent	Cooking Oil, Tea, Washing Powder, Toilet Soap, Tooth Powder, Casual Footwear, PVC Footwear	Transistor Radio
60-75 per cent	Vanaspati[17], Coffee Beans, Talcum Powder, Washing Powder, Hair Oil, Leather Footwear, Electric Bulbs	Table Fan, Mechanical Wrist Watch, Black and White TV, Bicycle
50-66 per cent	Packaged Biscuits, Ghee, Coffee Powder, Cigarettes, Electric Tubes	Pressure Cooker, Ceiling Fan, Electric Iron, Sewing Machine, Quartz /Electronic Watch, Cassette Player, Moped
33-50 per cent	Health Beverages, Juices/Squashes, Aerated Drinks, Beverage Concentrates, Vanishing Cream, Cold Cream, Shampoos	
<33 per cent	Butter	Refrigerator, Washing Machine VCR/VCP*, Motorcycle

Note: * Video Cassette Player
Source: NCAER, *op cit.*

Various reports claim that consumerism is able to 'take off' in India beyond an income threshold of US$2,000, on a Purchasing Power Parity basis. But consumption patterns are also changing at lower income levels where items are packaged in smaller, lower priced units. Table 3.1 shows how production of consumer durables has risen sharply in recent years in response to increased consumer demand. The higher consumption rate is likely to pick up even faster once restrictions on imports of consumer goods are removed.

The evidence demonstrates that purchasing power is increasing throughout the Indian economy. Table 3.4 shows the percentage of the total purchase of some products in the low and lower middle income classes, with annual incomes below A$1,250 in 1989-90. Table 3.2 shows that there are many products for which this relatively low-income category accounts for over 75 per cent of the total purchases. Such products include transistor radios, cooking oils, tea, toilet soaps, washing soap, PVC footwear,

[17]A kind of vegetable oil.

tooth powders and so forth. NCAER even suggests that the lower middle class be included as part of the Indian middle class, leading to a figure of over 58 million households or just under 300 million people.

The Indian Middle Class

In summary, the Indian middle class is characterised by the following features:

- Large but not affluent by OECD standards
- Well educated and likely to be numerate and literate in English as well as in at least one Indian language
- Consumption patterns are changing rapidly in response to new influences
- Beginning to buy and own staple consumer products and consumer durables
- Responsive to foreign advertising and brand names
- Purchasing power is greater for consumable or durable goods such as watches and televisions than for larger, more expensive, items
- Rising consumption is accompanied by an increase in savings

The potential market demand of the emerging consumer middle class in India is enormous. But because of the distinctive features outlined above, it is crucial that products and marketing techniques are specific to the market and designed to suit India's purchasing capacity.

Rural Middle Class

The growing rural middle class is a new phenomenon. Rural India, where approximately 70 per cent of Indians live, is also in the throes of change. Farm incomes are rising and the rural market for consumables is growing at a faster rate than in urban areas. Table 3.5 shows that rural India has a dominant share for many basic consumer products and some consumer durables.

Rising disposable incomes in the rural sector have come about through the success of the Green Revolution in the major grain producing States, successive good monsoons, high government spending, better procurement prices and an improvement in infrastructure such as roads and retail networks. Freedom from taxation and the capacity for families to be self-sufficient in food have also helped lift disposable incomes in the rural sector. A recent McKinsey and Co. report estimates that existing

Table 3.5
Share of Selected Consumable and Durable Items Purchased By Rural Households

10 per cent	20 per cent	30 per cent	40 per cent	50 per cent	60 per cent
Juices/ Squashes, Aerated Drinks, Shampoos, Butter.	Vanishing Cream, Concentrates Cold Cream.	Health Beverages, Electric Bulbs, Electric Tubes, Coffee Beans.	Talcum Powder, Washing Powder, Packaged Biscuits, Hair Oil, Coffee Powder.	Cigarettes, Vanaspati, Toilet Soap, Tea, Leather Footwear, Ghee.	Washing Cake, Tooth Powder, Cooking Oil, PVC Footwear, Casual Footwear.
Refrigerator, Washing Machine, Colour TV	Mixer/ Grinder, Pedestal Fan.	Pressure Cooker, 2-In-l (Stereo)	Ceiling Fan, Electric Iron, Digital Wrist watch Moped, B/W TV, 2-In-1 (Mono)	Sewing Machine, Table Fan, Motorcycle, Mono Cassette Recorder	Transistor Radio, Bicycle, Mechanical Wrist Watch

Source: Rao, S.L., *op cit.*

rural expenditure on packaged goods is about US$700 million or approximately one per cent of rural income.[18] For example, rural consumers in India who accounted for only 39 per cent of the total soap market in 1988, today are responsible for 54 per cent of the total market.

The New Entrepreneurs

A new generation of educated, less traditional, consumer-oriented and expectant young and middle-aged Indians is progressively changing attitudes in today's India. This impatient generation - born after India's independence at the hour of midnight on August 15, 1947, and labelled 'midnight's children' - forms an assertive and pragmatic social group that is beginning to demand an end to frustrating delays and instant gratification. Millions of India's youth do not relate to Mahatma Gandhi's bold declaration during the *swadeshi* (indigenous) campaign which was part of the struggle for Indian independence: 'by taking off this foreign shirt I shed myself of foreign rule'. That foreign shirt is now one of the new status symbols. Old values and viewpoints in India are being set aside as the country begins to embrace the global market. The new middle class is relatively free of inhibitions which shackled the older social structure. It is much less ideological and gives much more attention to pragmatic results-oriented economic behaviour.

[18] De Boer, K. and G Fell, *'A Fresh Look at India'*, in *The McKinsey Quarterly*, Number 2, 1993.

Huge brand franchises have been created for a number of products. One such success story has been the Indian soap company Nirma, which has grown to rival the two multinational-owned market leaders Hindustan Lever and Proctor and Gamble. Nirma started as a backyard operation in 1976 and by 1993 had an estimated production of 200,000 tonnes and a 60 per cent market share.

Another success story is that of Gulshan Kumar of T.Series, the largest recording music company in the country. Unknown a few years ago, he dominates the music recording industry and was the highest tax payer in India in 1993.

Opportunities created by India's economic reforms often suit smaller firms better since they are more able to respond rapidly. The new breed of entrepreneurs is more flexible than larger and older Indian companies, who operate with the constraints of over-manning, outdated plant and equipment and rigid corporate bureaucracies. Numerous younger companies are now emerging in high growth pockets such as the southern outskirts of New Delhi, the manufacturing centre of Pune near Bombay and the southern high technology city of Bangalore. It is notable that many of these new start-up firms are absorbing new technology into India, taking up the export challenge and sometimes feeding off each others' success. Many of these companies fail, but their strengthening position in the Indian economy does represent one bulwark against a reversal of liberalisation. The new trend is changing the attitude of Indians to making money, lifting the old stigma of profit-oriented capitalism. The fruits of the reforms are thus forcing Indian consumers to be more cost and quality conscious, introducing mutually beneficial domestic competition which stimulates continuous product upgrades.

Examples of this new phenomenon of middle class entrepreneurship abound. One is Ashok Chaturvedi who has prospered enormously by manufacturing plastic bags, including zip-locked flexible packaging, for use in the sale of consumer goods. Chaturvedi, aged 38, lives in New Delhi and runs his US$60 million company from each of his three Mercedes sedans, constantly linked to his office by radio telephone. He founded the firm only 10 years ago and expects to see sales rise 70-80 per cent in 1993-94.[19]

Another results-oriented Indian business person of the 1990s is Karin Mazumdar, a qualified master brewer who started the Biocon company at the age of 25 in 1979, after she failed to secure employment in the male-dominated brewing sector. She began to do business with an initial investment of a few hundred dollars. Mazumdar persuaded Biocon Biotechnology, an Irish enzyme manufacturer, to invest in her company and transfer proprietary technology. Today Mazumdar's company enjoys annual sales of about US$5.3 million, half of which represents export sales, and employs 105 people, including 25 scientists with advanced degrees.[20]

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[19] *Asia Inc.,* January 1994.
[20] *Asia Inc, ibid.*

Indian 'Yuppies'

To understand the effect of liberalisation on India's middle class one only has to walk through Big Kids Kemp, a huge children's clothing store in Bangalore's busy Mahatma Gandhi Road. The non-traditional pink interior, a waterfall, flashing neon lights and a toy train give the impression of an amusement park. Clowns dressed as Laurel and Hardy entertain the crowds while children eat free fairy floss and ice cream. Before buying US$15 jeans for their three year olds, parents can have them try on the clothes in a changing room designed to look like the front half of a car. The father and son team of Vashi and Ravi Melwani own the store, which is part of their chain of retail outlets. They set up the large store in 1990 in response to the city's rising incomes, yuppie high-tech population and lower cost real estate. The store was an immediate success, with annual sales of almost US$2 million.

Another Indian 'yuppie' couple is Rashmi and Vivek Gour and their new baby. The suburban Bombay couple have a take-home pay of US$500 a month after taxes, which places them in the top layer of India's middle class. Rashmi works as a human resources consultant for multinational pharmaceutical companies Pfizer Ltd and Hoechst Ltd. Vivek holds an MBA degree from the University of Delhi and worked for the finance company IL & FS. They have moved from a company apartment in the western suburb of Andheri to one in a more upmarket neighbourhood close to the homes of many of India's millionaire movie stars. Their home reflects newly acquired, middle class wealth. The family drives a Premier Padmini, a locally made car based on an old Fiat model. The home is filled with Indian-made consumer goods: a Sumeet washing machine, Godrej refrigerator and BPL-Sanyo television and VCR. They listen to the latest Indian pop music on a Philips casette player made in India. The Gours choose foreign brand names for some products such as cameras, cosmetics and some clothes. After working for eight years, the Gours have saved enough money to buy a US$21,000 apartment in New Delhi as an investment property.

Source: *Financial Times,* 24 February, 1994, p.4.

'Greater India': Non-Resident Indians (NRIs)

India's position in the world is strengthened by the presence on five continents of an estimated 18 million overseas Indians, many of whom are economically successful.[21] Many of these have family connections and established linkages with the new Indian middle class. Such a widespread and diverse network holds great potential which has only recently been tapped by business circles both outside and inside India. According to a recent study by the Federation of Indian Chambers of Commerce and Industry, Non-Resident Indians (NRIs) control an estimated investible capital of US$35 billion offshore.

India has been one of the great civilisations in world history, and its impact has not been confined to the sub-continent. The global Indian diaspora was formed over a period of more than one thousand years in three distinct historical phases. The first wave of emigration began in the fifth century AD, when Buddhism and Hinduism, and later Islam, were introduced to East and North Asia. At the same time, adventurous Dravidian sea traders began to establish commercial ties with the Persian Gulf, Byzantine Empire, East Africa and Asia. By 1500 an estimated 1,000 Gujarati merchants had settled in Malaysian Melaka. South-East Asia then emerged as a critical centre for Indian trade in spices, foodstuffs, handicrafts and textiles. As early as 1600, South-East Asia thus became part of a 'Greater India' in cultural and economic terms.

The second phase began in the first half of the eighteenth century when European economic interests attracted indentured contract labour from India to work mainly in East Africa, the Caribbean and South-East Asia as part of the colonisation process. Migrants included small-scale merchants and artisans. By the 1920s, Indian raw materials merchants were becoming active in Japan and in the Chinese cities of Shanghai and Canton. The third stage of Indian migration began in the 1960s, when large numbers migrated to new homes in North America, the UK, Middle East and Australia.

Business Influence of the NRI Community

The overseas Indian community is extremely diverse, depending on region of origin in India, ethnic and religious background and time of migration. Many of the new Indian migrants have been entrepreneurs and professionals who contributed considerable commercial vitality and important services to their adopted countries. These recent NRIs, who are often more prosperous than earlier waves of migrants, are usually more interested in building and maintaining links with India for personal and business reasons. Earlier generations of the Indian diaspora in the Caribbean, Indian Ocean and South Pacific, for example, limit their attachment to sentimental and nostalgic connections.

Whilst the economic power and influence of NRIs has not been as strong as that of the estimated 55 million overseas Chinese, Indians have still played key roles in certain

[21] Motwani, J.K., *Global Indian Diaspora*, New Delhi, DPS Enterprises, 1993.

sectors of the global economy, such as professional services. As in Chinese society, Indians often value large extended families which facilitate the pooling of resources, sharing of risks and the accumulation of capital through the generations. Tightly knit communities abroad, which include joint family companies, are both supportive and competitive, stimulating innovation, creativity and social mobility. Indian culture also tends to value education as a basis for professional, academic, scientific and technical excellence.

In the United States, first generation Indians are the wealthiest foreign-born group, according to the 1990 census. About one million Americans of Indian origin play prominent roles from Silicon Valley to Wall Street in sectoral niches ranging from high technology to medicine, hotels, garments, jewellery, real estate, entertainment and management consulting. Indian names dominate an unofficial list of Britain's wealthiest families: Indians own 60 per cent of all independent retail stores in the UK. Indians comprise less than 1 percent of Hong Kong's population but account for an estimated 10 per cent of Hong Kong's trade, mainly in textiles.[22] In Australia, Indian names are more likely to appear in professional services than in business.

[22] *Fortune*, November 15, 1993.

CHAPTER FOUR

THE INDIAN ECONOMY TODAY: A SNAPSHOT

India encompasses a wide spectrum of economic activity, ranging from high technology to subsistence farming. It is one of the ten largest manufacturing economies in the world, and indigenous technological achievements extend to fields such as nuclear energy, space and satellite communications, supercomputers, deep sea oil drilling and armaments manufacture. At the same time, three-quarters of its population still depend on agriculture for their livelihood.

The Indian economy has a number of strengths which augur well for the future. Those strengths include a thriving private sector; established financial and legal systems; sound engineering and managerial talent; and a large educated middle class.

Since the mid-1980s, the thrust of economic policy has been in the direction of deregulation and liberalisation but the balance-of-payments crisis of July 1991 forced the pace of change. Since then, the economy has undergone radical reform. The convertibility of the rupee has been further extended, foreign exchange currency reserves have risen to US$13 billion, inflation has been reduced to about 8 per cent and domestic investment is rising at 10 per cent per year. Foreign investment has increased considerably and the share market is booming.[23]

Inefficiency and low profitability of the large public sector have been a big drain on national resources. The Government has begun to dilute the public sector's involvement in industry and is moving gradually to privatisation. But reforms in this area are proceeding very slowly, as retrenchment has the potential to be a major political and social issue.

Economic Growth

India is not a stagnant economy. It has been growing steadily for decades in total and per capita average GDP terms. India achieved real economic growth of 4.2 per cent in 1992-93. For the first three decades following independence, the growth rate hovered around an average of 3.5 per cent, which came to be known as the 'Hindu rate of growth'. The 1980s saw a break from this rate. With the tentative beginning of economic reforms in the 1980s, GDP growth in the decade from 1980-90 was estimated to have improved to an average 5.18 per cent per year.[24] Modelling work commissioned for this report shows projected average GDP growth for the 1990s could be 6.3 per cent per year.[25]

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[23] World Bank *op.cit.*

[24] GDP growth rates are only a partial indicator of the size of the Indian economy. A significant part of the economy lies outside the money economy, but official GDP data is not inclusive of any measure of 'black' income. See Dandekar, V.M., in Jalan, B. *op.cit.*

[25] This projection is based on the Recent Momentum Scenario described in Chapter 11, which was also used to project export opportunities for Australia.

Higher growth rates in the 1980s were due to structural changes in the Indian economy including some reforms in industrial licensing and regulatory policies, comprehensive tax reforms following the 1985-86 budget, a higher growth rate in total factor productivity improvement in the incremental capital-output ratio (ICOR) and continuous devaluations of the rupee.

Since independence, Indian economic policy directions had been determined by a series of Five Year Plans, the first of which was launched in 1951. The Plans aimed to achieve economic growth, self-sufficiency, poverty reduction, and full employment. The Planning Commission has been the agency responsible for formulating and implementing the Plans. It allocates funding, and coordinates Central and State expenditure. As the public sector comes to play a less central role in the economy in future, the Planning Commission and the Five Year Plan process will assume less importance. The current Plan, which covers the period 1992-1997, is the Eighth Plan.[26]

Savings and Investment

India has a high savings rate of nearly 25 per cent in the 1990s. The World Bank has identified a high savings rate as one of the common factors in East Asian economic success. The private sector is the dominant contributor to gross savings in the Indian economy. The public sector's contribution to total savings has declined continuously to 1.1 per cent in 1990-91 (see Table 4.1). The Government's large deficit and dissaving reflect a continuing tendency for current spending on public administration, defence, subsidies and interest (on past deficits) to exceed current revenues. The failure of most Public Sector Enterprises (PSEs) to generate profits has further contributed to low government saving.

Table 4.1
Savings and Investment
(as a percentage of GDP at market prices)

	1985/86	**1986/87**	**1987/88**	**1988/89**	**1989/90**	**1990/91**	**1991/92**
Gross domestic saving	18.9	19.5	21.5	21.9	24.6	23.6	24.3
Gross domestic capital formation	21.3	21.6	23.6	25.9	27.3	26.3	25.5
Foreign saving	2.4	2.2	2.0	3.1	2.7	2.8	1.2

Source: Centre for Monitoring the Indian Economy, *Basic Statistics Relating to the Indian Economy*, August, 1993.

Gross capital formation as a percentage of GDP reached 27.3 per cent in 1989-90. Despite its low levels of savings, the public sector has maintained its share in total

[26]See Appendix 2 on the Eighth Plan.

investment. It has been able to do so by borrowing from the private sector. Now that the private sector plays a greater role in financing, it is forced increasingly to rely on overseas funds and recourse to deficit financing.

The gap between savings and gross domestic capital formation has been met by overseas savings (aid, credit and foreign investment). Despite the level of capital formation, poor returns on public sector investment have restrained India's growth performance.

Inflation

Moderate inflation has been a major strength of the Indian economy. Despite strong inflationary pressures in the world economy, and the escalation of oil prices in particular, Indian authorities have been generally successful in keeping inflation under control.

Relative price stability has been achieved through availability of essentials at stable and controlled prices, Government maintenance of buffer and reserve stocks, regular authorised imports of consumer items and controls on exports to curb domestic prices of commodities in short supply. Monetary policy has also been geared towards the same goal. But this has not been without cost, in terms of high unemployment and lack of export growth.

Although the Indian Government has been able to reduce its fiscal deficit substantially, the bulk of fiscal adjustment so far has occurred on the expenditure side. This is due to the already high tax/GDP ratio and the inflexibility of India's narrowly based tax structure.

Given the low tolerance of the Indian polity for inflation because of its capacity to erode living standards of large segments of the population, reducing the rate of inflation is one of the principal objectives of the Government's stabilisation program. The Government of India, in a discussion paper on future reforms, has identified control of inflation as a necessary condition to ensure adequate availability of credit for production and investment and to achieve external sector viability in the medium term.[27] A continued reduction of the fiscal deficit is a prerequisite for achieving that goal.

Balance of Payments

Balance-of-payments problems have been a persistent feature of the Indian economy in the post-independence period. Trade in invisibles, particularly remittances from Indian workers in the Middle East, has helped to reduce the impact of visible trade deficits. Foreign travel also contributed towards invisible receipts in 1989-90. At the same time, the investment income balance turned negative, reflecting the increasing cost of servicing foreign loans. But the contribution of net invisibles in financing the deficit

[27]Government of India, *Economic Reforms: Two Years After and the Task Ahead*, Department of Economic Affairs, Ministry of Finance, 1993.

declined sharply from nearly 50 per cent in the early 1980s to only 8 per cent in 1990-91, leading to greater dependence on inflows of external capital.[28]

Long-term foreign capital inflows have been financed by commercial borrowing, concessional assistance to India in the form of aid flows, and NRI deposits. With external sources of financing drying up, domestic saving as a ratio of GDP stagnant at around 20 per cent and imports not financed by export earnings, the economy was plunged into a severe liquidity crisis in early 1991. The Government was left with no choice but to make a concerted effort to reduce the current account deficit.

The balance-of-payments situation has now recovered and continues to consolidate. Foreign reserves, excluding gold and SDRs, have steadily climbed to US$15 billion, or approximately 6 months of imports - from the crisis level of less than one month in mid-1991.[29] The recovery has been the result of a variety of astutely implemented schemes to attract foreign exchange, an exceptional turnaround in the trade balance, high interest rates, a strong rupee in the wake of the float and moderately positive NRI transfers.

Foreign Debt

India, with an external debt of US$71 billion in 1991, ranks fourth among developing country debtors, although India's debt-to-GNP ratio remains lower than that of many other developing countries.[30] India's debt-to-GNP ratio, at 29 per cent in 1991, is lower than that of Indonesia (66 per cent) and Thailand (39 per cent).

Most of India's external debt is in the form of long-term concessional loans. The concessional component of India's debt, although declining over the 1980s, is still high in comparison with most other countries.

India has never defaulted on its official debt. Indeed, in the 1994-95 Budget, the Government announced that it would repay its debt to the IMF ahead of schedule.

Corruption and Black Money

A significant part of the Indian economy lies outside the money economy. Although official data ignore the 'black economy', it has attained vast proportions in relation to measured national income.

Various attempts have been made to estimate the extent of black income in India. Estimates by the National Institute of Public Finance and Policy put it at 20 per cent of GDP in 1980/81. This did not include income generated through smuggling of goods other than gold, or through black marketing in foreign exchange and other price-controlled commodities. In a recent interview, Finance Minister Manmohan Singh

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[28] Jalan, B., *op cit*, Table 2, p. 167.

[29] *Financial Review*, January 1, 1994.

[30] The biggest debtor is Brazil (US$116.5 billion) followed by Mexico (US$101.7 billion) and Indonesia (US$73.6 billion). These figures exclude defence debt.

estimated black income at 20 to 40 per cent of GDP.[31] The annual rate of growth of black income was estimated to be higher than the annual rate of growth of the economy.

> ***...there are still people who believe that the Indian economy can be managed in the nineties as it was managed in the fifties or sixties. ...Initially it [regulation] served a purpose, but over a period of time this excessive regulation became an instrument of harassment, it created excessive uncertainties. It also generated, I think, a lot of corruption in the system and it sapped the creative energies of all.***
>
> -Manmohan Singh, *Business World*, 25 August-7 September 1993

Excessive controls and unfulfilled demand for goods and services have led to widespread corruption in the Indian economy. The grant of industrial and import licenses, quotas and permits, transactions in urban real estate, smuggling, manipulation of import and export invoices, bribes and leakages from government expenditure have had a negative impact on the official economy.

A major benefit of liberalisation is the elimination of quasi-rents in a number of areas, removing the possibilities for corruption. With the replacement of required licenses and clearances of all types by decontrol of commodities and the restoration of the market mechanism in large sectors of the economy, opportunities for corruption will be substantially removed and the extent of black money reduced.

Partial convertibility of the rupee has reduced the attraction of *hawala* markets.[32] However, the generally high customs duties still provide an incentive for under invoicing and financing imports with the help of dollars bought in the *hawala* market. For years some Indians had shifted funds abroad to reduce or avoid tax, pay for real estate, business trips and holidays and deal in gold. The new reforms are acting as disincentives against this past behaviour. This has been successful in that the exchange rate has remained fairly stable and the premium on the illegal market has fallen from 25 per cent to about 8 per cent.

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[31] *Far Eastern Economic Review,* 17 March 1994. Gupta, S.B., *Black Income in India,* Sage Publications, New Delhi, 1992, gave an estimate of at least 50 per cent for 1987-88.

[32] Purchase and sale in black foreign exchange with delivery arrangements to designated parties are called *hawala* transactions in market circles in India. These are generally transactions by word of mouth, and the sums are paid on the basis of correct references *(hawala)*. A special feature of these transactions is that the verbal commitments made are fully honoured and full faith is placed in the honesty of the dealer. Cheating is most uncommon in this illegal trade and that explains why such transactions have flourished over time.

Sectoral Profile of the Indian Economy

Rising per capita incomes and the declining cost of food relative to durable goods and services, and the liberalisation process set in train since the mid-1980s, have seen a shift in the sectoral composition of output away from the primary sector towards services and industry. The share of the industrial sector and services sector in GDP has risen steadily from 24.4 per cent and 36 per cent in the 1980s to 27.3 per cent and 40.2 per cent respectively in 1992 (Table 4.2). Agriculture, while accounting for a declining share of GDP, remains significant.

Table 4.2
Sectoral Share of GDP
(per cent)

	1970	1980	1992
Agriculture	44.5	39.6	32.5
Industry	23.9	24.4	27.3
Services	31.6	36.0	40.2
Total	100.0	100.0	100.0

Source: Asian Development Bank, *ADB Outlook,* April 1993.

The steady increase in the proportion of services in the national economy partly reflects a changing pattern of final consumption away from staples like food and clothing towards services, especially transport and communications, and household goods; the involvement of government in activities such as increased defence spending; and the spread of rural banking.

The Public Sector

India, in its first resolution on Industrial Policy in 1956, opted for a centrally planned development strategy with the state playing a major role. Expansion of the public sector became a directive principle of economic policy and led to the creation of a large public sector and its involvement in diverse activities.

In 1991, India had over 1,000 public enterprises, of which about 700 were owned by the States. Public sector enterprises in manufacturing, mining, construction, transport, communication, banking, and insurance, including State-level enterprises, provided nearly 70 per cent of the 26 million jobs in the organised sector in 1989.

Public sector enterprises (PSEs) have dominated in infrastructure and basic industries. PSEs have a monopoly in the production of petroleum, lignite, copper and primary lead and produce about 98 per cent of zinc, 90 per cent of coal, more than half of steel and aluminium and about one-third of fertilisers. PSEs also run public infrastructure sectors such as railways, post and telecommunications, financial institutions such as banks, corporations incorporated under Company Law such as the Steel Authority of

India, and statutory bodies created by Acts of Parliament such as Air India and Indian Airlines. They have diversified their activities over the years from steel making and oil refining to manufacture of bread and footwear as well as service sectors such as consultancy, contract and construction services, and hotel and tourist facilities.

PSEs are often characterised by pervasive inefficiency and poor financial performance. Many are *de facto* monopolies and thus protected from competition. They are a serious drain on government resources and by their dominance in key basic industries such as power, oil, steel and fertilisers affect the overall efficiency and competitiveness of the economy. More than 40 per cent of Central PSEs incurred cash losses in 1989-90.

Factors which have acted as constraints on operational efficiency of PSEs include huge cost and time over-runs in project implementation; uneconomic location and investment decisions; choice of inappropriate or outdated technology or linking the choice of technology to availability of foreign financing; overstaffing and lack of growth in productivity; inadequate attention to R&D and human resource development; irrational product mix; poor project management; imposition of uneconomic marketing arrangements; uneconomic pricing policies and tariff rates; unviable regulations and procedures for investment; and restrictions on functional autonomy of enterprises especially in respect of labour and wage policy.

The Government has begun to dilute the public sector's involvement in the industrial sector and increasing emphasis is being placed on privatisation. Increasingly PSEs are expected to operate on commercial principles to yield the surplus necessary for their own expansion and servicing of their capital. The Government is committed to a degree of privatisation, which will require a solution to the problem of surplus labour through retrenchment and/or retraining.

The Private Sector

The Indian private sector has continued to thrive in India's 'mixed economy'.[33]

Liberalisation has resulted in sharp growth in the private sector. Mergers, amalgamations and restructuring were common in 1991/92 and resulted in some companies registering a phenomenal increase in assets. The stock market has been booming.

The contribution of the corporate sector to total savings of the economy has been very limited. Recent data show that private sector units have shifted away from internal sources to external sources for financing gross capital formation. About 70 per cent of gross capital formation is financed from external sources. In recent months, many

[33] The Industrial Policy Resolution of 1956 allotted certain industries to the private sector under the 'mixed economy' model.

INDIA'S TOP 30 PRIVATE COMPANIES
(ranked by 1992-93 profitability, earnings, dividends and market capitalisation)

Corporate Name	Main Industrial Sector
1. I.T.C. Ltd	Diversified in agro-food, cigarettes and tobacco, printing and packaging, hotels and tourism and business services
2. Tata Steel	Steel products
3. Reliance Industries	Textiles, petrochemicals and energy
4. Tata Engineering	Automotive vehicles
5. Hindustran Lever	Mass consumer products
6. Larsen and Toubro	Engineering, telecommunications, construction and electrical equipment
7. Grasim Industries	Textiles
8. Associated Cement Company	Cement
9. Mahindra and Mahindra	Automotive products
10. Bajaj Auto	Motor scooters
11. Century Textiles	Textiles and clothing
12. Southern Petrochemical Industries Corp	Petrochemicals
13. Gujarat State Fertilisers Corp	Fertilisers and petrochemicals
14. J.K. Synthetics	Textiles and clothing
15. Hindalco	Aluminium
16. Ballarpur Industries	Paper products and vegetable oil
17.Ashok Leyland	Automobiles
18. Escorts	Automotive vehicles, motorcycles and telecommunications
19. MRF	Tyres
20. Indian Rayon	Textiles
21. Bombay Suburban Electrical Supply	Electricity supply and distribution
22. Phillips India	Electrical and electronic products
23. Crompton Greaves	Engineering and electricial products
24. ICI	Chemicals
25. Indian Aluminum	Aluminum and related products
26. Tata Power	Electricial power supply
27. Videocon International	Diversified, including consumer products and oil exploration
28. Mukand	Iron and steel
29. CEAT	Tyres
30. Brooke Bond	Tea

Source: The Economic Times: India's 300 Corporate Giants, 1994.

have been raising money through foreign institutional investors and Eurobonds. The rapid development of the capital markets in the 1980s has helped this transition. Decades of design insularity and protection have left Indian products lagging in terms of technology, quality, and often price. As domestic industries are restructured and trade barriers lowered, many Indian firms are seeking to survive or assure their share of the market through joint ventures with foreign companies, the latter bringing with them the latest technology.

Besides the large private enterprise presence in the factory sector there are nearly 2 million smaller enterprises in the private sector employing over 12 million people. The small business enterprise sector, especially in wholesale and retail trade, is very active. New entrepreneurs have been enterprising in their marketing techniques and, by identifying markets and products at prices and quality suited to the needs of consumers, have contributed to overall growth in demand for these products. They have, in some cases, been able to seize a sizeable market share from multinational companies. There is also a lagging cottage and household industry sector, and an unorganised but flourishing small rural business sector, a backbone of India's thousands of villages.

The Manufacturing Sector

India has a diverse but technologically lagging manufacturing sector. Average annual growth over the last decade has been around 7 per cent. India has protected this sector by imposition of some of the world's highest tariff rates as well as non-tariff barriers. Protectionist policies have left many industries with inefficient technologies, production of sub-standard goods, poor quality management and undesirable work practices.

Impediments to Growth and Competitiveness of Indian Industry to Date

- an overburdened infrastructure handicapped by power shortages;
- outdated technology;
- militant unionism and prevalence of strike action;
- lack of competition and competitive pressures due to government monopolies and the highly protected domestic market;
- past reliance on 'captive' East European markets for poor quality exports
- the legacy of an industrial policy riddled with red-tape, delays and redundant controls;
- exit barriers leading to a number of 'sick' companies absorbing resources and adversely affecting the stability of the banking system;
- the problem of excess labour because of life-time employment guarantees; and
- inefficient property markets in major cities.

Selective subsidisation of industries encouraged special pleading and corruption. Deregulation and debureaucratisation of the industrial licensing system has been positive in lowering costs and providing for greater attention to customer needs,

innovation and output expansion. Liberalisation and competition, resulting in better quality and lower priced goods, should have a salutary effect on industry in the medium term.

Agriculture

India's agricultural sector (broadly defined to include forestry, fisheries and irrigation) accounts for about one-third of domestic product, employs the bulk of the labour force and harbours about 80 per cent of the country's poor. Large public investments in irrigation infrastructure and research and the introduction of high-yielding seed varieties and expanded use of fertiliser have resulted in some notable achievements over the past 30 years - including virtual self-sufficiency in wheat, rice, coarse grains, sugar, and edible oils, as well as eradication of famine.

These successes have created new challenges for the agricultural sector. Population growth has added to pressure on natural resources such as land, water, soil and forests. Despite increasing public expenditure on rural employment programs and on input subsidies for smaller farmers, India's poor, especially in the rural areas, have not benefited from growth to the extent expected. Rural people still earn only half of the country's average per capita income.

Except for forestry and logging, agriculture has had the lowest rate of growth of all sectors - 2.4 per cent sustained over a period of 40 years. This slow growth has been due to lack of needed investment, particularly in irrigation, underemployment and discriminatory government policies.

Despite its relative output size, the agricultural sector does not have a great deal of impact on other industries, unlike the service industries such as transport and storage and financial institutions. It is also least affected by changes in output of other industries.

Before 1991, there was heavy discrimination against agriculture relative to manufacturing in terms of measured nominal protection. In 1987-88, the nominal protection coefficient (NPC) was just above zero for agriculture but was around 50 per cent for manufacturing. With the rupee devaluation and increasing world commodity prices, the average NPC for agriculture has declined.

There are large differences between crops in terms of net incentives. At the official exchange rate, as measured by the effective subsidy indicator, the main crops are classified as having:[34]

Negative incentives	Rice, Cotton
Zero or low incentives	Wheat, Coarse grains, Pulses, Tobacco

[34] Pursell G. and A. Gulati, *Liberalizing Indian Agriculture: An Agenda for Reform,* World Bank Policy Research Working Papers, WPS 1172, Washington, 1993.

High incentives	Oilseeds, Rubber, Sugar cane

Consequently, India has been producing more oilseeds and sugar, and less food grains and cotton, than it would have if these distortive protection measures had not been there.

Wool is imported unrestricted over a 10 per cent tariff; imports of meat and dairy products are banned except for small regulated amounts of powdered milk. If these incentives are considered against average manufacturing products, or the estimated free exchange rate, the crops with low to positive incentives are strongly discriminated against, and the net incentives to oilseeds, sugar and rubber are reduced. The incentives for oilseeds and sugar in most years are high, even by standards of manufactured goods.

The incentive structure has not changed significantly since 1991.

All but a few agricultural imports and exports are subject to non-tariff barriers including licensing, canalisation and use of minimum export prices[35]. Only pulses can be imported (with a low import duty of 10 per cent). Liberalisation has encouraged initiative in developing many non-traditional agricultural products, such as acquaculture and seafood, for new export markets.

Indian agriculture will benefit substantially from liberalisation, although to date this sector has not been the focus of the economic reform program. Indian agriculture could be transformed if decades of stress on food self-sufficiency were to give way to the economics of comparative advantage.

Mining

India is a significant exporter of manganese, mica and iron ore. It also mines gold, copper, lead, zinc, bauxite, ilmenite, chromite, kyanite, gypsum, steatite and coal. In key industrial minerals such as iron ore, the country has among the largest reserves in the world. India also has a substantial reserve of bauxite and copper. Mining, however, is not a major contributor to the economy, accounting for only slightly over 2 per cent of GDP. Investment in the mining sector accounted for about 6 per cent of gross domestic capital formation in 1990-91.[36] But there is potential for this sector to make a greater contribution with the introduction of foreign investment and new technology.

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[35]Canalisation is where only specified parties or parastatals are allowed to import or export the commodity.

[36] The Economist Intelligence Unit, *op cit*.

Energy

India is a large consumer and producer of energy in Asia, with a strong focus on coal and oil. Non-commercial fuels such as fuel wood, agricultural wastes and cow dung cakes are also significant energy sources. India is a net importer of energy despite having large indigenous reserves of coal and some oil and gas reserves. Approximately 15 per cent of Indian energy requirements have been imported in the past few years. Domestic Indian energy production has accounted for about 85 per cent of total primary energy supply with coal constituting around 70 per cent of indigenous energy production. On average, 90 per cent of Indian energy imports are in the form of crude oil and petroleum products. Energy needs are met 58 per cent by coal, 32 per cent by crude oil, 6 per cent by natural gas and 4 per cent by nuclear and hydro-electricity. Coal utilisation is equally divided between the power sector and the industrial sector while petroleum products are used primarily in the transport sector and secondarily at a level of about 25 per cent in industry, agiculture and residential sectors. India's per capita energy consumption is low by OECD standards, suggesting scope for future demand growth in tandem with general economic growth.

India has only small deposits of high quality coking ***coal*** for steel production and imports large and increasing amounts, principally from Australia, for blending with lower quality local coal. Coking coal accounts for between 40-45 per cent of Australian exports to India.

India has substantial low-grade thermal coal resources. Around 73 per cent of known reserves have 35 per cent ash content or higher and there is very little benefication through washing. Mismatch of supply and demand (principally in the east) and projected industrial growth in the west of the country are likely to compound pressure to import and/or add value prior to transportation. In 1992, the Government offered up to 100 per cent foreign equity in captive coal washeries. However, the response has not yet been encouraging due to the uncertain financial status of the would-be end users.

Despite indigenous ***oil and natural gas*** reserves, India depends heavily on petroleum imports. These constituted 26 per cent of total imports in 1992. The declining performance of the state-owned Oil and Natural Gas Corporation (ONGC) has led to a fall in domestic production which the Government is moving to address through phased privatisation.[37]

In 1992, the Government opened up the oil and natural gas sector to 100 per cent foreign participation, and announced a willingness to consider joint ventures between foreign companies and the state-run ONGC and Oil India Limited.

[37]The Indian Parliament has approved legislation to convert ONGC to a public company, ONGC Limited.

Infrastructure

Investment in power, transport and communications together have accounted for a big proportion of total investment since independence. However, these expenditures have been spread thinly across a large number of programs and projects, and have paid very little attention to the actual provision of service as opposed to the provision of physical facilities.

Most infrastructural services in India are supplied by public sector monopolies which use administered prices and rely on budget support for the level and expansion of their activities. Inappropriate pricing of infrastructure services and little private sector participation have resulted in growing demand-supply gaps, declining rates of cost recovery and inadequate rates of return on investments and have discouraged operational efficiency. Most infrastructural sectors are in dire financial straits.

> ***India needs massive doses of investment. We want power. We want roads. We want massive expansion of ports. This is happening. In the next two or three years, people will actually see the change.'***
>
> -Prime Minister Narasimha Rao, *Financial Times*, March 1994

Power

The bulk of power generation is thermal (70 per cent) and hydro-electric (27 per cent) with 3 per cent nuclear.

Inadequate output of electric power can thwart the growth of the economy. The national power capacity 'deficit' has been estimated at 10 per cent or 21 per cent of peak demand. In March 1993, India had an installed generating capacity of 72,000 MW, that was operating at a low average 57 per cent plant load factor and with a crippling 23 per cent loss in transmission and distribution. Pilferage of power is not insignificant.

The performance of the State Electricity Boards (SEBs) in distributing power, setting tariffs and collecting revenues has been very poor. They have resorted to substantial deficit financing with funds meant for system expansion and the power system has expanded to the limits of government financing.[38]

The Eighth Plan aims to raise the generating capacity to 118,000 MW by 1998. Only half of this target is expected to be met. The shortfall in generating capacity is expected to be provided by the private sector.

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[38]The net effective subsidy to Indian power users is estimated to be around 3 per cent of GDP.

In accordance with recent policy changes, the Government has opened the power sector to private investment (local and foreign) and provided a package of incentives to attract private and foreign investment. The incentives offered include full ownership with a license period of 30 years, 20-year renewals, and a secure return on investment, thus safeguarding the investor in the unlikely event of a lack of demand. As at the end of 1993, seven foreign-funded projects have been approved in this sector, in the States of Tamil Nadu, Andhra Pradesh, Maharashtra, Karnataka and Orissa. Of these, to date, implementation has commenced only in Maharashtra.

Additional incentives include a reduction of import duty on power projects to 20 per cent and a five-year tax holiday for new private power projects. Apart from greenfield power generators, the Government is actively soliciting plant renovation and life extension, for which it is seeking financing from the international financial institutions.

Transport

India has the largest network of ***railways*** in Asia and the second largest in the world with over 62,000 route km. Indian Railways (IR) has been run as a state monopoly. Despite subsidies, IR has incurred increasing losses - around US$30 million in 1989-90.

India's coastline extends to about 5,700 kilometres. There are about 6,000 vessels operating in India. The Indian mercantile fleet is ageing (70 per cent of tonnage is over 10 years old) and there are limited numbers of container and product ***ships***. The Shipping Corporation of India did not take delivery of its first purpose-built container ship until 1993. The bulk of India's international cargo (about 64 per cent) is carried by foreign shipping companies. There are plans to double the fleet by 1994-95 because of the high costs of chartering foreign ships and to meet the growing demands for shipping Indian freight.

India has 11 major ***ports***. Indian ports are notoriously slow and poor in turnaround time by international shipping standards. Low capital and labour productivity result in costly cargo and ship delays.

The shipping industry has been recently opened up. Foreign investors are now permitted to invest up to 51 per cent. There has also been considerable easing of controls on the acquisition and sale of vessels.

