India

Budget calls for structural reforms

by Susan B. Maitra and Ramtanu Maitra

India's 1992-93 budget puts the economy on a new path, giving a further push to the program of economic reforms launched by the Congress Party government in July 1991. A number of major structural reforms, including partial convertibility of the Indian rupee, have been proposed and have received favorable responses from industrialists.

Presentation of the budget on the last day of February, as is the tradition in India, was done amid vocal charges by opposition leaders of virtual treason on the part of Finance Minister Manmohan Singh. An unprecedented 20-minute demonstration by the opposition had taken place in parliament, the Lok Sabha, on Feb. 4. Singh was accused of making the budget known to the foreign agencies, such as the World Bank and the International Monetary Fund (IMF), prior to the public presentation, thereby compromising budget secrecy. The opposition charged that the budget is no more than the diktats of the IMF and the World Bank. Not so, claimed the government.

The new budget for fiscal year 1992-93, beginning April 1, does satisfy demands made by the IMF-World Bank as prerequisites for granting the upper tranche loan which India has already signed with the IMF, and the structural adjustment loan which India is negotiating with the World Bank. As a result, trade reforms have been given precedence over labor and financial sector reforms. The budget also failed to address inflation which is presently running at an annual rate close to 12%.

What the reforms include

Structural reforms addressed in the budget include partial convertibility of the rupee, reducing the floor on bank interest by 1%, slashing the commercial banks' liquidity ratio by 8.5%, moving most imports from the restricted list into the Open General Licensing (OGL) category (and thus reducing the ceiling on duty to 10%), and downgrading government control over capital issues.

Partial convertibility of the rupee will allow 60% of all foreign remittances to be converted at a market-dominated rate, which is expected to be 15-20% higher than the official rate, while the remaining 40% will be pegged at the official exchange rate. All essential imports, such as oil and petroleum products, fertilizers, defense equipment, and life-saving drugs, will remain at the official rate. But other imports, which are included in the OGL and disbursements of foreign debt, dividends, and royalties will use the foreign exchange kitty at the market-dominated rate.

Behind this move is the fact that a large amount of foreign remittances, principally from Indian workers in the Persian Gulf and elsewhere, never reach India. These funds find their way into the hands of organized gold smugglers and others paying a much higher rate than the official exchange rate. It is expected that the partial convertibility will boost a reverse capital flight and over a period of time, the market-dominated rate and the official rate would merge.

Some analysts point out that this plan makes official yet another devaluation of the rupee. However, this hidden devaluation does not force up the prices of essential imports, which will be using the official rate. Moreover, in the 1991-92 budget, the government had already introduced the Exim Scrip safeguard, whereby 30% of export income in foreign exchange was sold to importers at a premium, establishing a market rate for foreign exchange. The partial convertibility plan simply enlarges the scope of this program.

Markets, industrialists pleased

Reduction of the floor on bank interest, slashing the statutory liquidity ratio and removing government control over capital issues have made both the market and industrialists happy—a fact also reflected in the steep rise in the Bombay Stock Exchange the day after the budget was announced. Finance Minister Singh has made clear that the government is now passing on the burden of investment in the industrial sector to the private sector. Dr. Singh has actually triggered the mechanism through which a shift could occur, although verbal assurances to do this had begun with the 1985-86 budget when the late Rajiv Gandhi was prime minister.

Industry has expressed confidence that the measures will stimulate growth, correct structural imbalances, improve the balance of payments situation, boost the capital market, encourage better tax compliance, and ensure the success of economic reforms. The small-scale sector is not so enthusiastic. The president of the Federation of All India Foundries has said that more positive measures should have been outlined for that sector. Their main concern is that the proposals will result in a higher cost of goods, no access to additional resources, and lower profitability due to the hiking of excise duties for the small-scale industries.

Others argue that the proposed trade reforms will not work. In this view, the government did achieve major macrobalances by reducing the budget deficits in the last two budgets and demolishing the licensing process. However, by not going after financial sector and labor reforms, the government has kept certain rigidities in place which work to blunt productivity.

Meeting IMF-World Bank demands

By reducing the fiscal deficit to 6.5% of Gross Domestic Product (GDP) during 1991-92 and promising to bring it down to 5% of the GDP in the next year, Singh has met the demands of the IMF-World Bank. Other of their demands are: reduction of import duties from the peak of 150% to 110%, reduction of duty on general projects and machinery from 80% to 60%, reduction of duty on capital goods, significant slashing of the statutory liquidity ratio, and allowing foreign pension funds to invest in the Indian capital market.

