

SANEI DISTINGUISHED LECTURE

November, 9, Colombo

INDIA'S MACROECONOMIC PERFORMANCE IN THE NINETIES *

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Introduction

It is a great pleasure to be here in Colombo to deliver this SANEI Distinguished Lecture. As many of you know, SANEI stands for South Asia Network of Economic research Institutes, which has been in existence for about three years. What most of you may not know is that the idea of SANEI was born right here in Colombo at a conference on South Asian economic development jointly organised by the Central Bank of Sri Lanka and the World Bank in the spring of 1998. I was an active participant at that conference but I can claim no credit for turning the idea of a South Asian research network into the vibrant reality of SANEI. That credit goes almost entirely to my friend and colleague Dr. Isher Ahluwalia, who is known to many of you.

I am particularly delighted to be delivering this SANEI lecture in the Marga Institute auditorium since Marga is a founding member of SANEI.

In my lecture today I will focus on four major dimensions of India's macroeconomic performance – overall economic growth, inflation, external sector performance and the domestic balance yardsticks of fiscal deficits, savings and investments. While my focus will be on the decade of the nineties, I will endeavour to add some historical perspective.

* This SANEI Distinguished Lecture was delivered in Colombo, Sri Lanka on 9th November, 2001. It draws heavily on the author's recently completed larger work, India's Macroeconomic Management in the Nineties, published by the Indian Council for Research on International Economic Relations (ICRIER) in October, 2001. The author is a professor at ICRIER on sabbatical leave from his previous assignment as Chief Economic Adviser, Ministry of Finance, Government of India. The views expressed are strictly personal.

Economic Growth

Economic growth is the principal yardstick of macroeconomic performance. By this standard, the two decades since 1980/81 have been easily the best in the last half century of India's economic performance (Table 1). After averaging the so-called "Hindu rate" of 3.6 per cent per year in the thirty years between 1950/51 and 1980/81, GDP growth accelerated to 5.6 per cent in the eighties and averaged even higher at 5.8 per cent in the final decade up to 2000/01. Indeed, if the crisis-affected year of 1991/92 is omitted, as it reasonably should be, GDP growth in the past nine years (1992/93 – 2000/01) averaged an unprecedented 6.3 per cent.¹

Furthermore, the growth performance of the eighties was bedevilled by the emergence of unsustainable fiscal deficits and increasing strains in the external accounts, which triggered the crisis of 1991. In the last nine years, although the fiscal imbalances have waned and waxed, the external sector has been far more manageable. Clearly, this has been a golden decade (almost) of growth for India. The trend in decadal growth rates looks even better when we look at per capita GDP growth, which accelerated from 0.8 per cent in the seventies to 4.4 per cent in the last nine years. If we think of per capita GDP as a rough proxy for average living standards of India's population, the last two decades have shown welcome improvement.

India's growth performance in the last two decades of the twentieth century also looks good in international perspective. Virmani (1999) ranks India sixth in the world growth league after China, Korea, Thailand, Singapore and Vietnam (Table 2). This is certainly a far cry from the conventional image of the Indian economy as a lumbering, shackled giant trailing far behind most significant emerging market economies in the growth race. Even more heartening is Virmani's finding that India retains sixth position when the ranking is redone in terms of per capita GDP growth.

¹ Some commentators believe that the growth in the crisis year of 1991/92 should be included in the earlier, "pre-crisis" period (which would pull down that average to 5.3 per cent) on the grounds that the crisis was a direct result of the policies and trends in the eighties. Others, such as Williamson, feel that 1991/92 growth belongs in the latter period because of "slack build up during the crisis". My preferred option of omitting 1991/92 from both periods would seem to be a reasonable compromise.