Six international airports handle about 20 million passengers and about 415,000 tonnes of cargo annually. There are 88 domestic ***airports*** in the country, linked by the public sector airline and several new private airlines. Domestic air travel has suffered from poor service and financial deficits, and there has been considerable pressure for increasing competition in the industry.

Telecommunications

India has its own network of telecommunication satellites. Telecommunication services in India are controlled by the Department of Telecommunications, which is

concerned with regulations, providing services, and promoting manufacturing of telecommunication equipment.

Around 1,100 towns and cities in India are linked to each other and 212 countries through the direct dialling system. The number of new telephone connections grew to 5 million in 1990-91, amounting to an increase of 8.4 per cent per annum during the 1980s. This compares very favourably with the global average of 5 per cent. However, the demand for telecommunication services has far outstripped the availability.

Connection waiting lists are long and fraught with corruption. It is difficult to get leased circuits and lines. The availability of international links can not always meet demand and prices are high. By international standards, India's telecommunications network is very poor. The system requires urgent expansion and facilities need upgrading.

Information Technology

India's broad base in scientific and technical skills, including mathematics and systems engineering, provides a strong foundation for a flourishing information technology industry. Indian Institutes of Technology and organisations such as the Tata Institute of Fundamental Research represent pools of excellence. These intellectual strengths have allowed India to become involved in indigeneous satellite and rocket production, parallel and supercomputers, rural digital telephone exchanges, provision of software services to foreign multinational corporations and advanced research in the pure sciences. The computer hardware sector has traditionally been heavily protected and therefore uncompetitive but a growing number of foreign companies have been attracted to India for manufacturing, including semi and fully knocked-down kits. The country's competitively priced software engineering labour pool increasingly allows India to produce software both for domestic needs and for export.

Numerous foreign high technology firms have recently established themselves in India.[39] For example, Texas Instruments is developing software in Bangalore for transmission by satellite to the United States, while specialised software for international banks is being written near Bombay for export. A 1992 World Bank-funded survey of 30 major US and European software and hardware companies concluded that India was the best choice for both on-site and offshore software development. Countries such as Germany, France, Sweden and Singapore are following the American lead in investing in India's high technology industries. Software exports are among India's fastest rising exports.

Much of the information technology sector is concentrated in the high technology city of Bangalore, the Santa Cruz Electronics Exports Processing Zone near Bombay and near Government of India research laboratories in New Delhi and other major centres. The Indian Government is establishing seven new high technology industry parks to improve competiveness. The parks will be in locations such as Hyderabad, Pune, Goa

[39]Among the newcomers are Hewlett-Packard, Motorola, Texas Instruments, Citicorp Overseas Software and IBM.

and Trivandrum, supported by special high speed communciation links via earth stations, and by modern office space. The sector is currently constrained by the relatively high cost of domestic manufactured inputs, the beginnings of a shortage of computer professionals and the related rise in labour costs, and a perceived lack of protection for intellectual property. Foreign firms have also faced the problems of a constantly changing policy framework.

Tourism

India has barely tapped its vast tourist potential, attracting only 0.3 per cent of the world's tourists and around 1 per cent of tourist spending. However, the contribution of this sector to foreign exchange earnings and employment is quite significant. In 1989-90, the tourism sector reported foreign exchange earnings of US$12.6 billion. This figure is projected to treble by the year 2000, with an increase in India's market share in the international tourism industry to 1 per cent of the world's tourists - about 6 million tourists per annum.[40]

With the opening of private sector airlines, which have effectively linked small industrial and commercial towns, domestic tourism is also likely to pick up.

There is, however, a shortage of hotel room accommodation. By the end of 1993, there were officially 49,000 guest rooms in the country. It is estimated that 34,000 additional rooms will be required by the year 2000. India's hotels do not generally attain international best practice standards, but there are a few exceptions in the luxury class.

The Indian Government is offering special tax incentives to the industry. Foreign investment in the hotel and tourism related industries has been liberalised. There is an automatic clearance for up to 51 per cent foreign investment (and up to 100 per cent for NRIs) in these industries, including for projects related to providing tourist transport by air, sea or surface, travel agents, tour operators, and convention facilities.

Hotels, restaurants, travel agents and tour operators have also been included in the Export Promotion Capital Goods Scheme. The scheme offers many special benefits along with the permission to import capital goods at a very low rate. Various State Governments have also been offering incentives to lure new hotel projects to their States.

Retail Distribution Sector

India's private manufacturing companies market their products through a vast distribution network across the Indian sub-continent. As domestic competition grows, firms are seeking to gain a competitive edge through improved sales strategies and distibution systems. Organised and small-scale enterprises deal through wholesalers, stockists, transporters and retailers in urban as well as rural areas. Sales and marketing are aided by the growing number of free-to-air and satellite TV channels

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[40] Department of Tourism, Government of India, adapted from a paper presented at a conference on *Profiting from the 'New India',* Hong Kong, January 1994.

broadcast on India's 40 million TV sets. Commercial advertising is also delivered through 2,550 daily newspapers and 6,000 magazines in English and numerous local languages. Few supermarkets or department stores exist but there is a new trend to develop such a retail presence in the larger metropolitan centres.

The rural market for consumer products is growing much faster than urban markets. Over 90 per cent of India's 560,000 villages have at least one shop which receives goods from distribution hubs in 4,690 towns. Of these towns, 2,850 have a population over 100,000. There are at least 12 million retail outlets, almost all small and family-owned.

Substantial consumer demand is developing in rural markets because they are largely non-taxable higher disposable income environments. All-weather roads linking over 70 per cent of India's villages now make them more accessible to marketers. Most consumer product manufacturers use distributors in addition to direct distribution. India has an enormous wholesale trade in every major urban centre to service small outlets and neighbouring rural markets where direct distribution is non-existent or infrequent. Manufacturers use warehouses operated by clearing and forwarding agents who hire their own salespeople and transport and distribute in local towns.

Pepsi Foods Limited is one of the largest foreign investors in India and a good example of retail distribution at work. As a major producer and exporter of Indian beverages, snack and fast foods, it typically ships goods to a clearing and forwarding agent in a city who, in turn, breaks bulk and transports the orders of each distributor in small towns. The distributor moves the product using its own salespeople on a weekly cycle and every month a Pepsi representative accompanies the distributor to promote sales and improve merchandising. High quality sales managers with an understanding of India's domestic sales networks are readily available. This distribution network operates on very low profit margins.

Financial Services

India's capacity to attract and manage foreign investment capital is becoming increasingly important as the Indian economy internationalises and becomes more dependent on capital flows. Indian firms in the financial sector have needed to respond to recent economic reforms more rapidly than the manufacturing and other sectors. The restructuring and modernisation of the Indian financial services sector, hitherto dominated by the public sector, will therefore be one of the litmus tests measuring the sustainability of current economic liberalisation.[41]

Dealing with this formidable challenge will also determine how commercially interesting and accessible India will be to Australian and other foreign players. Opportunities should broaden in fields such as banking, funds management, mergers and acquisitions, project finance, corporate advisory on equity issues, bullion banking and possibly insurance. Breakthroughs in the Indian financial services market could be expected to improve business conditions in the marketing, advertising, consultancy and human resource development ends of the Indian market.

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[41] See Chapter 6 for a detailed account of reforms in the financial sector.

Current Indian economic reforms point to greater liberalisation of both the foreign and Indian banking sectors as well as of capital markets. Liberalisation has also opened the door to foreign institutional investors, with dramatic results. The downside of greater domestic dynamism and competitiveness is increased volatility on financial markets and greater risks in a more competitive environment. In the face of this change, the Indian financial sector has made remarkable progress over the last decade. It now offers a wide range of instruments and services through an extensive commercial banking system, active primary and secondary securities markets, term lending institutions, investment funds, equipment leasing and venture capital funds. India's increasing sophistication in these areas encompasses well developed capital markets, professionally managed mutual funds and full service investment banks.

Banking

The commercial banking network comprises 275 banks, of which 51 are private, represented in over 60,000 branches. Among them are branches and representative offices of leading international banks. India is host to 56 foreign banks.[42] Most foreign bank branches or representative offices are located in the four main cities, particularly Bombay where the Reserve Bank and many financial institutions are headquartered.

The dominant player is the State Bank of India (SBI) which holds about 28 per cent of total deposits.[43] The SBI employs 200,000 people in 8,800 branches, many of which are said to be unprofitable. Strong labour unions have convinced the Government to retain majority state control and avoid major staff reductions.

Nine of the Indian banks have over 100 overseas branches, located primarily in Europe, North America, the Middle East and North-East Asia. The predominant State Bank of India is being privatised progressively. In early 1994, the SBI raised US$1 billion in the country's largest bond and share funding package, 42 per cent more than its target.[44] As a result, the state's share in the bank fell from 98 per cent to 66 per cent. It is now one of India's largest companies in terms of market capitalisation and its stock could be attractive to foreigners because it is now widely held and therefore more easily traded.

The public sector banking industry faces many problems, such as a poor record of customer service, low productivity, labour union resistance to automation, unprofitability and under-capitalisation with a high proportion of bad debts. These costs have lowered the competitiveness of India's nationalised banks.

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[42] Such as ANZ Grindlays, Hongkong and Shanghai Banking Corporation, Citibank, Bank of America, Standard Chartered, Deutsche Bank, Sanwa Bank, Societe Generale and Credit Lyonnais. (Government of India, Ministry of Finance, *Discussion Paper*, December 1993).

[43] Reserve Bank of India, *Banking Statistics*, Quarterly Handout, March 1993.

[44] *Financial Times*, 3 February 1994.

Nationalised banks account for most banking operations. Interest rates and the allocation of credit to specific sectors have been traditionally controlled by the Government but recent reforms are freeing both the cost and flow of credit from state control. New measures include encouraging private investment in the banking industry and allowing public sector banks to sell shares to the public. Long-term project finance remains in central or state public sector hands. The World Bank and Asian Development Bank are also major players in the development and project areas. Institutional arrangements also exist in India for export finance and risk coverage.

Between 1988 and 1993 no new foreign banks were allowed in India, but in early 1994, the Chase Manhattan Bank was granted a license to operate. Under economic reforms flowing from the Narasimham Committee Report on Banking, foreign banks can now more easily enter India and expand their retail networks.[45]

The priority lending obligations of foreign banks have recently been reformulated, taking account of the difficulties they face in lending to the agricultural sector to help achieve the Government's cross-subsidisation objectives. Foreign banks are now required to place 32 per cent of their advances in this priority sector but, unlike Indian banks, they are permitted to include export credits in this total. On the other hand, foreign banks have been allowed up to 20 per cent equity participation in the new private banks now permitted in India. The Indian Ministry of Finance is also interested in fostering technical and financial collaboration between foreign banks and Indian institutions.

Although holding less than 10 per cent of the Indian market share, foreign banks can now compete on service and profitability with Indian public sector banks. Between 1991 and 1992 foreign banks averaged a growth rate of almost 50 per cent in deposit mobilisation, against an overall average growth rate of almost 20 per cent registered by domestic banks.

India's financial markets are well developed and are expected to absorb rapid rates of economic growth, including a robust performance of stock market shares. The foreign exchange market is growing in both volume and depth. Spot and forward markets which allow hedging transactions such as currency and interest rate swaps are common.[46] Sub-sectors which are widely considered to be weak are custodial services, which involve security deposits, transfer and interest or dividend collections, and related services of strong interest to foreign portfolio investors.

A diversification in financial services is under way. The rise of India's middle class has led banks to begin introducing their own range of credit card services. Foreign banks have also aggressively sought NRI deposits and turned to setting up domestic and

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[45]Recognising these advantages, the Narasimham Committee's recommendations to the Indian Finance Ministry include the removal of government interference in bank operations (except for the normal regulatory powers of the Reserve Bank of India), the termination of bank nationalisation and the formation of private banks in collaboration with or as subsidiaries of foreign banks.

[46]Foreign and Indian banks also assist in offshore loan syndication, export credits and currency risk management.

offshore mutual funds.[47] However, poor property and tenancy laws have deterred most banks from becoming involved in mortgage financing.

In 1993, the Reserve Bank of India announced that new private banks could be established by domestic or foreign interests and that leading public sector banks would be allowed to access the capital markets for additional equity. At least one private bank, Bank IndoSind, is expected to be established in 1994, mainly by NRIs.

Indian Capital Markets

India's buoyant capital market is emerging as an increasingly important instrument for raising long-term finance. The Indian securities market is considered to be one of the most promising of the emerging markets and among the top ten performing markets in the world. In 1993, Indian companies raised a record US$6.9 billion through new share issues alone.[48] In the restructuring corporate sector there has been a rapid rise of specialised services such as issue management, factoring, depository services, portfolio management and corporate finance. The growth in capital markets has been facilitated by the establishment of two main credit rating agencies.[49]

In 1993/94 the Bombay Stock Exchange's (BSE) index of 30 top corporations rose by 30 per cent, a near record. The boom has been fuelled by the economic reforms, which have drawn international fund managers into investing in equity markets. In 1993, foreign institutions invested about US$1 billion in the Indian stock market and bought a further US$1.6 billion in issues made by Indian companies overseas. Recent record share market rises can be largely attributed to the weight of foreign funds seeking limited stock, rather than the actual value, although there have been some real increases in Indian corporate profitability.

The surge in foreign buying, despite starting from a relatively low base, has dispelled the sense of caution which revolved around the 1992 securities scandal. Indian economic reforms now include closer attention to policing the markets. The scandal was clearly a turning point for Indian securities markets and has accelerated the trend to faster transactions and the introduction of regulations to clear away old practices which bred corruption. The Securities and Exchange Board of India has announced eight sets of guidelines and regulations to correct systemic deficiencies, including with respect to stockbroking rules and insider trading.

Trading is carried out on India's 22 stock exchanges where some 7,000 companies are listed, second only to the number of share listings in the United States. Bombay is the largest, handling over 4,000 company stocks, and it accounts for over two-thirds of India's total market turnover.[50] The BSE executes about 70,000 transactions on a

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[47]For example, in 1992 Citibank set up Citicorp Securities and Investment Ltd, an asset management company. Standard Chartered opened an operation in Cochin to tap into Indian-Middle East funds transfers.

[48] *Economist,* 5 February 1994.

[49]The leading agency is Credit Rating and Information Services of India Ltd (CRISI) set up in 1988. The other is Investment Information and Credit Rating Agency (IICRA) established in 1991. Together they have already rated hundreds of instruments and companies.

[50]Founded in 1875, the Bombay Stock Exchange (BSE) is the oldest in Asia.

daily basis, one of the highest per-hour intensity rates of trading in the financial world. However, only about 200 stocks are traded in volumes which would attract foreign investors.

Other important stock exchanges are in Ahmedabad, Delhi, Calcutta, Madras, Bangalore and Cochin. These regional stock exchanges are served by over 20,000 brokers. With over 15 million investors, India's US$80 billion stock market capitalisation in 1992 was just behind that of Singapore, but exceeded other ASEAN countries such as Malaysia, Thailand, Indonesia and the Philippines. India's economic reforms have included the abolition of stringent capital issues controls and the consequent removal of administrative interference in the pricing of new issues.

A key element in advancing reforms will be the National Stock Exchange of India which was incorporated in November 1992 and is due to open in Bombay in 1994/95. A wide range of securities will be traded on this new exchange by means of a screen-based electronic trading system which will link dealers throughout India by satellite. This move will set model standards for other Indian exchanges and help to align the Indian capital market with international markets which already feature electronic clearing and settlements arrangements.

Reforms so far have allowed the entry of nine foreign stockbroking firms to deal in Indian markets on behalf of foreign investors.[51] The foreign brokers are not permitted to deal on behalf of domestic investors or join the Bombay Stock Exchange. Until September 1992, the only entry available to Indian capital markets for foreign investors was through listed country funds. Today, Indian companies can raise equity capital in the international market through the issue of Eurobonds or Global Depository Receipts (GDRs).[52] GDRs are internationally traded instruments which represent shares of Indian companies. They are designated in dollars and are not subject to any ceilings on investment. Eurobonds have been popular but the Indian Ministry of Finance has tended to discourage sales of convertible bonds in order to avoid a blow-out in India's external debt. In an effort to regularise the pace of these Euro-issues, the Indian Government is seeking to oversee the quality of companies which are borrowing.

These capital infusions have pushed the foreign exchange reserves beyond US$10 billion, putting upward pressure on the rupee which has necessitated costly Reserve Bank of India intervention to retain export advantages. The inflows may also affect inflation and siphon interest income from Indian domestic banks.

Another sector opening up to foreign firms is the insurance industry. There are currently six insurance companies in India, all in the public sector, one of which has sole responsibility for life insurance. The Government of India has begun to extend

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[51]They are Jardine Fleming, Marlin Partners and Crosby Brothers of Hong Kong; Citicorp and Lehman Brothers of the United States; Baring Securities, James Capel and Kleinwort Benson of the UK; and Credit Lyonnais Securities of France.

[52]ANZ Grindlays Bank arranged Euroloans for India totalling US$2.24 billion between 1990 and 1993, for power projects and other vital Indian requirements, During this period, ANZ led other foreign banks such as Citicorp, Chemical Bank and Barclays Bank in the value of this lending activity.

reforms to the insurance industry. A high level Government Committee report in early 1994 recommended the entry of the private sector into both life and general insurance business, and the partial privatisation and restructuring of existing public sector insurers. It also suggested that foreign insurance companies should be allowed into India through the floating of Indian firms and joint ventures with Indian partners. The 1994 budget included a statement in favour of evolving a broad national consensus to progressively deregulate the sector to create a competitive and financially strong industry functioning under a more independent regulatory authority.

The Economic Impact of the 1994/95 Budget

Finance Minister Singh presented his fourth budget on 28 February 1994. It was generally well received by business and financial circles. In accordance with the economic reform program, the Indian Government is accelerating the reform and modernisation of the tax system, continuing to restructure the banking sector, reducing interest rates to 14 per cent and allowing Indian exporters to retain a higher proportion of foreign exchange receipts. The budget did not contain any surprises and maintained the momentum of reform and restructuring while avoiding overly radical or speedy change that could cause major social disruption. For example, the continuing absence of any industry exit policy, the slow pace of public sector disinvestment and the retention of most subsidies remain as reminders of pre-reform India. However, many anomolies in the tariff, excise and tax systems were removed in a budget geared towards industrial growth, particularly for export-oriented industries such as food processing and electronic software.

The 1994/95 budget does not directly target the fiscal deficit which is 7.3 per cent of GDP, but the Indian Government is betting that improved growth in future will help to push the Government deficit down to 6 per cent of GDP. The fiscal imbalance is mainly due to a 50 per cent higher than planned expenditure on subsidies and major shortfalls on collection of customs revenue and excise duties due largely to imports not growing as forecast and production setbacks in some high excise yielding sectors. A major stimulus to industrial recovery will be necessary to correct the slippage in the fiscal imbalances. It is noteworthy that Finance Minister Singh's budget included the announcement that India would initiate early repayment of the US$1.4 billion IMF loan, a positive sign, but a move which may loosen IMF conditionalities on maintaining fiscal discipline.

Noteworthy among the latest budgetary announcements were across-the-board tariff reductions and the extension of the rupee's convertibility to the entire capital account. A renewed emphasis on infrastructural development, particularly in the power and telecommunications sectors, should provide further opportunities for foreign firms in the engineering and financial sectors. Corporate tax rates have been reduced to 40 per cent and the tax on companies incorporated abroad cut from 65 per cent to 55 per cent. While there were no measures in the budget to reform the insurance industry, the intention to evolve a broad national consensus about the future direction and content of reforms in this large sector was enunciated.

PART II

THE SLEEPING GIANT AWAKENS

'The Indian economy is like a sleeping giant which, if awakened, could by itself transform the face of the global economy. India has the potential to form an independent economic block on her own, without too much dependence on anybody else.'

Senior Minister and former Prime Minister of Singapore, Lee Kuan Yew, at the World Economic Forum in Davos, 1994.

CHAPTER FIVE

EPOCHAL CHANGE

A Survey of Economic Reforms to 1993

India's economic reforms can be traced back to the 1970s, but they gained little headway at that time. They were revived in the mid-1980s, but again were not sustained. It was not until 1991, when India faced an economic crisis of such unprecedented dimensions, that the initiation of a sustained and comprehensive reform process became paramount and unavoidable. The reform program was a crisis-confirmed accommodation of pressures for change which had been building up for some time. The balance-of-payments crisis of 1991 broke the mould and pushed the Government to make its first serious and systematic attempt at radical reform of the Indian economy.

In the first instance, reforms were introduced to cope with the immediate symptoms of the crisis - fiscal imbalances. These had built up to the point where India was in danger for the first time of being declared uncreditworthy if drastic action was not taken by the Government. Rising fiscal deficits (peaking at 8.4 per cent of GDP in 1990/91) had led to high levels of borrowing by the Government from the Reserve Bank. These had an expansionary impact on money supply and resulted in high inflation rates. High fiscal deficits also led to large current account deficits in the balance of payments and aggravated the problem of external indebtedness. A large proportion of national savings was channelled into supporting the budget which starved the economy of funds for productive investment. The situation was reflected in high commercial interest rates which discouraged new investment and reduced international competitiveness.

The Government was compelled to deal with the deficit problem as a central issue in its medium-term economic strategy. It committed itself to a reduction of the Central Government deficit from 8.4 per cent of GDP in 1990/91 to a target of 4.7 per cent in 1993/94. The fiscal deficit was reduced, but only to 7.3 per cent of 1993/94 GDP. This has raised some concerns that any medium to long-term fiscal imbalances might fuel inflation and endanger the sustainability of reform.

Beyond achieving and maintaining macroeconomic stability, the two most important objectives set for the reforms in the longer term were faster economic growth and international competitiveness through economic liberalisation. To achieve these objectives, the two areas of highest initial priority in reform measures from 1991 were trade and exchange rate policy reform and industrial policy reform.

Trade and Exchange Rate Policy Reform

India's trade and exchange rate regime was a major long-term obstacle to international competitiveness and faster economic growth. Protection was high and arbitrary owing to a complex range of quantitative restrictions, nominal tariff rates (averaging 117 per cent), numerous exemptions and special schemes. The system taxed exports and raised the costs of intermediate and capital goods, and actually raised the overall cost structure of Indian industry, rendering domestic production and exports uncompetitive.

To 1991, imports were controlled through a licensing system. Administrative discretion was applied to imports of raw materials, components, intermediate goods and capital goods. A key criterion was whether these were produced locally. Consumer goods were mostly prohibited. Licensing was supported by some of the highest tariffs in the world.

Consequently, India was isolated from the benefits of international trade. The insulation of domestic industries behind the protective wall bred inefficiency and high costs, traded inputs were expensive, the scale of production was often uneconomic and exports had to be subsidised. In addition, the rupee was overvalued. The regime produced both a direct and indirect bias domestically against agriculture and in favour of industry.

A sequence of reform steps, commenced in 1991, has already radically liberalised the trade policy regime.

The new exchange rate system provides powerful incentives for all exports and has greatly diminished the flow of foreign exchange to the illegal market. The removal of export subsidies has reduced delays and corruption.

India has moved towards a trade regime that is not biased against exports and is more uniform in the extent of protection afforded to different industries. It relies on price incentives rather than administrative interventions, and on exchange rate adjustment rather than import tariffs and export subsidies. The reform implies elimination of the array of non-tariff barriers (import licenses, bans, canalisation, and export controls) and a major reduction in tariff rates.

To date, the impact of these changes has been encouraging. Fears of an expansionary wave of imports have proved unfounded to the first quarter of 1994. Non-oil imports in 1992/93 were 15 per cent lower than in 1990/91, despite a rise of 5 per cent or more in GDP. Exports, which suffered a fall following the collapse of trading with the former USSR, recovered in 1993.

Trade and Exchange Rate Reforms

- The rupee exchange rate was adjusted downward by about 20 per cent in July 1991, and is now determined by market forces.
- The exchange rate system has been changed. In March 1992, a dual market Liberalised Exchange Rate Management Scheme (LERMS) was introduced. The 1993/94 budget went further and eliminated this in favour of unification. Now all exporters as well as other foreign exchange earners can convert 100 per cent of their earnings at the market rate.
- Import licensing has been virtually abolished, apart from consumer goods.
- Customs duties have been reduced in stages, with the maximum duty lowered to 125 per cent in July 1991, through further reductions to 65 per cent in February 1994. Duties on capital goods have been reduced to 25 - 35 per cent for many categories, and even lower for export schemes and certain project imports.
- A number of export incentives, including the cash compensatory support for exports, have been dispensed with.
- Imports of gold and silver have been liberalised.

Source: Government of India*, Economic Survey - 1992-93, 1994-95 Budget Papers*

Industrial Policy Reform

Limited reforms in industrial policy were introduced during the 1980s, but at the end of the decade, the manufacturing sector was still one of the most tightly regulated in the world. Up until 1991, relaxation of barriers to entry had been modest and piecemeal. The system was characterised by red tape, delays and redundant controls. Most industrial investment projects had to obtain an industrial license and various other clearances before commencing operations. Large and foreign-controlled enterprises (with a foreign equity share of over 40 per cent) suffered extra restrictions, such as the need for separate permission to invest or expand. This was used as a means of regulating the concentration of economic power. Certain activities and products were reserved for the public sector or for small-scale industry and there were locational restrictions. Direct foreign investment was generally discouraged.

Industrial Reforms

- Abolition of industrial licensing for all new projects regardless of size, except in 18 designated industries, and for projects within 25 kms of 23 cities with populations over one million. Licenses were not required within this radius if industries were designated as being non-polluting (eg. electronics, computer software and printing) or where they were located in designated industrial areas. More flexibility was permitted in cities which were industrially depressed.
- Automatic clearance of capital goods imports for delicensed projects if foreign exchange requirements are made available from foreign equity investment, or if the requirement is less than 25 per cent of the total value of plant and equipment, up to a maximum of US$800,000.
- Abolition of all pre-entry clearance requirements in the Monopolies and Restrictive Trade Practices (MRTP) Act, which applied to large or dominant firms. The Act was restricted to focus on policing of monopolistic, restrictive or unfair trade practices as well as consumer protection.
- Automatic approval for projects involving foreign equity investment up to 51 per cent in high priority industries (see Appendix 5), provided the foreign exchange for imported capital goods is met from foreign equity and repatriation of profits is covered by export earnings.
- Permission for foreign technical collaboration in high priority industries up to a lump sum payment of US$400,000, 5 per cent of domestic sales or 8 per cent of export sales, subject to an overall limit of 8 per cent on total sales in the 10 years after approval or seven years from the start of operations.
- Elimination of the requirement to enter into a Phased Manufacturing Program (PMP) whereby producers were required progressively to indigenise production of parts and components over time.
- Abolition of the mandatory convertibility clause in term loans from financial institutions (conversion of a portion of loans value into equity) for new projects.
- Reduction of the list of industries reserved for the public sector from 17 to 6 (see Appendix 5). Private sector participation is allowed in industries on the reserved list.

Administrative, regulatory and other barriers to exit in the system led to large numbers of financially 'sick' companies absorbing resources, and adversely affected the stability

of the banking system.[53] Labour regulation was pervasive in the organised sector, and excess labour could not be discharged nor plants closed without State Government approval. Real wages of workers rose steadily in the organised sector, inhibiting new hiring and encouraging greater capital intensity and other methods of holding down labour costs, with resultant confrontations such as lockouts and unauthorised closure of facilities.

These controls had become inefficient and dysfunctional. They led to protracted delays in decision making, and often to inefficiencies in choice of scale, location and technology. The system protected established producers from competition by new entrants and encouraged high costs. There was an overwhelming need to replace bureaucratic control with entrepreneurial decision making, subject to the normal disciplines of market competition.

On July 24 1991, the Government introduced a Statement of Industrial Policy which represented a radical departure from past regulatory practice in terms of relaxation of barriers to entry, expansion, diversification and modernisation by industrial firms.

Foreign Investment Reform

While India has always recognised the importance of the role of foreign investment in facilitating industrial development, and permitted it in substantial areas of the economy, restrictive rules and procedures generally deterred foreign investors. By the early 1990s, foreign investment had failed to become a significant source of non-debt inflows, of new technology and of linkages with international firms.

Foreign Investment Reforms

- Foreign investment approvals up to 51 per cent of equity in a specified list of 34 priority sectors was made automatic, subject only to registration with the Reserve Bank of India.
- Investment of over 51 per cent equity was made approvable on a case-by-case basis by the Foreign Investment Promotion Board (FIPB), which was made responsible for expeditious processing of government approvals.
- The Foreign Exchange Regulation Act (FERA) was amended to remove constraints previously applicable to firms with foreign equity operating in India and also to make it easier for Indian business to operate abroad.
- India signed the Multilateral Investment Guarantee Agency (MIGA) Convention, joining many other developing countries keen to promote foreign investment. India also signed its first ever Investment Guarantee Agreement with Britain in March 1994.

[53] 'Sickness' = 7 years of incorporation, complete erosion of net worth and two years of continuous cash losses.

In recognition of the advantages of foreign investment, of India's urgent need for it in view of the scarce domestic capital resources, and of the heavy international competition for foreign capital, a new policy was initiated to bring rules and regulations into line in order to make the terms attractive to foreign investors.

Out of total investment that has flowed in during the two years of reforms, around 90 per cent is going to core sectors: 22 per cent into power, 19 per cent into fuels and oil refineries, 12 per cent into food processing industries, 7 per cent into chemicals, 7 per cent into electrical equipment and electronics and 6 per cent into metallurgy.

Public Sector Enterprise Reform

Pervasive inefficiencies and poor financial performance in public sector enterprises (PSEs) are a major obstacle to industrial development and international competitiveness. Inefficiency and lack of dynamism stem mainly from cost-plus pricing and distribution controls. Many are *de facto* monopolies, protected from competition. A 'soft budget constraint' allows virtually bankrupt PSEs to survive with easy access to budget funds and/or credit from the financial sector. Ambiguous relationships with Government supervisory authorities are not conducive to efficiency. PSEs are constrained by multiple objectives, lack of managerial autonomy and overstaffing pressures in relation to operational needs. At State level, PSEs are even less efficient and profitable. They constitute a serious drain on government resources.

The public enterprise sector has not lived up to expectations in terms of generating surpluses for reinvestment. Overall profitability has been below targets, especially if the petroleum sector is excluded. This is also the case at State level, notably in the State Electricity Boards (SEBs), road transport and irrigation works. This systemic weakness is unsustainable. There is a continuing need to increase efficiency and reduce the losses that so many PSEs impose on the Government budget at a time when there are many unmet demands in education and health and in higher expenditures for the poor.

In the July 24 1991 Industrial Policy Statement, the Rao Government announced major changes. Results to date have included:

- A stronger system of monitoring with MOUs - 23 PSEs were signed up in 1991/92.

- Divestment varying between 5 and 20 per cent of equity for 31 companies by February 1992. Shares were offered to selected financial institutions and mutual funds. Total shares disinvested in 1991/92 were 8 per cent of the total Government share holding in the 31 PSEs. Disvestment is continuing.

Public Sector Reforms

- Designation of essential infrastructure, oil and mineral resource exploitation, technology and manufacturing development in key areas where private investment is inadequate, and strategic activities (defence) as priority areas for PSE development.

- Review of the existing portfolio of PSEs in light of new priorities.

- Reduction of the reserve list of PSE activities from 18 to 6 by 1993. Those remaining include arms and defence, atomic energy, coal, petroleum, some mining and railway transport; those removed included iron and steel, heavy castings and forging, heavy electrical equipment, air transport, ship-building, telecommunications equipment and electric power.

- Introduction of the Sick Industrial Companies Act (SICA) to enable the Board for Industry and Finance Reconstruction (BIFR) to decide if loss-making PSEs should restructure or close down.

- Creation of a social security scheme - the National Renewal Fund (NRF) - to protect workers affected by enterprise restructuring.

- Full or partial divestment of selected PSEs, particularly those in competitive areas. Some PSE equity will be sold.

- Announcement of efficiency measures for existing PSEs, including more powers to boards which are to be staffed increasingly by professionals; and greater emphasis on MOUs to enhance managerial accountability.[54]

- Provision of budgetary support as non-Plan loans to loss-making PSEs are to be phased out after 1994/95.

- Divestment of public sector equity up to 49 per cent in selected profit-making enterprises, for budgetary reasons and also to broaden the base of ownership and to commercialise management.

- Permission for PSEs to form joint ventures and raise fresh equity to finance expansion. Profitability will be allowed to expand.

- Introduction of greater flexibility in pricing decisions, especially for steel, petroleum and coal.

[54] The Memorandum of Understanding (MOU) system was introduced in 1988/89. The MOU contains details of the mission, objectives and annual targets set for an enterprise. Target achievement is based on a 5 point system ranging from excellent to poor.

- Reference of 91 'sick' units to the BIFR by 1992, with the aim of restructure or closure.

- Earmarking of around US$67 million for the National Renewal Fund in 1991/92. The NRF is expected to provide assistance to firms undertaking modernisation and technological upgrading of existing capacities to cover the costs of consequent retraining and redeployment of employees. The NRF would also provide compensation to employees affected by restructuring or closure of industrial units in the private sector. A social safety net would be provided for labour through allocating a part of the NRF funds to finance employment generation schemes in the organised and informal sectors.

Tax Reform

Revenue mobilisation has been high in India by developing country standards, and the tax/GDP ratio continued to rise in the 1980s. However, tax increases were narrowly based and distortionary, mainly involving customs duties, and to a lesser extent, central excise taxes. Direct taxes contributed nothing to the increases, and personal taxes fell significantly as a share of GDP.

The Government of India recognises the linkage between tax reform and any program of stabilisation. Macroeconomic stabilisation requires a reduction in the fiscal deficit, and while some of this can be achieved by reducing low priority expenditure, much of the improvement has to come from higher tax collection. These are best achieved not by high taxation rates, which encourage evasion, but by systems that are simple to administer, are set at moderate rates, and have a broad base. Over decades, the Indian system became unduly complex and economically unjustifiable. Special exemptions and preferences abounded, nominal rates were high, evasion was widespread, and the burden across taxpayers was often unfair.

Customs duties are easy to collect, as are excise taxes from large producers. Many indirect taxes are specific to avoid valuation problems, so collections tend to lag behind inflation. The personal income tax base has been kept narrow through pressures from organised sector employees for increases in the exemption level, together with difficulties in assessment and collection.

The system of Centre-State fiscal relations influenced tax trends adversely. Customs duties grew rapidly, as they were totally retained by the Indian Government, as was the corporate profit tax. But some 85 per cent of personal income tax goes to the States, which may explain its slower growth. The Central Government has used surtaxes widely, apparently to avoid having to share the proceeds with the States.

Farmers have prevented any serious taxation of agricultural incomes, and land tax has sharply declined as a source of revenue.

The devaluation of the rupee in 1991/92 has buoyed customs duties and increased the dependence of the Central Government budget on this source. The sizeable increases in corporate tax rates are burdensome and distortionary and may not yield commensurate revenue growth, and there is therefore opposition to any further tax

increases. Since the fiscal crisis had its origins on the expenditure side, it is argued that the remedy should be sought there.

Tax Reforms

Direct Taxes:

- Reduction of the maximum marginal rate of personal income tax to 40 per cent, while removing certain exemptions.
- Abolition of the wealth tax on all productive (financial) assets, including shares, securities, bonds and bank deposits. Wealth tax will be levied on non-productive assets at one per cent, but with a rise in the tax exemption limit.
- Introduction of a system of presumptive tax for small traders and retailers on an optional basis to start the process of broadening the tax base.

Indirect Taxes:

- Lowering of the level of import duties to that of similar developing countries. To reduce the cost of new investment, the duty on project imports was reduced from a maximum of 80 per cent to 55 per cent. It was reduced to 30 per cent for capital goods for coal mining, power projects and petroleum refining.
- Commencement of simplification of excise duties in the 1993/94 Budget, with a moderation of the high duty rates on some commodities and some reduction in the scope of exemptions. There is a recognition that the structure should be progressively converted to a value-added tax.
- In relation to tax administration, a National Court of Direct Taxes was proposed to ensure litigation in direct tax matters is settled expeditiously. This and other measures are designed to improve tax compliance and simplify administration.

Trade reform and tax reform are closely related as reductions in tariffs will need to be partly compensated for by increases in collections from other sources. These include making excise rates more uniform; introducing a form of VAT; avoiding high indirect taxes on capital goods; strengthening personal income tax by holding the exemption limit constant in nominal terms to widen the tax base; raising taxes on fringe benefits, housing and vehicles; relying more on income tax deduction at source where appropriate; and, at State level, broadening the tax base and increasing revenue mobilisation.

The Government accepted the extensive reforms recommended by the Chelliah Committee on Tax Reform in 1992.[55]

The overall budgetary deficit of the States remains a serious problem, with the fiscal deficit showing no significant decline. Budgeted non-developmental expenditures of the States are expected to increase faster than developmental expenditures. The ratio of developmental to total expenditures has fallen from 74.4 per cent in 1983/84 to 65.5 per cent in 1992/93.

Finance Sector Reform

The Banking System

At the time of the crisis in 1991, India was successful in mobilising savings, but the financial system had been seriously weakened by government policies over the years. Commercial banks operated at low margins owing to heavy obligations to provide directed credit at subsidised rates to Government and priority sectors. Internal efficiency in commercial banks was low and administrative costs were high. Most alarming of all, bad and doubtful debts had built up on an already inadequate capital base: 7 per cent of bank lending was to large and medium-sized financially 'sick' companies. Urgent needs were to improve the prudential regulation of banks, and to undertake substantial restructuring and additional capitalisation to preserve their solvency. Reforms were also needed to strengthen term lending institutions and to improve the workings of rapidly expanding capital markets.

Many of the problems stemmed from fiscal deficits and the Reserve Bank of India's attempts to counter the potential monetary effects of deficits by requiring commercial banks to hold extensive Government debt at below market rates. Solutions depended to a large extent on regaining fiscal balance. Direct lending to priority sectors was another problem and hurt the financial system in two ways:

- it imposed a tax on the banking system, since about half of lending occurred at subsidised interest rates

- the need to meet targets subjected banks to higher risk and consequently they accumulated a substantial burden of bad debt.

The Government initiated a number of short-term measures to improve the position, and to pave the way for deeper reforms in future:

- the Narasimham Committee on Financial Sector Reforms reviewed the structure, organisation, functions and procedures of the financial system

- interest rates on term loans and on the bulk of debt instruments in capital markets have been decontrolled, and deposit interest rates increased

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[55] Tax Reforms Committee, *Final Report*, Parts I and II, Government of India, New Delhi: Department of Revenue, Ministry of Finance, 1992.

- full statutory powers have been given to the Securities and Exchange Board of India (SEBI) to regulate, promote and monitor stock exchanges
- the private sector is now allowed to establish mutual funds.

Banking System Reforms

- Implementation of new accounting and prudential norms related to income recognition, provisioning and capital adequacy, in line with international standards.
- Reduction of the proportion of bank funds pre-empted through the Statutory Liquidity Ratio (SLR). This will continue to an average SLR of 25 per cent over the next 3 years and will greatly increase the volume of bank funds available for trade, agriculture and industry.
- Recapitalisation of the national banks, as implementation of the new norms will mean considerable impairment of capital. Management systems are being revamped to avoid recurrence.
- Use of capital markets to mobilise equity funds from the public, to minimise the burden of recapitalising on the Budget, the State Bank of India and the healthy nationalised banks. The Government will retain 51 per cent equity and remain in control.
- Permission for existing private banks to expand and for new private sector banks to be established.
- Strengthening of the supervisory system of the Reserve Bank of India with a new Board for Financial Bank Supervision.
- Rationalisation and simplification of the regulated interest rate structure.
- Increase in interest rates offered on Government market borrowing to levels closer to market rates. This will reduce the burden on banks and smooth the transition to creating an active market for Government debt, which is essential.