At a press conference on the budget, a Finance Ministry official predicted that the GDP growth will increase from 2.5% in the present fiscal year to 4.0% by the end of March 1993. "The bottom point of the economy's performance was in 1991-92 and the worst is over, with a pickup in growth already being noticed from January this year," said Finance Secretary K. Geethakrishnan. He said the various steps outlined in the budget would help generate more employment opportunities by stimulating industrial and agricultural growth, as well as providing funds for social overheads, particularly poverty alleviation programs.

It is on the issue of inflation that many have expressed doubts. Finance Minister Manmohan Singh predicts that the budget will bring down inflation from the prevailing 12% to about 7% by the end of the next fiscal year. But a similar promise was made about last year's budget.

At the time of last year's budget presentation, the hike in world oil prices due to the impending Persian Gulf war was cited as a key component behind the price rise. In the interim, however, the oil price has crashed and inflation has continued.

India's *Economic Times* editorialized that the failure to curb inflation was due to two causes—excess net bank credit to the government which kept pumping high-powered money into the economy, and inflationary expectations which fueled agricultural prices.

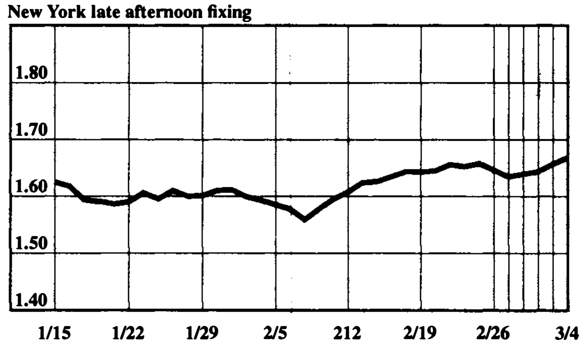
The government has yet to tackle these issues.

Finance Secretary Geethakrishnan told newsmen that inflation would be curbed not only by containing the fiscal deficit, but also by increasing production, raising foreign exchange reserves through expanding exports and removing import curbs.

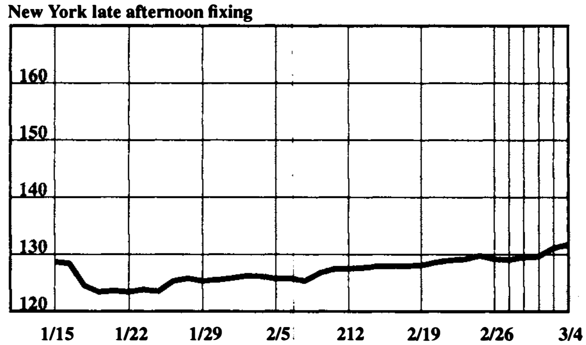
The *Economic Times* points out that, import compression through physical Reserve Bank of India curbs had ended, but bringing all private sector imports into the convertible rupee scheme is import compression by another name. So, customs revenue, which plunged in 1991-92 and caused the revenue deficit to widen, is going to depend more and more on exports. At the same time, inflationary expectations in agriculture will worsen if the government fails to procure a large amount of wheat in the winter crop season. Already in Punjab, wheat is selling at almost 50% above the procurement price.

Currency Rates

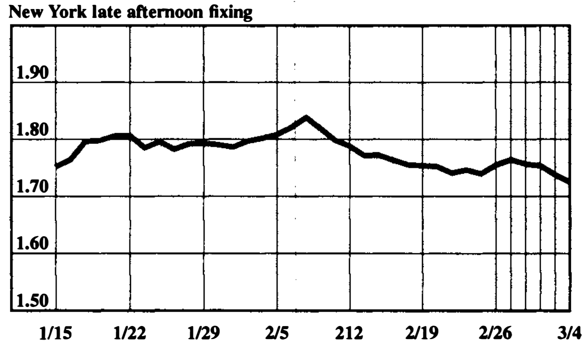
The dollar in deutschemarks
New York late afternoon fixing



The dollar in yen
New York late afternoon fixing



The British pound in dollars
New York late afternoon fixing



The dollar in Swiss francs
New York late afternoon fixing