Table 1: Average Growth of Real GDP over Fifty Years

(percent)

	1951/52- 1960/61	1961/62- 1970/71	1971/72- 1980/81	1981/82- 1990/91	1991/92- 2000/01	1992/93- 2000/01
1. Agriculture and Allied	3.1	2.5	1.8	3.6	2.8	3.2
2. Industry	6.3	5.5	4.1	7.1	5.7	6.4
3. Services	4.3	4.8	4.4	6.7	7.8	8.1
4. GDP (factor cost)	3.9	3.7	3.2	5.6	5.8	6.3
5. Per Capita GDP	2.0	1.5	0.8	3.4	3.9	4.4

Source: Central Statistical Organisation**Note:** Industry includes Construction**Table 2: Growth Trends for Medium and Large Countries: 1980-2000**

(percent)

Country	GDP		Per Capita GDP	
	Growth Trend	Rank	Growth Trend	Rank
China	10.1	1	8.8	1
Korea, Rep.	7.7	2	6.6	2
Thailand	7.1	3	5.7	3
Singapore	6.9	4	5.1	4
Ireland	5.3	10	4.9	5
India	6.0	6	4.1	6
Vietnam	6.2	5	4.1	7
Chile	5.6	9	4.0	8
Indonesia	5.7	8	3.9	9
Hong Kong	5.3	11	3.7	10
Malaysia	6.0	7	3.5	11

Source: Virmani (1999)

- Notes:**
1. Medium and Large countries are defined as those with population greater than 10 million and GDP greater than \$ 40 billion.
 2. The growth trend for 1980-98 is a log average of the growth trends for 1980-90 and 1990-98, from *World Development Report, 1999-2000*.
 3. Population growth trends from *World Development Report, 1998-1999* and projections.
 4. Forecasts of 1999 and 2000 are from Asian Development Bank's *Asian Economic Outlook 1999* and IMF *World Economic Outlook* where available.

Table 3 presents more detail on India's growth in the most recent decade, including performance of the major sectors which constitute GDP. Furthermore, we subdivide the nine years following the 1991 crisis into an initial high growth period of five years (corresponding to the Eighth Plan) and the subsequent four years up to 2000/01. Several points are worth noting. First, comparing performance in the last nine years to the pre-crisis decade, it is interesting that the acceleration in GDP growth (from 5.6 to 6.3 per cent) is entirely attributable to the services sector where growth surged to 8.1 per cent from an already high 6.7 per cent in the eighties. Indeed, the growth of both agriculture and industry averages a little slower in the post-crisis nine years compared to the pre-crisis decade. Second, focusing now on the post-crisis quinquennium, the acceleration of GDP growth to 6.7 per cent from the pre-crisis decadal average of 5.6 per cent is quite remarkable. Clearly, economic policy (including macro policy) was getting some things right! Third, it is noteworthy that in the post-crisis quinquennium all the major sectors (Agriculture, Industry, Services) grew noticeably faster than in the pre-crisis decade. Fourth, it is interesting to note that in both the pre-crisis and post-crisis quinquennium, the sectors of industry and services grew at almost identical rates.

The good news ends when we look at the average growth performance in the four most recent years. Overall GDP growth drops to 5.8 per cent. Much more disquieting is the collapse of agricultural growth to 1.4 per cent (from over three times the rate in the Eighth Plan period) and the significant fall in industrial growth down to 4.9 per cent. Indeed, the drop in GDP growth in these four years would have been much steeper but for the extraordinary buoyancy of services which averaged growth of 8.8 per cent. This growth in services was much faster than industry, a pattern which is quite different and novel compared to our past experience and, at the very least, raises questions of sustainability.

Table 3: Growth of GDP and Major Sectors

	Share in Real GDP 1993-94 prices (%)	Average Annual Growth Rates			
		Average of 1994/95 - 1996/97	1981/82 - 1990/91	1992/93 - 2000/01	1992/93 – 1996/97
	(1)	(2)	(3)	(4)	(5)
1. Agriculture	28.9	3.6	3.2	4.7	1.4
2. Industry	27.6	7.1	6.4	7.6	4.9
3. Services	43.5	6.7	8.1	7.6	8.8
4. GDP (factor cost)	100.0	5.6	6.3	6.7	5.8

Source: Central Statistical Organisation

The growing importance of services in India’s economic growth is brought out in Table 4. In both the pre-crisis decade and the post-crisis quinquennium services accounted for a little under half of GDP growth. For the full nine years, post-crisis, the growth-contributing role of services was almost 60 per cent. Even more remarkably, the proportion rose to 70 per cent in the last four years. Without wishing to be labeled as a commodity-fetishist, this kind of numbers surely raises genuine issues of both plausibility and sustainability.