One of the problems facing the banks was that levels of the Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) had been progressively increased over the years: the SLR because of the desire to mobilise increasing resources through so-called market borrowings to support government budgetary resources; the CRR because of the need to counter the expansionary impact on the money supply of large budget deficits. Together, the SLR and CRR stipulation pre-empted a large part of bank resources into low income-earning assets, thus reducing bank profitability and

Capital Market Reforms

- Movement to a market-determined system regulated by an independent authority, such as the Securities and Exchange Board of India (SEBI).
- Preparation by SEBI of stock market rules and regulations; subjecting private mutual funds to SEBI rules; allowing foreign institutional investors to invest in capital markets subject to SEBI regulations.
- Introduction of greater transparency into capital markets including by authorisation of the SEBI to conduct inspections of various mutual funds; registration of intermediaries; a disclosure requirement for companies issuing capital in the primary market and bringing merchant banking under the regulatory framework of the SEBI.
- Approval to establish the National Stock Exchange of India (NSEI) to serve as a model exchange integrating stock markets across the country.
- SEBI advice to stock exchanges to collect from companies making public issues a deposit of one per cent of the issue amount, which could be forfeited in case of non-compliance with the provisions of the listing agreement or non-dispatch of refund orders and share certificates within the prescribed time.
- Notification of regulations on insider trading under the provisions of the SEBI Act.
- Reserve Bank of India liberalisation of the investment norms involved for NRIs by allowing companies to accept capital contributions and issue shares or debentures to NRIs or overseas corporate bodies without prior permission.
- Permission for foreign institutional investors such as pension funds, mutual funds, investment trusts, asset or portfolio management companies to invest in the Indian capital market provided they register with the SEBI.
- SEBI guidelines for its composition in order to make the governing body of a stock exchange more broadly based.
- SEBI setting up of an advisory committee for primary and secondary capital markets to provide wider consultation with investors.
- Repeal of the Capital Issues Act. Indian firms can now access international capital markets via Euro-equity issues.

pressuring banks to charge high interest rates on their commercial sector advances. They were, in fact, a tax on financial savings in the banking system and encouraged distortionary flows in markets where this tax did not apply. The Government decided to phase out this distortion. The SLR is to be reduced in stages over 3 years from

38.5 per cent to 25 per cent, and the CRR is to be reduced over 4 years to a level below 10 per cent.

The Government's aim is to restore the health and long-term viability of the system over the next 3 to 4 years, and to this end it has announced a number of reform initiatives. Also, the lack of transparency in accounting practices and non-application of international norms has meant that the balance sheets of the banks have not reflected their underlying financial position accurately. In this situation, the quality of the advances portfolio has deteriorated and a culture of 'non-recovery' has developed in many parts of the banking system. The Indian Government has been strongly influenced by the findings and recommendations of the Narasimham Committee and by the 1992 securities fraud scandal. It has recognised that the sector is over-regulated and under-governed.

Capital Markets

Along with the banking system, it was necessary to undertake reforms in the capital market. The need for reforms had been evident for some time. While there had been an impressive expansion in quantity this had not been matched in quality. Stock exchanges, for example, have suffered from long delays, lack of transparency in procedures, and vulnerability to price rigging and insider trading. To counter these the Government moved to establish a non-statutory Securities and Exchange Board of India in 1987 to regulate capital markets. It was given statutory powers in 1992.

The Government recognises that the process of reforms in the capital markets has only just begun. It needs to be deepened to bring about speedier conclusions of transactions, greater transparency in operations, improved services to investors, and greater investor protection while encouraging the corporate sector to raise resources

directly from the market at an increasing scale. Major modernisation of the stock exchanges, to bring them into line with world standards in terms of transparency and reliability, is also necessary if foreign capital is to be attracted on any significant scale.

Infrastructure Sector Reform[56]

India's development strategies have always given a high priority to the expansion of the country's physical infrastructure. Over the past decade, the infrastructure sector absorbed about 50 per cent of planned public resources.[57] But these expenditures have been spread thinly across a large number of programs, and have paid too little attention to the actual provision of services as opposed to physical facilities. The prime consideration has been to provide basic services at the lowest possible charge, and inappropriate pricing of public infrastructure services and little private sector participation have been the norm. The result has been a pattern of growing supply-demand gaps, disappointing levels of efficiency and effectiveness, declining rates of

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[56]World Bank, *India*, *op.cit.*

[57] Includes power, transport, communications, irrigation and flood management, and water and sanitation.

cost recovery, and inadequate returns on investments. The infrastructure sector is now accepted as a priority focus for future reforms.

Transport Sector Reform

In transport, there are three areas in which substantial reform of services have taken place in India up to 1993: in domestic trucking, airline services and bus transport. Of these, only the airline services have been consciously selected as a priority area since 1991. The others have been incremental reforms implemented over considerable time.

Trucking in India has never been in the public domain, nor has it been subjected to tight government control. Over time, as freight transport demand grew, the railroads withdrew from haulage of privately owned goods in favour of haulage of public sector goods and passengers. In 1986, the Indian Government removed the ceiling on national permits and in one year the number of permits increased from 25,000 to 57,000. Today there is no shortage of trucking capacity in India and services of various quality can be purchased by any user willing to pay. Deregulation and privatisation of trucking has shifted India from a rail-dominated freight market in the l950s to a road-dominated market in the l990s.

Pressure for introducing competition to domestic air travel came from poor service from the single domestic carrier, Indian Airlines; financial deficits; declining traffi; and a large number of redundant staff. After Indian Airlines' monopoly was removed, the largest privately owned airline in India has captured around 20 per cent of the domestic intercity air travel market. By being able to choose the high traffic intercity routes, these companies were able to maximise returns, thereby disadvantaging Indian Airlines, which is required to service all routes. In an effort to protect Indian Airlines, the Government unveiled a new aviation policy on 2 March 1994, under which all major route operators must fly a quota of uneconomical routes to remote areas.

Pressure for reform in bus travel has come principally from financial problems, and there has been a steady shift towards privatisation of State bus monopolies. At the national level the process has been reflected in the decline of public sector buses. Losses of State bus monopolies and services have been maintained by turning over the least profitable bus routes to the private sector which has managed to make a profit without fare increases.

Energy Sector Reform

While energy is recognised as being critical to the success of reforms to correct macro imbalances and accelerate growth, the sector has not been a priority focus in the first two years of reforms.[58] With demand outstripping supply, imports are expected to place heavy pressure on foreign exchange reserves within a few years and could slow down the rate of economic development. Therefore, this sector can be expected to receive urgent attention in future reform initiatives.

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[58] About a third of total public investment resources are absorbed in developing indigenous energy resources and power absorbs almost 25 per cent of the Public Investment Program.

There is no practical alternative to coal as the most important source of energy in India over the next 20-30 years. Current reforms are thus focused on the coal and power generation sectors, particularly the attraction of foreign sector participation and overcoming rail transport constraints. This policy orientation is designed to deal with persistent energy shortages in most Indian States.

Irrigation Reform

A 'quiet' reform that has received little attention is in the shift from public canal irrigation to private tube wells and low-lift pumps.[59] Portable motorised pumps did not become a prominent feature of irrigation in India until well after their introduction in the l950s.[60] In 1950/51 most irrigation was effected by large-scale surface canals and small-scale reservoirs or tanks. By 1984/85 the well share had risen to 48 per cent of the net irrigated area. The 'privatisation' of irrigation was well advanced a decade ago through a 'minor irrigation' technology that allowed individual farmers and small farmer groups to pump water from the aquifer. With the 'lift' technology of the deltas, farmers were able also to use portable low-lift pumps to raise water from drains and ponds to the fields.

Agricultural Reform

The 1991/92 reforms reduced the share of internationally tradeable goods subject to some form of quantitative restriction from about 93 per cent at the end of 1990 to about 75 per cent in 1992. Almost all was in manufacturing, for which the share of value added subject to quantitative restrictions (QRs) fell from 90 per cent to about 46 per cent. By contrast the share of the agriculture and livestock sector subject to QRs fell only slightly from 94 to 93 per cent.

Agriculture has not been included in the trade liberalisation measures except for some export control relaxation. At the end of 1992, some 60 agricultural and livestock products were under an export control plus about 46 manufactured products, most of which were processed agricultural commodities. A further range were removed from the list in April 1993, but most that are exported or have export potential either remain on the list or are subject to various kinds of export controls, or were removed from the list but are now subject to ad hoc export controls announced in public notices.

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[59]This farmer response to change in pumping technology is a 'reform' in the sense that it has led to 'privatisation' of a substantial share of irrigation service. While public investment in tube wells have been made, they have not performed well and are a small proportion of the total investment in pumping machinery.

[61]According to the Eighth Plan there were 200,000 electric pumps in the country in 1950. By 1989/90 the number had risen to about 8 million. If the estimated diesel-driven pumps of about 5 million are added then the total number of irrigation pumps would be about 13 million for a national net irrigated area of about 42 million ha; approximately one pump for every 3 ha. of irrigated land. What is usually referred to as 'minor' irrigation equipment has become a 'major' element of irrigation technology. See: Chapter 3 (Irrigation Command Area Development and Flood Control) and Chapter 8 (Energy) in Government of India, *India Eighth Five Year Plan 1992-97,* Volume II, New Delhi, 1992, pp.56-91, and pp. 159-219.

The overall bias against agriculture is still in place, although measured manufacturing protection has fallen. The domestic prices of wheat, rice and coarse grains have not risen by the full devaluation, so agricultural prices have fallen relative to world prices. But after devaluation in 1992, border prices of rice and wheat were about double domestic prices. This situation was maintained by the continuation of export controls. Relative to border prices, the cost of traded inputs for agriculture has probably declined. Fertiliser prices have increased but not by as much as the extent of devaluation. The same is probably true for farm machinery and agro-chemicals. Non-tradeable input subsidies to agriculture have declined in real terms but are still substantial and distortionary. Real devaluation reduces the subsidies on non-tradeables but the loan default rate has countered this.

Labour Market Reform

With increased competition and emphasis on improving efficiency and productivity, there has been considerable pressure on companies to reduce their labour force. This pressure is particularly strong in enterprises controlled by the public sector. However, employees may not be dismissed without notice. In addition, companies with a work force of over 300 cannot make workers redundant or close the business without authorisation from the Government.

In order to address this situation and ease the burden of adjustment on employees, a National Renewal Fund has been established by the Government. PSEs are encouraged to reduce the numbers they employ through the 'voluntary redundancy scheme' using resources from the National Renewal Fund to provide compensation. Private sector companies have also been using voluntary redundancy in the absence of other means to cull surplus labour.

Facilitating redundancies and the closure of businesses is proving to be difficult. The Government is negotiating with trade unions and is hoping to reach a consensus for reforming the labour laws. As this is a key area of concern for foreign investors, the Indian Government will have to work out a way of overcoming domestic resistance to the redundancies and dismissals likely to be necessary to make the reform process work.

CHAPTER SIX

THE SUSTAINABILITY OF INDIAN ECONOMIC REFORMS: GETTING THE PACE AND SEQUENCING RIGHT

Judging the most appropriate speed of reforms is a difficult exercise. The upper limit is probably set by the need to maintain macroeconomic stability throughout the reform process, using fiscal and monetary adjustment measures to prevent overheating of the economy. For instance, the onset of high inflation, a rising deficit and excessive borrowing will negate the achievements of reforms and shake the confidence of business and industry in the sustainability of the reforms.

But it would be counterproductive to err on the side of caution with slow implementation. At the minimum, reforms should be able to fulfil the expectations of the people, otherwise support will begin to diminish. Ultimately, the benefits from the reform process will depend upon the intensity and comprehensiveness of reform measures undertaken.

Provided the requirements of macroeconomic stability are met, the objective should be fast implementation of the widest possible range of reform measures to achieve rapid and substantial benefits. Most observers consider that the Indian Government has in fact followed a path of reform at a reasonable pace while successfully maintaining stability to date.

Ashok Desai, former Chief Economic Consultant to the Ministry of Finance, has argued that the slow pace of economic reform and irrationalities in the tariff structure were sending the wrong signals to industry in India.[61] And while there may be valid reasons to vary the pace according to judgements of political sustainability, sending the right signals to business, domestic and foreign, should be an important element of government strategy.

Political factors can also influence the speed of reforms. It would be tempting economically to privatise public sector enterprises immediately and to implement rapidly an exit policy on inefficient loss-making plants to reduce subsidies. On a large scale, this could cause major labour problems with retrenchments which could jeopardise the reforms. A gradualist approach towards privatisation and exit policy which gives time for a social safety net to be put in place appears preferable. The National Renewal Fund will go a long way towards smoothing the passage of this sensitive stage in the overall reform program.

It is difficult to separate speed from sequencing. The reform package comprises a wide range of measures where complementarities are important. Thus *relative* speed where complementarity exists is important in terms of outcomes.

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[61] *Economic Times,* October 12, 1993.

Careful sequencing in agricultural reforms is important. It has been estimated that the removal of discriminatory measures against agricultural producers and the liberalisation of marketing on the one hand, and the removal of subsidies on tradeable and non-tradeable inputs on the other, will result in a net gain to most (though not all) farmers. Removal of subsidies alone would have a decidedly negative impact on farm income and threaten the reform process in an overwhelmingly rural country. A recent reduction of the fertiliser subsidy did cause a considerable furore.

The most disappointing feature of the pace and sequencing of reforms in India to date has been the absence of direct liberalisation measures in agriculture. Of all sectors, agriculture has been hit hardest in terms of trade with domestic industry and indirectly with the exchange rate regime. Of all sectors it probably has the greatest potential for supply response with the removal of discriminatory measures.

It may not always be possible to arrange that gains and losses coincide and in some instances there will simply be losers. If reforms are extensive and comprehensive and involve large numbers of people, there may be a greater likelihood of acceptance than if the measures are applied piecemeal, affecting a few at a time.

The fact that the Government has a package of reforms planned for the next three years is testimony to its belief in the wisdom of speed and comprehensiveness in the reform process. In this regard, the Indian Government strategy is strongly supported by leading Indian economists Bhagwati and Srinivasan.[62] Their expectations of the speed of reforms differ little from that of the Government, with two exceptions. They draw attention to the continued existence of bureaucratic inertia, or worse, obstructionism, and warn that certain reform measures, such as delicensing, will be rendered ineffective unless bureaucrats are taught to promote and facilitate production and investment decisions. The second brake on speed of reform lies with the continuation of licensing at State level despite its removal at the Centre. Allocation of industries now occurs through competition, and eventually, this will lead to the disappearance of State level restrictions. However, the Indian Government could accelerate this process by encouraging State governments to simultaneously dismantle State-level restrictions.

A final factor impinging on the speed and sequence of reforms is the financial capacities of the States to implement reforms. Many States are in serious fiscal difficulties, and the Central Government has only limited powers of influence over them. It is, of course, in the States' own interests to put their fiscal houses in order, but until they do, their capacities to undertake reforms at State level will be circumscribed. This will of course vary from State to State and will probably lead to differing rates of progress with reforms and indeed in post-liberalisation development. Those States with initiative will welcome greater economic autonomy and flexibility in decision making and greater fiscal freedom will encourage creativity in resource mobilisation. There is no doubt that a new element of competition will emerge between States for investors and investment, which should sharpen the economic focus of State bureaucracies and promote closer relationships with the business sector.

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[62]Bhagwati J.N. and T. Srinivasan, *India's Economic Reforms,* New Delhi, 1993.

The above-mentioned difficulties have led us to a more cautious assessment of India's growth prospects in the 1990s than some more optimistic India watchers. Our assessment of 6 per cent average annual growth is perhaps conservative but it is unprecendented for India and comparable to projections for South-East Asian economies. There are also those, therefore, who see it as an overly optimistic assessment of the likely success of the reform process. But reform is here to stay.

Past The Point Of No Return

Our considered assessment is that Indian economic reforms have passed the point of no return. Most informed observers both inside and outside India agree that progress to date is irreversible. Three years of courageous, bold and rapid liberalisation have sufficiently entrenched deregulation trends in both the popular middle class thinking and among most economic actors and opinion leaders. However, for the reforms to be sustained in the longer term, economic liberalisation will need to be accepted beyond the middle class, so as to widen ownership and potential benefits from its success. The 1994/95 Indian Government Budget announced in February 1994 is consistent with India's reform trends but avoids causing social disruption. The Budget's extended convertibility of the rupee, customs duty reductions and tax streamlining are fully in accord with reform trends. India is staying the course. A steadily growing consensus supports trends to even greater opening up of Indian markets against increasingly isolated islands of resistance.

The 1993 State election results and the shift to majority government in New Delhi have further reinforced this bridgehead to more painful restructuring of the economy. The basis of a political consensus is clearly in place. A clear break with past policy failures and the increasing emergence of success stories will add impetus to reforms. Resistance to the new self-perpetuating logic of growth through freer markets cannot, however, be underestimated. As reform decisions become harder, those elements opposed to change could slow down the process. But their capacity to stop reforms completely is highly questionable.

Reforms always entail losses and gains. If well designed and implemented, a reform program should confer gains on those forces promoting growth and efficiency. Conversely, it should mean losses for those unproductive forces which drain national output and resources. But in the end, both groups need to obtain benefits or compensation. The Indian Government faces the daunting challenge of minimising losses and pain and maximising gains. India faces the uphill task of managing the stresses and strains, indeed the fractures, which will be associated with the fears and anxieties of some of the masses, classes, castes, regions and states that make up much of such an immense and complex country. The Indian people are now in the process of judging the reform drive on the basis of growth in employment and the associated additional income which such progress is expected to generate.

Measured confidence in India's socio-economic future is based on assumptions that external conditions will encourage further reforms. These include a favourable outlook for a post-Uruguay Round world economy and the concomitant growth of Indian export markets worldwide. Cautious optimism with respect to sustainability

also assumes that continued good monsoon weather will keep India's huge rural sector on an even keel and that India will be able to maintain peaceful relations with neighbours such as Pakistan. However, India's economic reforms remain incomplete. Additional measures over the next several years, will be needed to deliver impetus to domestic growth and external diversification.[63]

India's future reform initiatives will be subject to ups and downs as targets and deadlines occasionally slip. Temporary reversals may also affect the inevitable progression to greater liberalisation. While conscious of the multiplying socio-economic benefits to Indians in general, the obstacles and dangers associated with momentous change loom ominously on the horizon of India's new dawn. The historic and ideological baggage, physical inertia, diversity of conflicting interests and post-colonial sensitivities which have characterised Indian policy making in the past all argue against an easy transition. In the face of these risks, India is depending on the international climate which argues against turning back, the unprecedented speed and magnitude of the reform campaign and an intentional strategy to precede more difficult reforms with openings to highly visible consumerism in order to build a bigger and broader constituency in favour of liberalisation.

Any assessment of the sustainability of India's economy reforms needs to take full account of the key players opposing reform, inherent shifts in ideology and thinking, the main physical and cultural obstacles and the strength and determination of opinion leaders and policy makers in New Delhi and State capitals. India's success will also be affected by how well its political economy is perceived in foreign countries by both governments and the international business community.

Most interested observers in foreign political and business capitals acknowledge the revolutionary policy shifts announced and implemented in India since July 1991. A broad range of foreign opinion encompassing foreign business executives, institutional fund investors, government trade officials, bankers and political figures takes the view that momentum is indeed building in the Indian economy. Generally seen as more than a knee jerk reaction to a crisis or world developments, India's medium to long-term economic evolution is seen to warrant careful monitoring and to offer greater scope for mutual economic benefit. Expanded interest in welcoming India into the global economy indicates a marked shift to a more positive image.

There are many opponents of reform. The Rao Government has been careful to avoid disturbing powerful Congress party constituencies. Many politicians and officials loyally served the old protected and privileged regime. Some still believe in the need for controls, euphemistically terming them 'guidelines' or 'frameworks'. Social democrats are attempting to preserve the Centre's capacity to redistribute wealth, protect vulnerable groups and win re-election. But despite the continuation of political rhetoric criticising multinational corporations, 'IMF rule' or the 'foreign hand', more and more politicians are focusing on the positive outcomes which validate the reforms. Nonetheless, competition and policy differences between the Ministries of Commerce, Industry and Finance often cloud the fast moving situation and blunt the instruments of change.

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[63] See Chapter 7.

Vested interests opposed to the direction of current reforms include wealthy farmers, many bureaucrats, the hitherto protected industrial bourgeoisie, unionised workers and the poor. It must be borne in mind, for example, that Indians living under the poverty line constitute a larger group than India's reform-oriented middle class. Resistance to change is also evident at State Government level, particularly among bureaucrats in certain States. Opposition politicians, disturbed by the success of the Congress party and desperate to enhance their prospects for power, are likely to call for the revival of a campaign against foreign goods, first pursued during India's independence struggle.

The hurly burly of parliamentary debates are but one reflection of how market-oriented reforms divide Indian public opinion. Elements of the media, party factions, industrial associations, trade unions, academics and public interest groups are resistant to some or all of the reforms. Some of the larger private sector enterprises exhibit a fear, verging on paranoia, about the impact of competition from abroad, particularly with respect to multinational corporations. A concern over at least maintaining a 'level playing field' between domestic and foreign firms has resulted in the formation of the so-called 'Bombay Club' comprising leading executives from the long established Indian business houses. Large member firms wish to slow down the reforms to give them time to adjust to foreign competition.

But there is another recently formed business grouping, the 'Bangalore Group', which consists largely of newer big business interests asserting the need for Indian corporations to go global. These firms are pushing for more rapid economic reform. There is also a public constituency in favour of reform: the new entrepreneurs, shareholders, professionals, technocrats, traders, middle-class consumers and innovative agricultural producers.

An anticipated shake-out in industry as well as in the state sector is expected to lead to higher unemployment in the short term. High profile union leaders are poised to fight through general strikes and other mass action. There is clearly a need for major labour market reform and restructuring, which will need to be sensitively handled in order to minimise the disruption.

At the level of ideology there has been a sea change in attitude. A new confidence animates the post-independence generation. In their 30s and 40s, they have no attachment to the nationalist emphasis on self-sufficiency. The generational shift, indeed the divide, between old and young, is the result of a new wave of Indians more exposed to global trends than their parents, who seek an end to the frustrations of policy failings and an obstructive, ritualistic and corrupt bureaucracy. An internationalising business community is inspired by rising export figures together with growing pride and confidence in reputation and quality. International recognition of older reformers, such as *Euromoney's* selection of Manmohan Singh as Finance Minister of the Year in 1993 together with H.S. Singhania's rise to President of the 110 member International Chamber of Commerce and Industry in Paris, have inspired the new generation. Rising aspirations and ambitions have therefore replaced the fear and mistrust born of past mindsets.

The question of sustainability of the reform process in India can be addressed in terms of two key determinants: necessity, and feasibility or the likelihood of success.

Necessity

The reform process in India is now an unavoidable imperative. In 1991, the country reached a point of near bankruptcy in macroeconomic terms, due principally to the failure of its microeconomic policies. An unsustainable level of indebtedness was the result of past policies of import substitution and self-reliance. It was premised on expectations of efficiency and revenue contributions from a core of public sector enterprises that would lead the economy. These expectations were not fulfilled. The low growth performance was not due to lack of savings and investment. It was because India did not achieve adequate returns from its investments. The policy framework was inefficient and betrayed deep-seated microeconomic flaws.

The macroeconomic crisis thus forced the Government to address the inefficiencies in the policy framework. Clear diagnosis of the causes of the crisis in 1991 provides the basic imperative as to why the reforms must be sustained. There is no return possible to previous low growth rates and growing indebtedness of the Central and State Governments. There is thus no prospect of return to the vision of a centrally planned system, and there is no viable alternative to economic liberalisation. For this reason alone, the reform process must succeed and the recognition of this reality is one important reason why there is such widespread support for reform.

Second, there is an acute consciousness domestically that, by comparison with the performances of the developing economies of East Asia (especially the other giant economy, China), India is being left behind. More and more Indians recognise that it was incorrect to adopt an attitude of export pessimism in relation to the international trade scene over the past decades. The successful regional economies over the same period were not so pessimistic and, with outward-looking development policies, benefited from the growth in international trade and investment that did take place. In view of the continuing dynamism of her neighbours to the east, India can no longer ignore its unfavourable comparative position. Put simply, India can no longer afford to resign itself to a relatively low growth rate in the dynamic setting of today's Asia. As Bhagwati and Srinivasan have observed, 'these structural reforms were necessary because (India) had evidently failed to generate adequate rates of growth of income and of per capita income'.[64]

Thus in absolute and relative terms, there is a strong domestic consciousness of unfulfilled expectations which has created a climate of opinion that is receptive to change. This helps to explain why domestic opposition to the reform process has so far been weak and why there is almost a political consensus on the need for economic reforms of the types that are currently being implemented. It took the crisis of 1991 to persuade India of the need to implement and sustain the reform process. Nevertheless, Bhagwati and Srinivasan make the valid point that constant reaffirmation of reforms are needed to still doubts about the Government's commitment to reforms. Without

[64] Bhagwati and Srinivasan, *op. cit.*

this, India's past history of half-hearted reform efforts will provoke doubts about its determination to stay the course.

One source of concern surrounds the capacity of the Rao Government to secure and maintain the political support of the States in the reform process. The most recent test was the elections held in the northern States previously governed by the BJP (Rajasthan, Uttar Pradesh, Himachal Pradesh and Madhya Pradesh and the Union Territory of Delhi), where Presidential rule was imposed in the wake of communal problems. It was thought that if the BJP was convincingly victorious in these States with an increased vote, the grip on power of the Rao Government at the Centre could be weakened. In the event, while the Congress party did not fare particularly well in these State elections, the BJP lost ground, except in Delhi. Thus, an important challenge to the Rao Government, and in the minds of some to the reform process, has been neutralised for the time being.

A more diffuse source of criticism of the reform process is voiced in a number of ways by those apparently still attracted to the pre-1991 policies. Bhagwati and Srinivasan have undertaken the useful exercise of summarising these criticisms as 'four misunderstandings' and have rebutted them as follows.[65]

'India is turning to laissez-faire'

In this view, the reform process is rejecting planning in favour of free market economics. However, the Government is not withdrawing from planning but rather rethinking intervention and identifying appropriate directions for it in the light of experience. The reforms do mark a strong shift away from previous dominance of centralised decision making by politicians and bureaucrats towards greater determination of resource allocation by international and liberalised domestic markets. They are intended to remove government from areas of economic decision making where experience has shown that such intervention is harmful and to refocus intervention into areas where it will be constructive and is needed on social grounds.

The Eighth Plan reassesses the role of central planning in the light of the evolving reform process. In reviewing the wide-ranging influence of the public sector on the economic life of the nation, it assesses its strengths and weaknesses. For the latter, 'the lack of cost consciousness of the public sector, its increasing ineffectiveness in achieving targets and depletion of its resources crippling its ability to carry on its activities without high cost borrowing' have compelled the Government to redefine and limit its role and to set down the objective principles of its operations.

The Eighth Plan is cast as 'a Plan for managing the transition from a centrally planned economy to a market led economy without tearing our socio-cultural fabric'. As public sector investment is reduced in those sectors where the private sector can operate more efficiently, public intervention is to be expanded in the infrastructure and

[65] This interpretation appears to be a way of preventing controversy being elevated to an ideological plane, which could become more divisive.

social sectors.[66] The role of public sector enterprises will ultimately depend upon their survival without state support under competitive conditions. India remains commited to a policy of a 'mixed economy' under which the public and private sectors coexist and function side by side, but one in which unfettered market signals play a far more significant role and in which both sectors need to be efficient.[67] In line with this new thinking, the role of the Planning Commission has been redefined as moving from a highly centralised planning system towards one of indicative planning.

'India is abandoning poverty alleviation for growth'

Bhagwati and Srinivasan interpret this as an anti-growth misunderstanding which portrays the two objectives as being mutually antagonistic. They see three misconceptions behind this:

- That anti-poverty programs are what is required, not growth. This ignores the fact that growth has been shown to create employment. Past problems have been due to the fact that the rate of growth has been inadequate to reduce poverty. Furthermore, if stagnation prevails, the financial capacity to mount anti-poverty programs will be jeopardised.

- That there is a retreat to a preoccupation with growth that is reminiscent of past policies. Some, including Bhagwati and Srinivasan, deny that this was ever true in the past. Policies since gaining independence have consistently regarded growth as a means of combating poverty and growth has never been seen as an end in itself.

- That growth is a conservative 'trickle-down' strategy. Far from being conservative and passive, growth has been considered as an 'activist radical pull-up strategy' from the early 1950s, and the only relevant question is how to obtain the maximum returns from resource use in terms of joint gains in growth and employment. In this context the policy framework of the past has been shown to have been ineffective, so the issue of reform is now deservedly placed on centre stage.

[66] It is therefore not clear whether the overall role of planning will be maintained or diminished as the market economy expands and decision-making is devolved to the States.
[67] See Government of India, *Eighth Five Year Plan, 1992-97, op. cit.* Volume II, p.104.

'India is yielding to foreign pressures'

This criticism arises from the view that the reforms were imposed under the conditionality terms of multilateral assistance and thus represent foreign pressures that are inappropriate to India. Conditionality stiffened the Government's resolve to undertake the reforms, a resolve that was lacking in the past. However, the compulsion for reform lies primarily in the recognition that India had been left behind in the dynamics of development and that reform was the sole option left. Furthermore, the reform policies, far from being exotic, had been advocated by some Indian development economists for decades.

'India is turning back on all it did earlier'

This criticism assumes that current reforms imply that all past policies since independence were a failure. In certain important areas of policy, where the reforms are now directed, failure has to be admitted. The reasons are clear: for example, economic autarchy through import substitution and other inward-looking policies was short sighted, based as it was on export pessimism which flew in the face of the realities of rapid expansion in world commerce and the success stories of the developing economies in East Asia over the same period. Indian economic policy remained restrictive and inflexible in ignoring these realities. However, India has made significant progress nevertheless, and the successes should be given due recognition.

Feasibility

A key economic factor which has much bearing upon the sustainability of the reform process is the success the Government has in stabilising the economy. It can be argued that stabilisation and reform are inseparable, for the root cause of instability is the microeconomic weaknesses which the reform package is designed to address in each sector. But in the short run, macroeconomic measures have to be undertaken to achieve and maintain stability to enable the reform package to be launched and subsequently sustained. This is the reasoning underlying the priority given to the achievement and maintenance of stability in the economy. Accordingly, short-run indicators of stability are important signals to be watched.

The first full year of the comprehensive adjustment (stabilisation and reform) program initiated by the Indian Government in mid-1991, was 1992/93. The signals were favourable. Real GDP rose by over 4 per cent from 1 per cent growth in the previous year; inflation fell to over 7 per cent from 14 per cent in 1991/92; the deficit of the Central Government was reduced to 5.7 per cent of GDP despite a major shortfall of revenues caused by civil disturbances, and foreign exchange reserves rose to the equivalent of 3.6 months of imports.

These results were achieved during a period when significant reforms were introduced, economic recession plagued OECD markets and the Soviet Union - a leading market - collapsed. The exchange rate was reunified; plans were announced for recapitalisation of the nationalised banks; tariffs were further rationalised and reduced; additional steps were undertaken to liberalise the financial sector and foreign investment code; and the

budget provided for increased spending on the rural and social sectors, while reducing the overall fiscal deficit.

The World Bank was commendatory in observing that 'these improvements in policies and performance in 1992/93 have set the stage for a broadening and deepening of the adjustment process to expand its benefits and to ensure its sustainability in coming years.'[68] The serious challenges were, however, noted. These included a slower than expected recovery in exports, and constrained progress with tax reform owing to the complexity of the tax revenue sharing arrangements with the States and to concerns about broadening the tax base. There were also delays in industrial restructuring and dealing with the problems in the public enterprise sector and the credit system. The Bank observed that, as the country moves into its third year of adjustment, 'the initiatives that are required to make the reforms sustainable are likely to prove technically and politically more challenging.'

Another important economic question concerns the evolving form of Centre-State relations on effective implementation of economic reforms. This affects policies with respect to industry, agriculture, infrastructure, external trade and foreign investment at the State level. A further new area of economic interest lies in the question of what forms of State-State relations will evolve. Will there be State economic groupings? Will widening gaps emerge between States and regions over time in the development process?

Broadly, the picture is emerging of a previously centralised Indian Government releasing the reins on the economy and encouraging the States to take up the slack. This represents a devolution of economic initiative and control in two important ways. First at government level, the States will need to have greater resources to match their enhanced fiscal responsibilities. Will the Central Government devolve its financial controls and shares in concert with these responsibilities? Second, the role of State Governments needs to be more clearly defined. State level planning, previously subject wholly to Central Planning Commission monitoring and agreement, will take on added significance.

The sustainability of reforms depends on their effectiveness in generating rapid growth and equity. Thus, the reforms need to succeed if they are to be sustained. The level and distribution of benefits they achieve for industry and for the people will depend heavily upon the effectiveness of implementation. But this could be threatened by bureaucratic inertia and/or obstruction, and the parlous financial situation of some States.

It has been noted earlier that bureaucratic adjustment to the reform process and to the transfer of responsibilities from the public to the private sector has been slow, most frequently in certain States. While this is a cause for concern in terms of the pace of implementing reform and achieving results, once pinpointed, it is adjustable and should not threaten the sustainability of the reform process.

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[68] The World Bank, *India, op.cit.*

> ***'I think if you have determined political leadership, [stalling bureaucrats] will have to fall in line. There are still people who don't like the direction of reform, but they are in a declining minority. ...But it's not a one day operation, not even a one year operation. The reform process has to go on for a decade if India is to achieve her full development potential...What we're trying to do is to create a more competitive environment which applies to the private sector as well as to the public sector.***
>
> -Manmohan Singh, *India Today*, March 31, 1993

The severe financial difficulties of some States are of more serious concern and can affect progress in a number of ways. In particular, they can limit the level of public investment at State level available for the basic development expenditure required to attract investors, such as for economic infrastructure and services.

At the same time, the greater economic autonomy of the States may stimulate State Governments to welcome the new fiscal responsibility of bringing State finances into better balance for the opportunities that will open up for economic development within their sphere of accountability. If so, the existing deficits may be reduced as State governments learn to mobilise revenue and capital more efficiently and to attract new private sector business ventures. Not only does India face the challenge of international competitiveness at the national level, but this now increasingly extends down to sub-national level, with each State vying to attract both domestic and international investors. It is therefore in the States' own interests to sustain the reforms by modernising their public administrations and expanding financial resources at their disposal for developmental purposes.

Bhagwati and Srinivasan are in broad agreement with steps already taken to revamp the policy framework, but have made some observations which are relevant to the nexus between performance and sustainability of the reform process. Broadly, they believe India needs to take new steps if the returns are to be high enough to enable the completion of the new policy framework. Without a continuation of initiatives in this direction, the returns from existing reforms are likely to be low. These steps would include:

- Actions to consolidate 'important and bold' reforms already taken to date and to correct for mistakes revealed by experience, and

- Implementation of new measures which would complement and greatly enhance the efficiency of measures already taken.

Finally, the question of sustainability turns on the capacity of the economy to respond to the new initiatives. In this respect, India is well placed to succeed. First, it already has a large and established market economy and the institutional framework to match.

It is driven by an entrepreneurial culture, tens of millions of educated and skilled people who dream of a better future, and abundant natural resources. [69]

Second, India's agricultural sector has been the best performing sector since the 1960s despite government policies which have discriminated against it. Recent analysis suggests that, with liberalisation of policies, agro-food industries have the potential to be the leading sector in a faster growing economy, as has been the case elsewhere in Asia. [70]

Third, India has a large middle class of at least 120 million. An acceleration of economic growth in such an economy makes India an attractive prospect for investors. On the basis of these characteristics and prospects, there are strong grounds for optimism that the reforms will be sustained through the returns they will bring in the process.

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[69] See The Stock Exchange *Indian Stock Markets,* Bombay, 1992.

[70] See Shand, Ric and Kalirajan, K.P. *Foodgrains in Asia* (mimeo) Australian National University, 1993; Pursell and Gulati, *op.cit*.

CHAPTER SEVEN

DIRECTION OF FURTHER REFORMS AND OUTLOOK FOR THE INDIAN ECONOMY

Future Reforms

For companies interested in the opportunities presented by the opening up of the Indian economy, the direction of future reforms is crucial. While all sorts of factors could temporarily derail reforms or cause variations in their pace and sequence, business confidence will be enhanced by knowing, as far as possible, what is in store over the next few years.

The Indian Ministry of Finance's discussion paper, *Economic Reforms: Two Years After and the Task Ahead*, is the single best guide for the next three years.[71] While that document does not profess to cover all the issues on the agenda, it does canvass most in summary form.

> ***India has pushed its reform process ahead - haltingly sometimes - but with a clear sense of direction... But the government has accepted the long-term nature of the reform process, and in a rare attempt to generate public debate on the matter has documented for collective scrutiny its proposed future course of action. ..It represents a clear statement of intent..and is indicative of the irreversibility of the Indian reform process- and the desire to make it work.***
>
> *Euromoney* magazine in its September 1993 issue honouring Manmohan Singh as 'Finance Minister of the Year'.

There are other contributions to the agenda for future reforms. The Eighth Plan (1992-1997), while not a document of reform, does assist in identifying critical areas of weakness and potential in the economy which can help guide the agenda.[72] There is also the advice of expert observers.[73] The multilateral financial institutions also offer

[71]Government of India, *Economic Reforms, op cit.*

[72]See Appendix 2 for a summary of the Eighth Plan.

[73] Prominent amongst whom are J.N. Bhagwati, Professor of Economics at Columbia University and T. Srinivasan, Professor of Economics at Yale. The two wrote Government of India, *India's*

guidance and advice for the future. And many Indian coporate leaders have strongly advocated their views on future directions for reform, particularly through the business press.

The observations in this chapter draw on all of these sources. What follows is an indication of likely directions, which we consider to be consistent with indications already provided by the Indian Government.

The key areas of focus for reform in the years ahead will be consolidation of the gains in the first two years; supplementary action in the States to derive full benefits; and new initiatives beyond the policies already announced.

Fiscal Reform and Consolidation

A continued reduction of the fiscal deficit is essential to control inflation, to ensure adequate availability of credit for production and investment, and to achieve external sector viability in the medium term. Without such a reduction, a high fiscal deficit will divert savings away from productive investment with severe longer term consequences.

To avoid re-emergence of external debt and liquidity problems, the current account deficit in the balance of payments needs to be reduced from about 2.2 per cent of GDP to below 1 per cent in 1996/97.

Taking the Central Government and States together, the overall target in the next three years is to reduce the fiscal deficit from around 7 per cent of GDP in 1993/94 to around 5 per cent in 1996/97. This requires a reduction in the Central Government's fiscal deficit to about 3 per cent of GDP in 1996/97. Such a reduction in the future fiscal deficit will require:

- Reduction and redirection of subsidies.
- Implementing a new approach to administered prices.
- Further reductions in budgetary allocations to public sector undertakings.
- Measures to tighten expenditure controls.[74]
- Completion of the tax reform agenda.

Economic Reforms, New Delhi, 1993, and Bhagwati has also written *India in Transition: Freeing the Economy*, Clarendon Press, Oxford, 1993.

[74]In cutting expenditure to reduce the fiscal deficit, Bhagwati and Srinivasan believe that development expenditure has been pruned too heavily and this could compromise later growth.

Subsidies

Subsidies are currently large for fertilisers, food, several oil products (kerosene and liquid petroleum gas) and are massive for irrigation, electricity, public road transport and many other activities. The rising subsidy bill is uncontrolled and is already beyond the country's fiscal means. Further action on subsidies is likely in the near future to contain them by targeting them to the needy. For example, the fertiliser subsidy to farmers could be restricted by targeting small and marginal farmers, and by more efficient use through better extension.

Similarly, the food subsidy is justified on a needs basis. But a Public Distribution System (PDS) exclusively targeted to the poor would be more effective. Elimination of the subsidy to the Food Corporation of India (FCI) would improve FCI efficiency. Decentralisation of procurement and distribution to the State level and introduction of competition among procurement agencies would also enhance operating efficiency.

Current user charges recover only a fraction of the costs of providing infrastructure services for electricity, irrigation, public transport and non-primary education. Prolonged under-pricing and poor revenue collection has severely undermined the quality, viability and future growth these services. These services primarily benefit the better-off groups. If costs are not contained, there are likely to be worsening problems of water shortages, power failures and poor education skills. There is scope for user charges to be raised to cover the cost of services provision and this is likely in the future. Some cross-subsidisation is likely to be built in to assist the poorer sections of the community. Regulation of the pricing structure, along with competition among private producers, are essential to ensure that higher prices are not a license for even greater operational inefficiency and leakages in these key sectors.

Administered Prices

The practice of keeping administered prices unchanged over long periods when costs are rising produces mounting losses which increase the fiscal deficit and aggravate inflation. The Indian Government is unlikely to maintain administered prices in the future. Where goods are importable or have close substitutes as importables (for example, coal, oil, petroleum products, fertiliser and critical agricultural products) prices can be kept in check by delicensing imports and exports, subject to approved levels of tariffs. For infrastructure services, such as power and transport which are non-tradeables, price checks are preferable, either through regulatory frameworks where there are 'natural monopolies' or by induction of competitive private suppliers. Where prices continue to be administered, frequent price changes will help to avoid accumulating losses. Small price changes are not as disruptive.

Public Sector Enterprises (PSEs)

A large proportion of PSEs have not been operating satisfactorily. In a bid to make the state sector more responsive, the Government of India has decided to disinvest from some as a first step.[75]

Budgetary support has already been reduced for PSEs, with an insistence that they operate on commercial principles to yield the surplus necessary for their own expansion and the servicing of their capital.

Tightening of procedures for expenditure control and re-evaluation of all ongoing departmental programs would provide the right setting for implementing reform. In the light of recent reforms, some departmental functions have become redundant and new ones have arisen. Re-organisation of Government structures to fit post-reform needs could take place through a redeployment which improves operational efficiency and staff morale. The Indian Government has many models of such public sector reform to guide future directions.