Furthermore, a part of the services sector growth in the last four years was “spurious” in the sense that it simply reflected the revaluation of the value added in the subsector “Public Administration and Defence” because of higher pay scales resulting from decisions on the Fifth Pay Commission. It is a peculiarity of national income accounting conventions that value added in non-marketed services is estimated on the basis of cost. These Pay Commission effects (including knock – on effects in States) were spread mainly over three years, 1997/98, 1998/99 and 1999/2000, when ‘real’ growth of ‘Public Administration and Defence’ soared to 14.5 per cent, 10.3 per cent and 13.2 per cent, respectively, compared to an average growth in the previous five years of less than 4 per cent. Subtracting the trend growth from the exceptionally high reported growth rates gives a measure of the “spurious” (or Pay Commission effected) growth in these years, which we also subtract from overall GDP growth in the relevant years. This adjustment reduces GDP growth by 0.5 per cent in 1997/98 and 1999/2000 and by 0.4 per cent in 1998/99. The adjusted (net of Pay Commission effect) GDP growth becomes 4.3 per cent in 1997/98, 6.2 per cent in 1998/99 and 5.9 per cent in 1999/2000. As a result of

these adjustments, the average GDP growth in the last four years 1997/98 to 2000/01 drops to 5.4 per cent, which is below the 5.6 per cent average for the pre-crisis decade and substantially lower than the 6.7 per cent achieved in the post-crisis quinquennium.²

Table 4: Sectoral Contributions to Growth

(percent)

	1990-91/ 1980-81	2000-01/ 1991-92	1996-97/ 1991-92	2000-01/ 1996-97
1. Agriculture and Allied	21.9	14.0	21.1	6.1
2. Industry	32.0	27.3	30.8	23.4
3. Services	46.1	58.7	48.1	70.5
4. GDP (factor cost)	100.0	100.0	100.0	100.0

Source: Central Statistical Organisation

A serious investigation of the determinants of growth in the last decade is far beyond the scope of this paper. But we can essay a brief heuristic story.

GDP growth collapsed to 1.3 per cent in 1991-92 as the balance of payments crisis of 1991 took its toll. The stabilization and structural reform measures of 1991-93 restored macroeconomic stability and fuelled one of the swiftest recoveries of economic dynamism seen anywhere in the world in recent decades [see Acharya (1995, 1999)]. GDP growth recovered to nearly 6 per cent in 1993/94 and exceeded 7 per cent in each of the next three years. Manufacturing recorded average real growth of 11.3 per cent in the four years 1993/94 to 1996/97. Export growth in dollar terms averaged 20 per cent in the three years 1993/94 – 1995/96 and the rates of aggregate savings and investment in the economy peaked in 1995/96. Real fixed investment rose by nearly 40 per cent between 1993/94 and 1995/96, led by a more than 50 per cent increase in industrial investment. It was, manifestly, boom time for the Indian economy.

² It could be argued that, for strict comparability, similar adjustments should be made to the growth in previous periods following previous Pay Commission decisions. However, the scale of the pay increases following the FPC is of a different order.

The year 1997 was a watershed, which rang in the end of the economic party. In particular, three marker events occurred within a six month period to check the momentum of growth. In March, the instability inherent in coalition governments became manifest in the political crisis which ended the Deve Gowda government and ushered in the Gujral version of the United Front government. In July the Thai financial crisis raised the curtain on the Asian crisis saga, which dominated the international economic arena for next 18 months. Finally, in September, the Gujral government announced its decisions on the Fifth Pay Commission report, decisions which were to prove costly for both the fiscal and economic health of the country.

Economic growth fell to 4.8 per cent in 1997/98, 4.3 per cent if the “Pay Commission effect” is netted out. Agriculture recorded negative growth in value added, while the growth of manufacturing slumped to 1.5 per cent from 9.7 per cent in the previous year. Only services boomed at 9.8 per cent. Although industrial expansion remained subdued, GDP growth recovered smartly in 1998/99 thanks to a strong rebound in agriculture and continued buoyancy in services. Growth was sustained in 1999/2000 by a temporary recovery in industry. In 2000/01, renewed industrial deceleration and virtual stagnation in agriculture pulled GDP growth down to 5.2 per cent.

The marker events of 1997 are by no means the only reasons for the deceleration in India’s economic growth after 1996/97. Others included the petering out of productivity gains from economic reforms, which clearly slowed after 1994. Although reforms continued throughout the decade, they never regained the breadth and depth of the early nineties. Key reforms in the financial sector, infrastructure, labour laws, trade and industrial policy and privatization remained unfinished or undone. Real investment in industry, which had risen fast until 1995/96, plateaued thereafter for several reasons, including the political instability associated with three general elections and a succession of coalition governments, rising fiscal deficits after 1996/97 which kept real interest rates high, and the loss of momentum in reforms. Third, despite good intentions, the bottlenecks in infrastructure became worse over time, especially in power, railways and water supply, reflecting slow progress in reforms of pricing, ownership and the regulatory framework. Fourth, the low quality and quantity of investment in rural infrastructure combined with distorted pricing of some key agricultural inputs and outputs to damp the growth of agriculture. Fifth, the continuing decline in governance and financial discipline

in (especially, but by no means exclusively) the populous States of the Gangetic plain constrained growth prospects for over 30 per cent of India's population. Finally, aside from the Asian crisis of 1997/98, the economic sanctions of 1998/99 and the rebound of international oil prices in the last two years have together made the international economic environment less supportive than in the Eighth Plan period.

The above discussion omits the important issue of the evolution of **potential** GDP over time and the gaps between potential and actual GDP. Some interesting work has been done by Reserve bank of India (RBI) analysts Donde and Sagar (1999) showing much lower differences between potential and actual growth in the post – 1991 period as compared to the previous four decades. Although the study is not conclusive, it does suggest that macroeconomic policy has had greater success in attaining the economy's output potential in the last decade than in any previous period.

Inflation

If growth is the key measure of macroeconomic performance, inflation (or rather its absence) is the generally preferred indicator of macroeconomic stability. As Table 5 shows, the 1950s was the best decade in the last half century as far as inflation is concerned. The seventies had the worst record, with annual inflation averaging in double digits. This is mainly because the decade straddled the two oil shocks of 1973/74 and 1979/80. In both the decades since 1980/81 inflation has averaged in the 7 to 8 per cent range: the average annual rate was 7.2 per cent in the ten years upto 1990/91 and 7.8 per cent in the ten years since. If the crisis year of 1991/92 is omitted, the average rate of inflation in the last 9 years was 7.1 per cent.

**Table 5: Average Annual Inflation (WPI) over Fifty Years
(percent)**

1951/52 to 1960/61	1.8
1961/62 to 1970/71	6.3
1971/72 to 1980/81	10.3
1981/82 to 1990/91	7.2
1991/92 to 2000/01	7.8
1992/93 to 2000/01	7.1

Sources: RBI and Ministry of Finance.

**Table 6: India's Inflation in Global Perspective
(Average Annual Percentage Increase)**

	1981-90	1991-2000	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
India	7.2	7.8	13.7	10.1	8.4	12.5	8.1	4.6	4.4	5.9	3.3	7.0
Advanced Economies	5.6	2.6	4.7	3.5	3.1	2.6	2.6	2.4	2.1	1.5	1.4	2.3
Developing Countries	39.0	25.6	43.2	42.8	43.2	55.3	23.2	15.4	9.9	10.4	6.7	6.1
Asia	7.1	8.2	8.3	8.6	10.8	16.0	13.2	8.3	4.8	7.7	2.5	1.9
Latin American and Caribbean	145.4	77.3	173.9	150.3	152.1	200.3	36.0	21.2	12.9	9.8	8.8	8.1

Sources: IMF, *World Economic Outlook*, various issues and RBI *Handbook of Statistics for the Indian Economy, 2000*.

Notes: 1. For India the data relate to the WPI and fiscal years (1991 means 1991/92).

2. Country grouped data from the IMF are consumer prices.

How does India's inflation record stack up in international perspective? Table 6 provides some answers for the last two decades. In the eighties India's average inflation rate of 7.2 per cent was close to the average rate for Asian Developing Countries as a group (7.1 per cent), a little above the average rate for the "Advanced Economies" (5.6 per cent) and much lower than the average for all Developing Countries (39.0 per cent), which was driven high by Latin American inflation (145.4 per cent). In the most recent decade a similar pattern is repeated except for the conspicuous difference that inflation in Advanced Economies is very low at 2.6 per cent, or one-third the average rate for India. Two other points are noteworthy. First, although the average inflation recorded by Asian Developing Countries is marginally higher than India's for the decade, the Asian group does better than India in the two most recent years. Second, Latin American inflation has dropped to single digits in the last three years.