Completion of Tax Reforms

A clear final reform objective is a tax system which is simple, well administered and promotes efficiency, growth and equity in line with the recommendations of the Chelliah Tax Reform Committee. Measures are likely to include the following elements:

- Reduction of corporation tax from its current level of 51 per cent to 40 per cent in 1994/95. It has also been suggested that the tax on foreign companies be reduced substantially to a range of from 47.5 to 50 per cent in 1994/95.

- Progress to a full value-added tax system in consultation with State Governments.

- Broadening of the tax base to enable rationalisation of rates of customs and excise and for implementing the corporate tax.

- Phased reductions in customs tariffs to comparable international levels in the next few years.

- Elimination of complex and wasteful exemptions in customs and excise.
- Improvement and modernisation of tax administration.

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[75]In the ongoing process of privatisation of public sector enterprises, Bhagwati and Srinivasan argue that the proceeds from equity sales should not be used to reduce the current budget deficit. Instead, the proceeds should be used to 'retire the substantial accumulated government debt'. This would speedily reduce the interest payments which afflict the budget and would pressure the Government to proceed with fiscal reforms.

Indirect Taxes

The long-term Indian Government objective is to move to a fully fledged Value-Added Tax (VAT). But this would require a modification of the present constitutional arrangements governing the allocation of taxation powers between the Central Government and the States. Within the existing constitutional arrangements, India can still move further towards incorporating VAT principles in its present excise-cum-MODVAT (modified value-added tax) system by:

- Broadening the base to include many currently exempt goods and services.
- Abolishing almost all commodity-specific and user-specific exemptions.
- Moving towards only one or two rates for raw materials, components and other intermediate goods, while confining rate differentiation to the final consumption goods stage distinguished by categories such as necessities, ordinary and luxury goods.
- Extending MODVAT credit to cover virtually all sectors.
- Gradually switching from specific to *ad valorem* rates or to a system of automatic, inflation-indexing of specific rates.
- Changing from physical to accounting methods of tax collection and checking.

Customs Tariffs

The Indian Government recognises that the customs duty structure, with a maximum rate of 65 per cent, is still one of the highest in the world. India is not competitive when other developing countries have reduced their rates to between 10 and 20 per cent for most items except consumer goods. For consumer goods, the situation is even more complicated as, in addition to high tariffs, there are import restrictions which provide high protection to this sector. This protection is likely to come down in due course. If border measures are not relaxed, production will be diverted away from areas where protection has been reduced and towards consumer goods. India's program of customs tariff reform over the next three years could include:

- Gradual reduction in the average tariff level to around 25 per cent (excluding duty free imports) with a maximum rate of about 50 per cent.
- Elimination of end-use exemptions, excepting inputs used in export production.
- Elimination of exemptions from the countervailing duty.
- Rationalisation of customs duties and import policies for consumer goods. By 1996/97, all should be on a tariff or Open General License import regime, except for a few exceptions on social, environmental and health grounds.

These changes will need to be carefully phased in order to give priority to raising the revenues needed to achieve the goal of continuing reductions in the overall fiscal deficit. The Government of India is working on the basis of international experience, that moderate direct taxes, combined with limited tax deductions and exemptions and with effective enforcement, will encourage voluntary tax compliance and increase revenues.

The extensive restrictions on consumer goods imports constitute a major exclusion from liberalisation of the trade sector. Bhagwati and Srinivasan believe that the reluctance to liberalise these goods stems from fallacious reasoning.[76] They argue against the view that the removal of protection for consumer goods will reduce savings and will increase the availability of luxuries. They also believe that fears that such imports will reduce government revenues and create a balance of payments crisis are exaggerated in the former case and unfounded in the latter. They recommend liberalisation through a shift from quantitative restrictions to tariffication, followed by gradual reductions in tariff rates.

Income and Corporate Taxes

The 1993/94 Budget announced that corporate taxes would be reduced in the next budget. The Government of India delivered on this promise in its March 1994 budget. The intention is to continue the process of gradual reduction of income and corporate taxes, staging the process in accordance with the fiscal situation. Tax simplification will continue and the presumptive tax scope will also be gradually expanded.

The Indian Government recognises that these policy changes will not work without reform of the tax administration system. Comprehensive reforms in this area are to be implemented over the next three years.

Financial Sector Reform

The broad strategy is to provide producers and the public with a wide choice of accessible instruments for financing to better match the demands of savers with those of producers in terms of returns, maturity, risk and liquidity. This requires a Securities Exchange Board regulatory framework, with sufficient protection for investors without being unduly burdensome. India is seeking trading mechanisms that are quick and fraud-resistant; breaking up of monopolies and promotion of competition; and development of new markets. Among the new target markets are secondary markets for public debt instruments, and options, futures and forward markets for financial instruments and commodities.

The 1993/94 Budget provided a large sum for nationalised banks to meet the requirements of the new norms for capital adequacy, income recognition and provisioning for impaired assets. Requirements for further provisioning and for meeting the 8 per cent capital adequacy norms will require equity sales by these banks. To ensure that these sales are successful and that past difficulties are not repeated, a

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[76]Bhagwati and Srinivasan, *op.cit*.

number of measures will have to be taken over the next three years that will implement progressively the recommendations of the Narasimham Committee.[77] These include:

- A complete ban on generalised loan waivers.
- Institution of speedy loan recovery procedures to preserve and recycle public savings.
- Continued implementation of a phased reduction of the Statutory Liquidity Ratio (SLR) level to 25 per cent and the Cash Reserve Ratio (CRR) to 10 per cent to increase banks' lending potential, to reduce the fiscal deficit and dependence on money created by the Reserve Bank.
- Phasing out of ceilings and floors on bank deposit and lending rates, except for one concessional lending rate set about 3 per cent below the rate set for prime borrowers.
- Careful targeting of concessional lending to the needy.
- Creating an environment where banks will have better incentives to lend to agriculture, small industry and other priority sectors, which may involve revamping of agricultural credit institutions.
- Strengthening institutions and procedures for bank supervision.
- Modification or elimination of restrictive regulations which limit competition. The policy of entry of new private banks should be continued, including joint ventures with foreign banks.
- Computerisation of bank operations.

In insurance, the same reform process will be necessary to introduce greater efficiency and more competition. These issues have been addressed by a Committee headed by R.N. Malhotra, ex-Governor of the Reserve Bank.

[77]The Narasimham Committee's recommendations cover the functioning of the system, its organisation and structure and the regulatory framework. They are an integrated package aimed at improving portfolio quality, providing greater operational flexibility and ensuring prudential norms, while at the same time improving the system through measures aimed at enhancing productivity, efficiency and profitability. Central to this approach is the agreement to full autonomy with respect to internal operations of banks and financial institutions subject to their accountability for performance and compliance with prudential norms and guidelines and macroeconomic policies. The Committee stresses proper sequencing of the reforms. These are to be phased in over 3 to 5 years, but should start immediately in many areas to signal firm intentions.

Policies for External Sector Viability

The 1990/91 financial crisis revealed India's vulnerability on the external payments front, the need to improve its balance of payments and to reduce its dependence on borrowed funds. The solution to this problem lies in a much more rapid growth in exports to achieve self reliance in order to finance import needs without excessive reliance on foreign borrowing. Some of the necessary policies have been put in place in the last two years. Further measures likely to be considered at some stage are:

- Phasing out the remaining quantitative restrictions on exports as quickly as possible.

- Reducing the customs duty structure to eliminate the anti-export bias in trade and industrial policy.

- Phasing out the remaining licensing restrictions on imports (other than for social and environmental reasons).

- Improving access to imports so that exporters have access to imported inputs and thereby reducing excessive profits of domestic production in sectors protected by import licensing, which draw resources away from export activities.

- In due course, reducing protection on consumer goods.

- Modernising the delivery and organisation of infrastructural services in power, transport (ports, roads, rail and air), communications and banking. Many of the changes will have to be undertaken by State Governments and agencies.

- Increasing oil production. Apart from export performance, the single most important factor affecting the external sector is the performance of the petroleum sector. The current decline in oil production has to be reversed. This requires revamping of the Oil and Natural Gas Corporation (ONGC) and attraction of the private sector into oil exploration and development, including the development of existing oilfields. This, in turn, requires major changes in pricing policy in the oil and gas sectors. Pricing of petroleum products in line with world prices will ensure adequate resources and effective demand management.

- Introducing major improvements in the tourism industry and services account. In 1990, China enjoyed 27.5 million visitors while Thailand attracted 5.3 million tourists and Malaysia hosted 7.5 million foreigners. India was only able to draw 1.7 million visitors although their average stay in the country exceeded that of other Asian countries. Major improvements in facilities and infrastructure will be required, including particularly hotels, telecommunications, railways, roads and airlines. A start has been made with the partial deregulation and privatisation of domestic airlines.

India needs to encourage foreign direct investment to supplement the mobilisation of domestic resources. This could be facilitated by familiarising foreign investors with developments in the economy and concluding bilateral agreements with key capital exporting countries. Progression towards full current account convertibility is easing this transition. Efforts to expand foreign investment in infrastructure industries would help compensate for the lack of investment resources. Infrastructural investment could be facilitated through reforms in regulatory and pricing frameworks, aiming for an annual flow of direct foreign investment of around US$2 billion by 1996/97.

External policies will need to monitor strictly the external debt situation. This will hinge on oil production, export growth, prudent fiscal and monetary policies and rapid growth in foreign exchange earnings from services and non-debt creating capital inflows such as foreign investment.

Industrial Reforms

Deregulation and debureaucratisation of the industrial licensing system has resulted in lower costs and greater attention to consumer needs. It has also stimulated innovation, output expansion, and competitiveness in producing better quality and lower priced goods and services. However, constraints are still pervasive at the State level. Requirements for licenses, permits and inspections in the States are onerous and exact a heavy toll on industrial units. Enterprises are still facing difficulties in acquiring land, water and electricity. In future, governments at all levels in India are likely to consider the following additional initiatives:

- At the State level, improving the investment climate by providing high quality infrastructure and removing the 'license raj'.

- At the Centre, eliminating remaining barriers to industrial production, investment and import of foreign technology. Its role will shift increasingly to restructuring unviable enterprises, ensuring fair business practices, safeguarding consumer interests and minimising the adverse effects of industrial development on the environment.

- Restructuring weak and non-viable enterprises, both public and private, remains a major challenge. Massive resources are locked up in these enterprises. Reforms should first strengthen the Sick Industrial Companies Act (SICA) and make the National Renewal Fund fully operational. The Government of India's Rangarajan Committee Report on *Disinvestment of Shares in Public Sector Enterprises,* has outlined a strategy for restructuring PSEs.

- There is a need to take account of workers' interests. Voluntary retirement schemes are needed, just as there is a need to create new jobs. Labour unions will need to engage in a dialogue to reach an understanding on how to facilitate the transition at the level of individual employees.

- There remains a continuing need to stimulate small industry.

- Sensible policies are required for urban land use. The implementation of the Urban Land Ceiling and Regulation Act (ULC Act) of 1976 severely undermined the land market operation, contributed to spiralling land prices and has failed to eliminate speculation and profiteering. It may need to be amended. The approvals system blocks sensible land use policy. In Bombay, for example, as many as 57 approvals must be obtained for construction of a housing project.

Reform Priorities for Agriculture

Agricultural development underpins economic reform and regeneration in India. It is needed for raising general living standards, alleviating rural poverty, assuring food security, generating a buoyant market for expansion of industry and services, and contributing to the national export performance. The example of China, based on its agricultural reform and liberalisation from 1978 to 1985, is highly relevant to the Indian experience.

- Agriculture requires higher investment and more efficient resource use. The former has declined in recent years, and public assets are rapidly declining for lack of resources and operations and maintenance effort.

- There is a need to radically restructure the pattern of expenditures for agriculture to favour durable and productive investments and provide for their maintenance. This includes containment of massive subsidies for water, electricity and fertilisers. It would entail an increase in charges on these inputs and services to recover costs and to avoid deterioration of delivery of these critical inputs.

- India also needs to upgrade research and extension support services, ensure better arrangements for meeting energy needs on a sustainable basis, develop technologies for dry land farming and for better control of water and land degradation.

- Trends in investment and upkeep of public infrastructure in agriculture might be reversed by maintaining remunerative prices, encouraging rural processing, phasing out domestic trade and marketing restrictions and scaling down preferential protection for the industrial sector - all to secure more private investment.

- India could open up agricultural export opportunities within the new exchange rate regime and lift controls on agricultural exports.

- The weakened agricultural credit system with its subsidised interest rates, poor loan recovery, high intermediation costs of cooperatives and commercial banks and write-offs could be improved through supply of timely credit, especially institutional credit; and reconsideration of the interest rate structure and of subsidies.

- In some States, land reform and tenancy regimes need reform, particularly to assist irrigation development and other infrastructure services to small and marginal farmers and to restore the health of the credit system

Infrastructure Reforms

The major pressure for reform in the infrastructure sector is fiscal. The rationale for reform within the sub-sectors is low and inadequate quality services and financial difficulties. For example, financial pressures in the aviation industry have resulted in recent airline reform. Similar pressures are currently generating reforms in the electric power and the railway sub-sectors. It is expected that these pressures will spread to other sub-sectors as the rest of the macroeconomic and structural reform package is put into place. Brief observations on possible directions for future reform are given below for the principal infrastructural sub-sectors.

Power

As the largest infrastructure sub-sector in terms of public expenditure, power is receiving close attention from the authorities, and there is a new and growing appreciation of the potential role of the private sector. However, the reform of this sub-sector is complicated by the overlapping concerns of the Central and State Governments.

While the regulatory framework for the sub-sector gives the State Electricity Boards (SEBs) considerable autonomy, in practice, they must obtain State Government approval for most major decisions. It is difficult for the Central Government to undertake needed reforms directly. Apart from pressing the States to adjust power tariffs, the Centre can only address the SEB's problems indirectly through Central sector agencies and by using the private sector.

Recent policy changes and promotional efforts have encouraged interest in private power projects. Full ownership of power companies by the private sector (local and foreign) is now permitted with an license period of 30 years, 20-year renewals and increased financial returns. Some 43 proposals are currently under active consideration, and various SEBs have signed MOUs for 38 private developments.

Additional incentives were introduced in the 1993/94 budget, including a reduction of import duty on power projects to 20 per cent and a five-year tax holiday for new private power projects. While these incentives will encourage the private sector, large-scale investments may await reforms of the SEBs.

Telecommunications

Telecommunications in India is a sector of national importance. However, the quality of the current service is extremely poor by international standards. The potential market is estimated to be up to four times the market being served. There is an obvious need for reform.[78]

The Department of Telecommunications has agreed, in principle, to establish a separate regulatory authority for the sub-sector and is collaborating with the Industrial Credit and Investment Corporation of India (ICICI) to determine appropriate arrangements for new entrants in rural areas. Reforms would envisage the separation of the three functions of regulation, provision of services and manufacturing, and the entry of private sector competition.

Ports

Indian ports are organised as monopolies for bulk and container cargoes, administered by autonomous Port Trusts. Problems with Indian ports mirror those of other infrastructure sub-sectors. User charges are set to cover costs, and provision of infrastructure takes precedence over provision of services. Accordingly, port services are high cost and low quality, arising from low capital and labour productivities. The weaknesses are apparent in container delays and long ship waiting times; in the outdated technology of feeder as against mainline services and in the slow turnaround of cargoes. The modern container facilities at New Bombay and Madras handle fewer than ten containers per hour compared to 25-30 per hour in other regional ports. Port labour and custom employment is excessive, applies restrictive practices, and charges high rates of 'speed' money to facilitate clearances.

Successful reform could be to give port authorities responsibility for the provision of the basic physical infrastructure and control of safety and environmental elements. It could then lease or franchise the various operating services to the private sector, which would organise the equipment and labour to provide services for a fee to ships calling at the port.[79] The initial step to improve rapidly the operation of the key container terminals (moving most of the high value import and export cargoes), would be to lease their operation to qualified firms. This is being considered by the Government of India but has not yet been undertaken.

Railways

Indian Railways (IR) has been run as a state monopoly, and a manufacturing/transportation conglomerate and, as such, it has not been concerned with the provision of competitive rail services to private shippers, most of whom have

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[78]See papers presented at the workshop 'International Experiences in Telecommunications Reform and its Relevance to India', New Delhi, November 1992. Also see Bruce Robert and Jeffrey Cunard *Restructuring the Telecommunications Sector in Asia: An Overview of Approaches and Options,* The World Bank, 1992.
[79]See Zvi Ra'anan, *Ports Administration: Should Ports be Privatized*, The World Bank, 1992.

chosen the more costly but more responsive road haulage alternative.[80] This has left the railways with the public sector freight shippers and passenger traffic. The former have paid rates which have covered the losses on the latter, but overall, the railways, since they are used to subsidies, have incurred increasing losses. The social costs of subsidies, incurred on passenger operations and on carrying certain essential commodities such as foodgrains and salt, and losses on uneconomic branch lines, exceed those of any other transport system. Moreover, the labour force of 1.7 million, of which at least 400,000 are said to be redundant, is another strong deterrent to reform.

IR's financial performance has been declining along with the quality of service for freight shippers. Budgetary support from the general exchequer has declined over the years and IR has been forced to borrow from the market. While this has boosted resources, it has been a burden on working expenses because of the higher leasing charges on the bonds. There are also pressures of increased freight and passenger traffic. Carrying capacity on the important rail corridors has reached saturation point and can only be expanded by new investment. Also, IR continues to face competition from road transport.

To reverse the trend towards road transport, IRs will find it is necessary to increase the carrying capacity on certain sections of the railways. It will also need to improve its operational efficiency and commercial practices and its linkages with road transport at loading and unloading centres. It has been suggested that a corporatised transportation organisation, operating along commercial lines and answerable to an independent regulatory commission, would begin to provide an environment in which appropriate services and correct pricing signals could be sent to public and private sector users. The coexistence of a competitive private sector bus and truck system would then give users alternatives from which to choose.

Roads

It is generally accepted that the main road system in India, particularly the National Highway System, is highly congested, and that the expansion of road traffic is expected to be rapid in the years ahead. While there has been steady growth in the road network over four decades, increases in the length of national highways have been relatively slow. The proportion of surfaced road length rose only from 39 per cent in 1950/51 to 46.7 per cent in 1984/85. The most impressive increases were recorded for minor road lengths (district and village roads).

The most compelling argument for reform in the financing, provision and maintenance of main roads is that of poor quality infrastructure leading to costly service and the pressing need for expansion of high density road corridors (HDC) that carry most of

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[80]Private bus and truck operators have been able to offer relatively better quality services than rail. Despite the emphasis on passenger services and bulk freight, IR currently accounts for only 22 per cent of intercity passenger-kilometres and about 40 per cent of intercity ton-kilometres. India's transport system is dominated by roads and road transport despite official objectives to the contrary. These realities have, however, led to a situation where main corridor road congestion is severe thereby raising typical marginal returns on core road investments to very high levels which are not being matched by investments in expanding road network capacities.

the traffic between major cities. A recent expressway study by the Indian Ministry of Surface Transport indicated that 10,000 km of HDC road capacity expansion will be required by 2015, and about 1,350 kms are recommended and economically justified by 2000. This would require expanding existing two-lane roads in the HDC to four lanes with urban bypasses together with construction of a parallel access expressway. The scale and standards required for such construction would be unprecedented in India, raising major problems of planning, finance and implementation.

Augmentation of the Central Road Fund will be required, but it will be necessary to seek non-governmental sources of funds and private participation in road construction. One option could be toll-based highway projects, an approach which has been used in many countries.[81] Revenues could be allocated to operation and maintenance of the facilities, together with a contribution to the capital costs. A toll road authority could introduce competition for and privatise many of the services provided by States (engineering design and supervision services, toll collection, axle weight control and road maintenance). Private participation through Build, Operate and Transfer (BOT) projects could be encouraged. Another source of funds might be a substantial earmarked diesel fuel and gasoline tax for exclusive use of the core road network. Overall, a system of private competitive provision of trucks and buses operating on a combination of public free access and toll facilities is likely to be the most fruitful strategy of road transport reform.

Canal and Public Tubewell Irrigation

The history of public irrigation services in India is one of initial profitability, before the advent of significant competition from private tubewells, and subsequently, a long period of declining user charges and collection rates combined with rising overhead costs of irrigation bureaucracies at the State level to produce rapidly expanding deficits requiring public subsidies. While these subsidies have been dominated by the canal system, the public tubewell bureaucracy in India has been unable to keep public wells operating efficiently.

The absence of well-defined user groups paying substantial user charges to a regulated and independently monitored canal irrigation bureaucracy is a major weakness in the operation of the many canal irrigation systems in the country. Reforming public irrigation systems into regulated, revenue generating public utilities would do much to deal with the financial problems and poor service at the State level but would not solve the larger problem of efficient national water resource use that arises from perverse financial incentives for farmers to over-exploit water and the inability to effect basin-wide planning of water resources. The removal of these farming incentives would promote desirable long-range changes in patterns of food production and consumption, but is likely to be resisted by beneficiaries of the current system in the short run.

The economics of canal irrigation are highly complex. They may receive increasing attention from the Government in the form of central water resource planning and

[81]India has collected tolls on bridges for many years but not on roads.

exploration of feasible user charge regimes, but the latter is problematic as successful reform models in large-scale public canal irrigation are difficult to find. For the

above reasons, reforms in canal irrigation are unlikely to be high on the reform agenda in the near future.

State Capacity for Implementation of Reforms

States are crucial in public spending (see Table 7.1). State Governments spend the bulk of budgetary spending on social services as well as on economic services such as agriculture and irrigation. They also absorb large amounts of Central budgetary funds and take responsibility for implementing numerous programs sponsored by the Indian Government.

States vary in terms of the seriousness of their fiscal problems. In the last two years, some have run into serious liquidity problems leading to some delayed payments and wages. State Governments have limited autonomy to borrow, and the Central Government has clamped down on States' overdrafts since 1985 so that expenditure growth has been somewhat constrained in recent years. This has resulted in the reduction of States' support for economic development for which they are mainly responsible. There is a growing backlog of uncompleted investment projects tying up large public resources and reducing efficiency. There is also a worsening record of capital maintenance with poor overhead and maintenance funding (especially the non-wage components).

The 1980s were marked by a significant deterioration of Central and State finances in India.[82] State revenue surpluses in the 1970s became deficits in the 1980s - (see Table 7.2). Net revenue expenditures (net of non-tax receipts) grew fastest (3.9 per cent) reflecting the decline in cost recovery rates. The fastest growing source of funds has been the special purpose plan grants tied to centrally sponsored schemes. Plan revenue expenditures were highly significant in bringing about the deficit in revenues. Thus the growing State deficits have been due to development plan schemes involving the additionality of Central funds for the States and the declining rates of cost recovery. The States have overspent on subsidies and on anti-poverty programs (where there is a maximum potential to tap additional Central funds).

On the other hand, capital expenditures by State Governments, after significant growth in the 1970s, have stagnated and even declined slightly in the 1980s. However, since the decline in the revenue surpluses was much sharper than that in investment, the States have accumulated a growing debt burden to finance their capital expenditures. This debt burden has been a barrier to increased investment levels and investment plans have been cut because of this resource constraint.

Table 7.1

Shares of States in Budgetary Expenditure

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[82]Ravishankar, V.J., 'Public Spending and Investment in Indian Agriculture' (mimeo), New Delhi, 1990.

(per cent of total)

Item	1980/81 (Gross[a])	1989/90		
		Gross[a]	Net[b]	Central Transfers
Total expenditure[c]	52.2	49.4	48.2	1.2
Capital expenditure[c]	48.4	42.7	n.a.[d]	n.a.[d]
Revenue Expenditure	53.7	51.1	n.a.[d]	n.a.[d]
Education	91.4	92.3	88.8	3.5
Health and family welfare	95.1	91.9	76.5	15.3
Social security and welfare	89.9	82.4	81.2	1.2
Agriculture and allied services	91.4	87.4	78.5	8.8
Rural development	88.6	88.8	10.1	78.7
Irrigation and flood control	98.9	98.7	95.5	3.1
Energy	53.1	34.1	32.7	1.4
Industry and minerals	20.0	29.2	24.0	5.2
Transport	48.2	42.4	39.9	2.5
Interest payments	19.0	15.4	36.5	-21.1
Administrative services	73.6	74.2	74.2	0.0
Fiscal services	45.4	61.5	61.5	0.0
Pensions and misc. services	24.9	28.6	26.3	0.0
Other	29.5	28.6	26.3	2.3

a Including spending by specific-purpose Central Government grants and loans.
b. Excluding funding by specific-purpose Central Government grants and loans.
c. Capital expenditure includes lending net of loan repayments received.
d. It is difficult to allocate specific-purpose Central grants between those supporting capital and current expenditure at State level.

Sources: Central budget documents and Reserve Bank of India bulletins (see World Bank CEM, 1993).

To the extent that State finances continue along this trend, the pace of reforms and the reform process itself will be adversely affected. One of the needed reforms then is fiscal stabilisation at the State level, if the necessary level of new investment is to be achieved. This means the removal of subsidies, which will raise cost recovery. The immediate need to reduce budget deficits and the long-term need of economic growth together call for enlightened management and monitoring of public resources to control the growth of current spending and at the same time to protect funds for investment.

Table 7.2
Growth Trends in Sources and Uses of Funds in 14 Major States[83]

	1974/75	**1979/80**	**1986/87**	**Real Growth Trend** (per cent)
Gross revenue receipts	8,426	14,068	20,529	3.0
Non-plan revenue expenditure	7,060	10,367	16,063	3.1
Plan revenue Expenditure	837	2,065	4,633	5.8
Gross revenue expenditure	7,897	12,432	20,696	3.4
Revenue surplus/deficit	529	1636	- 167	
Rate of cost recovery (per cent)	24.7	25.0	20.9	

Sources: Central budget documents and Reserve Bank of India bulletins (various issues)

Options for Fiscal Reform

Options for reform comprise both the States' own actions and measures taken by the Central Government affecting incentives and resources for adjustment.

State Governments may wish to:

- Gain control of the wage bill.
- Increase cost recovery rates (power and irrigation).
- Place greater emphasis on overheads and maintenance, especially on irrigation, roads and key social sectors.
- Review the portfolio of unfinished State public sector investment projects to weed out low priorities and those with poor completion prospects and whose role and/or technology have become obsolete.

[83] These 14 states are Andhra Pradesh, Bihar, Gujarat, Haryana, Karnataka, Kerala, Madhya, Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh, West Bengal.

- Better utilise the States' available tax revenue sources (mainly agricultural and property).

The Central Government, while having only limited leverage over the States, could can exert influence in the short term by:

- Changes in discretionary flows to States.

- Indirect actions, for example decisions on pay and benefits to Central Government employees.

- Dialogue with States over planning.

- Central regulation of public investment projects and other activities.

And by taking specified policies to:

- Rationalise the number of Centrally sponsored schemes, to focus on sector-oriented programs with greater flexibility for State use of funds.

- Adjust allocation of funds for Centrally sponsored schemes to favour poorer states and focus on anti-poverty objectives and at same time.

- Provide incentives for resource mobilisation at State level.

- Set an example in expenditure management (wage bills, control expenditures in Union Territories).

Centre-State relationships are changing. The Government of India has taken measures to tighten the relationship between fiscal management by State Governments and their access to Central Government assistance. The financial link to the Reserve Bank of India is ultimately the strongest means of control.

In the longer term, reforms are needed in fiscal relations between the State and Central Governments which could require legislative and/or constitutional change. There is a strong need for decentralisation of financial authority and resources to the level of the State Governments, combined with measures to ensure accountability.

Changes in State-Centre fiscal relations could be appropriately undertaken according to the 10th Finance Commission review forecast of 1995/96 to 1999/2000. Its recommendations include ways to:

- Strengthen resource mobilisation by States and reduce their fiscal deficit.

- Improve maintenance of capital assets.

- Modernise their administrative systems.

- Ensure reasonable returns on irrigation, power and other State public undertakings.

Economic Outlook to the Year 2000

While it is relatively easy to assess likely economic priorities and directions of India's economic reform in the 1990s, the pace of reform, and therefore its impact on economic growth, is more difficult to assess.

Economic Policy Priorities

- Continue with fiscal correction to ensure inflationary expectations are curbed. The fiscal deficits at the Centre and in the States must be further reduced as a percentage of GDP.
- Use fiscal room to manoeuvre gains in the first two years to give a strong fillip to developmental expenditure in 1993-94, especially to programs of poverty alleviation, rural development and vital social services - education and health.
- Translate the hesitant industrial recovery into a strong revival in 1993-94, and to vigorous growth for the last three years of the Eighth Plan period.
- Make further progress with tax reform, with moderate rates and a much greater focus on compliance.
- Give full support to agriculture in economic strategy, and also to agro-processing industries which have a strong potential for generating employment and income in rural areas.
- Make exports a high national priority to enable management of the balance of payments without resort to exceptional financing from abroad, as the only meaningful route to self reliance.

In assessing the medium-term outlook for the Indian economy, it is important to realise that the economy is not, and has not been, stagnant. India's GDP has risen by an average of almost 4 per cent per year since the early 1950s. And during the decade of the 1980s, annual growth averaged 5 per cent. The Indian economy arrived in the 1990s with a running start that went largely unnoticed in a world where attention was diverted to even higher growth rates in much of East Asia.

Future prospects for India start from a base of a production growth track record. It is this recent growth record which will dominate factors influencing future growth. But pressures for change have been building in India throughout the 1980s and reforms in 1991 will add to the existing forces for growth. Growth rates in the 1990s, therefore, are likely to build on and exceed those of the 1980s. But they will not equate to the

sudden spectacular growth rates produced by more major change from a stagnant start evident in recent Chinese economic performance.

In the 1990s we predict

- A continuation in the fall in the share of agriculture in GDP; although agriculture will continue to have a major role in economic activity, including through agriculture-based manufacturing.

- A rise in the role of the finance industry.

- Continued growth in the role of manufacturing industries.

- Average annual growth in GDP of 6.3 per cent.

As for much of the world economy, growth rates in the first few years of the 1990s have been slower than those for the 1980s. However, quantitative work undertaken for this study predicts annual average growth rates of 6.3 per cent for the 1990s. This growth forecast is a base-case scenario, influenced largely by recent growth momentum. The forecast takes into account some caution over the pace of reforms in difficult but crucial areas such as the labour market and the bureaucracy. It accounts for some concern over financing India's deficit but generally assumes sound macroeconomic policy management. Should reform processes meet the expectations of some of the more optimistic India watchers, even higher growth might follow. Assessments of opportunities for Australian exports in subsequent chapters assume a base-case scenario of 6.3 per cent average annual GDP growth for the 1990s. Higher economic growth would mean even greater opportunities for Australian firms.

CHAPTER EIGHT

INTERNATIONAL RESPONSE TO INDIA'S LIBERALISATION

International Business Perceptions

Throughout the world, business decision making is influenced by many different factors. One important factor is that of 'business perceptions', which can have a significant influence on trade and investment decisions. Perceptions in this context encompass general impressions and opinions, as well as particular insights gained through experiences in conducting business. Some of the elements that influence business perceptions between countries are international trade policies, macroeconomic and microeconomic policies, the business environment itself, and the cultural, political and social framework.

While recent international investment response is an extremely positive endorsement of India's reform process and group prospects, there is also a degree of caution evident in the international business community. From our survey of Australian business, and from commentary in the media and elsewhere, it is clear that India has an 'image problem'.[84] The general Australian perception is that India is an exceptionally difficult place to do business, and overall images of India are negative. To gauge a wider view on perceptions of doing business in India, and to assess whether negative perceptions are related to peculiarities of Australia's experience, we examined the experience of other countries in doing business in India. Experiences of India's major trading partners were surveyed to determine how Australia's competitors have been affected by the business environment, whether they perceived it as particularly difficult, and if so whether they did so for the same reasons as Australians.

The Business Environment: An International Perspective

Like many countries, India is attempting to pick up its share of the pieces left behind after the end of the Cold War and the dissolution of its past mentor and partner, the former Soviet Union. Interviews and discussions with business and government representatives conducted by Australian Department of Foreign Affairs and Trade officers in posts in the United Kingdom, United States, Germany, France, Belgium, Canada, Italy, Japan, China, Hong Kong, Thailand, Indonesia, Malaysia, the Republic of Korea, and Singapore, indicated that internationally, India is still widely viewed as a difficult market. The reasons given were not surprising - bureaucratic delays, lack of adequate levels of protection for intellectual property rights, restrictions on the repatriation of profits, lack of basic infrastructure, high costs of joint ventures, high corporate taxes, difficulty of negotiations, widespread corruption and difficulties in retrenchments under current labour laws (see Figure 8.1).

Figure 8.1

[84]See Chapter 10

Summary of International Business Perceptions of India

Negative perceptions	Positive perceptions
• bureaucratic delays • financial uncertainties • lack of Intellectual Property Rights (IPR) protection • regional conflicts/tensions and natural disasters • problem with 'exit policy' for 'sick' industries • labour union militancy • widespread corruption • poor manufacturing quality and labour discipline • unprofessional business style and practices • continuing market dominance of the public sector • constantly changing laws and regulations • high import duties and taxes • poor quality infrastructure	• low cost and plentiful skilled labour • a burgeoning middle class • relatively low cost workforce • widespread use of English • a strong British-based legal and accounting system • strong ethnic links with Indian communities, including NRIs • provision for ownership of property by foreigners • an established tradition of entrepreneurship and investor culture • no corporate tax for businesses which export significant volumes of their products • a developed banking system and established stock exchanges • Government commitment to continued economic liberalisation

Our competitors, while negative about many aspects of doing business in India, were clear sighted about India's strengths. They recognised that India has a burgeoning middle class; low cost, plentiful, and readily available skilled manpower; a strong legal system; widespread use of the English language; and strong ethnic links to Indian communities abroad. They also showed that they were well aware of the new commercial opportunities presented by its economic reforms.

While Australia's competitors do not consider India to be an easy place to do business, they are of the view that radical changes are under way, and that reforms are gaining momentum. A few are still suspicious of the reform process and of the prospects for foreign investment, but are cautiously optimistic about the medium to long term nonetheless. For example, the business sectors in Korea and Japan continue to take a cautious approach to the Indian market. In some respects they seem to be playing a game of wait and see with respect to foreign investment in India. The Japanese business sector, in particular, is watching American activity in India, especially the recent increase in investment by American companies, with keen interest.

Many observers have wondered about a perceived lack of foreign investment by Japanese interests in India, relative to other major industrial players such as the United States and Germany. Some, including Government of India officials, attribute the

relatively slow pace of Japanese corporate activity in India to timing. India's reform program concided with a downturn in the Japanese economy and consequent cautious behaviour by Japanese firms and banks. Others point to Japanese concern over perceived infrastructural weaknesses and conflicts in management style. Nevertheless, it is worth noting that one of the most successful joint ventures in India is the Maruti Suzuki automobile company, a former public sector company which was privatised and has attracted equity from Suzuki of Japan.

Case Study: Maruti Suzuki Joint Venture

Japan's Suzuki Motors has maintained a major investment in the Indian automobile industry, in partnership with Maruti Udyog, since 1982. In the wake of economic reforms, Suzuki demonstrated its confidence in the Indian economy by increasing its equity share from 40 per cent to 51 per cent, and by retaining its Indian Managing Director. The New Delhi-based company enjoys the highest value-added productivity of any manufacturing operation in India, as well as high levels of local content. By the early 1990s, sales exceeded US$600 million. In 1994, 157,000 units will be produced, and the five 'Maruti Suzuki' models have around 70 per cent of market share. A proportion of production is exported to EU markets. In 1994, Suzuki will terminate its 800cc automobile production in Japan and begin marketing its small Indian-produced Zen car model as the Alto in EU countries. The company's Indian component manufacturers have been stimulated to collaborate for new technology, including from Australian seat belt manufacturer, Autoliv.

Suzuki encountered some difficulties in introducing Japanese management styles to its Indian operation. Problems included lack of punctuality, different concepts of quality control, and the sharp distinction between management and workers. Training of Indian employees in Japan helped overcome some of these difficulties.

Strategies Adopted By Australia's Competitors

Many of Australia's competitors view India as a market with vast potential and have therefore taken steps to alleviate some of the difficulties experienced in order to make business dealings function better. A range of strategies have been adopted.

India is increasingly looking to ASEAN countries for broader economic and political linkages. Chief among these new partners is Singapore, a country which complements India's emerging economic strengths with a capital-intensive, labour scarce economy which plays the role of a regional financial and entrepôt centre.

Singapore's officially sponsored trade ties with India began in 1985, with a government mission headed by the Trade Development Board (TDB). As a consequence, over the following three to four years the Singapore Government established two trade promotion offices in India, in Bombay and New Delhi. From 1985 to 1990, trade fluctuated due to political unrest and disruptions to economic reforms begun by Rajiv Gandhi's Government. However, with the implementation of the Rao Government's

reform process, the relationship began to stabilise. Through the signals from Singapore's TDB, the perceptions of Singapore's private sector of India have changed and business interest in India is growing. Singapore has recently announced the opening of another TDB office in Madras to tap new opportunities in India's south. In addition, the TDB signed an agreement allowing for the exchange of trade and investment information between itself and Indian public and private organisations.

Another approach has been to utilise trade displays or trade fairs. In this regard, displays on specific trade themes have been particularly effective. For example, the Belgian Government mounted a series of displays on pharmaceuticals, which moved from towns to cities around India over a period of weeks targeting and attracting local businesses in and around new locations. An advantage of this approach was to help promote a better understanding of the country itself, and the capacity for its export industries to produce high value-added products.[85] Australia, through Austrade, already promotes such specialised trade displays. Australia was 'partner country' at the Indian Mining Exhibition in Calcutta in 1992.

One approach to achieve market penetration for small to medium-size businesses has been the use of 'piggy-backing' on bigger firms that have established connections in India. Large firms might be offered specific incentives, such as support in tendering for contracts, in exchange for recommending and promoting smaller companies, as appropriate. For example, Belgian dredging companies have used their capacity to open up opportunities for industries in related fields such as shipbuilding, port handling equipment, and even computerisation and communications equipment in South and South-East Asia.

Countries have also signed a range of cooperation agreements to facilitate their business dealings and investment opportunities. For example, the European Union signed a new cooperation agreement with India in December 1993, seeking to enhance and develop trade and investment. The European Union consists of countries with whom India has long-standing and friendly relations. The scope of this agreement includes cooperation in some industrial sectors, including energy and telecommunications. It is envisaged that the process of economic reforms in India will increase the scope for such commercial and economic exchanges.

[85] This is opposed to labour-intensive goods where most of our competitors and Australia are at a disadvantage.

THE SINGAPORE CONNECTION

- Singapore's Prime Minister Goh Chok Tong led a major delegation of senior business executives to India in January 1994 when he was guest of honour during India's Republic Day ceremonies;
- High level political visits have gradually advanced a six member consortium of Singaporean companies which is establishing a 23 hectare Information Technology Industrial Park in the southern Indian city of Bangalore. The US$150 million project involves government-backed Singaporean firms holding a 40 per cent share;
- The India Business Interaction Group has been formed in Singapore and comprises member firms of the Singapore Manufacturers Association, the Confederation of Indian Industry and other industry groups;
- An economic cooperation project near Madras in the southern State of Tamil Nadu, known as the 'Madras Industrial Corridor', is planned but progress in establishing the 323 hectare industrial park has been slow;
- Trade between the two countries is growing rapidly, rising from US$1.5 billion in 1992 to over US$1.8 billion in 1993, and is largely petroleum products, high technology products and jewellery. Services trade includes computer software and project management;
- Singapore is ASEAN's largest foreign investor in India and is a leading commercial partner in terms of numbers of projects;
- An increasing number of Indian corporations and public sector organisations, including some from the State level, are establishing offices in Singapore;
- There are at least 100,000 persons of Indian origin living in Singapore with ancestral roots primarily in southern India;
- Singapore is actively promoting its experience and expertise in information networks, financial trading and tendering processes, project management, worker training, real estate and property development and the establishment of physical infrastructure attractive to multinational business;
- The Singapore Trade Development Board is organising participation in selected trade fairs and missions.

Negotiation of Investment Promotion and Protection Agreements (IPPAs) has been a focus of bilateral trade policy for a number of countries. Britain has successfully

negotiated an IPPA with India, signed during Prime Minister Rao's visit in March 1994. This was the first such agreement to be signed by India. Germany is currently negotiating an IPPA, and Japan, Singapore and the United States are also looking to enter into negotiations. The Indian Government has agreed in principle to negotiate an IPPA with Australia.[86]

Some countries have also established partnership initiatives, designed to better inform businesses of the new reality in India. These have been given a high profile through Prime Ministerial or Ministerial visits. The Indo-British Partnership Initiative established recently is a good example. This Initiative arose out of Britain's Prime Minister Major's visit to India in early 1993. It is managed by a core group of prominent CEOs. The main elements of the Initiative have been the promotion and establishment of trade and investment strategies such as the initiation of sector steering groups to identify and report on priority sectors for the United Kingdom, a 'British week' in Bombay and a series of high-level trade missions to India. While the focus in its first year was on large companies, in its second year the emphasis will shift to small and medium-sized enterprises. The publication of a booklet on *How To Do Business In India*, endorsed by both Prime Ministers, has also resulted from this Initiative.