All of this suggests that in the closing years of the twentieth century the inflation dragon had been slayed in most parts of the world. This was both a boon to India (in helping contain price increases of freely traded commodities) and a challenge to keep inflation low or suffer the penalties in competitiveness and exchange rate volatility.

Conventionally, inflation in India is measured by the wholesale price index (WPI) for the principal reason that its coverage is far wider and more uniform than that of the three available consumer price indices (CPI) for selected sections of society. Of the three available CPIs, the index for industrial workers, CPI(IW), is most commonly used when there is a special need to focus on consumer prices. Of late (e.g. Reserve Bank, 2000) the concept of "core inflation" has gained some currency both in India and abroad. Alternative measures of "core inflation" have been experimented with by the RBI. For our purpose, the essence of the idea (of filtering out temporary fluctuations because of supply shocks and administered price hikes) may be adequately captured by looking at trends in the wholesale price index for manufactures, WPI(MP).

In Table 7 and Figure 1 we look at the evolution of inflation during the last decade. It is also instructive to split the decade into two five-year periods. The first noteworthy point is that inflation was in double digits in the first half of the decade according to all three indices. Even if the crisis year of 1991/92 is excluded, inflation averaged close to 10 per cent in the next four years according to all three indicators.

Second, the rate of inflation clearly decelerated in the second half of the decade according to all three measures. Going by the usual measure of inflation, the WPI, the rate was halved down to 5 per cent in the latter quinquennium. The deceleration was even more dramatic, down to 3 per cent, in core inflation as measured by WPI(MP). The CPI(IW) slowed the least, mainly because of the exceptional spurt in food prices (especially onions and potatoes) in 1998/99. Third, although the WPI ratcheted up by 7 per cent in 2000/01 because of higher oil prices, the increase in both core inflation and the CPI(IW) remained subdued.

Table 7: Indian Inflation in the Nineties

(Average Annual Percent Increase)

	WPI(AC)	WPI(MP)	CPI(IW)
1991/92- 2000/01	7.8	6.6	8.7
1991/92- 1995/96	10.6	10.2	10.2
1992/93- 1995/96	9.8	9.9	9.4
1996/97- 2000/01	5.0	3.1	7.3
1991-92	13.7	11.3	13.5
1992-93	10.1	10.9	9.6
1993-94	8.4	7.8	7.5
1994-95	12.5	12.2	10.1
1995-96	8.1	8.6	10.2
1996-97	4.6	2.1	9.4
1997-98	4.4	2.9	6.8
1998-99	5.9	4.4	13.1
1999-00	3.3	2.7	3.4
2000-01	7.0	3.2	3.8