International Capital Flows and Foreign Investment

Not only have business perceptions changed, but international capital flows and foreign investment have increased vastly since the launch of India's economic reforms in 1991 (see Table 8.1).

Typically in this stage of economic growth, investment is greater than national savings. The amount by which investment exceeds savings is the 'savings gap', and is equal to the current account deficit. Current account deficits are financed by drawing on global savings. Foreign capital inflows may take the form of foreign direct investment (FDI), portfolio investment, loans and aid. However, the relative attractiveness of investment in individual countries is influenced by macroeconomic and political stability, physical infrastructure, labour skills and wages, local support industries, level of government controls, and availability of information on investment opportunities. For example, almost all ASEAN countries and NIEs in Asia have assigned a prominent role to the private sector; liberally opened fields of investments to foreign and domestic companies; lowered, simplified, and removed tariffs and surcharges; relaxed and deregulated the capacity licensing system; relaxed foreign investment regulations; and introduced liberal foreign exchange policies. These policies have proved to be very successful in attracting foreign investment.

In the past, India's overriding trade policy objective was to develop domestic industries by following a policy of import substitution and self sufficiency. This policy and the imbalances in macroeconomic measures in the late 1980s and early

[86]See Chapter 9.

Table 8.1
Post-reform: Increases in Foreign Equity, August 1991-September 1993

Indian Company	**Foreign Partner**	**Sales** (US$Million)	**Former Foreign Equity** (per cent)	**Current Foreign Equity** (per cent)
Maruti Udyog, New Delhi	Suzuki Motor, Japan	693	40	50
Lipton India, Bombay	Unilon, Switzerland	220.9	40	51
Glaxo India, Bombay	Glaxo Group, United Kingdom	177.6	40	51
Colgate Palmolive, Bombay	Colgate Palmolive, United States	159.6	40	51
Castrol India, Bombay	Castrol, United Kingdom	90.8	40	51
Kinetic Honda India, Pune	Honda, Japan	53.1	28.6	50.9
Cadbury India, Bombay	Cadbury Schweppes United Kingdom	50.8	40	51
Procter & Gamble, Bombay	Procter & Gamble. United States	47.1	51	65
E.Merck (India), Bombay	E.Merck, Germany	38.6	40	51
Digital Equipment, Bangalore	Digital Equipment, Netherlands	35.8	40	51
Indian Sewing Machines, Delhi	Singer, Canada	21.1	40	51
Indian Shaving Products, Delhi	Gillette, United States	16.6	40	51
Stovec Industries, Bombay	Stork Screens, Netherlands	10.8	40	51
Rexroth Industries, Bombay	Rexroth, Germany	9.7	35	51
Indag Rubber, Delhi	Bandag, United States	8.6	26	66
Birla 3M, Bangalore	3M, United States	4.4	40	65
Assam Carbon Products, Assam	Morgan Crucible, United Kingdom	2.9	30.3	51
AKG Acoustics India, Delhi	AKG Akustische, Austria	1.8	39	55
Pepsi Foods, Chandigarh	Pepsico, United States	6.8	44.4	91.4

Source: Asiaweek, 2 February 1994.

1990s contributed to India's large current account deficit, which led to capital flight and a virtual cessation of foreign lending. This critical situation persuaded the Indian Government to revise its policy approach to one that is more outward looking, with economic integration into the world economy as the goal. The major aim is one of stimulating export-led economic growth by increasing the role of international trade in the economy.

Foreign Direct Investment

India in the past has not drawn significantly on foreign direct investment compared to most other Asian economies (Table 8.2). Up to mid-1991, permission for FDI into India tended to be contingent on technology transfers. Thus inward flow of FDI was permitted, normally up to a maximum equity participation limit of 40 per cent, in industries that required sophisticated technology, in those with critical production gaps, or industries that could expand their exports. FDI policy was relatively more liberal in Export Processing Zones (EPZs) and for Export Oriented Industrial Units (EOIUs), where permission for up to 100 per cent foreign equity participation could be granted.[87]

The introduction of economic reforms saw policy towards foreign investment liberalised in 1991 to permit automatic approval for foreign investment meeting certain criteria. In July 1991, a new industrial policy liberalised FDI, foreign technology agreements and compulsory industrial licensing. With respect to FDI, the requirement that inflows be accompanied by technology transfers was abolished, and the approval process was streamlined and liberalised. The authorities now view inflows of FDI as an important element in the restructuring of the Indian economy and its integration into the global trading network.

Table 8.2
Foreign Direct Investment Inflows in Selected Asian Countries
(per cent of gross domestic capital formation)

Country	**Average per year 1985-87**	**Country**	**Average per year 1985-87**
Singapore	25.5	Thailand	2.7
Hong Kong	15.2	China	2.2
Indonesia	14.4	Sri Lanka	2.1
Papua New Guinea	12.8	Pakistan	1.4
Malaysia	8.7	Republic of Korea	1.4
Philippines	3.9	Bangladesh	0.4
Taiwan	3.3	India	0.2
Fiji	3.1	Nepal	0.2

Source: GATT Secretariat, *Trade Policy Review Mechanism: India,* 1993.

[87]See further discussion of EPZs and EOIUs in Chapter 12

The new FDI procedures stipulate that industries in 34 sectors are eligible for automatic foreign investment approval by the Reserve Bank, up to an equity participation limit of 51 per cent and subject to foreign equity exceeding the foreign exchange required for the importation of capital goods. Applications for FDI inflows that do not fall within the automatic approval criteria under the Reserve Bank but are within the general ambit of government policy are considered by the Secretariat for Industrial Approvals (SIA) within the Ministry of Industry. Proposals for inflows of FDI that have special features and do not fall within the Government general policy framework are considered by the Foreign Investment Promotions Board (FIPB). The FIPB was set up in 1991 and operates from the Office of the Prime Minister.

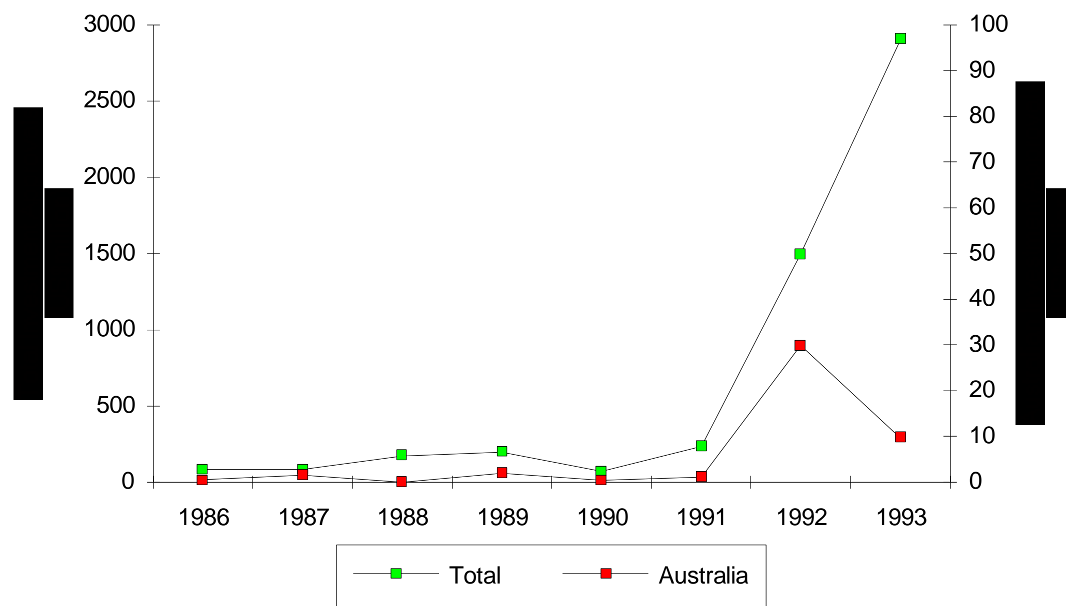
> ***'I would like to reassure you that the reform process initiated over the years is almost as irreversible as time. It can only move forward. Our plan of action on the policy front detailed in the Eighth Plan Document should remove any residual fears that you may have on the reversibility of economic reforms...I would like to assure you that your investment in India is as safe as anywhere in the world. India has already signed the Multilateral Investment Guarantee Agency Protocol (MIGA).'***
>
> -Pranab Mukherjee, Minister of Commerce, Hong Kong, 10 January 1994

Table 8.3
Foreign Direct Investment Approvals by Year and by Approving Authority

	1990	**1991**	**1992**
Total foreign collaboration approvals:	666	950	1,520
Secretariat for Industrial Approvals	666	760	585
Reserve Bank of India	n.a.	188	736
Foreign Investment Promotions Board	n.a.	2	199
Total approvals involving foreign investment:	194	289	692
Secretariat for Industrial Approvals	194	246	243
Reserve Bank of India	n.a.	41	251
Foreign Investment Promotions Board	n.a.	2	198

Source: GATT Secretariat, *op cit*.

Figure 8.2
Foreign Direct Investment Approvals



Source: Centre for Monitoring the Indian Economy, *op cit.*

Since the announcement of the liberalised foreign investment policy, a large number of foreign collaboration proposals have been approved. Total approvals have increased from 666 in 1990 to 950 in 1991 and 1,520 in 1992 (Table 8.3). The total value of FDI inflows approved has risen from an average of some US$120 million a year in the period 1985-88 to about US$1.5 billion in 1992.[88] International investors are responding positively to recent reforms with approvals estimated as US$2.9 billion in 1993 (see Figure 8.2). The largest source of FDI approvals has been the United States. In 1993, investment approvals from some Middle East countries (particularly Oman and the United Arab Emirates) rose substantially. In recent years, Switzerland and the United Kingdom have also shown strong interest. Recent foreign investment and collaboration proposals and approvals have covered a wide range of India's manufacturing industries such as oil refining, chemicals, electrical equipment, and food processing.

The Role of Non-Resident Indians (NRIs)

An NRI is defined as an Indian citizen who stays abroad for employment or business outside India or intends to stay abroad for an uncertain duration. Non-residents of Indian origin who are foreign citizens are treated on a par with non-residents who are Indian citizens.[89] NRIs play important economic roles in the rest of Asia, North America and parts of Europe disproportionate to their numbers.

Government of India Incentives

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[88] GATT Secretariat, *Trade Policy Review Mechanism: India,* 1993.

[89] Reserve Bank of India, *Facilities for Non-Resident Indians*, June 1992.

In recognition of the potential mutual benefits represented by such an economically successful overseas community, the Government of India began a process of engagement with NRIs in the late 1970s. India continues to seek financial remittances from overseas Indians as one element in a strategy to maintain liquidity in the current account. In the 1970s the first target market was the Indian manual labourers in the Middle East who were remitting millions of dollars home to their families, transforming lives in cities and rural villages. India is also interested in tapping into sympathetic resources abroad for technological, scientific, managerial and other skills. Furthermore, attempts have been made to mobilise the political influence of NRIs in favour of India in foreign political and business capitals.

The chief mechanism for funnelling remittances from abroad has been a preferential scheme for high interest deposits in both foreign exchange and convertible rupees. In the 1970s and 1980s NRIs were offered double-digit interest rates and the right to repatriate funds from India tax free. Funds from NRI remittances helped India to absorb the oil shocks of the 1970s and early 1980s and restore liquidity in the wake of the July 1991 balance-of-payments crisis. By the end of 1991, the Indian balance of payments was supported by NRI deposits valued at over US$10 billion, including over US$5 billion in dollar deposits. By December 1992, this level had fallen to US$8 billion but has subsequently stabilised and risen.[90] In parallel with deposits activity, NRI foreign investment approvals rose sharply between 1991 and 1992 from only US$8.5 million to US$ 170 million.[91]

The combination of patriotism and self-interest which motivates NRIs is potentially a more powerful determinant of India's balance of payments than the drier judgments of other foreign investors and bankers. The World Bank contends that the higher interest yielding deposits utilised by NRIs are more costly, volatile and less predictable than other instruments such as bonds. On the other hand, the unwillingness of creditors to roll over short-term loans or advance medium-term loans was a major factor in the 1991 crisis when most NRI funds remained in place.[92] In addition, the factoring of NRI deposits by commercial banks has given foreign banks an added incentive to lend to Indian borrowers.

With an eye to retaining and expanding NRI interest in India, the Government of India's more recent economic reforms include the relaxation of the ceiling on NRI holdings of Indian companies acquired by secondary market dealings. An amnesty scheme was also announced in an effort to repatriate black money without penalty as long as the funds became non-repatriable once back in India. The source of funds, purpose and nature of remittance are not subject to scrutiny under exchange control regulations.

In addition, the Indian Development Bonds Scheme is designed to attract NRIs with offshore holdings. The high interest bonds have a five-year maturity period and are denominated in US dollars and pounds sterling. They are freely transferable among

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[90] Economist Intelligence Unit (EIU), *Country Profile*, 1992-93.

[91]Ministry of Industry data published in Government of India, *Doing Business with India*, 1993.

[92] EIU, *Country Report No 1*, 1992.

NRIs, Indian overseas corporate bodies (owned predominantly - normally at least 60 per cent - by NRIs) and Indian residents (as gifts). Free from income, wealth and gift taxes in India, the bonds attracted US$1.37 billion in the first 13 months of operation.[93]

The Indian Government has decided to appoint a Chief Commissioner of NRIs with a view to mobilising their capital. In the private sector, exclusive residential communities are being built to house NRIs near New Delhi and Bombay. Another private investment channel is the Bombay Fund, an open-ended fund of US$50 million set up in the Gulf countries for NRIs interested in the Indian stock market.

India's new economic reform framework provides special incentives to NRIs and overseas corporate bodies. These incentives include scope to invest up to 100 per cent equity on a repatriable basis in high priority industries, tourism, oil exploration and hospitals. NRIs are also permitted to make direct stock exchange investments on a repatriable basis in new issues of both new and existing manufacturing companies up to 40 per cent of the issues and up to 100 per cent in a wide range of construction and real estate activities, including residential, commercial, infrastructure and building materials.

In January 1993, the Reserve Bank of India announced guidelines for granting licenses to new private sector banks. Foreign participation in new banks has been permitted up to 20 per cent for foreign companies, including banks, and up to 40 per cent for NRIs. This move makes the investment rules for NRIs in banking on a par with rules for NRIs entering industry. By 1994, the overseas Sindhi community was investing in the first private bank in India known as Bank IndoSind while Gujaratis, led by the wealthy Ambani family, were considering a second private bank which would specialise in financing the diamond trade.

The NRI community has been responding to these further business inducements, despite the reform-oriented 'levelling of the playing field' which, for instance, now gives foreign mutual funds a 30 per cent tax advantage over NRI deposits.

There have been moderately positive NRI transfers in the wake of economic reform measures. American companies have been the largest foreign investors in India since the beginning of the economic reform program. Top executives of the Indian subsidiaries of Du Pont, Hewlett-Packard and PepsiCo have all at one time worked for their parent multinational firms in the United States as NRIs. The billionaire Hinduja family, operating from offices in the United States, Europe and the Gulf, plans major investments in telecommunications, transportation, power generation and petroleum over the next three to five years.

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[93]Kapila, U., *Indian Economy Since Independence*, New Delhi, 1993.

PART III

OPPORTUNITIES FOR AUSTRALIA

CHAPTER NINE

AUSTRALIA-INDIA: TRADE, AID AND INVESTMENT

The Australia-India Trade Relationship

The Indian Government's economic reforms have led to substantial growth in trade. In 1991/92, India's exports grew by 24 per cent over the previous year, while imports grew by 28 per cent over the same period.[94] Australia's trade with India has also benefited from the liberalisation process. In 1992/93, India was Australia's 19th largest trading partner, up from 24th in 1989/90, and two-way trade totalled A$1.33 billion, an increase of 14.6 per cent over the previous year.[95] With the Indian Government committed to phasing back tariffs over the next five years, this growth is set to continue.

Australia's trade linkages with India first developed late last century with the importation of camels to serve in the outback. Coal was one of the earliest Australian exports to India. Indian labour was recruited to work in the cane fields and fruit plantations of Queensland. Most went on to Fiji, although some remained, and the thriving Sikh community in Woolgoolga is a direct legacy of those days.

As shipping services between Australia and Europe, with stopovers on the subcontinent, became more frequent in the 1920s, the potential for trade became more apparent. Tentative commercial dealings were formed in jute products, dried fruits, raw cotton and handicrafts. In the early 1930, a trade delegation visited India, but found that prospects for trade were bleak.

The 1950s saw a more substantial commercial interest in India, although trade continued to be restricted to traditional goods - imports from India centering on handicrafts, Australian exports on foodstuffs. The next three decades saw steady growth in bilateral trade, but no dramatic development in trade flows in either direction. As a result of India's new found self-sufficiency due to the Green Revolution, Australia's exports shifted from primary products to bulk commodities, mainly coking coal. There was also a slight increase in imports from India (garments, jewellery, footwear and spices), due to the popularisation of Indian culture during the 1960s.

During this period, no serious effort was made by either party to develop new or exploit existing complementarities, and trade tended to rely on natural flows rather than on government encouragement. In a relative sense, Australia's exports to India peaked in 1967/68, accounting for 2.15 per cent of our total exports. By 1989/90 they had fallen to 1.25 per cent. Similarly, imports from India peaked in 1963/64 at 1.4 per

[94] Department of Foreign Affairs and Trade, *Country Economic Brief, India*, November 1993, p. 24 - 25

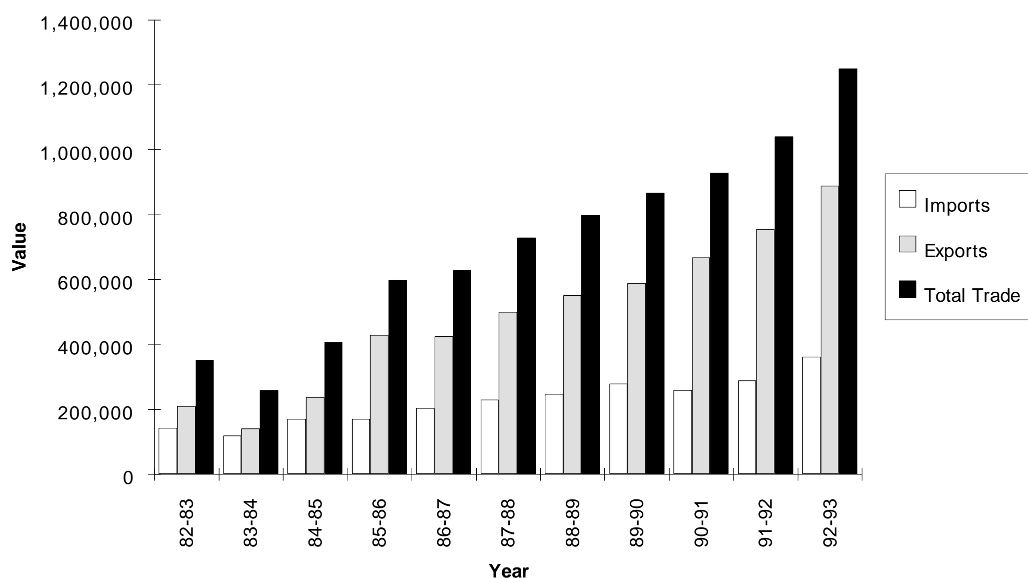
[95] Data obtained from Department of Foreign Affairs and Trade, Canberra.

cent of total Australian imports and fell to 0.5 per cent by 1989/90. Since then there has been a slight resurgence in trade, with India in 1992/93 accounting for 1.5 per cent of our total exports, and 0.6 per cent of our total imports.[96]

Large infrastructure and development projects, such as dams and steel plants, began to come on stream in the 1970s. These projects, designed to carry the country through its industrialisation, pushed India to increase its imports of coal, and were the main reason for growth in bilateral trade during the 1970s. Since then, India has been an expanding market and by 1988, Australia/India trade totalled A$618 million. The trade surplus was firmly in Australia's favour.

Since 1990, the twin trends of expanding trade and a growing balance in Australia's favour have continued. In 1993, India was Australia's 15th largest export market, but only our 25th largest import source. By 1993, Australian exports to India were worth A$920 million, while imports from India were worth A$407 million, with a resultant trade surplus of A$513 million in Australia's favour. However, between 1992 and 1993, Australian merchandise exports to India grew by 10 per cent, in contrast to imports from India which rose by 26 per cent, suggesting that the trade imbalance may have peaked.

Figure 9.1
Value of Australia's Trade With India
(A$'000)



Source: Department of Foreign Affairs and Trade, *Composition of Trade, Australia 1992-93*

Major Australian exports were coking coal (48 per cent of total exports), wool (10 per cent), specialised machinery (3 per cent), and non-ferrous metals and ores (3 per cent). Between 1991 and 1993, the value of coal exported to India rose from A$2.7 million to A$439.7 million, while the export value of wool and animal hair increased from A$65 million to A$89 million. Manufactured exports have risen dramatically, albeit

[96] Data obtained from Department of Foreign Affairs and Trade, Canberra

from a very low base, over the last five years. Exports of civil engineering equipment rose from A$43,000 in 1991 to A$14.3 million in 1993, while exports of other machinery and transport equipment increased from A$5.1 million to A$21.7 million over the same period.[97] There are also strong indirect linkages, such as in the diamond trade, with significant quantities of Australian industrial and small diamonds being processed in India. Argyle Diamonds operates an office in Bombay to oversee the cutting and polishing of small diamonds mined in Western Australia prior to onward processing.

The growth in exports of coking coal and wool will be assisted by the successful conclusion of a longstanding negotiation between India and Australia in the GATT context. The essence of the agreement, announced in April 1994, involves India agreeing to reduce the effective tariff on coke from 85 per cent to 25 per cent, and its tariff on raw fine wool from 40 per cent to 25 per cent.[98] Tariff cuts announced in the 1994/95 Indian budget included reductions in the effective tariff on steaming coal from 85 to 35 per cent, as well as reductions in the customs duty for wool and coke. The duty for wool fell to 25 per cent in line with the agreement, while the concessional rate of 25 per cent customs duty on coke has been extended to all industries. The effective tariff on coking coal (with an ash content less than 12 per cent) remains at 5 per cent. These changes open up new opportunities for Australian suppliers, especially for steaming coal.

From India's perspective, Australia is the ninth largest source of imports.

Table 9.1
Australia's Trade With India
(Top five principal exports, A$ million)

	1991	**1992**	**1993**
Coal	2.7	394.1	439.7
Wool & Animal Hair	65.2	89.0	89.0
Vegetables	21.2	17.3	27.3
Metal Ores and Scrap	21.7	29.0	26.9
Copper	1.2	12.3	24.9

Source: Department of Foreign Affairs and Trade

Imports from India have also continued to rise since the mid-1980s and Australia is currently India's 19th largest export market. Textile, clothing and footwear (TCF) products remain prominent, accounting for a third of Australia's imports from India. However, new areas of trade, such as travel and sporting goods, iron and steel products, machinery and transport equipment, have also emerged. Overall, imports from India have tended to be more diverse than Australian exports. In 1993, the

[97] Data obtained from Department of Foreign Affairs and Trade, Canberra.
[98] The change relates to removal of a phosphorus restriction which had resulted in a higher tariff discriminating against Australian metallurgical coke.

composition of imports from India also included fruit and nuts (6 per cent), pearls and gems (6 per cent) and chemicals. A range of machinery and manufactured products, particularly automotive parts, was also imported. For instance, imports of general industrial machinery increased from A$5 million to A$7 million between 1990 and 1993.

Table 9.2
Australia's Trade With India
(Top five principal imports, A$ million)

	1991	**1992**	**1993**
Textile yarns and fabrics	53.9	85.8	99.7
Clothing	30.2	42.9	52.9
Pearls and Precious Stones	22.7	19.4	23.8
Fruit and Nuts	18.1	15.8	23.0
Travel Goods and Handbags	9.8	12.3	14.8

Source: Department of Foreign Affairs and Trade.

India's recent entry into the global market presents attractive new opportunities for Australian exporters, not only for an expanding range of permissible raw material imports, but also in the field of sophisticated manufactures and a range of services, particularly related to infrastructure development. As programmed liberalisation is implemented in coming years, access to the enormous consumer goods market will also inevitably increase. The deregulation of foreign exchange regulations is of direct benefit to service suppliers, particularly the education and tourism sectors. Of less tangible but equally important value is a slow but perceptible shift in official Indian attitudes to acquisition of foreign technical expertise. India has been long content to receive only what donor countries were prepared to give by way of development assistance projects, but now there are signs that India is beginning to enter the global consultancy market as a paying customer.

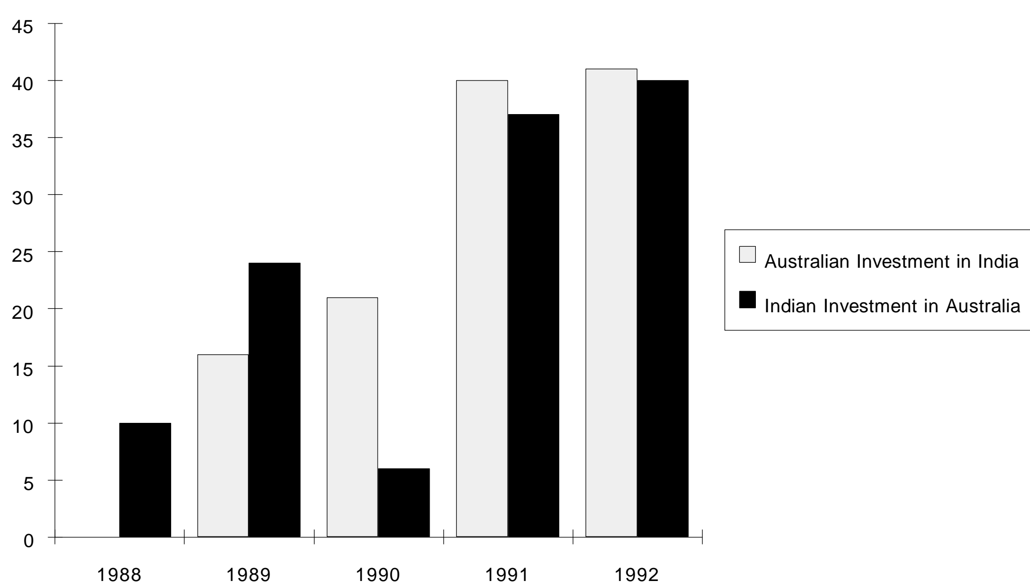
Australian industry groups have been active in India to tap some of these project-related opportunities. Through major industry groups, such as Austmine, Agritec and Austenergy, smaller companies benefit from participation in consortia with larger organisations.

Australian Investment in India

The balance-of-payments crisis in mid-1991 led the Indian Government to initiate a radical liberalisation policy, aimed at attracting foreign investors by simplifying the rules and procedures associated with foreign investment. These substantial measures resulted in an increase in foreign investment approvals, although actual capital inflows remained low.

During the 1980s, Australian investment in India was almost negligible. From 1981 to 1991, only about 60 collaborative arrangements were approved. In 1990, the value of Australian investment stood at A$21 million, up from A$16 million in 1989. Approximately A$7 million of this total was invested in wholesale business activities, while the bulk of the remainder was devoted to the manufacturing and financial sectors.

Figure 9.2
Australia-India Investment
(A$ million)



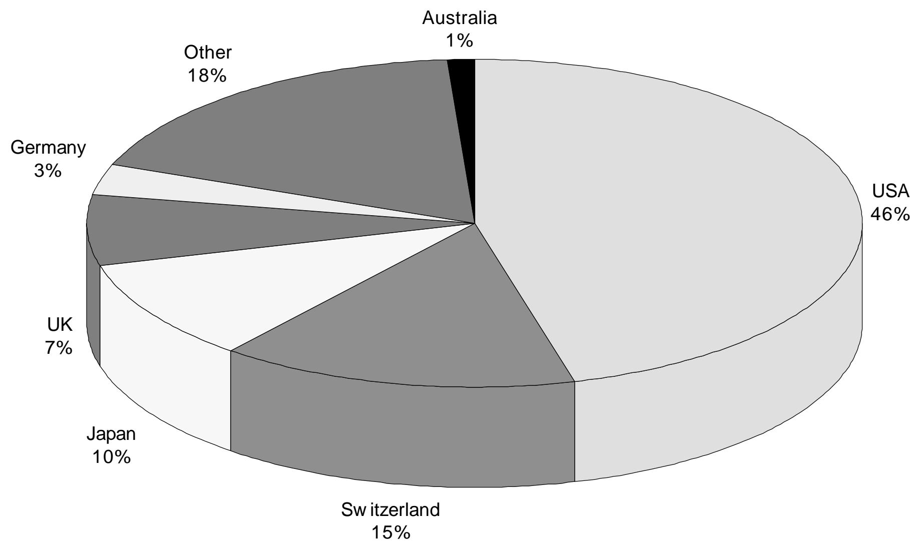
Note: Total Investment Data (FDI plus portfolio).
Source: Australian Bureau of Statistics.

Since the beginning of economic reforms in 1991, Australian business interest in India has risen. Australia has been the 10th largest source of foreign direct investment approvals in India since 1991, representing 23 projects.[99] In value terms, this amounted to flows of A$40 million in 1991 and A$41 million in 1992. When compared to overall Australian direct investment offshore of A$36 billion in 1991, however, it is evident that relative to other offshore destinations, India has been largely ignored by Australian investors.[100]

Figure 9.3

[99] Department of Foreign Affairs and Trade, *Country Economic Brief, India*, November 1993, p. 33.
[100] East Asia Analytical Unit: *Changing Tack: Australian Investment in South-East Asia*, AGPS, 1994, p. 30.

Indian Investment Approvals by Country of Origin, 1992



Source: Department of Foreign Affairs and Trade, *Country Economic Brief: India,* November 1993.

The largest Australian corporate presence in India is the ANZ Bank, resulting from its acquisition of the Grindlays International Banking network in 1984/85. ANZ Grindlays has the largest foreign branch network in India, with 56 branches. Other existing or imminent Australian investment covers banking and financial services, cellular phones, concrete products, railway parts and radio communications. Several Australian companies are set to take advantage of new mining legislation, passed through parliament in March 1994, which will permit up to 50 per cent foreign equity with provision for higher levels on a case-by-case basis. With the geographical and climatic similarities between Australia and India, Australian technologies are not only price competitive but are also suited to Indian conditions.

With the streamlining of the foreign investment application process, new industrial relations policies and the critical requirement for development of infrastructure, Australian firms have begun increasingly to target India as a potential investment destination. During 1992-93, 15 Australian organisations made significant investments in a wide range of areas, while more than 100 Australian companies are involved in developing industry links. The number of Australian business visitors to Austrade's office in New Delhi in 1992 increased by 85 per cent over the previous year.

Australia is currently in the process of negotiating an Investment Promotion and Protection Agreement (IPPA) with India. In general, IPPA's restrict the scope for expropriation, provide adequate compensation in the event of expropriation, guarantee free movement of capital and establish mechanisms for settling investment disputes. Australia has entered into a number of IPPA agreements with Asian and East European countries. An IPPA with India could help to facilitate trade and boost investor confidence.

Some Australian Firms Which Have Recently Established Joint Ventures or Consultancy Agreements in India

- Telstra, with B K Modi Group of India, is moving to secure a license to provide cellular telephone services in Calcutta.
- Southern Pacific Hotels Corporation is developing a range of three and five star hotels in India to increase their chain of hotels in the Asia-Pacific region.
- A P Morling Pty Ltd of Melbourne has been contracted by the International Airports Authority of India to upgrade the baggage handling facilities at New Delhi and Bombay airports.
- Fletcher Construction of Sydney and Seanet of Perth are undertaking a turn-key abattoir construction project in Punjab.
- OPCV, under the Agritec Australia banner, has a World Bank contract to develop an integrated animal husbandry program for Tamil Nadu.
- Ansett is leasing aircraft to India's new private airline operators.
- Kembla Coal & Coke have entered into a collaboration with Sesa Goa to provide raw material - coking coal - and coke-making technology for the Indian company's pig iron plant in Goa.
- Snowy Mountains Engineering Corporation (SMEC) has established a representative office in New Delhi.
- Warman International established a joint venture in India in 1993 for the production of slurry pumps for the mining industry.
- Rapid Roller Co Pty Ltd of Melbourne are establishing a plant in Haryana for the production of rubber rollers for the rotogravure printing industry.
- An IBM subsidiary, Lexmark International, of Australia, has obtained approval for a joint venture to produce computer printers and related hardware.
- BHP Engineering - Kinhill Engineers joint venture in India is involved in a number of projects for provision of consultancy services to environmental management and training programs in the Indian steel industry. They are also consultants for the mechanised coal handling project at Paradeep port in Orissa.
- Command Petroleum Holdings NL of Australia, in a joint venture with Videocon-Marubeni, has been awarded the contract to develop the Ravva offshore oil field.

Given India's commitment to structural readjustment and economic liberalisation, Australian investment will continue to rise. The extent to which it does will largely be determined by business awareness of India as a potential market for investment and the relative appeal of competing destinations. On present trends, Australian companies

will have to market themselves extensively and nurture networks to enable them to establish credibility and gain a larger share of the Indian market.

Indian Investment in Australia

The flow of Indian direct investment into Australia has fluctuated over the years, registering just A$6 million in 1990 and A$40 million in 1992. This figure was only slightly less than that for Australian investment in India. The two most significant investments are by Oberoi International Hotels, which jointly manages the Windsor Hotel in Melbourne, and the Tata Group, which operates a computing services unit in Australia.

During late 1993 and early 1994, a major Indian based multinational has been actively seeking investment opportunities of the order of A$70 million in Australia.

Australian Aid to India

India was second only to Papua New Guinea as a recipient of Australian aid from the end of World War II until the early 1970s. With the development of India's own capacities and Australia's increasing focus on its South-East Asian neighbours, Australian program aid declined, and following aid budget cuts in 1986, Australia's aid to India was only able to meet ongoing commitments.

In February 1989, former Prime Minister Hawke announced a new three-year aid program. Designed to assist India in meeting its development needs by promoting mutually beneficial economic linkages, the program was valued at A$35 million. It commenced in 1991/92.

The program is divided into programmable and non-programmable components. Programmable aid targets sectors that have been identified as having high developmental priority in areas for which Australia has specialist expertise and internationally competitive technology. These are:

- *Mining and Energy* - The development of India's mining and energy sector is crucial to India's continued economic growth. Australian technology can help in the development of this sector, and strengthen Indian and Australian economic and commercial linkages.

- *Telecommunications* - The Indian telecommunications environment presents opportunities for Australian technology, particularly in the areas of network design and management.

- *Railways* - Increased freight and passenger capacity by rail is essential for sustained development in the Indian economy, especially given that other sectors, such as mining and steel production, are dependent on an efficient railway network. Australian technology can assist in the development of this sector, at the same time offering significant commercial opportunities for Australian firms.

- *Food Processing* - The expanding Indian middle class is creating a significant market for high quality processed foods. This presents significant commercial opportunities for advanced Australian technology.

- *Environment* - With considerable expertise in waste management technology, environmental management and planning, Australian involvement in the sector is likely to lead to the development of commercial linkages.

The program is delivered through five mechanisms, of which project activities make up the largest share. Projects under the scheme include: transfer of coal mining technology; a demonstration of Australian coal processing technology; the training of Steel Authority of India personnel; and the development of a non-ferrous smelter complex.

Other mechanisms include:

- a Sponsored Training Program which offers awards for training in Australia. Under this program, post-graduate courses are offered with relevant industry attachments and study tours of up to 12 months duration.

- a Small Activities Scheme finances relatively small development activities and is controlled by the Australian High Commission in New Delhi. With Austrade advice, many small and medium-sized companies can piggy-back project activities through the scheme.

- a Commodities Assistance Support Program was introduced in 1993-94. Under this program the Government of India is supplied with manufactured and non-primary commodities from Australia for use either directly in developmental activities or to be resold to raise funds for other developmental activities.

- the Private Sector Linkages Program aims to promote sustainable development and economic growth by providing greater linkages between the Indian and Australian business sectors. It will facilitate joint ventures and provide short-term work placements and technology demonstration.

Expenditure under the country program in 1991/92 amounted to A$3.96 million, comprising A$2.3 million in project activities and the balance between training and the Small Activities Scheme.

The Development Import Finance Facility (DIFF) has also assisted in the financing of high priority developmental projects. By mixing AIDAB grant aid funds with concessional loans under the Export Finance and Insurance Corporation (EFIC), DIFF helps Australian companies to compete with the aid-subsidised finance packages of other foreign governments. To be eligible, Australian firms' project proposals must be in accordance with the recipient government's development plans and contribute to their economic and social objectives.

DIFF funds, totalling A$16.9 million in 1991/92, have been used to fund a number of projects including the Piparwar Project - the development of an open-cut coal mine and washery involving a total Australian contract value of A$206 million.[101]

In addition to the above, India receives Australian aid from a number of other projects, most of which relate to education and training.

The Institutional Framework

While 1994 marks the fiftieth anniversary of the establishment of official Australian representation in New Delhi, three years before India's independence, it was not until 1976, when the first Trade Agreement between Australia and India was signed, that serious efforts were made to expand the economic and trade relationship. The Agreement sets out the framework under which trade is to take place.

Despite the Agreement, it was not until the mid-1980s when the Indian Government introduced measures aimed at economic reform that the relationship became more substantial. Those measures lead to increased Ministerial contact which, in turn, was accompanied by efforts to develop a broader institutional framework for advancing the relationship.

Since 1985, a series of bilateral agreements has helped strengthen the relationship. Not all of the mechanisms listed below have worked to their full potential. A reinvigorated bilateral relationship could encourage greater benefits from these institutional arrangements.

1985: Memorandum of Understanding for Science and Technological Cooperation

The first of these was the 1985 Memorandum of Understanding for Science and Technological Cooperation. Under this agreement, the Indian Council of Agricultural Research (ICAR) and the Australian Centre for International Agricultural Research (ACIAR) meet to discuss work plans for two-year periods, with the main focus being the development of collaborative projects in agriculture and natural resource management.

1985: Senior Officials Talks

Senior Officials Talks were reactivated in 1985. The most recent talks were held in Canberra in February 1994.

1986: Joint Working Group on Coal

In 1986, the Joint Working Group on Coal was formed to further cooperation in coal mining and the uses of coal. At its last meeting in 1992, the Group defined a number of projects in the coal sector which could be pursued commercially.

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[101] See case study in Chapter 10.

1989: Joint Ministerial Commission (JMC)

The JMC was set up to review the economic relationship. The first JMC meeting was held in 1989 in Canberra, with the most recent being held in Sydney in February 1994. These meetings provide an opportunity for high level discussions on matters of importance pertaining to bilateral economic and commercial relations.

1990: Development Co-operation Agreement

Signed on 25 October 1990, the Agreement provides for both governments to cooperate in a program in support of the developmental needs of India, while promoting mutual economic links. Australia's A$35 million aid program, implemented in 1990, is directed to assisting those sectors of the Indian economy to which the Indian Government accords greatest priority, and in which Australia has expertise and comparative advantage.

1991: Joint Working Group on Power

The Group's first meeting was held in New Delhi in July 1992, at which time the Indian energy sector endorsed the importation of Australian thermal coal. The working group meets as frequently as both sides consider as necessary to discuss viable new projects.

1991: Double Taxation Agreement

By allocating taxation rights between Australia and India over all forms of income flows, this Agreement has been designed to promote trade and investment between Australia and India. Fees paid for certain technical and other services are treated as royalties. The Agreement includes tax sharing provisions, and allows for the exchange of information and consultations between the taxation authorities of the two countries.

1991 Special Arrangement (CSIR) on Science and Technology Co-operation

This arrangement governs specific fields of cooperation, as well as having administrative and financial provisions related to such cooperation. Collaborative projects have been developed in biotechnology, telecommunications and climate change.

Other Organisations

The Australia-India Joint Business Council

The Australia-India Joint Business Council meets at least once a year with its counterpart organisation, the India-Australia Business Council. Its last meeting was in Perth in April 1994. The Council aims to promote friendship, goodwill and understanding between the business communities of Australia and India and to

encourage the flow of business opportunities between the two countries. By building strong personal relationships at senior executive levels and promoting a network of private sector linkages, trade and investment flows can be enhanced, technological and economic cooperation achieved, and joint ventures established both in Australia and India as well as in third countries.

The Australia India Council

The Australia India Council was established by the Australian Government in 1992 to encourage and support contacts between Australia and India and to increase levels of knowledge and understanding between the peoples of the two countries. The Council carries out this mandate by initiating or supporting activities that promote people-to-people and institutional linkages in many areas, notably the arts, sport, youth, commerce, the media, education, and science and technology. A counterpart body on the Indian side would be helpful.

The National Centre for South Asian Studies

The National Centre is a consortium established in 1993 between seven Australian universities and the Department of Education, Employment and Training. The Centre has a wide brief to improve national education about India in schools, media, government and business circles. It does this by producting educational material, providing cross-cultural briefings for Australian firms, and arranging visits to Australia by eminent Indians.

The Australia South Asia Research Centre

The Australia South Asia Research Centre, established in April 1994, is part of the Australian National University. It engages in research on key issues of economic development associated with economic reform and liberalisation in South Asia. Major fields of interest include the reform process itself, macroeconomic policies and stable growth, financial issues, international trade and cooperation, and industrial and agricultural development.

CHAPTER TEN

AUSTRALIAN BUSINESS EXPERIENCES AND PERCEPTIONS

Anecdotal evidence often suggests that India suffers from an image problem, with inefficient or irregular business practices singled out as being the norm in the economy. On the other hand, a large number of Australian companies have been and are engaged in a wide variety of business activities with India. To test image against reality, we undertook to gauge the views of those companies on the opportunities and constraints in doing business with India. Questionnaires were sent in late 1993 to some 1,000 companies believed to have current dealings with India.[102]

The Business Survey

Most of the surveyed companies were listed under the Australia-India Council's *Directory of Australia-India Links,* with the rest gathered from other sources. An additional 200 surveys were sent to companies believed to have recently taken an interest in or become involved in the Indian market. Responses were received from 162 companies, spanning a wide range of business sectors from agriculture, mining, and manufacturing, to services, representing a response rate of 17 per cent. Of the total, 39 companies had no current dealings with India and their responses were excluded from the analysis.

While this sample cannot claim to represent the general views of Australian business toward India, the responses do provide some indication of the perceptions of Australian companies which have had first-hand experience in dealing with this market. We would expect that a similar business survey conducted in several years time could show an evolving picture of business perceptions in both countries as India's reforms continue.

Sample Characteristics

The majority of the respondents were engaged in exporting goods from Australia to India (69 companies). Around 30 companies each were either exporting services from Australia or importing goods from India. A small number of companies (10) exported goods from other countries to India.[103]

Over 40 per cent of the respondents had more than 100 employees in Australia, with another 38 per cent employing 10-100 staff. However, the majority of these companies did not employ any staff in India and this reflects the fact that the majority of respondents were involved in direct export from an Australian base. Of the 44 companies that did employ staff in India, over two thirds had less than 10 Indian staff.

[102] For a copy of the survey questionnaire see Appendix 3.
[103] A company may be engaged in more than one category of activity.

The extent of Indian ownership among these companies was low, with only 11 per cent of them being Australian-Indian partnerships, owned either by an Australian with family linkages to India or by an Indian.

Almost one third of the respondents had commenced business in India since 1991. Almost 75 per cent of the respondents reported that their business involvement with India was profitable. Among the profit-making companies, 72 per cent had achieved profitability within the relatively short period of two years.

Summary Findings

Most respondents were attracted by the size and potential of the Indian market. Despite being only cautiously optimistic about the current reforms, they were mostly positive toward the scope for further expansion in their Indian business in the next few years. This is likely to be because of the high percentage of already profitable dealings.

Perhaps not surprisingly, the existence of business links or contacts in India was an important factor in encouraging Australian firms to trade with or invest in India. These contacts helped smooth the path to entering a new market. Nevertheless, from both the survey and the case studies it is apparent that although Australia and India share a common English language and important institutional settings, many companies find it difficult to cope with local customs, regulations, and above all, the bureaucracy. Companies had to develop strategies to deal with these, including the recognition that the business negotiator needs to be positive and open-minded about 'the Indian way', and that perseverance is critical. They also believed that it was necessary to employ the services of local agents in their dealings with India. NRIs could be helpful in this regard.

Most companies had a rather poor assessment of India's business environment, especially in the areas of government regulations, bureaucratic procedures and physical and business infrastructure in the country. Nevertheless, when asked about the extent to which their dealings with India were affected by identified constraints, only excessive bureaucracy and regulation were considered to be important by over half of the respondents. Again, the extent of concern over business infrastructure might have been even higher, had a larger share of respondents been located in-market.

A tentative conclusion arising from this survey is that India does indeed have an image problem. While the stereotyped portrayal of the Indian business environment is not without foundation, Australian business ventures in India are generally profitable, and the country's stock of skilled labour and managerial staff is valued quite highly. But the overall impressions of business still tend to be negative, and the fact that two-thirds of respondents had been involved in India prior to the 1991 reforms may have conditioned this response. Old impressions die hard. In order to attract more overseas investment, India will have to do more than just improve its business environment. It will also need to put greater effort into promoting and publicising the changes that have taken place, emphasising the ushering in of a new era with an entirely different attitude to foreign business interest. This image problem must be

addressed, so that the perceived negative aspects of the Indian economy do not mask its great potential.

The survey results do not distinguish between trading companies and investing companies. Factors considered relevant or critical for investors may not be as relevant to companies engaged in direct trade only. The survey results should be interpreted with this in mind.

Detailed Survey Results

Factors affecting the decision to deal with India

The two most important factors that influenced Australian firms' decisions to do business with India were perceived Indian demand for their products and the access to a big market (Table 10.1). Around half of the respondents were also motivated by India being part of the firm's international network or by the existence of Indian business contacts.

Table 10.1
Factors Affecting the Decision to Enter the Indian Market
(percentage)

	Unimportant (1 & 2)	Neutral (3)	Important (4 & 5)
Common English language	39	26	36
Common heritage of business, legal system, and institutional settings	60	22	18
Access to large market	26	13	60
Availability of low cost labour	69	15	15
Availability of skilled labour	57	23	20
Availability of finance	77	12	11
The firm's international network	32	14	55
Existence of Indian business contacts	36	20	44
Proximity to Australia	60	24	16
Media or other promotion of India	90	8	2
Indian demand for firm's particular product	27	11	61
Preferential treatment of NRIs	93	5	2

Common use of the English language was perceived by over one third of the respondents to be an important factor. However, the common heritage of business, the legal system and institutional settings was not considered as decisive.

The availability of competitively priced labour, often considered a drawcard for developing countries attracting foreign business, was only an important factor in the decision to deal with India for 15 per cent of companies. Only 20 per cent of the

respondents considered that the presence of skilled labour had played an important role in their decision to deal with India. These responses may have been higher had the sample contained more firms locating production within the market, rather than exporting from outside India.

Although over three quarters of the respondents believed they did not lack information on other potential areas, personal or business contacts seemed to be the only significant factor affecting Australian firms' choice of business location within India (Table 10.2). Communications and transport facilities, infrastructure, skilled labour and local market potential were all considered secondary.

The respondents' choice of business location, according to this survey, was almost totally unaffected by regional promotional efforts or concessional policies.

Table 10.2
Factors Affecting Decision on Business Location within India
(percentage)

	Unimportant (1 & 2)	Neutral (3)	Important (4 & 5)
Personal or business contacts in particular region	24	11	65
Good communications and/or transport facilities	53	21	26
Availability of suitable infrastructure	47	20	33
Market research indicating size or other benefit of that local market	58	16	26
Availability of skilled labour in that area	70	15	15
The region's promotion efforts	83	13	4
Particular local/regional policies to attract business	81	9	9
Lack of information on other potential areas in India	78	14	8

Experiences in dealing with India

Firms were asked to identify constraints in dealing with India. Consistent with anecdotal evidence, excessive bureaucracy and high tariffs had seriously affected a large number of the respondents (see Table 10.3). Not far behind were the uncertainty regarding regulations and sudden changes in Government policies.

Despite anecdotal evidence of frequent complaints by Australian business with respect to the difficulties of coping with corruption in India, the survey results did not indicate that this was a major problem. Practices or payments perceived as unethical were only cited by one-quarter of the respondents as an important element affecting their business. This finding could also be a result of companies' circumspection about this issue.

Because of the predominance of trading companies within the sample and the fact that they tend to employ very few, if any, Indian staff, labour market issues were not considered important by most respondents. Similarly, repatriation of profits and intellectual property protection did not register as highly as could have been expected with a heavier sample of investors.

Table 10.3
Extent to which Dealings with India are Affected by Constraints
(percentage)

	Unimportant (1 & 2)	Neutral (3)	Important (4 & 5)
High tariffs	37	16	47
Quantitative restrictions	61	20	19
Restrictive local equity requirements	65	15	19
Restrictions on foreign investment	64	20	16
Lack of clear regulations	39	31	31
Excessive bureaucracy and regulation	20	18	63
Local customs, culture and language	61	19	20
Poor quality business infrastructure	36	35	29
Lack of market-specific information	58	24	19
Difficulty of repatriating profits	60	14	27
Availability or quality of labour	65	20	15
Absence of labour market exit policy	83	15	2
Industrial relations issues	81	14	5
Practices or payments you perceived as corrupt	48	25	27
Poor intellectual property protection	57	23	20
Political risk	54	26	20
Sudden changes in government policy	41	31	28

To attempt to understand the strengths and weaknesses of the business environment in India, respondents were asked to provide an assessment of various aspects of the Indian economy. Many firms were satisfied with its skilled labour and management competency, followed by the country's research and development capabilities and technological base.

However, most respondents again expressed misgivings about the bureaucracy, while transport, communications and other infrastructure, as well as Indian Government assistance, were not far behind.

It is worth noting that only one aspect of India's business environment, namely the quality of its skilled labour, registered a net approval rating (see Table 10.4).

Table 10.4
Indian Business Environment
(percentage)

	Not good (1 & 2)	Neutral (3)	Good (4 & 5)
Unskilled labour	41	44	15
Skilled labour	21	39	39
Transport	66	29	5
Communications	69	25	7
Technology	29	52	19
Research and development	40	38	23
Indian government assistance	68	28	5
Infrastructure	65	29	6
Accounting and business services	37	46	17
Quality of products	48	35	17
Reliability of suppliers	55	35	10
Management competence	33	38	29
Legal system and services	45	41	14
Market information	48	39	13
Quality and accessibility of the bureaucracy	74	21	5

Support Services

More than half of the respondents were aware of support services provided by Austrade, EFIC and the Department of Foreign Affairs and Trade. The utilisation rate was highest for the Export Market Development Grant (EMDG) Scheme and other Austrade services. Not many companies had used advice or assistance provided by the Indian Government.

The utilisation rate did not, however, coincide with the level of satisfaction felt by Australian companies. Only around half of those which used Austrade services, including the EMDG scheme, found them to be useful. On the other hand, while the utilisation rates for services from EFIC and the Australian High Commission in India were relatively low, both recorded higher levels of satisfaction. It is likely that services provided by Austrade would also have been part of the services registered as provided by the Australian High Commission in India. Additionally, it should be noted that Austrade underwent major reorganisation and redirection in the early 1990s, which has made a difference in the level of business satisfaction with its services. Survey responses gave no indication of when services had been used, but the fact that most respondents had been involved in the market prior to 1991 suggests that criticisms of Austrade may have already been addressed. Similarly, the many smaller companies responding to the survey may have expressed dissatisfaction with the EMDG scheme as it was prior to changes in the 1990s.

Table 10.5
Awareness and Usage of Support Services
(number of companies)

	Aware of	Have Used	Considered Useful
Austrade	74	64	35
Export Finance and Insurance Corporation (EFIC)	73	30	23
Department of Foreign Affairs and Trade in Australia	72	32	18
Export Market Development Grant Scheme	58	48	28
Other Australian Government Assistance Programs	37	6	7
Australian High Commission in India	51	31	20
Indian High Commission in Australia	46	21	7
Indian National Government Programs	44	15	6

Awareness and perceptions of India's economic reforms

Almost 80 per cent of the respondents were aware of the recent economic reforms in India. The majority of them did not find obtaining information on the reforms to be difficult. However, they were less certain about whether the reforms would bring sustained changes in India or affect their business.

Table 10.6
Perceptions of the Recent Reforms
(percentage)

	Yes	No	Not Sure
Do you believe these reforms will bring about sustainable change in India?	47	5	48
Do you believe recent reforms will affect your business?	48	10	41
Do you expect strong growth in India as a market for your product?	61	13	26
Does your company plan to expand its dealings with India in the next 5 years?	70	10	20

For example, while 47 per cent of the respondents believed that these reforms would bring about sustainable change in India, a slightly higher proportion - 48 per cent - were unsure of their sustainability. Similarly, over 40 per cent of the respondents were not sure whether the recent reforms would directly affect their business activities.

Despite these uncertainties, 61 per cent of respondents expected strong growth in India for their product, while 70 per cent were planning to expand their dealings with India in the next five years.

Case Studies

While the business survey provides quantifiable summary information on Australian companies' perceptions of the Indian market, the alternative approach of detailed case studies provides deeper insights into the particular circumstances which have confronted specific businesses in their dealings with India.k

The following seven cases were selected out of a larger pool of case studies. The experiences they describe are in various ways representative or illustrative of aspects of the Indian business environment.

The Largest Business Deal with India: White Industries

In September 1989, White Industries of Australia won a contract to build an open-cut coal mine and washery at a cost of A$500 million in the State of Bihar, India.[104] The Piparwar contract now stands as the largest business deal between Australia and India. Trade diplomacy, a competitive soft loan package, and the role of an Indian expatriate in negotiations were crucial factors in White Industries' success.

During the mid-1980s, diplomatic exchanges between Australia and India proved to be particularly important in setting the background against which the Piparwar negotiations took place. It was, however, a visit by an Indian coal industry delegation to Australia in March 1986 which provided the most important impetus.

During their visit to a number of coal mines and coal preparation plants around Australia, the Indian delegation expressed particular interest in White Industry's Ulan mines in Western NSW. Not long after, the Indian Government asked the Australian Government to become involved in developing open-cut mines in India as part of our aid program. What followed were three years of a A$3 million negotiation process (fully funded by White Industries), punctuated by regular visits to India necessitated by the complexities of bureaucracy, technology and finance.

On one occasion in 1988, the soft loan package had to be reduced from approximately A$234 million to A$206 million, requiring a downward adjustment of technology that could be sourced from Australia. These factors, coupled with the Indian counter-policy supporting 'indigenous preference in suppliers', provided the major focus of the negotiations during the three years.

The presence of the project manager at White Industries was pivotal in winning the project. He was born in Bihar, not far from Piparwar, and grew up within the surrounds of Indian mines. Before coming to Australia in 1971, he worked as a mine manager in India. He provided the company with the indispensable background knowledge necessary for all stages of the negotiations. Early marketing campaigns by White Industries preceded the official Indian Government invitation to bid. His familiarity with India's business culture also enabled him to sort out problems at other stages of the negotiations.

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[104] Vicziany, M (ed), *Australia-India, Economic Links: Past, Present and Future,* Indian Ocean Centre for Peace Studies and SARU, Curtin University of Technology, 1993, chapter by C. Paligaru, pp. 132-46.

Trade diplomacy was integral to the Piparwar negotiations. Where major projects are involved, the Indian Government has a clear preference for contract negotiations to be conducted within a government-to-government framework. Early ministerial visits by former Minister for Foreign Affairs Hayden, and former Minster for Trade Dawkins, and subsequent visits by DFAT officials, provided sustained links during negotiations. Former Prime Minister Hawke's visit to New Delhi in 1989 provided the final impetus to conclude the deal after three years of commercial negotiations.

Equally important was the competitive soft loan package provided by EFIC/AIDAB under the DIFF scheme. India is a major recipient of aid-supported export credits from countries like Germany and France which were already collaborating with India on the coal mine construction front. To win the contract, Australia and White Industries needed to make a soft loan offer that could match other countries' proposals.

It Does Not Hurt to be a Branch of a Multinational: Asea Brown Boveri (ABB)

The ABB factory in Dandenong, Victoria, is a subsidiary of one of the largest multinationals in the world - Asea Brown Boveri.[105] Over a period of five years, ABB Transportation Systems in Zurich negotiated a contract with India's Ministry of Railways to transfer locomotive technology to India and to supply locomotives the the value of A$300 million. The geographical proximity of the Dandenong factory to the Indian subcontinent, together with the factory's excellent reputation for engineering excellence, persuaded ABB's head office to give some of the work in this contract to Australia.

It is a commonly held view that the activities of multinationals in Australia hinder our export drive into Asia. The argument is that Australian branches and subsidiaries of multinationals cannot determine which markets they can access and this is often the case. The success of the ABB contract indicates that head office decisions sometimes support Australia.

As at early 1994, the Dandenong factory will produce only the locomotive bodies and bogies, install some mechanical components and transfer the associated technology. Installation of equipment and electrical systems and the finishing of the locomotives, together with supporting technology transfer, will be done by ABB in Switzerland.

ABB has built complete locomotives and a wide range of rolling stock, both for domestic and export markets in Australia, including Australia's fastest train (XPT). Detailed design work is in hand in Australia on a project for 222 electrically powered passenger carriages to be delivered by a consortium of ABB companies to the South Eastern Pennsylvania Transportation Authority in the United States in 1995. Apart from detailed structural design, the Australian work is expected to include manufacture of body shells and supply of bogie frames.

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[105] Further details in Vicziany, M, chapter in *Australia-India Economic Links: Past, Present and Future. vol. 2, Case Studies of Successful Australian Companies in India* (forthcoming).

The capabilities of the Dandenong factory suggest that much more of this type of work could be carried out in Australia. ABB's decision to do part of the India work in Australia demonstrates that international companies are prepared to place work in Australia if the experience and capacity exists. The only obstacle to winning a lot more export work appears to be a lack of appreciation of Australian expertise.

It seems that much work needs to be done to convince India that Australia is technologically sophisticated and fully able to deliver quality equal to anything being produced anywhere else in the world.

Diversified Trading and Manufacturing Links with India: a Medium-Sized Company

The company discussed in this case study was established by an Indian expatriate in 1980, initially in the restaurant business. In 1982, the restaurant closed and the firm began importing food items from India. Later on, the business was expanded to the import of ready-made Indian garments. These are sold through the company's retail outlets in Western Australia and by exporting to the eastern Australian states.

In 1985, the company entered into a second phase of expansion by manufacturing agro-industry related products. For this purpose, it established a sister concern in northern India. The head office is in Australia where production planning, design and the sale of products takes place. The manufacturing side of operations is carried out in India, largely because labour is low cost.

The firm today is a medium-sized operation with an annual turnover in excess of A$1 million. It imports a wide range of Indian products: fabricated materials, fencing and fencing equipment, and processed food products.

It also exports to India a diverse range of items including non-ferrous metal ores and old machinery which is no longer serviceable in Australia. Finally, it also has significant equity in an export clearing house in India.

To the company, the chief attraction to producing in India has been the relatively lower cost and skilled labour force. The more sophisticated aspects of the production process are organised in Australia - design, the mobilisation of resources and research and development.

The company has faced many obstacles in the Indian market. For example, it reports that the Indian Customs Department has regularly caused problems which have led the firm to sustain financial losses. The delay in loading and unloading cargo in Indian ports was also considered troublesome. Often, unethical and illegal practices resulted in further delays, causing considerable embarrassment. The company also complained that the Australian banking system did not favour small firms with limited time and resources. Lending rates were too high and financial institutions did not support R & D projects.

The company accepts these problems as part of the business environment in India. By adjusting, it has established itself as a successful and profitable concern.

Importing from India, without Difficulty: Malika

Malika has been importing garments, handicrafts and accessories from India for the last 22 years.[106] By the mid-1970s, the business had expanded to nine retail outlets. Today, except for knitwear stock which comes from China, all other Malika garments are sourced from India.

The experience of Malika differs from that of many other companies which import from India. The key to the differences lies in Malika's detailed understanding of the constraints and conditions under which trading with India occurs, and the careful management of their Indian operations.

For example, Malika maintains an Indian office which operates as a buying and liaising base. It ensures that the designs received from Australia are correctly executed and that the quality matches customer expectations. It ships the consignments by air to avoid delay. Air shipments are also less prone to pilferage, a common occurrence when importing from India. Malika employs local staff to monitor the quality of the cloth and garments produced, and therefore has a very low rejection rate. It insists that garments are wrapped in plastic to prevent damage, especially water damage during the monsoon season, thus avoiding complaints voiced frequently by other importers.

The company employs local staff to monitor the quality of the cloth which is sourced from the south of India and also the quality of the garments being produced for exports. The key to Malika's success is its physical presence in India and the company's commitment to producing quality merchandise.

The Importance of Vision and Persistence: Olex Cables

Olex Cables (a subsidiary of Pacific Dunlop) is Australia's largest cable manufacturer and a world leader with 50 years of success in the field.[107] The Olex range includes instrumentation cable, copper communication cable, optical fibre cable, copper and aluminium power cable, rubber cable, paper cable and data cable. The company's overseas expansion began with the Pacific Rim countries. It now does business with Singapore, the Philippines, Hong Kong, Malaysia, Indonesia, China, Pakistan and India.

In the mid-1980s, Olex management took a strategic decision to project the company as an engineering supplier and not merely as a cable manufacturer. A new company called Olex Optical Networks was established to change the company's image. After successfully implementing a number of turnkey projects in Australia, the company

[106] Poliness, M. *ibid.*
[107] Mathur, S. in *ibid.*

ventured further afield to secure international contracts. Olex selected India as the first market to target for two reasons:

- India has been the largest project market in the world; and

- the General Manager of Business Development within Olex is an Indian who felt that he could capitalise upon his cultural background to crack the Indian market.

The company initially bid for two telecommunications projects in India but faced tremendous problems in finding reliable equipment suppliers to form a consortium. This is because the telecommunications equipment market is dominated by a few big multinationals who patronise their own cable suppliers, and because there are no Australian equipment manufacturers. Olex decided to concentrate on communications projects in other areas such as railways and refinery pipelines.

Olex eventually bid for the telecommunications portion of the Maharashtra Gas Cracker Project and was successful in obtaining a A$10 million project. The project, which entailed connecting three oil refinery terminals to a petrochemical complex some 120 km south of Bombay, required communication and commercial administration. The equipment was sourced from Nokia Telecommunications in Finland. Optical fibre test equipment and accessories were sourced on a world scale, checked in Australia and delivered with the equipment.

The company believes that patience, good interpersonal skills and persistence are important to its success. It also helps to develop the buyer's trust and have a thorough understanding of the working of the Indian tendering system.

Olex has a very positive opinion of Indian companies. It found its counterparts to be professional and technically sound. The Indian companies, in turn, have a favourable attitude towards Olex, a company which has acquired a good name in the Indian market. Not surprisingly, the company has subsequently won other contracts in India including one for Reliance Petrochemicals and the Calcutta Metro.

Small Business: An NRI Aboriginal Joint Venture

This case study gives some insight into how small firms can, with limited resources, enter the Indian market. This small company was set up by a NRI and an Australian aboriginal. The two partners met in 1984 and started toying with the idea of manufacturing dolls with Australian aboriginal features. They thought that this would be a unique way of popularising Australian aboriginal culture: the dolls were to be given aboriginal names and the packaging was to carry examples of aboriginal folklore.

The Indian partner suggested that the components be manufactured in India where the costs of production were low. In 1991, both partners visited India for five months. They studied all aspects of doll making, and arranged for Indian producers to supply doll parts on a regular basis. The dolls are now sold through museums, exhibition stalls and mail orders. The similarities between some Indian tribal peoples and Australian aborigines have also encouraged the firm to market the dolls in India.

The firm incurs only 30 per cent of the cost of manufacture in India and the remaining 70 per cent in Australia, because the 'Made in Australia' label is more saleable than the 'Made in India' label. But the 30 per cent cost incurred in India covers almost 70 per cent of the total product components.

The business experience of this firm is probably typical of small Australian firms working in the Indian market. Their success depends on the patience and tactful handling of Indian artisans. They have also found it advantageous to use a local person or Indian partner to help overcome bureaucratic and market problems.

Networking: Establishing Transport Services

In 1993 Australian National Line (ANL) began using its Singapore base to investigate the possibility of marketing its freight shipping services in the Indian sub-continent.[108] In light of India's increased growth and new outward economic orientation, the company was interested in trans-shipping containers from Australia, through Singapore by efficient feeder lines, to destinations such as the ports of Bombay and Calcutta. ANL's main problem was the shortage of easily accessible information on the Indian market, but information on local business culture, marketing advice, and assistance with contacts was obtained from the Australia-India Business Council and from Austrade's New Delhi office. ANL discovered that a market did indeed exist for transportation of manufactured and semi-manufactured goods such as whitegoods, telecommunications or medical equipment. ANL's strategy for India rapidly turned from ambivalence to enthusiasm, even against competing opportunities such as China. Shipping services are now in place, with ANL offering five vessels that move cargo from eastern Australian ports to Singapore in 18 days and onward to Bombay in a further nine days. In addition, ANL runs shipping services to Madras and Calcutta. The company's push into India has exceeded market share projections with customers, such as the Australian retail chain, Target, shipping with ANL.

TNT Express Worldwide has had a similar experience in establishing courier services to India.[109] There were obstacles and difficulties to be surmounted, but in 1993/94 the Australian company became the first foreign express distribution company to enter the Indian market when it launched service to five Indian business centres. The joint venture company, TNT Express Worldwide India (PVT) Ltd, is 51 per cent owned by TNT, 41 per cent by the Singapore-based Reddington Pty Ltd, and 8 per cent by Premier Corporate Services, an Indian company. It has opened offices in Bombay, Delhi, Bangalore, Madras and Calcutta to provide the full range of parcel and document courier services. TNT Express Worldwide, like ANL, is extremely optimistic about India's commercial potential as economic reforms remove barriers to trade and investment. The company decided to bypass agents or local associates and use its Indian company to tap into the multi-million dollar delivery services market. India's economic liberalisation has allowed TNT to assume full managment control of the joint venture company with only one expatriate stationed in India to participate in

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[108] *Asian Business Review,* December 1993, p.16.
[109] *Australia Business Asia ,* 23 February 1994, p.4.

management, while about 310 Indian staff have been trained in Singapore and London. TNT's strategy calls for India to become the trans-shipment hub for express distribution to South Asia with warehouse support in Bombay, New Delhi and Madras to receive incoming consignments and consolidate outgoing deliveries.

Success Factors for Australian Business in India

- comprehensive market research - having a product suited to the market
- assistance from government agencies in Australia
- selecting the right local partner or representative (following rigorous assessment of accurate financial and commercial data on prospective partner/representative)
- sound professional advice on Indian Government regulatory processes and how to deal with them
- thorough assessment of regional conditions, in terms of infrastructure and political and business environment
- diplomatic support for Australian business efforts
- establishment of good relations with State and Central Governments
- structuring of business visits to ensure appropriate access and commercial outcomes
- recognising the importance of social events in business networking
- use of knowledge and connections of Australian NRIs
- corporate commitment to the market
- strategic planning.

CHAPTER ELEVEN

NEW OPPORTUNITIES

Opportunities for Trade

Opportunities for Australia will be driven by Indian industries' need for inputs to the production of goods and services. In addition, the wholesale, retail and public administration industries will need final consumption items. Investment opportunities will be driven by industries' need for capital and technology.

In identifying the scale of opportunities, we have used as a base case a scenario based on recent momentum in the Indian economy, no change in India's propensity to import and no change in Australia's market share in each industry. Growth and opportunities that exceed this base case would be dependent largely on the pace of reform and the Indian Government's capacity to address some of the remaining difficult areas of reform.

This base case scenario is built on growth in production in Indian industries over the 1990s and their propensity to import; evidence of Australia's capacity to supply what India imports; and Australia's track record in supplying the market.

Using the base-case scenario, India is likely to be importing US$49 billion (1992 dollar terms) worth of merchandise annually by the end of the 1990s. A salient feature of the base-case scenario is that unless major changes take place in the composition and volume of Australia's exports to India, Australia will lose market share in India over the next decade. While the absolute value of trade will rise and Australian annual exports to India could double, our market share will fall from about 3 per cent in 1990 to 2.3 per cent in 2000. Australian exports are concentrated in sectors where the rate of Indian import growth is likely to be relatively low, so even though it is assumed that Indian merchandise imports will grow at over 7 per cent per year, imports from Australia may grow at a slower rate. The base-case scenario however, ignores new import growth areas that break with the trend. Such new areas may favour Australia, but it is likely that Australian firms would still have to work hard to capture shares of these new growth areas in the face of considerable competition.

Export Opportunities for Australia

An examination of Indian economic growth industry by industry indicates that the apparent export opportunities for Australia to supply India's industries are in the areas of manufacturing, wholesale and retail trade, construction, electricity, gas and water, transport and communications and in the Indian government sector. Commodity opportunities for Australia lie in base metals, food, crude materials, oil and coal, edible oils, chemicals, machinery equipment, and transport and telecommunications.

Table 11.1 indicates the frequency of opportunities for Australia by industry and commodity sector. However, this does not indicate which sectors will import the most by value. Although the incidence of opportunities in the electricity, water, transport and communciations sectors is low, the opportunities may be much larger in dollar terms. The examination in table 11.1, therefore, provides some indication of areas of extensive opportunity that smaller and medium-sized firms might find informative.

Australian Shares of Indian Imports

For all imports, from all sources, the heaviest importing industry divisions in India in 1990 and 1991 were:

- chemicals, petroleum, coal, rubber and plastics products industries, accounting for about 20 per cent of total Indian imports;
- fabricated metal products, machinery and equipment industries, accounting for about 6 per cent;
- public administration, defence and community-related services, accounting for about 5 per cent;
- 'other' manufacturing industries (such as gold and jewellery fabrication, clocks, and instruments) accounting also for about 5 per cent of total Indian imports; and
- basic metal industries, accounting for about 3 per cent of total Indian imports.

Australia's share of total Indian imports is about 3 per cent, representing about $US650 million a year in 1990 and 1991. The Indian industry divisions with the heaviest imports from Australia in those two years were:

- basic metal industries, using about $US400 million of Australian imports a year, accounting for around 30 per cent of total Indian imports used by that industry division;
- textiles, wearing apparel and leather industries, using around $US55 million of Australian imports a year, accounting for around 8 per cent of total Indian imports used by that industry division;

- chemicals, petroleum, coal, rubber and plastics products industries, using around $US40 million of Australian imports a year, but accounting for only about 0.5 per cent of total Indian imports used by that industry division;

- fabricated metal products, machinery and equipment, using around $US47 million of Australian imports a year, but accounting for only about 1.6 per cent of total Indian imports used by that industry division;

- the transport and storage industry division, particularly in 1990 when $US86 million of Australian imports were used by that industry, accounting for 12 per cent of total Indian imports used by the industry division;

- the wholesale and retail trade division, particularly in 1990 when $US71 million of Australian imports were used by that industry, accounting for 7 per cent of total Indian imports used by the industry division.

Thus, Australia's share tended to be low for the heaviest importing Indian industry divisions. This is a broad indication that Australia's exports to India could be increased by lifting market share in areas of heavy imports.[110]

Looking at India's imports in terms of products, as distinct from using broad industries, India's top imports by value in 1990 (over $US300 million) were, in descending order:

- petroleum
- gems
- fertiliser
- scrap metal
- inorganic chemicals
- coal
- steel
- instruments
- copper
- textile machinery.

Indian imports from Australia (those worth over $US 20 million) were in the following products, the figures in brackets being Australia's share of total Indian imports:

- coal (84 per cent)
- ships (31 per cent)
- vegetables (21 per cent)
- wool (47 per cent)
- petroleum (1 per cent)

[110]This is provided there are no 'mismatch barriers'. 'Mismatch barriers' occur where opportunities identified at the broader sectoral level are not present in particular sub-sectors because of particular circumstances or conditions of these sub-sectors. Analysis using the base-case scenario suggests that there are few such mismatch barriers.

- lead (68 per cent)
- zinc (17 per cent)

While we can be confident of the opportunities identified in the base case, the list should not be seen as exhaustive. As the Indian economy grows, in a changing global environment, there are a number of new areas where Australia could develop an advantage, such as environmental, mining and agricultural technologies, telecommunications and education services.

Steel, Iron Ore and Coal Projections

As India is one of Australia's main competitors for iron ore exports, an analysis with respect to India's supply of iron ore and steel and demand for raw materials into the steel-making process can identify opportunities of commercial interest to Australia.

Projections undertaken for this study provide a snapshot of production, consumption and trade changes between the years 1993 and 2003.[111] For India, the results indicate a 76 per cent increase in production of flat steels to satisfy an 83 per cent increase in domestic consumption of these products. To date, flat steels have comprised most of the output of blast furnace based steel making, while electric arc furnace based steel making has produced little flat steel. Thus, the increased flat steel production in India requires commensurate increases in Indian consumption of iron ore and coking coal. These are forecast to increase by 79 and 75 per cent respectively.

The implication for Australia is that Indian imports of coking coal from Australia are projected to increase by 113 per cent. This is consistent with a smaller increase in Indian coking coal production (65 per cent) than in coking coal use (75 per cent) and an increase in Indian coking coal prices (12 per cent). In 1990, Australia was the sole supplier of coking coal to India with a significant transport cost advantage over Canadian and US competitors.

The possibility also exists that India may consider the import of thermal coal, especially in the light of the recent large reduction in import tariffs and the high priority the Indian Government places on private power development. Many private power projects are looking to import coal rather than rely on the lower quality, unreliable domestic industry. Economic liberalisation will force domestic prices to more fully reflect actual resource mining and transport costs, thereby enhancing the competitiveness of imports. There is, therefore, considerable scope for thermal coal imports by India over the longer term.

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[111]The Australian Bureau of Agricultural and Resource Economics's (ABARE) policy simulation model of world markets for steel and steel-making materials was adopted to produce projections, up to 10 years, of India's supply and demand for iron ore, steel and coking coal. The projections are based on assumed GDP growth and reductions in steel tariffs in India and rest of the world. These projections were then analysed with respect to their effects on the world market and their implications for Australia. The ABARE projections are based on tariff reductions and assumed GDP growth in India and the rest of the world. The tariff cuts were based on known offers, as of February 1994 by the United States, EU, Canada, Japan, India and Australia. They assume that real prices of inputs to coking coals mining, iron ore mining and steel production and of other inputs would remain unchanged.

Steel, Iron Ore and Coking Coal Projections:
Implications for Australia

Projections of supply and demand, and the implications for Australia, can be summarised as follows:

- Iron ore: competition from India in Australia's export markets will be moderated by the large increase in domestic demand for ore from Indian steel producers.
- Coking coal: exports from Australia to India should grow strongly given Indian input requirements and Australia's advantages as a supplier.
- Steel: there is scope for increased Australia exports of specialty steels to India and increased Australian imports from India of lower value steels for selected end uses.

Prospects for Lifting Australia's Share of the Indian Market

There are a large number of commodity classes for which Australian exports to India in the reference year, 1990, were less than US$1million. In these circumstances, there may be prospects for Australia to lift its share of the Indian market in these types of commodities. Such commodity classes include crude materials, chemicals, metal manufactures, machinery equipment and miscellaneous manufactures.

Prospects for Developing Market Share in New Import Growth Areas.

Economic reform and consequent industrialisation processes will boost demand for a range of infrastructure-related goods and services. Evidence suggests that Australia will have to work hard to convince India of its international competitiveness and world class expertise and quality in such areas.[112] Opportunities will arise in telecommunications, road, rail and power supply development, and a range of building projects. The fact that Australian investment in India is small means that many of our competitive suppliers are not locked into commercial networks in India. Austrade and other government sources of information on major projects may be crucial, in the early stages of building Australia's reputation by breaking into new fields.

Changing import barriers are likely eventually to affect consumer goods. Australian firms can expect demand for food products and a range of services such as education and tourism to provide opportunities. In the case of food products, provision in-market is likely to offer earlier opportunities than direct export from an Australian base.

[112] See case studies in Chapter 10.

The development of the agricultural and mining sectors is likely to boost demand for specialised technology and equipment as well as expert consultancy services and training. Australia is well-placed to capture some of these opportunities and already has an image in India as a world class producer of these goods and services.

Regional Concentration of Opportunities for Australia

There is great regional diversity in India. The process of economic liberalisation at the State level make it likely that Australia's comparative advantage in the telecommunications, dairy, mining, storage, handling and warehousing, construction and alcoholic and non-alcoholic beverages industries will be of considerable interest to States in India.

In terms of regional focus, by using a cluster analysis based on available infrastructure facilities, we have identified Tamil Nadu and Karnataka in the south, Gujarat and Maharashtra in the west, Haryana and Punjab in the north and West Bengal in the east as possible areas for trade and investment.[113] These areas have better basic infrastructural facilities than other States, including reasonable 'economic-supporting' factors such as the supply of educated and skilled personnel, banking facilities, telecommunication facilities, transportation and other infrastructural facilities. These seven states therefore offer good prospects for Australian firms.[114]

However, this does not mean that Australian firms will necessarily have difficulties in entering into other States where particular goods or services which Australia has the capacity to supply are in demand. As foreign investment in each State is handled case by case, not all firms may face the same degree of difficulties. Further, for certain types of investment and business, not all the particular advantages of the seven target States are essential. For example, mining industry operations do not require as many skilled employees as the telecommunications industry.

Other States may also present particular opportunities. Neither Madhya Pradesh nor Andhra Pradesh should be overlooked. Recently, the Madhya Pradesh Government has initiated steps for identification, demarcation and assessment of new mineral reserves in the State. This State, which occupies second place in India with regard to exploitation of mineral resources, has started work on exploration of limestone in Raipur, Bilaspur, Durg, Jabalpur and Satna districts with a view to setting up at least three new cement plants in these areas. Official sources claim a bauxite reserve of an estimated 36.2 million tonne has been identified in Sarguja district, while valuable mineral stones, including alexandrite and garnet, have been found in the Devbhog area of Raipur district.

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[113] Cluster analysis is a technique that assesses the characteristics of variables or objects using a combination of mathematical and statistical analyses to determine how closely they correspond to one another with the group being assessed. Cluster analysis is used extensively across both social and physical sciences to group or classify plants, medical conditions and consumer products. For a readable and often cited reference on cluster analysis, see Everitt, B., *Cluster Analysis,* Heinemann Education Books, London, 1974.

[114] Austrade has developed a 'South India Initiative' to provide an intensive business development program for the major southern growth centres of Bangalore (Karnataka) and Madras (Tamil Nadu).

Andhra Pradesh's capital city, Hyderabad, is a leading pharmaceuticals manufacturing centre and engineering base for several machine tool makers. The rest of this southern State is predominantly oriented to agro-food (including aquatic products) and resource-based industry. The State is also relatively strong in non-metallic minerals, fertilisers, chemical products, base metal alloys, glass, cement and sugar. Andhra Pradesh benefits from the operations of the port of Visakhapatnam on India's east coast where a new Export Processing Zone is located. The State Government offers a variety of attractive incentives for new industries in specific sectors such as agro-food, computer software, pollution control and non-conventional energy. Commercial opportunities exist for resources exploration and mining, food processing, environmental clean up and protection, telecommunications and transport infrastructure and educational services.

Opportunities for trade and investment for Australia at the regional level may be further divided into infrastructural and non-infrastructural categories.

Infrastructural Development

Opportunities in this category are plentiful and almost every State is keen to woo foreign investors for capital and technology. For instance, the Government of India recently approved the implementation of a light rail transit system for Hyderabad in Andhra Pradesh to be undertaken on a commercial basis. The proposal, developed by the Ministry of Urban Development, envisages the promotion of a joint stock company to undertake the construction of the rapid transit system. The project is estimated to cost around US$94 million for Phase I and would be implemented in two phases. Foreign collaboration is being actively sought. A similar plan is under way in Karnataka.

In Kerala, a sum of around US$470 million is to be invested in the modernisation and development of the telecommunications network during 1992-95, and 330,000 new phone connections will occur during that period.[115]

Orissa has approached Germany to provide technology to set up a steel plant at Kalinga. On receipt of the awaited report from Germany, work is expected to start later in 1994.

In late 1992, the Cabinet Committee on Foreign Investment (CCFI) cleared a proposal to allow two major American power utilities, Enron Corporation and General Electric Corporation, to set up a US$2.2 billion power project at Dabhol in Maharashtra. The proposed plant would be the largest capacity power project in India. This project had been shrouded in controversy following objections from the Planning Commission as it was based on imported liquefied natural gas (LNG) and thus would imply an annual drain of US$250 million in foreign exchange. Nonetheless, the CCIF scaled down the planned capacity addition to the project from 2,500 MW to 1,920 MW and approved it. This confirms that foreign investment and technology are now welcome in India, and indicates that the bureaucracy is not always slow in approving project proposals.

[115] See *The Observer of Business and Politics*, 1992.

Mining

Mining, one of the more recent sectors to be liberalised, offers excellent opportunities for Australian exports of goods and services. Much of southern India is geologically similar to Western Australia due to a common tectonic plate pre-history. In early 1994, the Government of India issued an ordinance amending national mining regulations so that foreign companies could operate in India and own controlling interests in joint ventures. The Indian Government and some large India mining firms are interested in advanced Australian technology for the mining of coal, iron ore, manganese, mineral sands and diamonds. Australian expertise and investment is also being welcomed in the recovery of gold through the re-working of alluvial deposits.

Indian mining companies recognise that Australia's longstanding experience allows its companies to operate economically at half the grades which Indian miners have needed to break even. The liberalisation of the sector comes at a time when the 1994/95 budget has significantly reduced import duties on the following minerals and metals:

- Hard coal from 85 to 35 per cent
- Coking coal (ash content 12 per cent or higher) from 85 to 25 per cent while ash content below 12 per cent remains at 5 per cent tariff
- Metal ores and concentrates from 85 to 10 per cent
- Iron ore pellets from 15 to 10 per cent
- Project goods from 35 to 25 per cent

The moderate but still significant duty reduction is consistent with India's gradual and sustainable reform approach. Further reductions are possible in future budgets.

Non-infrastructural Development

There are also several opportunities for trade and investment in non-infrastructural areas. In view of its high employment potential, value adding and foreign exchange earning capacity, the food processing sector has been declared a high priority area in the new industrial policy. Australian expertise in this area is recognised and sought after by Indian firms. The Indian Government has formulated a scheme for the development of a technical link between processors and producers, which would provide incentives to the producers and farmers. The recent contract between the Punjab Agro Corporation and Pepsi Foods falls into this category.

Haryana, Punjab and Uttar Pradesh in the north provide great potential for investment in the food processing industry. The southern States of Andhra Pradesh, Karnataka, Kerala and Tamil Nadu are also possible areas for investment in the food processing industry. Delmonte Corporation has recently entered into producer-processing contract with a group of farmers in Karnataka and Tamil Nadu to supply tomatoes and other vegetables.

With respect to alcoholic beverages, there is a large demand for beer, which has not been fully satisfied by the Indian industry. With Australian brewing expertise, this area also offers great potential.

Opportunities for Australian Services Exports

India principally records small amounts of shipment services (freight and insurance) in the national accounts and, by inference, relatively small amounts of other types of services. Due to the non-availability of data, the base-case scenario model did not refer to India's imports of individual types of services. Nevertheless, other evidence from Australia and overseas suggests that there are mounting efforts by international companies to export a number of services to India, outside the area of shipments and travel services. These include:

- sale of financial services as part of the extremely fast growing international funds flow business; as people need to access global treasury transactions, portfolio management services, and make investment decisions;

- increasing sale of telecommunications services for data, as distinct from voice services, as the means of delivery of other services such as computing, database, and other electronic information services; and

- sale of data processing services as remote computing services, in connection with global messaging networks. An example is quality control of an Indian factory being carried out in the United States, with the quality control engineers inspecting production in India on screens in America;

- sale of database services from information banks whose country of domicile is increasingly difficult to specify. Database-related company functions, such as order and accounts keyboard entry functions, are being flexibly located;

- remote provision of professional services, particularly in legal, accounting, advertising and architectural services;

- remote provision of information-related services; examples abound in library access, academic and technical research, and in vocational further and higher education; and

- insurance services, particularly with the planned opening of the Indian insurance sector to foreign participation. (GIO Australia has an office in Bombay).

Although it is not presently possible to document specific Indian imports in these fields, the pressures for rapid growth in imports of services by India are strong, despite resistance in some quarters in India to the unrestricted growth of overseas purchase of newly emerging products. International trade in services is the fastest growing aspect of world economic activity.

In shipment services, India imports freight and insurance services, which are provided by the country of the shipping (and to a minor extent airline, road transport and rail transport) companies, and the insurance companies. There are opportunities for Australia in these fields, whose growth should be in proportion to the trade they serve.

In travel services, India principally imports through its tourism and travel expenditures in Australia. Opportunities for Australia are in the growth of overseas travel by Indian residents. Indian overseas travel should grow at least as fast as imports in total. Liberalisation of foreign exchange controls is likely to lead to a rapid expansion of tourism. But the history of India's international relations, and her economic and financial ties with Europe, Africa and Russia have in the past encouraged India to look west and north.

The present scope for service export opportunities could be appreciable, and the future growth in Indian demand should vary fairly directly in proportion to the overall rate of its economic growth. In the base-case 6.3 per cent growth scenario, with goods imports growing at about 7 per cent per annum over the 1990s, services imports could grow at up to 9 per cent per annum. Australia's services exports prospects could expand by more than 9 per cent per annum given our international competitiveness in a number of these areas.

Attention must be drawn to potential opportunities for Australia in exports of telecommunications, finance, computing, and professional and information-related services to India. Education services are also a new area of opportunity for Australia, with considerable potential for expansion.

Tourism Between India and Australia

While there is little likelihood of India and Australia becoming major tourist markets for each other in the near future, the long-term tourism potential between the countries may hold more promise.

There are approximately 1.5 million to 2 million arrivals worldwide by Indians but, in relation to India's population, these travellers represent the pinnacle of the socio-economic strata. In 1992, 9,600 Indians arrived in Australia for short-term visits, 200 fewer than the 1991 figure of 9,800 arrivals. Provisional arrivals for 1993 were 9,700. Australian residents visiting India as their main destination on departure from Australia decreased in 1992 by 12.7 per cent over the 1991 figure to 18,000. This fall could be partly explained by concerns following the civil unrest in northern India in late 1992. In 1993, Australian resident departures to India rose by 22,800, a 26.6 per cent increase over 1992 departures.

The easing of foreign currency exchange controls and the introduction of full convertibility of the rupee has resulted in overseas travel becoming somewhat easier in recent times and there is likely to be an increase in Indians travelling abroad over the next few years. Despite this, there are still some limiting factors on Indian outbound traffic. Currency regulations that restrict the amount of money an Indian resident can spend on overseas travel and lack of direct air services between India and Australia are constraints to travel between the two countries.

Currently, India is not an important focus of Australian Tourist Commission (ATC) marketing activity, although the ATC constantly monitors and undertakes basic marketing activities in the Indian market.

Education Services: An Area Of Opportunity

Australia has been actively pursuing opportunities to promote trade in employment, education and training services in the Asian region. In 1986, the Australian Government decided to allow government-funded institutions to accept fee-paying overseas students, leading to a large increase in the number of overseas students studying at Australian institutions. While India is not yet a major source of international students for Australia, the ongoing economic liberalisation process marks India as a potential major market for Australian education and training services.

The number of Indian students at all levels in Australia rose from 525 students in 1990 to 744 students in 1993, of which 733 were full fee-paying students. Higher education courses accounted for 603 students, while other secondary courses, such as Advanced Certificate courses, accounted for 103 students. Over the same period the relative numbers of Indian students, as a percentage of all international students studying in Australia, rose from 0.90 per cent to 1.18 per cent. This growth is set to continue with the Australian High Commission in New Delhi advising that there had been more than 800 visa applications in the year to the end of February 1994.

Of the Indian students studying in Australia in 1993, 278 were involved in business, administration and management courses, while a further 144 were involved in engineering courses. Other courses attracting relatively large numbers of Indian students included computer science and hospitality.

The majority of these students were involved in post-graduate study. With the relaxation of the rules governing foreign exchange controls in the 1993-94 Indian budget, and moves to full convertibility of the rupee in the 1994-95 budget, undergraduate students securing admission to an overseas tertiary institution now have greater access to foreign exchange. These measures will result in a greater number of undergraduate students studying at overseas institutions than is presently the case.

Added to these budget incentives are a number of other points that make studying overseas attractive for Indian students. While some Indian universities are highly regarded, many others are unable to provide a high standard of teaching due to lack of facilities and funding. As a result, the prospects for employment are greatly enhanced for those with degrees obtained at reputable foreign institutions.

Entrance to Indian universities is highly competitive and many students are unable to find a place in their desired course or university. Over 30,000 students applied for 50 vacancies when the University of New Delhi advertised its new MBA in 1993. Added to this is the policy of reservation of university places for members of scheduled castes and tribes. Under this system, members of the higher castes can find it difficult to gain entrance to universities, with the result that many enrol at overseas institutions.

The United States, with over 32,000 Indian students in 1991, dominates the Indian overseas student market, because of the perception that it offers higher quality education.[116] American universities also tend to offer more scholarships and financial assistance to overseas students, while the existence of a large NRI population provides an effective support network. The United States has a relatively relaxed policy on granting visa extensions after students complete their studies. By obtaining employment during these extensions, students are often able to contribute to loan repayments originally taken out to pay for their studies.

Australia offers some advantages over its competitors. With a mild climate, geographical proximity, compared to the United States and Canada, and price competitiveness with other markets, Australia is well placed to pick up a larger market share of Indians studying overseas.

At present, most Australian institutions recruit students through private agents. With an Australian International Education Foundation (AIEF) office set to be established in India late in 1994, this will change. The AIEF's role is to improve the quality of service to Indian students and to establish closer government-to-government links. Private agents, though, will still have an important role in attracting fee-paying students. The Department of Employment, Education and Training is also likely to create a Senior Education Counsellor position in India, after their current market survey on India has been completed.

Australia must adopt a strategic approach to marketing Australian education in India. It will be important for the AIEF, the High Commission and private agents to coordinate activities if Indian students are to be attracted to the Australian educational market in growing numbers. It is also imperative that Australia markets its educational services in regional centres, as well as New Delhi and Bombay, as it is these areas that will have the highest propensity for growth. Likewise, in order to attract greater numbers of undergraduates, Australia has to ensure that information is being disseminated to appropriate secondary colleges, as well as to universities.

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[116]UNESCO, *Statistical Yearbook*, 1993

Educational Programs

Australian International Education Foundation (AIEF)
The recently established AIEF aims to consolidate the resources of the Australian Government and education providers into a coherent program. The AIEF will be establishing an education office in India in 1995.

National Centre for South Asian Studies (NCSAS)
DEET and a consortium of seven Australian universities funded the establishment of the NCSAS, based in Melbourne, in 1993. Its role is to promote and develop the study of South Asia in Australia.

Targeted Institutional Links Program (TIL)
Under this program, since 1990, Australia has provided funding to higher education institutions to support collaborative research links with Asian counterparts. Curtin University of Technology and Murdoch University have received funding for collaboration with the University of Delhi and the University of Jadavpur respectively.

Australian Awards for Research in Asia and the National Asian Languages Scholarship Scheme.
Both these programs provide opportunities for Australians to undertake postgraduate studies in Asian countries. Four awards for study in India (including study of Hindi) were made in 1992, and one each in 1993 and 1994.

Commonwealth Scholarship and Fellowship Program
The AIDAB-funded Commonwealth Scholarship and Fellowship Program provides opportunities for Indian scholars in Australia, and to a lesser extent for Australians to study in India.

Commonwealth of Learning
The Commonwealth of Learning was created in 1988 and provides India with the benefit of Australian experience in education. For example, the Open Learning Technology Corporation in Adelaide is currently identifying expertise in distance education and examining prospects for the commercial marketing of Australian curriculum development skills.

Commonwealth Universities Study Abroad Consortium
A pilot phase of this new program has been introduced to provide opportunities for students from Commonwealth countries to study in other member countries as part of their degree course.

UNESCO
Australia has recently taken the lead in UNESCO regional consultations at ministerial level to promote the establishment of an Asia Pacific Program of cooperation in vocational education and training. Australia could also contribute its expertise in training in literacy to an existing UNESCO Asia Pacific Program on Education for All (APPEAL) program.

International Labor Organisation (ILO)
Through its Asian Multi-Disciplinary Team (MDT), based in New Delhi, the ILO is involved in employment training and vocational education.

Australia must also identify areas of study which are in demand by Indian students and in which Australia is price competitive. It is clear that there will be continued calls for business and commerce courses, because of strong economic growth in India. There is also scope for growth in engineering, computer science and medicine, as these areas have been targeted by the Government as important for India's human resource development. Given Australia's expertise in agriculture and the similar geographical conditions of Australia and India, agricultural science could offer prospects for growth. Tourism is another area that offers great potential, as with India's growing tourism industry, the demand for hospitality courses is set to increase.

Australia could benefit from participating in the development of educational infrastructure programs in India. With extensive experience in literacy programs, both at school and the workplace, Australia could offer distance education and open learning expertise to help establish programs. Australia has experience in design curriculum, educational materials for a number of educational programs, including workplace literacy, English as a Second Language and vocational training, that are suitable for Indian conditions. Australia also has expertise in courses that utilise education communication technology, such as school-of-the-air services, satellite training, computer based training packages and interactive audio-visual technology.

Investment

Investment in Indian industries has been typically from the use of private domestic savings, grants, soft loans and other loans from international development agencies, proceeds from commercial borrowing, and inter-governmental arrangements which have had the effect of making overseas capital resources available. However, an assessment of the attractiveness of investment in Indian industries must be mainly based on the track record of growth in real capital formation.

Role of Private Capital Formation and Foreign Capital Inflow

Private capital flow from overseas has been relatively unimportant as a source of investment in India. India's external debt obligations have been principally public sector obligations. The Indian public sector, which has dominated ownership of infrastructural industries and industries providing public services, has been responsible for about 10 per cent of national gross fixed capital formation, and 90 per cent of dependence on overseas capital resources. India's private external debt, and annual private capital inflow, are both small in comparison with public external debt and public capital inflow.

In the future, private ownership is likely to penetrate the public enterprise sector to a far greater degree than at present, and foreign ownership is scheduled to have far wider scope than formerly in both private and public enterprise industries. This is a profound change, which should be a source of many opportunities for Australian investment in Indian production.

Investment Opportunities

Table 11.2 summarises the apparent investment opportunity areas for Australia in Indian industry divisions. To assess these opportunities account was taken of growth potential in the Indian industry, level of deregulation and openness of the industry to foreign investment, level of international investor interest, presence of bottlenecks that might affect the industry, and growth prospects in counterpart Australian industry sectors that might suggest an increasing potential to provide capital and technology to offshore investment activities (see table 11.3 for a summary of these factors by industry).

Using this methodology there appear to be investment opportunities in

- food, beverages and tobacco;
- chemicals and chemical petroleum, coal, rubber and plastic products;
- fabricated metal products, machinery and equipment;
- other manufacturing industries; and
- financial institutions.

These industry sectors are most likely to have readily identifiable projects for investment, a level of interest from the Australian business community, and good prospects of early returns.

Medium to longer term opportunities will also exist in mining and minerals exploration and in the Indian coal industry. These areas can provide exceptional opportunities, but will require longer term investment before returns are realised. For example, steaming coal projects for industry self-provision of electrical power could be classed as medium to longer term opportunities, with long payback periods.

At the other end of the spectrum, some sectors do not present good opportunities for investment, although they should not be excluded altogether. For example, the Indian agriculture and farming industry division is rated as low growth. This industry has not yet been substantially deregulated and contains numerous bottlenecks. It is therefore currently of little foreign investment interest. But while potential opportunities in this industry would be exceptional, they may exist nonetheless.

Table 11.2
India: Summary of Potential Investment Opportunities for Australia

Indian Industry Code	Favourable sub-sectors	Longer term potential	Specific areas of potential opportunity
Agriculture and farming		Cash crops and products for export	
Forestry			
Fishing			Sea fishing vessels and processing plants
Coal mining		Steaming coal for industry self-provision of electricity	Technology assistance to State mines
Crude petroleum	Oil/gas exploration handiest to using areas	Exploration for gas offshore for export	
Metal ore mining		Iron ore mining	Nonferrous exploration
Other mining			Exploration
Food, beverages & tobacco	Meat, milk, fruit and vegetable products		Processing for long life of fresh produce, e.g., irradiation
Textiles		Knitted fabrics Synthetic spinning and weaving	Upgrading of cotton and woollen mills
Wood & wood products			Reconstituted and preserved products
Paper & paper products		Printing and publishing	Audiovisual communications products Narrow/Broad casting services
Chemicals & chemical products	Fertilisers, Pharmaceuticals, Coal, Oil products	Oil refining	Gas liquefication, Personal care products
Non-metallic products			
Basic metals industries		Steel, Aluminium, Copper	Metallurgy - Remelt mini non flat steel products

Table 11.2 continued

Fabricated metal products	Railway vehicles, Electrical eqp., Electronic eqp., Machinery	Engineering, Household appliances,	Pipeline components, Computer components and assembly, Ships
Other manufacturing	Scientific eqp.	Photographic goods	Aircraft and parts
Construction		Pipeline construction Hotel construction Railway terminals and lines Highway construction Telecommunications network construction	Concrete pumping Low cost dwellings
Electricity, gas & steam			Hydroelectric projects
Water works			Water treatment
Transport and storage		Domestic air services Tollways	Railway ops computerisation, Container transhipment facilities and development, Nhava Sheva and Madras
Communication		Value-added data services Line leasing International voice and data services Mobile voice services	Telephone exchange upgrading Customer premises eqp. installation and maintenance Facilities management
Wholesale and retail trade			Farm surplus storage transport and merchandising
Restaurants and hotels			Hotel operation
Financial institutions	Banking, Non-bank finance, Investment, Business services	Financial institutions Computerisation	Gold monetisation, Futures market development
Insurance			
Real estate			
Social services		Education	

Table 11.3

India: Overview of Factors Used in Assessment of Investment Opportunities for Australia in Indian Industries

Indian Industry	**Growth in GDP pa base-case scenario** per cent	**India - Character of Provisions**	**Foreign Investment Recent Principal Foreign Investor Interest in India**	**India - Presence of Important Bottlenecks**	**Australian Industries with Strong Growth Prospects**
Agriculture	3.1			Yes	Milk cattle
Forestry	-1.0				
Fishing	5.4				Fishing
Coal mining	4.8	Captive mines open		Yes	Coal Exploration
Crude petroleum	15.5	Open	Some	Yes	Exploration, Oil Gas
Metal ore mining	5.4	Open			Exploration Ferrous and Non-ferrous
Other mining	7.8	Open			Exploration Minerals
Food, beverages	6.4	Open	UK, United States, France		Meat, Milk, Fruit, Vegetable products
Textiles	3.4	Open	Italy	Yes	
Wood	-3.0	Open			
Paper	7.1	Open			Publishing, Printing
Chemicals	10.5	Open	UK, United States, Italy, Switzerland, Japan, Australia		Fertilisers, Pharmaceuticals Oil, Coal products
Non-metallic mineral roducts	9.2	Open	United States	Yes	Except Glass, Clay, Cement
Basic metals	2.2	Open		Yes	Basic Iron & Steel, Non-ferrous metals
Fabricated metals industry	8.1	Open	United States, France, Japan		Railway vehicles, Electrical & Electronic eqp., Machinery
Other manufacturing	11.8	Open	United States		Scientific equipment
Construction	3.6			Yes	
Electricity, Gas, steam	9.1	Open	United States, Germany	Yes	
Water	8.7			Yes	
Transport & storage	7.6	Nonrail open		Yes	Railways, Water transport
Communication	6.1	Eqp. joint ventures open Value-added open		Yes	Communication
Wholesale, Retail	6.2				
Financial institutions	13.8	Open	United States		Banking, Non-bank finance, Investment, Business services
Insurance	6.4				
Real estate	4.6			Yes	
Social, community services	4.6			Yes	Education

CHAPTER TWELVE

DOING BUSINESS IN INDIA

The Indian business environment is often considered complicated by foreign firms, including those from Australia. The usual factors of cultural unfamiliarity are combined with a complex regulatory environment. India does not, as yet, have a one-stop shop for prospective traders and investors. So it is incumbent on those interested in the Indian market to obtain necessary information, with assistance from relevant providers of business services such as Austrade and private sector consultants. This chapter sets out some basic information designed to assist business with market entry strategies. But India is reforming its trade and industry regime, and so Australian firms would be well advised to check the latest details thoroughly. A list of useful contacts for acquiring such information is presented in Appendix 4.

Culture, Social Customs and Language

Culture

India has one of the largest and most diverse mix of races in the world and, as a consequence, is host to a variety of social types, cultures and languages. The country's culture and social customs are very different from those found in Australia. Despite the modern and cosmopolitan outlook of many Indian business people, certain areas of behaviour and etiquette remain distinctive. Customs are often based on religious teachings and practices. Those seeking to do business with India should be open-minded and try to observe the etiquette associated with such customs. The following provides examples of the more common customs likely to be encountered:

- many Hindus are vegetarian and among those who are not, beef is generally taboo;
- the majority of Indians, particularly orthodox Muslims, do not consume alcohol;
- in general, alcohol is not served at a typical Indian meal on social occasions;
- it is forbidden for Sikhs and Parsis to smoke tobacco;
- Muslims do not eat pork; and
- most Indians should be proffered food and drink using only the right hand.

Social Customs

In the business context, official and business contacts are addressed in what might be regarded as a rather formal manner: by title, either Mr/Mrs/Ms or Sri/Smt (Srimati), and surname. This is especially the case for business superiors and those senior in age. Superiors may also be addressed as 'sir' or 'madam'. It is not common to use people's first names.

In the principal cities, business appointments, meetings and entertainments can be expected to be conducted very much as they are in Western countries. However,

Indians are fairly relaxed about time and adherence to set timings can often be 'flexible'. Business will generally be conducted in English. Instead of shaking hands, Indians, especially women, often greet people with the *namaste*, a gesture with the hands similar to that adopted when praying; it is a very common social greeting.

Lounge suits are generally worn only for very important meetings. The normal office dress for men is a shirt, tie and slacks. Women, in general, dress conservatively, usually a conventional sari.

Indians are hospitable and place considerable emphasis on building 'relationships'. Food or snacks are usually served in a meeting, and it is considered impolite not to accept this hospitality. In business, Indians may try to avoid a negative response to proposals out of courtesy.

Language

There are 14 principal languages spoken in India, with over 800 different dialects. The official language is Hindi, which is also the most commonly used language and is spoken by about 45 per cent of the population. The Official Languages Act 1963 gives the English language 'associate' status. English is widely used, especially in government, courts, media, education and business. In fact, India is the second largest English-speaking country in the world. However, in doing business with India it is as well to remember that while the English vocabulary is the same, differences in interpretation can and do arise.

Even though most business negotiations involving foreigners are conducted in English, a knowledge of Hindi or local languages is a useful asset. The importance of regional languages may grow as the States play a more active role in encouraging trade and investment.

Judiciary and Legal System

Based on the principles of justice, liberty and equality, the Constitution guarantees certain fundamental rights to its citizens: the right to property, freedom of speech and religion, cultural and educational rights and an independent judiciary. The main sources of law are the Constitution, statutes (legislation), customary law and case law (precedent). Statutes are enacted by the Parliament, State Governments and local authorities.

Laws enacted by the Parliament extend throughout the territory of India. However, laws enacted by State legislatures only apply within that State. The Constitution therefore delineates distinct legislative areas for the Centre. Not withstanding this delineation, an interesting feature of the Indian judicial system is that it provides for a single integrated system of courts to administer both the Union and State laws. At the apex of the judicial system is the Supreme Court of India, located in New Delhi. Beneath this there is a High Court for each State or group of States, under which is a hierarchy of subordinate courts. India's legal system, like its financial system, is overstretched due to the immense size and complexity of the country. The

overburdened court system is characterised by delays and any legal action requires great patience.

Investing in India

The Investment Climate

As mentioned in previous chapters, the Indian Government's attitude to foreign investment has changed significantly. In the New Industrial Policy announced in July 1991, and since, the Government has taken a series of initiatives aimed at ending the previous restrictions on obtaining industrial licences and foreign investment approvals, as well as simplifying the approval procedures for joint ventures and technology transfer with Indian partners. It provides a framework for the private sector to take a greater role in production and opens the door to most forms of foreign investment; spreading out the red carpet rather than the red tape.

Local Attitudes to Foreign Investment

The attitude of indigenous businesses to foreign investment is generally positive. There is an appreciation among Indian business leaders that foreign investment can bring new capital and technology, both of which are crucial if they are to respond positively to market liberalisation and increased international competition. Not surprisingly, where business people perceive a direct threat from foreign investment to their own businesses then the reaction can be less than favourable.

In general, the labour force is also favourably disposed towards foreign investment and management. This is partly related to the perception that foreign companies produce higher quality products and services, are up to date with modern business practices and generally more professional than Indian companies. In addition, there has been a general tendency to perceive foreign companies as paying more and providing better benefits to employees.

Potential investors are advised to investigate the political climate in the particular region or State where they are investing as it could have a bearing on the viability of the investment.

Industrial Licensing

The new industrial policies, introduced in July 1991, effectively mean that most undertakings are now exempt from licensing. In most cases, there is now only a requirement to file an Entrepreneur's Memorandum with the Secretariat for Industrial Approvals prior to commercial production and another memorandum when production begins. These memoranda do not need to be filed for small-scale (ie where the investment in plant and machinery is less than 6 million rupees) or ancillary (ie where the investment in plant and equipment is less than 7.5 million rupees) undertakings, but they should be registered with the Director of Industries in the State where they are located.

Licences still have to be obtained in a number of specified cases, including:

business undertakings (other than small-scale or ancillary) that are:

- under the list of industry sectors subject to compulsory licensing (Appendix 5);
- reserved for the public sector (Appendix 5); or
- reserved for the small-scale or the ancillary sector.

non-exempt business undertakings which propose to:

- establish a new unit;
- expand an existing unit substantially;
- manufacture a new product; or
- move location.

While industrial location licensing requirements have been reduced substantially, they still apply when the proposed undertaking is to be established within 25 kilometres of a city of population over one million. This requirement excludes those activities classified as non-polluting, such as printing, computer software development and electronics.

The phased manufacturing program for granting licences in certain sectors is no longer applicable for new projects. However, programs established for existing projects will continue to operate.

In cases where industrial licences are required, applications must be made to the Secretariat for Industrial Approvals. Licences are usually granted within six months.

Foreign Equity and Investment Approvals Process

Proposals involving foreign investment in India require official approval. To encourage foreign investment, the approvals process has been simplified and made more transparent. Changes to the revised guidelines for approvals have also speeded up the process considerably.

Two types of approval can be sought:

- automatic approval for proposals that meet specified criteria, which is dealt with by the Reserve Bank of India (RBI); and

- approval for all other proposals, which is dealt with by the Foreign Investment Promotion Board (FIPB) or the Secretariat for Industrial Approvals.

The RBI has the authority to grant automatic approvals for foreign investment proposals, provided that they meet certain specified criteria. Automatic approval is given for proposals where:

- foreign investors wish to increase their equity holdings up to a maximum of 51 per cent as part of an expansion in one of the 36 high priority industry sectors; (see Appendix 5)

- foreign equity participation does not exceed 51 per cent of the total equity in:
    - a high priority industry sector, as long as the foreign equity component is at least sufficient to cover the foreign exchange requirement for the import of capital goods of the proposal and that the capital goods are not second hand;
    - trading companies engaged mainly in producing for export;
- units are set up in Export Processing Zones or are 100 per cent export oriented, in which case up to 100 per cent foreign equity may be permitted;
- foreign technology agreements are within prescribed monetary and royalty limits;
- NRIs wish to invest in 100 per cent of the equity of new or existing companies in high priority industry sectors.

Foreign investors applying for automatic approval should submit the standard application form to the Exchange Control Department at the RBI. Applications are usually cleared and approvals given within two weeks.

Foreign investment of up to 24 per cent is now permitted for certain specified industries that are reserved for the small-scale sector.

Foreign investment proposals that do not satisfy the criteria for the automatic approvals process require specific government approval. These are dealt with by the FIPB consisting of the heads of Commerce, Finance and Industry Ministries, the Cabinet Secretary, and other senior officials. The official line is that any proposal will be assessed on its merits. In practice, the Board is likely to look more favourably on those proposals consisting of new technology, key infrastructure, or a sizeable export component. In principle, proposals involving foreign investment of up to 3 billion rupees are cleared by the Finance Minister. Investment applications in excess of 3 billion rupees are decided by the Cabinet Committee on Foreign Investment, headed by the Prime Minister.

Foreign Technology Agreements

Technology transfer is no longer a requirement for the approval of foreign investment. In the high priority industry sectors, automatic approval will be given for foreign technology agreements providing certain criteria are met. Payments for technology that do not fall within the guidelines outlined above require prior Government approval.

The new policy on foreign technology agreements also means that employing foreign technicians no longer requires the permission of the Government. This also applies to the foreign testing of technologies developed in India.

Currency Convertibility

Under the Liberalised Exchange Rate Management System introduced in March 1992, the rupee was made partially convertible, with 40 per cent of foreign exchange receipts on the trade account converted into rupees at an official rate determined by the RBI and the balance determined at the prevailing market rate. In general, the market rate was around 15 per cent above the official rate.

The new system was revised in March 1993 with the introduction of a unified exchange rate mechanism. The new arrangements are such that:

- all foreign exchange transactions (receipts and payments under both the capital and current accounts) are processed by authorised foreign exchange dealers;
- authorised dealers are permitted to retain the entire foreign exchange receipts without any obligation to surrender any portion to the RBI;
- foreign exchange receipts and payments will continue to be subject to Exchange Control Regulation and foreign exchange will be sold by authorised dealers only for permissible transactions and approved purposes; and
- money changers will also conduct transactions related to foreign currency and travellers cheques at market rates.

The result is that market exchange rates are now used in all export and import transactions, investment flows, the repatriation of dividends, fees and royalties for technical know-how agreements, and foreign travel.

In line with the 1993 arrangements, the Government of India's 1994/95 budget, announced in February 1994, took the next step toward full convertibility of the rupee. By announcing the extension of the currency's convertibility beyond the trade account to the entire current account, India will now allow greater access to foreign exchange for all current business transactions, financial services, borrowing, travel, education and medical expenses. The new policy is expected to provide a greater incentive to Indian exporters and will significantly diminish the black money underground economy.

Capital Repatriation

Indian companies are now allowed to freely repatriate dividends to their foreign shareholders (subject to the payment of withholding taxes). However, companies in the consumer goods industry are required to balance the foreign exchange outflow with export earnings from the specified high priority industry sectors over a seven-year period.

Disinvestment of foreign equity must be approved by the Government and transacted on the stock exchange through a merchant banker or stock broker. For listed

companies, the disinvestment price is determined by the lower of the prevailing market prices and the average quotation for the one month preceding the sale. If shares are not traded regularly, or if the company is closely held, the RBI will assess a value based on net asset value and earnings per share.

A Note of Caution

Although the policy changes make it considerably easier to do business with, and in, India, there are aspects of the investment environment that make the investment process less than straightforward. For example, the extremely restrictive conditions for the import of consumer goods encourages direct entry in the Indian market. The usual pattern of foreign companies first exporting to the market and then moving into locally based manufacturing is therefore not prevalent. In fact, the policy changes are designed to encourage foreign investors to find an indigenous partner. It is far easier for foreign companies to enter the Indian market through a joint venture arrangement than through 100 per cent equity ownership of an Indian enterprise.

Another point to consider relates to the approvals process. The process itself requires interaction between the Central and State Governments. The Central Government may well deal with the industrial policy aspects of applications for joint ventures, but it will be one of the State Governments that is responsible for the provision of specific site and environmental clearances and so on. While States deal with these matters reasonably effectively, some are better than others.

The Regulation of Business

Patents, Trademarks and Intellectual Property Rights

Patents can be protected under the Patents Act 1970. Under the provisions of the Act, foreign patentees are treated equally with their Indian counterparts. Patents are normally granted for a period of up to 14 years from the date of application. There are different periods covering foods, medicines, drugs and chemical substances. In these cases, the period of patent coverage is normally five years from the date of sealing or seven years from the date of the patent, whichever is the shorter.

In collaborative agreements between a foreign investor and an Indian company, the government policy to granting patents is that the Indian collaborator should be permitted to produce the patented item without payment when the patent expires.

Recent changes in policy now permit the use of foreign brand names and trademarks for the sale of goods in India. Before a trademark is registered, there is usually a process of advertising to determine any opposition. Once registered, it is protected for seven years at which point it can be re-registered. However, if the trademark is unused for five years, its registration may be cancelled. Trademarks that have not been registered can be protected through passing-off actions.

Copyright in India is regulated under the Indian Copyright Act 1957. It provides for the registration of works. It extends to all works first published in any country that is

a member of the Universal Copyright Convention and the Berne Convention. India is a member of both Conventions.

Competition Policy

The stated policy of the Indian Government is to promote competition in the market. In particular the Government encourages entrepreneurial activity so as to invigorate the economy. It has therefore embarked on a series of reforms aimed at removing and reducing government control over production as well as making the economy more open to foreign investment and competition. The policy changes are designed to stimulate activity within the country, reduce costs through a more efficient and market-based allocation of resources, and raise efficiency to internationally competitive levels. However, a number of controls on the activity of companies remain.

Monopolies and Restrictive Trade Practices

Monopolies and restrictive trade practices are controlled under the Monopolies and Restrictive Trade Practices Act 1969. The Act was initially designed to regulate the economic activity of what were classified as giant undertakings (based on an asset size criterion) and dominant undertakings (based on a market share criteria). In particular, it regulated the establishment of new units, significant expansion of existing units, mergers and takeovers that were undertaken by these large undertakings. The Act did not, however, cover the activities of state-owned enterprises.

These regulations have now been deleted from the Monopolies and Restrictive Trade Practices Act. As a result, there is no longer any investigation into the activities of these large business undertakings before they establish new units. However, if the activities of a large undertaking are considered to be against the public interest or have led, are leading or are likely to lead to a monopoly position or restrictive trade practice, then the Monopolies and Trade Practices Commission can force it to make disinvestments and cut related activities, as well as imposing deterrent punishment for contravention of its recommendations and orders. In addition, state-owned enterprises are now subject to the scope of the Act.

The objective of these changes is to provide an environment that encourages industrial growth where companies are not inhibited from achieving scale economies.

Mergers and Acquisitions

A merger may occur if an order has been made by the Board of Industrial and Financial Reconstruction under the provisions of the Sick Industrial Companies (Special Provision) Act or under the Companies Act through a court order. However, approval from the RBI, under the Foreign Exchange Regulation Act, would be needed if there is more than 40 per cent NRI share holding in either or both of the companies involved in the merger. The same requirement also exists where either company in the merger is engaged in agricultural or plantation activity.

Apart from these specific circumstances there is no separate act or code for mergers and acquisitions in India. However, where there is an acquisition or purchase of a target company's shares, the acquirer may have to:

- obtain the permission of the Government under the provisions of the Companies Act, especially when either an acquirer or a target company is classified as a dominant undertaking under the Monopolies and Restrictive Trade Practices Act;

- comply with rules in the mandatory listing agreement for companies quoted on one of the recognised stock exchanges;

- comply with the guidelines set down by the Securities and Exchange Board relating to the acquisition of a significant proportion of a target company's shares;

- obtain the permission of the Government if an acquiring company has an aggregate share holding in all companies or aggregate share holding in companies in the same industry sector above a prescribed proportion - these are set at 30 per cent in the case of the former and 20 per cent in the case of the latter;

- obtain the permission of the Government if the acquisition of share capital amounts to 25 per cent of total share capital of a target company; and

- obtain the permission of the Reserve Bank of India to acquire shares under the Foreign Exchange Regulation Act 1973 - where the acquirer is a foreign investor who already has an equity stake in an Indian company in a high-priority sector and wishes to increase the share holding to the maximum of 51 per cent.

Foreign Exchange Regulation

The Foreign Exchange Regulation Act (FERA) 1973 has been revised substantially since July 1991. In particular, in January 1993, the Act was amended by Parliament. This effectively liberalises the exchange control regulations and enhances the climate for foreign investment.

Under the amended Act, the RBI has issued notifications granting FERA companies (ie companies in which there is a 40 per cent or more NRI equity share holding) permission to:

- undertake trading, commercial or industrial activity in India;
- borrow funds or accept deposits in India;
- accept appointment as an agent, technical or management adviser of any person or company in India;
- acquire, hold, transfer, lease etc immovable property in India; and
- use their trademarks in the sale of goods in India.

Foreign companies in India are permitted to remit abroad profits, royalties and dividends, as well as to repatriate capital. This is subject to certain rules and regulations administered by the RBI. In particular:

- for the consumer goods industry sector the flow of dividend payments must be balanced by export earnings from the specified high priority industry sectors over a seven-year period;

- remittances must be made through normal banking channels; and

- remittances must be made after the exchange control and income tax formalities for approved foreign collaboration agreements.

Permission is no longer required from the RBI to transfer shares, bonds and debentures between NRIs. Foreign individuals and companies may, with the permission of the RBI, acquire immovable property in India, provided purchase is made using foreign exchange out of remittances from abroad.

Price Controls

The price of certain essential commodities, consumer goods and intermediary goods is controlled by the Government. The objective of this is to ensure goods in short supply are made available at a reasonable price. There are minimum prices set for a proportion of the production of agricultural commodities such as sugar. There are also price controls on the production of monopolies and public utilities such as fertilisers, petroleum and electricity as well as on drugs and pharmaceutical products. The prices are fixed by the Government to ensure that producers earn a fair return.

Exporting To and From India

The Policy Environment

Since July 1991, there has been a significant reduction in import tariffs, as well as a simplification and extensive relaxation of the import and export licensing system and procedures. These reforms are covered in Chapter 5.

Exporting to India: General Provisions

The current import policy is set out in the Export and Import (Exim) Policy announced on March 31st 1992. It covers a five-year period from 1 April 1992 to 31 March 1997.

Capital goods, raw materials, intermediate components, consumables, spares, parts, accessories, instruments and other goods can now be freely imported. The exception to this is where imports are regulated by public policy or listed under the Negative List of Imports. The Negative List comprises prohibited, restricted and canalised items:

- prohibited items are not permitted to be imported;
- restricted items are not permitted to be imported except under specific licence or in accordance with a Public Notice conveying a general schedule; and
- canalised items can only be imported through an agency designated by the Government.

The actual-user condition on the import of capital goods, raw materials, intermediate components, consumables, spares, parts, accessories, instruments and other goods has been removed. However, the importation of consumer goods remains restricted.

The importation of second-hand capital goods without a licence is now permitted in specified sectors. Other second-hand capital goods may be imported with a licence under specified conditions. Certain capital goods, including second-hand capital goods, may be imported on a re-export basis without a licence and at concessional rates of duty, under the Export Promotion Capital Goods Scheme. The Scheme is also applicable for the import of capital for specific categories of service providers.

The import of raw materials, intermediates, components, consumables, parts, accessories, packing materials and computer software required for the direct use in the production of goods for export is permitted free of duty. These must, however, be imported under certain specified categories of licences.

The importation of gold and silver is now permitted under special import licences issued to certain categories of exporter on the basis of net foreign exchange earnings.

Import Duties and Tariffs

The Indian import tariff system is complex, despite changes to simplify the situation. The First Schedule comprises two categories of basic duties; 'standard ' or 'basic' rates and those applicable to 'preferential' areas. The standard rates of duty are statutory and changed only by legislation. However, these are frequently replaced by rate concessions or complete exemptions without requiring legislative changes. As a result, the effective rate of duty can vary considerably from that implied by the standard rate.

Preferential rates of duty are applied to imports of goods from areas that are declared as being 'preferential' such as Mauritius, Seychelles and Togo. Other preferential areas are those with whom India has negotiated bilateral or multilateral trading agreements.

There are also a number of imports that are subject to 'additional' or 'countervailing' duties. These are equivalent to excise duties on similar goods produced domestically. Goods that are exempt from domestic excise tax are usually also exempt from additional duties when imported. Those goods on which additional duties were levied up to 28 February 1993 have now been merged with the standard rate of customs duty.

Since July 1991, the Indian Government has announced a series of successive and substantial reductions in import tariffs. The objective of these tariff reductions is to bring down the cost of essential imported industrial inputs and to make them comparable with other developing countries. The maximum standard tariff rate on all goods, inclusive of additional duties of 45 per cent, has been lowered as follows:

- from 355 per cent to 150 per cent in July 1991;
- to 65 per cent in February 1994.

In addition to lowering the maximum rate of duty, the Government has reduced the effective rate of duty on imports. Reductions have been effected through general and specific concessions. This is most evident in the case of capital goods. Concessional rates of 30 per cent on capital goods used in mining, petroleum refining and power generation were introduced in February 1992. These have been cut subsequently to 20 per cent. The effective rate of duty on most other capital goods has been lowered from 80 per cent to 35 per cent. To a large extent these tariff reductions have made many of the concessional rates redundant. As a result, the number of concessional arrangements has been reduced. At the same time a large number of exemptions have been withdrawn. An indication of the current import tariffs and how they have fallen are set out in Table 12.1.

It is expected that further reductions in import duties will be made over the next few years. For example, in the 1994/95 Budget, import tariffs for software came down from 85 per cent to 20 per cent while that for coal fell from 85 per cent to 35 per cent. The Government has, in principle, accepted the recommendations of the Chelliah Committee on tax reform which suggested that there should be a phased reduction in duties so that by 1997/1998 the rates on industrial inputs would range from 5 per cent to 30 per cent. For non-essential consumer goods it was recommended that the rate of duty should be no more than 50 per cent.

Table 12.1

Indicative Import Tariffs

Item	Percentage Rate		
	1991/92	1992/93	1993/94
Maximum rate of custom duty (except alcohol and personal baggage)	150	110	85
Project and general machinery	80	55	35
Project imports for coal mining and petroleum refining	80	40	25
Project import for power sector	30,40	30,40	20
Components of general machinery[a]	65	35,40	25
Project imports for electronics	60	30,50	25
Capital goods for leather, textiles, marine products, gems and jewellery	40	40	25
Machinery for agriculture, horticulture, forestry, poultry etc	80	55	25
Basic chemicals[a]:			
Propylene	120	80	15
Butadiene	55	40	15
Benzene	40	25	15
Styrene	45[b]	40	15
Ethylene, Ethylenedychloride etc	40-120	25-110	15
Specified bulk drugs[a]	0-120	0-110	0-80
Specified drug intermediates[a]	0-120	0-110	0-50

Notes: a These articles also attract countervailing duty
b Plus 1,700 rupees/PMT

The Import Process

Importers are required to have an Importer-Exporter Code (IEC) number, unless they are specifically exempted. Exemptions under the Code are for:

- importers of goods for personal use;
- Central and State Government bodies; and
- importers of goods not subject to the provisions of the Imports (Control) Order 1955.

IECs are granted to importers by the relevant regional licensing authority.

Documentation for customs purposes is particularly important when exporting to India. The legislation covering the importation of goods into India is the Customs Act 1962. It indicates that the importer, or their agent, is required to provide an import declaration disclosing full and accurate details of the value of any goods being imported. This value should be prepared in CIF terms, this being the basis on which customs tariffs are levied. The documentation must be accompanied with an import

licence, where required, as well as any documentation requested by Customs for the verification of the declared value of the goods being imported, such as the sales invoice, freight and insurance certificates. In the absence of documentary evidence, Customs adds 10 per cent to the invoice price in calculating the value of the imports for tariff purposes.

All imported goods also need to be accompanied by an ordinary commercial invoice. Each invoice, which should be signed, must give details of the packaging specification, weights and measurements of items in a consignment.

Consignments of imported goods are normally inspected prior to clearance. In general, 5 per cent of the total consignment is opened for examination. In cases where the consignment is being imported by a 'reputable importer' inspections may be reduced or waived.

In June 1992, the Government introduced limited facilities for the self-assessment of customs duty in order to speed up the customs clearance process. These facilities are experimental and may be used for government and public sector importers, as well as known private importers with a clean record of importation. Importation documents are audited by Customs. The consignment is examined and customs duties paid prior to clearance.

There is also a green channel for imports where no inspection is required. This applied initially only to public sector imports. It has since been extended to cover private importers with a clean record of importation. It is also available to bulk importers, sourced directly from reliable suppliers as well as for single-product consignments of a well known brand or specification. However, if the consignment has been self-assessed for duty it can not be 'green channelled'.

Appeal may be made concerning the valuation of imported goods or the clearance procedures. These must be submitted within three months of the initial decision date to the Collector of Customs (Appeals). Judicial appeals can be made by an importer to the Customs, Excise and Gold (Control) Appellate Tribunal directly within three months of the date of the decision being appealed.

Indian importers generally make payments to overseas suppliers through confirmed and irrevocable letters of credit which is an assurance that the buyer has the funds to import. These are initially allowed to be opened with a validity of 12 months and generally the expiry dates of letters of credit are harmonised with the expiry dates of import licences. As a general practice, advance remittances are normally not permitted by the RBI. Government companies prefer to establish letters of credit with Indian banks.

Caution is necessary when other terms are offered, as debt collection is impossible if goods are shipped to a customer who does not have authority to import. Legal proceedings for recovery of debts are protracted, expensive and often inconclusive. Businesses should be aware that the Indian Statute of Limitations Act bars most commercial debt after three years.

Exporting from India: General Provisions

Most goods may be exported freely from India. The exceptions to this are listed under Part I of the Negative List of Exports, and cover exports prohibited for religious and environmental reasons. However, the Director General of Foreign Trade may, through the issue of a Public Notice, specify terms and conditions under which any goods not included in the Negative List have to be exported with a licence.

A small number of export goods are subject to licensing. On 1 April 1993 the list of items requiring an export licence was reduced from 51 to 29 product categories. These are included in Part II of the Negative Import List. The Government indicates that exports licences are required for these items for security or environmental reasons, and to ensure the ready domestic availability of key raw materials. The Director General of Foreign Trade will consider applications for export licences on their merits.

The export of a number of goods is canalised through state trading agencies. These items are set out under Part III of the Negative List of Exports. Private importers may be granted a licence to export products on the canalised list but this is rare.

The Negative List of Exports also covers those goods which, although not requiring a licence for their export, do require certain conditions to be fulfilled before export can take place. These conditions usually refer to certification, registration and inspection requirements. The items covered are mainly in the agricultural, chemical, textile and clothing sectors.

Export Duties and Tariffs

The Government can introduce or increase duties on exports under the provisions of the Customs Act 1975. In practice, few goods are subject to export duties. This follows a significant reduction in the coverage of such duties since 1989. At present only goat, sheep and bovine leather is subject to payment of export duties, although these are at the 'exempt rate' of 5 per cent rather than the statutory rate of 25 per cent.

The Export Process

Exporters are also required to have an Importer-Exporter Code (IEC) number. Anyone wishing to apply for a licence to export goods under the Negative List of Exports or receive any concession under the Import and Export Policy is required to have a Registration-cum-Membership Certificate. This can be granted by any Export Promotion Council of which they are a member.

Under the Export (Quality Control and Inspection) Act 1963 certain types of export are subject to mandatory control and pre-shipment inspections. The purpose of the inspections is to ensure that the exports conform with Export Policy conditions. In total some 995 items are required to be inspected, covering engineering, chemicals, food and agricultural commodities, as well as jute, coir, footwear, cashews and fish. The agency responsible for inspections is the Export Council of India.

Steps have been taken to simplify the inspection process. The number of items requiring inspection has been reduced. Star Trading, Trading, and Export Houses, as well as units in Export Processing Zones and Export Oriented Units are exempt for all notified products. Where manufacturing units have in-process quality control procedures, they may issue their own certificates of export-worthiness. In addition, where written evidence is given by the overseas importer that pre-shipment inspections are not required the goods may be exempted.

Export Incentives

The Government has, over a protracted period, provided various incentives designed to encourage exports. In part this was to increase foreign currency earnings but it was also to compensate producers for the tariffs and restrictions on imports. The encouragement of exports through the use of incentives was enhanced in the current Export and Import Policy effective from 1 April 1993. A number of changes were introduced to simplify and streamline various export schemes.

The Export Promotion Capital Goods Scheme reduces the capital costs of domestic manufacturers. The scheme allows manufacturers to import machinery and equipment at a concessional duty of 15 per cent, subject to certain export performance obligations in the form of foreign exchange earnings. The scheme is also applicable for the import of capital for specified categories of providers of services at the same concessional duty, and subject to specified export obligations. Those service providers eligible to take advantage of the scheme are: architects, artists, chartered accountants, consultants, diagnostic centres, doctors, economists, engineers, hotels and restaurants, journalists, lawyers, scientists, and travel agents and tour operators.

The Duty Exemption Scheme allows the licensed import of intermediaries and components duty-free to domestic manufacturers. The licences are granted in advance subject to certain minimum value-added norm and export conditions being met. The Advance Licences can be obtained by any exporter and are freely transferable. There are also special schemes under the Duty Exemption Scheme for eligible exporters of pharmaceuticals, garments and electronics.

There are special export promotion schemes to provide for the export of diamonds, gems and jewellery under the Replenishment Licences and Diamond/DTC Imprest Licences.

For goods classified as 'deemed exports' there are export-related benefits available. 'Deemed exports' are specified categories of transactions where the goods are sold on the domestic market and payment is in Indian rupees, thereby saving foreign exchange. They include:

- inputs in Export Processing Zones or Export Oriented Units;
- capital goods, components and parts for public oil companies for their off-shore and on-shore exploration, drilling and production operations;
- goods for projects financed by specified international agency funds; and
- goods for fertiliser plants and other projects under international competitive bidding.

Export profits are exempt from income tax in the proportion of export turnover to total turnover, provided they are deposited in India in convertible currency. This can be a significant benefit at the higher marginal rates of income tax. The exemption to this is profit made from the sale of oils and ores.

Star Trading Houses, Trading Houses and Export Houses

Merchant manufacturers, exporters and trading companies that satisfy specified export performance targets and are recognised as Star Trading Houses, Trading Houses and Export Houses are eligible for certain special benefits. Eligibility also covers those merchant manufacturers, exporters and trading companies with foreign equity as well as units located in Export Processing Zones.

The main form of benefit available to the 'houses' is the ability to import a range of certain restricted products from the List of Negative Imports, up to a prescribed maximum, through the provision of Special Import Licences. These products include electronic items (for instance cathode ray tubes, integrated circuits, printed circuit boards), consumer goods (such as cameras, compact disc players, electronic typewriters) as well as button cells and dry batteries. The licences are freely tradeable and are usually sold rather than used by 'houses' directly for the import of goods.

Export Promotion Councils

The Government has established 19 Export Promotion Councils (EPCs) to promote and develop exports from India. Each EPC is responsible for the promotion of a particular group of products, projects or services. Their main role is to project India's image overseas as a reliable supplier of high quality goods and services. They also support their members in taking advantage of export opportunities through such activities as the provision of information and professional advice, and organising overseas trade visits and trade fairs, as well as mediating between exporters and the Government. Any exporter may apply to become a member of an EPC.

Trade Finance and Insurance

The system of export financing in India is extensive. One of the major sources of export and import finance is the Exim Bank. It is government owned, with its working capital provided by the RBI and long-term government borrowing. The interest rates on finance from the Exim Bank are lower than those available from commercial banks. It also provides consultancy and technology services involving deferred payments, pre-shipment finance, term loans for 100 per cent export oriented units, overseas buyer credit as well as re-discounting short-term export bills discounted by commercial banks.

The commercial banks provide export credit following guidelines set out by the RBI. It is usually provided at concessional rates of interest and is generally exempted from bank service charges and default penalty rates. Export credit has also been exempted from credit control directives issued by the RBI. Export finance covers both pre-shipment and post-shipment credit.

To ensure the ready availability of finance the RBI directed the commercial banks to provide export credits equivalent to a minimum of 10 per cent of their total advances by June 1993. Banks not achieving this level of export credit financing have been subject to penalties. Interest rates on rupee-denominated export credits were also reduced in 1993 and interest rate charges levied by banks on export credit are no longer subject to the Government's interest tax.

The Export Credit Guarantee Corporation provides cover for export risk - non-payment by foreign buyers.

Export Processing Zones And Other Business Incentives

The Government of India provides special incentives for foreign companies to undertake manufacturing for export from India. The primary vehicles in this effort are Export Processing Zones (EPZs) or 100 per cent Export Oriented Units (EOUs) established outside EPZs. In the wake of economic reforms launched in the early 1990s, India's EPZ and EOU policies have been under active review and are likely to change further. Despite fresh EPZ/EOU concessions announced in 1993, the Indian Government believes that the performance of EPZ/EOUs has generally been below expectations. Some attribute this shortcoming to complex administrative procedures. The World Bank agrees that India's EPZs have so far been unsuccessful due to continuing poor infrastructure.

Favourable Business Conditions

Among the attractive fiscal incentives for companies who choose the export incentives scheme marketing route are duty free import of components and intermediate goods, permission for 100 per cent foreign equity, some limited ability to raise foreign currency loans and tax holidays. Production operations established in these zones are exempt from payment of corporate income tax for a block of five years in the first eight years of operation while export earnings continue to be exempt from tax even after the tax holiday has expired. EPZ/EOU participants are also exempt from payment of Central and State sales tax. In addition, supplies from the Indian domestic market to EOU/EPZ manufacturers are regarded as deemed exports and are therefore exempt from excise duties. EOU/EPZ plants are expected to achieve specified value-adding norms.

The EOU self-standing plant scheme was introduced in 1980 to generate additional capacity for exports by providing an appropriate policy framework, flexibility of operations and incentives. For international operations, companies adhering to this program can import machinery, raw materials, components and consumables free of import duty and, if procured indigenously, are free of excise duties. By the end of March 1991, 193 units had commenced production and exports from EOUs almost doubled between 1986/87 and 1991/92.

India's EPZ Network

While EOU production facilities can be set up anywhere in India, EPZs are designated areas which are characterised by special infrastructure and other attractive business features. EPZs were established in India to provide an internationally competitive duty-free environment for export production and/or processing of manufactured products at relatively lower costs. The EPZs have been set up as enclaves, located mainly along India's eastern and western coasts, separated from the domestic tariff area by physical barriers.

India has established seven EPZ complexes across the country, of which five were recently established (Falta, Madras, Noida, Cochin and Vishakhapatnam). The first two were established at Kandla in 1965 and Santacruz in 1974. The Santacruz Electronics Export Processing Zone near Bombay airport is the largest and most successful EPZ. The Kandla Free Trade Zone was originally established to facilitate rupee clearing account exports to the former USSR and Eastern Europe. The sudden and rapid decline in countertrade with these countries has resulted in Kandla becoming marginalised.

Each zone provides basic infrastructural facilities at concessional rates. These include developed land, standard design factory buildings, roads, power, water and drainage. Other facilities include banking, post offices and customs clearing agents. EPZ/EOU facilities are allowed to sell up to 25 per cent of the value of production in the domestic tariff area if local inputs are greater than 30 per cent. If the indigenous inputs are less than 30 per cent, then domestic sales are limited to 15 per cent of production. EOU/EPZ units in the following sectors can sell up to 50 per cent of their output in the domestic market: agriculture, animal husbandry, floriculture, horticulture, pisciculture, poultry and sericulture. These units can also dispose of up to 5 per cent of rejects in the domestic markets. However, firms which produce jewellery, diamonds, motor vehicles, audio and video casettes and silver bullion are not permitted to sell any or part of their production in the Indian market. The seven EPZs may be described briefly as follows:

Santacruz Electronics Export Processing Zone (SEEPZ)

The SEEPZ, located near Bombay in the western state of Maharashtra, was initially designed for the export of electronic products such as computer software. A gem and jewellery export component was added in 1988 and has been successful in stimulating the diamond trade. In 1990-91, 108 units were in production with exports rising steadily on an annual basis. Some 38 units of the 108 in production involve foreign collaboration and 16 have marketing and technical collaboration. The SEEPZ is regarded as highly successful and provides employment for about 10,500 persons in mainly high technology skilled sectors.

Kandla Free Trade Zone (KAFTZ)

KAFTZ was established to promote industrialisation in the backward coastal area of Kutch in the western state of Gujarat. In 1990-91, of the 135 operating units there were subsidiary units of five multinational companies and twelve units financed by foreign, including NRI, investment. Most of the export business has related to recently declining markets in the former Soviet Union and Eastern Europe.

Noida Export Processing Zone

Located inland near New Delhi and its international airport, the Noida EPZ has stimulated considerable interest among entrepreneurs interested in duty-free manufacturing and is expanding. A total of 202 industrial projects have been approved, of which 60 are in production.

Madras Export Processing Zone

Infrastructural facilities for Phase I of the EPZ on the eastern coast of India have been completed and development of Phase II is proceeding in response to demand. A total of 172 units have been approved and 65 are in production. This EPZ, like SEEPZ and Noida, is located near a large industrial centre.

Falta Export Processing Zone

The Falta EPZ was established in 1984 near the industrial port of Calcutta but remains small. In 1992, the EPZ employed only 400 in 14 export-oriented production facilities located in West Bengal.

Cochin Export Processing Zone (CEPZ)

The CEPZ, located in the western coastal state of Kerala, is growing rapidly and is considered to be one of India's best equipped EPZs. The 103 acre facility is attracting many new corporate members from India and abroad. A new container port will be complemented by a planned trans-shipment facility by the end of the decade.

Vishakhapatnam Export Processing Zone (VEPZ)

This port-based facility on India's east coast in Andhra Pradesh was only approved in 1989 and is now in the process of being established. In 1993 there were reports of inadequate shipping and storage facilities in Vishakhapatnam.

How Domestic Reforms Affect Export Incentives

The reduction or elimination of industrial licensing, import duties and limits on foreign direct investment has brought India's domestic tariff area more in line with conditions applying to preferential export-oriented schemes. The new Export Promotion Capital Goods Program, with its limited export obligations, has also helped to level the playing field. EPZs and EOUs enjoyed advantages in the past but companies set up in this manner are now generally at par with other domestic operations. The Government of India's Gill Committee has made some recommendations on the future of these concessions which are being implemented through customs notifications. For example, streamlined procedures include delegation of approval powers, allowing entry of imported raw materials on a provisional basis to expedite customs clearance,

replacement of multiple bond by a single bond for obtaining import clearance and permitting companies under these schemes to supply and/or transfer finished goods among themselves.

However, the new focus on specialised industrial clustering, for both domestic and export markets, appears to be industrial or technological parks and model towns. These duty-free areas are known officially as Electronic Hardware Technology Parks (EHTPs) and Software Technology Parks (STPs). The more recent park proposals are advocated by the Department of Electronics and other Government agencies as an alternative to EPZs and EOUs which come under the jurisdiction of the Department of Commerce. The following conditions apply: 100 per cent equity and 25 per cent domestic sales permitted, ability to combine both hardware and software operations within the 60 per cent minimum value-adding requirement and 100 per cent income tax deduction.

In an effort to overcome a shortage of infrastructural facilities for business the Export Import Bank of India has been discussing the new town concept with Japanese interests. A number of 400-700 acre sites are being considered in areas such as the state of Karnataka and the New Delhi region. Locations are being decided on the basis of proximity to airport or harbour, accessibility by road, availability of power and suitable land. Similarly, the Singapore Government is working with the Government of Karnataka to establish a high technology industrial park in Bangalore. The computer companies IBM and DEC are involved in the Singapore initiative. Despite the growing equalisation of fiscal incentives, many companies continue to prefer the stable business environment, relative policy predictability and lower rents of EPZs: for example, there is a 40 company waiting list to enter the high technology Santacruz EPZ near India's business capital, Bombay. Foreign firms should thus examine all of these options, according to what best suits the foreign company, in considering any market entry strategy.

Taxation

Taxation is an extremely complex area, and an area of ongoing reform focus. The economic policy changes introduced in India also include a comprehensive reform of tax structures. The reforms have been discussed in Chapters 5, 6 and 7. Details relating to taxation which are likely to be relevant to setting up business operations in India are outlined in Annex 6.

Under the basic philosophy of introducing a simpler tax system with moderate rates of tax and a broader tax base, as well as a better tax administration, a number of significant changes in personal income tax were introduced in the 1992/1993 Budget. Significant reforms of corporate taxation and indirect taxes were announced in the latest 1994/95 Budget.

Employment Regulations

Labour Regulation

In India, the Government has responsibility for most employment and labour-related matters. Employees are afforded rights under a number of labour-related laws enacted at the Central and State levels. Employment regulations in public sector industries, such as power generation and distribution and transport, are under the jurisdiction of the State Governments.

Hours Worked

Work hours for full-time adult factory workers are 48 hours per week. Office workers work shorter hours. In general, offices work a 35 to 40-hour week. Overtime pay is usually equivalent to between one and a half to two times the usual hourly wage rate.

Minimum Wages

Wage levels for employees are fixed under minimum wages legislation. Wages comprise two elements, a basic wage and a cost of living ('dearness') allowance. The basic wage level is determined under criteria related to the category of employee. This, in turn, depends on the nature of the work required to be undertaken or the skills involved. The cost of living allowance is based on a cost of living index compiled by the Commissioner of Labour's Office in different industry regions across the country.

In practice, wage levels are above the legal minimum. Wage levels vary between companies and industry sectors, reflecting different market conditions and collective bargaining arrangements.

Employees are also entitled to other non-wage benefits. These can add about 50 per cent to the cost of labour. These benefits include:

- an annual bonus;
- contribution to employees' state insurance scheme;
- contribution to employees' provident fund;
- employment termination gratuity; and
- workers rent allowance (applicable in some states).

In the first three years of operation, newly established companies are exempt from making a contribution to the employees' provident fund.

Statutory Holidays

The number of paid statutory holidays per year for employees varies between States. In general, these normally amount to 10 to 20 days. In addition to these statutory holidays, there is provision for annual leave on full pay, according to length of service, as well as casual and sick leave, usually on half pay.

Health and Safety

There are statutory obligations on both employers and employees to ensure the health and safety of workers in all industries.

Employment Termination

A number of rules govern the termination of employment. Arbitrary dismissal is not permitted. Employers are required to give a month's notice, in writing, to employees who have worked for more than a year. In practice, the notice period is often longer than the required minimum, especially where long-standing and senior employees are involved. The notice should include justification from the employer for the termination of employment. In certain circumstances an employee may also be entitled to additional severance pay.

Equal Opportunity

Human rights laws prohibit employment discrimination on a number of grounds. These cover discrimination based on sex, age, marital status, handicap, race, religion, or ethnic origin. In addition, discrimination on the basis of sex is prohibited in the payment of wages where the job is the same. The exception to this is where the employment of women for certain jobs is legally restricted or prohibited.

Labour Relations and Trade Unions

Over the past few years, labour relations have improved markedly, with militant trade union actions becoming less frequent. This trend has been driven by a number of collective bargaining and negotiation mechanisms used by employers and employees to settle disputes and grievances and introduce changes to working practices.

Union membership is not obligatory. Most large industry establishments are represented by at least one union, usually connected to a political party. The unions, on behalf of their members, negotiate binding contracts and settlements with employers.

Social Security

Social security for individuals is provided for by a number of laws. These cover a range of issues relating to insurance, worker family pension, health insurance, compensation for accidents at work and contraction of occupational diseases, payment of gratuity on termination of employment, retirement payments, superannuation, and maternity benefits.

In some cases, employers are also required to provide certain social amenities for the welfare of employees and their families. These include canteens, first-aid facilities, creches for children, and education and recreational facilities where the employer operates a mine, factory or plantation.

Employment of Foreign Nationals

RBI permission is required before a foreign national can be employed in India, practice any profession, or carry on any occupation, trade or business where foreign exchange will be used to remit earnings outside the country. However, no permission is necessary to hire foreign technicians where:

- the engagement of foreign technicians by a company does not exceed 12 months in a year, with no single technician employed for more than three months;
- the payment to the foreign technician does not exceed US$500 per day, regardless of whether the local costs for board and lodging and other items are met by the Indian company; and
- in the case of company-to-company payment, the payment by the Indian company to the foreign company does not exceed US$50,000 in a year.

There are no restrictions on foreign nationals being accompanied by their families. Work permits are not required but foreign nationals do need a visa.

Market Entry Strategies

Forms of Business Enterprise

There are a number of routes to doing business in India, the choice of which depends on the particular requirements of the individual company concerned. In principle, the following types of business enterprise are open to foreign investors:

- a representative or liaison office;
- a branch office;
- acquisition of part or all of an existing Indian company; and
- the formation of a new company
    - with the foreign investor holding up to the maximum permitted proportion of equity
    - wholly owned by the foreign investor.

Representative or Liaison Office

Representative or liaison offices are only permitted to engage in specific activities. They include:

- acting as an intermediary;
- executing approved projects and contracts;
- undertaking promotional activity; and
- gathering information for the parent company head office.

A representative or liaison office is not permitted to accept orders or sign contracts. In addition, the office's expenses must be met directly by the inward remittance of funds from the parent company head office.

Permission to set up a representative or liaison office in India is required from the Reserve Bank of India. In the past, difficulties were often experienced in obtaining

permission because of the strict interpretation of what activities could be undertaken locally. The Reserve Bank is now more flexible in this respect. Permission is usually received within 30 to 45 days of applying.

Branch Office

Recent policy changes now permit foreign manufacturing and trading companies to open branch companies in India. However, the branch offices can only undertake a number of specified activities. These comprise:

- representing the parent company or other foreign company in India;
- conducting market research for the parent company (but the results of the research must be made available to Indian companies);
- undertaking import and export trading activity as buying and selling agents; and
- promoting potential technical and financial collaboration between Indian and foreign companies.

Permission must be obtained from the Reserve Bank of India to open a branch office. Permission is usually received within 30 to 45 days.

Acquisition of Part or all of an Existing Indian Company

It is possible for foreign investors to acquire part or all of an existing Indian company. In order to acquire an equity stake in an Indian company, under the Foreign Exchange Regulation Act 1973, foreign investors must obtain prior permission from the Reserve Bank of India. Similarly, divestment of an equity holding in an Indian company by a foreign investor to an investor resident in India requires permission from the Reserve Bank. This permission may be applied for by either the transferor or the transferee.

In addition to the requirement for a foreign investor to obtain permission from the Reserve Bank of India, the Indian company selling or transferring the equity is required to satisfy provisions of the Indian Companies Act 1956 and guidelines of the Securities Exchange Board of India, as well as to obtain a listing agreement with the stock exchange.

There are no restrictions on a foreign investor acquiring an equity stake in more than one Indian company.

The rules governing the acquisition of equity in Indian companies by foreign institutional investors are different. Such investors are allowed to acquire equity stakes in listed companies whose shares are traded on the stock exchange. However, there are limits to the proportion of share capital that can be held by a foreign institutional investor. These are currently 5 per cent of paid-up capital, subject to an overall limit of 24 per cent. Other acquisitions can be made but only through private arrangements.

There are also rules governing the acquisition of equity in Indian companies by NRIs. An NRI cannot acquire the whole or any part of any undertaking in India without the permission of the Reserve Bank of India.

The Formation of a New Company

A foreign investor can form a company as a joint venture with an Indian partner. This may be a partner from the private or public sector. Joint ventures are typically set up for a specific purpose. In practice they are rare, because a joint venture is not particularly well defined under Indian law and does not have a legal identity that is separate from the parties involved in the venture.

In addition, depending on its constitution, a joint venture is treated as a partnership or association of persons. In both cases the tax implications are not as favourable as for other forms of business entity.

A new company can also be formed with a foreign investor acquiring a proportion of the equity up to the permitted maximum. Essentially, the formation of a company is more flexible than a joint venture arrangement. In addition, if the foreign investor holds the majority equity holding it provides a means of implementing business practices and controls that are common to the parent as well as limiting the liability involved.

Other Forms of Business Enterprise

There are two other types of business enterprise in India: partnerships and sole proprietors. Both partnerships and sole proprietorships, as forms of business entity, are not open to foreign investors.

Appointment of Agents

Before making a significant commitment to the Indian market, a company is well advised to undertake local research in order to gain a greater understanding of local conditions. This could be done through agencies such as Austrade, a market research firm, or a business consultant. Alternatively, an Indian agent can be appointed to do this. There are no specific regulations governing the appointment of an Indian agent by an individual or company from outside the country.

Only companies incorporated in India can operate as agents. Until the beginning of 1992, this did not include those companies with more than 40 per cent non-Indian equity share holding (ie companies classified under the Foreign Exchange Regulation Act 1973). However, as part of the liberalisation program, this restriction is no longer applicable and such companies are permitted to act as agents.

There is a substantial number and variety of agents available in India. The actual appointment of an agent will, however, require some care. Any agent will accept the opportunity to act on behalf of a foreign individual or company. Unfortunately, this is often irrespective of their suitability and experience. As a result, consideration will

need to be given to identifying an appropriate agent by establishing, for example, whether the agent:

- specialises in a particular geographic area, State or industry sector;
- acts on behalf of other foreign companies, and in what capacity;
- can provide after-sales service;
- is competent technically to provide after-sales service; and
- is known to be reputable.

Austrade can provide assistance in matching companies with agents suited to their particular needs.

PART IV

AUSTRALIA'S INDIA STRATEGY

CHAPTER THIRTEEN

SEIZING THE MOMENT: AUSTRALIA'S INDIA STRATEGY

Projected average growth in the Indian economy of 6 per cent per year until the year 2000 offers a range of opportunities related to growing demand for technology, training and industrial inputs; growing demand for infrastructure; and growing demand from a large and expanding middle class of consumers. Australia could double its annual exports to the Indian market by the year 2000.

How can Australia make the most of these opportunities? Past efforts at closer economic relations have foundered once initial enthusiasm and momentum waned. Enthusiasm depended, in some part, on the commitment of particular individuals in politics, in government, and in business. Once they were no longer on the scene, the institutional structures in place were insufficient to generate further activity. That is not to deny the effort that did go into maintaining linkages and developing the relationship. Companies did go into India, and some did reasonably well. But results were far from spectacular.

Since then, as this report shows very clearly, India has broken with past economic policies and embarked on a new course. Opportunities are opening up, and while India has not yet attracted the degree of interest that China and other East Asian countries have, it is beginning to seem an attractive proposition for trade and investment. As noted in Chapter 8, many of Australia's competitors, particularly those from the United States and some of the countries in the European Union, have been more active than Australia. Australia has yet to match this level of activity in the sectors where we are competitive. One of the key findings of this report is that unless Australia increases its efforts in India, its share of the Indian market will drop.

Australia has for some time now pursued a policy of engagement with Asia. We now see ourselves very clearly as part of the Asian region, and our foreign and trade policies intermesh with those of our Asian neighbours where possible. Business, too, has been seized of the need to link in to the growing dynamism of the Asian region. India, while indisputably Asian, has not been part of our Asian orientation. The rest of East Asia has not had particularly close relations with India either. The obvious reason for this is that India itself, while mindful that its culture provided the underpinnings for much of East Asian civilisation, has not looked eastward. Its orientation has, for the most part, been westward: to Europe, and particularly the United Kingdom, to the United States, to the Middle East, and to the former Soviet Union and Eastern Bloc.

Nonetheless, as noted in Chapter 1, India is now starting to look east, to the rest of Asia, to fuel its economic growth. And Asia is beginning to take India seriously as a potential regional economic power. In looking east, India is also looking to Australia. The relationship with Australia has an added dimension, as we are also partners in the

Indian Ocean regional context, although at this stage the Indian Ocean is a far less integrated economic entity than the Asia Pacific region.

Australia now needs a strategy which revolves around 'putting India into Asia' in terms of Australia's policy focus. It should be a strategy designed to sustain closer linkages over the longer term. The three key objectives of the strategy are

- putting India into Australia's Asia focus
- kick-starting attention and providing information
- building the linkages

A framework for action based on this strategy appears at the end of this chapter.

Putting India Into Australia's Asia Focus

The Australian Government has developed a range of initiatives focusing on Asia. While India is not specifically excluded from these, for the most part it has not been a target country and, as a low priority, in many cases has been effectively excluded from participating. India would fit into a number of these schemes, and their focus should be reviewed in light of the findings of this report. Such schemes encompass those presented in the March 1993 'Australia in Asia' package of initiatives, including:

- Asian Entrepreneurs Scheme, to promote Australian exports to and business with Asia by tapping the skills of Australians of Asian origin

- the Industry, Science and Technology Network, which promotes greater awareness in Asia of Australia's industrial, scientific and technological capabilities by posting Department of Industry, Science and Technology counsellors to key centres in Asia

- Austrade's Australian International Management Exchange Plan, to enhance business links by enabling Asian business managers to work with Australian firms on short exchanges. India is not currently one of the eight priority markets

- Environmental cooperation with Asia, to strengthen commercial relationships by enhancing Asian awareness of Australian environmental technology and expertise, and

- DEET's Asia Fellowship Program, to enable Australians from a range of professonal and occupational backgrounds to undertake short-term professional development, exchange, study or travel in Asia.

India should also be included in the coverage of the East Asia Analytical Unit which produced this report. The report was produced by the Unit on a one-off basis.

Austrade has recently expanded its presence in India by upgrading its office in Bombay. Austrade could also review whether opening of further posts in India, for instance in the south (Bangalore or Madras) or east (Calcutta) might be warranted. Local trade

representatives in key business centres might also be an option. Other agencies might also consider the value of a regional presence.

Australia should ensure that special programs designed for visits, exchanges and training of contacts in the region (such as the Asia-Australia Institute's Young Leaders Forum) include India as a matter of course.

Kick-starting Attention and Providing Information

Australia needs to send the right signals to India to show that we are interested in pursuing closer relations. A Prime Ministerial visit to India, should take place as soon as possible. This should be followed by an invitation for Indian Prime Minister Rao to visit Australia. The flow of high-level visits should be kept up. For instance, business missions led by Ministers could be an effective means of promoting awareness of Australian capacities. Such visits could include trips to target regions rather than focusing only on New Delhi and Bombay.

To capture wider business interest, the strategic decision makers - Chief Executive Officers - need to be convinced of the opportunities. The first major business mission to India led by the Minister for Trade should be at this level. CEO commitment will provide added impetus to government initiatives to deepen the economic relationship. Subsequent business missions could be pitched at different levels, and regionally and sectorally focussed.

To fill the information vacuum on India, the findings of this report should be widely disseminated. We propose to hold a series of seminars in Australian State capitals to follow up the report. There is a continuing need for comprehensive information packages on India - fact sheets, directories and so on, in addition to existing channels such as the Department of Foreign Affairs and Trade's Country Economic Brief, its Cable Subscription Series, and Austrade's regular India Update series, Newscan services, amd India seminars.

Wider media exposure in India and Australia, focusing on new economic orientations, would assist in changing perceptions and correcting stereotypes. This could include support for the ABC's Australia Television International in developing an Indian satellite TV audience for purposes of public diplomacy (image building) and commercial advertising now that Australian Television's footprint is being extended west to encompass India. Promotional supplements on Australia in prestigious Indian magazines and newspapers with a wide circulation, such as *Business India*, *India Today*, and the *Economic Times*, will assist in raising Indian awareness of Australia.

Building the Linkages

There are sufficient institutional mechanisms in place to conduct the economic relationship effectively, and this report does not recommend the setting up of new ones. But not all of the existing mechanisms are working as effectively as they could be. For instance, the Joint Ministerial Commission has been held only sporadically, and has not always reflected preparation of an agenda designed to advance the dialogue at a high-level discussion. There needs to be a regular intersessional process to follow-up on

issues raised and to concentrate on devising an agenda appropriate for ministerial discussion.

Considerable scope also exists to revitalise existing bilateral agreements, for instance in science and technology. This is an area where Australia and India could usefully draw on each other's expertise in areas of mutual interest. The India-Australia Science and Technology Agreement could provide R & D and technical support to facilitate entry to India of Australian industry, and vice versa.

Australia should seek to foster institutional linkages across a wide range of areas where we can see complementarities with India. For instance, given recent Australian experience with restructuring the public sector, India may be interested in setting up an exchange scheme involving key areas of the Indian bureaucracy which draws on relevant Australian expertise in improving management and productivity. Australian 'technology transfer' in labour dispute arbitration and conciliation, initially with public sector unions, which could involve both the Department of Industrial Relations (DIR) and the Australian Council of Trade Unions (ACTU), might assist India in improving labour market flexibility.

Other institutional linkages could be developed, working with the Australia India Council. For instance, it would be useful to foster further institutional linkages between Indian Institutes of Technology and Management with equivalent Australian educational institutions and the CSIRO, with a focus on Bangalore high technology, Bombay/Ahmedabad management schools and Madras manufacturing enterprises. The establishment of an Indian counterpart to the Australia India Council should be encouraged.

Twinning between States or cities in Australia and India is an effective means of increasing the focus in both directions. Given existing close links between India and Western Australia, we would recommend that Perth be designated as a 'Gateway to India'. Other Australian cities should also be encouraged to twin with regions identified in this study where there is some perceived complementarity.

As a longer term measure, Australia should seek partner status in major trade exhibitions. We should accept India's invitation for Australia to be the 'partner country' in the 1999 biennial International Trade Fair organised by the Confederation of Indian Industry (CII), and should invite the CII to set up a temporary office in Perth, Melbourne or Sydney from 1995-1998 to organise this, as the United States and Canada did when they were partner countries. Such an occasion would be appropriate for concurrent organisation of a major Australian promotion in India, along the lines of 'Australia Today 94' in Jakarta.

Australia should also consider Singapore as a third country partner in the region to jointly develop the Indian market in targeted sectors both at the government and industry levels, in expectation of exploiting synergies of combined government support, NRI community, comparative advantages and shared risks and burdens.

India should continue to be included in the National Trade and Investment Outlook Conference. This provides an opportunity for raising Australian awareness of

opportunities in India, and also for senior Indian business executives to see Australian capacities.

The passing of the midnight hour on 14 August 1947 marked the achievement of India's independence from Britain. While less precisely marked, its second midnight hour, the opening up of the economy, may be equally significant. Australia's India strategy needs to seize the moment of the midnight hour of the Indian economy. Others are doing so. Australia should not be left behind. But it is starting from a low base, and there is a considerable distance to go. Let it be hoped that by the dawn of the new day, Australia will be recognised as a significant player on the Indian economic scene.

Figure 13.1
FRAMEWORK FOR ACTION[117]

AUSTRALIA'S FIVE-YEAR OBJECTIVES IN THE INDIAN MARKET	**MINIMAL**	**MAXIMAL**	**INVESTMENT LINKS**
	(A fall in market share from 3 to 2.3 per cent) achieving annual exports of A$1.5 billion by the year 1999* * assuming a base-case scenario of 6.3 per cent average annual growth in India in the 1990s. Faster growth would boost our export opportunities.	***(Improving market share from 3 to 3.5 per cent)*** achieving annual exports of A$2.3 billion by the year 1999*	***(Keeping Australia's investment links with India in line with the increasing interest shown by international players)*** maintaining Australia's position in the top 10 sources of foreign investment approvals by increasing the annual flow of investment to match the upsurge of international involvement in India.

[117] The concept for this framework was first developed by the East Asia Analytical Unit for its research on South-East Asian markets. It is an equally valid approach for formulating strategies for any market and has been developed here for the Indian market based on the foregoing analysis.

AUSTRALIA'S INDIA STRATEGY

MARKET PRIORITIES

(There will be opportunities arising in all states depending on the type of industry so this list is not exclusive)

- **Top priorities due to complementarities and better basic infrastructure for business**

SOUTH ***Tamil Nadu, Karnataka***
WEST ***Gujarat, Maharashtra***
NORTH ***Haryana, Punjab***
EAST ***West Bengal***

- **Other Areas of interest based on mining and infrastructure development plans**

Madhya Pradesh
Andhra Pradesh

AUSTRALIA'S INDIA STRATEGY

MAJOR INDUSTRY OPPORTUNITIES

Manufactures
Infrastructure Materials including Specialised Steel and Aluminium Products; Transport; Telecommunications and Power Equipment; Processed Foods; Specialist Technology-based Machinery & Equipment; Niche Consumer Products

Services
Financial Services; Telecommunications and Information (computing, database and data processing) Services; Legal, Accounting and Business-related Services; Education and Technical Training; Freight and Insurance Services; Infrastructure and Mining-related Consultancy Services; Tourism

Agriculture
Wool; Vegetables; Dairy Products

Minerals and Energy
Coal; LNG

AUSTRALIA'S INDIA STRATEGY	**MAJOR INVESTMENT OBJECTIVES AND OPPORTUNITIES** ***Securing market access*** Establishing a name in-market; getting close to a large and increasingly affluent market; gaining early access prior to removal of tariff barriers. ***Utilising complementarities*** Particularly blending Australian technology with Indian resources and labour ***Accessing commercial information networks*** Locking into the Indian market for the future
ACTIONS	**GOVERNMENT ROLE** **Engaging India as we have engaged East Asia** ***Putting India into Australia's Asia Focus*** Ensure India is included in Australia's existing Asia Programs ***Kick-starting Attention and Providing Information*** Undertake public affairs activities to ensure India is aware of Australia's capabilities; reinvigorate existing bilateral agreements and dialogue; increase the frequency and level of officials' and ministerial visits; targeted trade missions ***Building the Linkages*** Pursue market access; pursue bilateral agreements (eg. investment protection); broaden institutional linkages; encourage twinning of States and cities; seek partnerhip status in trade exhibitions.

ACTIONS	PRIVATE SECTOR
	Reassess the Indian Market Obtain up-to-date read-out of information on reforms and outlook, investigate potential opportunities, review and update perceptions. ***Factor India into Consideration of Commercial Strategies*** India will not be the right market for every firm, but growth projections and potential opportunities indicate it is worth considering for many industries. ***Do Your Homework*** Sophisticated markets require hard work. Be prepared. Understand constraints and difficulties. Examine success factors for the market. Build contacts and utilise networks.

PERFORMANCE INDICATORS

- **Increased exports of goods and services to the Indian market**
- Maintenance or improvement of our current market share
- Increased investment flows
- Improved knowledge of Australia and Australian products in India (tested by market surveys)
- Increased flow of business visitors in both directions
- More productive bilateral dialogue and progress on market access and other issues impeding trade and investment
- Increased science and technology links
- Increased educational links
- Increased use of networking among firms to secure market opportunities