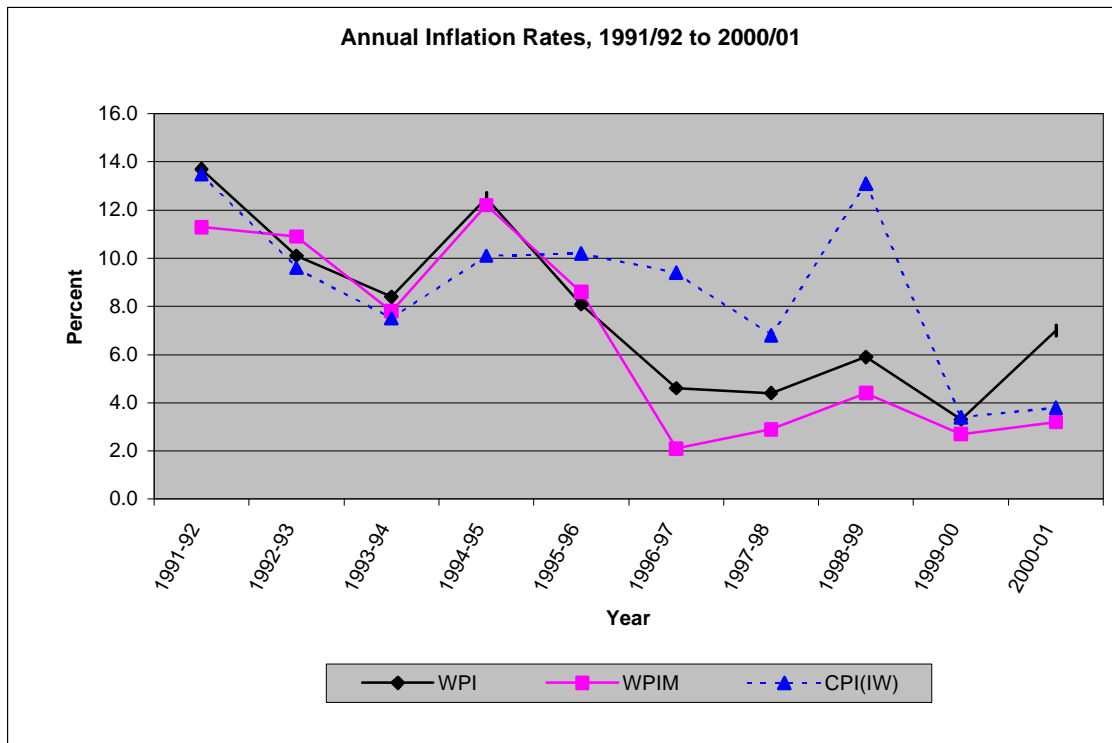
Sources: RBI and Ministry of Finance

Notes: WPI(AC): Wholesale Price Index for All Commodities

WPI(MP): Wholesale Price Index for Manufactured Products

CPI(IW): Consumer Price Index for Industrial Workers

Figure 1



As with economic growth, inflation is a multi-causal phenomenon, which defies simple explanations. A short heuristic story would run as follows.

The balance of payments crisis of 1991 and attendant severe restrictions on imports disrupted industrial production. Coupled with a bad year in agriculture these supply problems propelled inflation to nearly 14 per cent in 1991/92. Inflation moderated in the next two years as the stabilization programme took hold and confidence in macromanagement was restored. By the second half of 1993/94 the restoration of confidence and liberalization of foreign investment policies had triggered a temporary surge in foreign capital inflow, which added over US\$ 12 billion to foreign exchange reserves between September 1993 and October 1994. As a result, reserve money shot up by 25 per cent in 1993/94 and by over 22 per cent in 1994/95, fuelling broad money growth of over 18 per cent in 1993/94 and 22 per cent in 1994/95 (Table 8)³. This surge

³ To some extent both the acceleration in monetary growth in 1994/95 and the deceleration in 1995/96 were exaggerated by there being 27 reporting fortnights for banks in 1994/95, with the last of them ending on March 31, 1995 and coinciding with the closing day for banks' accounts "thereby giving rise to the phenomenon of year-end bulge in aggregate deposits and credit" (Reserve Bank (1995), p. 47).

in liquidity pushed inflation back up to 12.5 per cent in 1994/95. By the following year monetary growth had been curbed and the simultaneous boom in industry and imports ensured an easy supply situation, resulting in moderation of inflation down to 8 per cent.

In 1996/97 aggregate demand cooled as both investment and exports levelled off after the boom in the preceding three years. The supply situation remained easy with strong growth in agriculture and industry. More significant for the medium-term, the cumulative impact of import liberalization and customs tariff reductions combined with low world inflation in manufactures to bring down the increase in the WPI(MP) to 2.1 per cent in 1996/97. As a result, the increase in the overall WPI dropped to 4.6 per cent in 1996/97.

Table 8: Trends in Money and Credit

(Annual Percent Increase)

	Broad Money (M3)	Reserve Money	Net RBI Credit to Central Government	Net Foreign Assets of Banking Sector	Non-Food Credit of Scheduled Commercial Banks
1985-90 Average	17.6	17.2	17.8	17.2	18.1
1990/91	15.1	13.1	20.5	55.2	12.4
1991/92	19.3	13.4	6.3	100.6	8.2
1992/93	14.8	11.3	4.6	15.2	20.1
1993/94	18.4	25.2	0.3	123.4	5.7
1994/95	22.4	22.1	2.2	44.7	29.8
1995/96	13.6	14.9	20.1	3.9	22.5
1996/97	16.2	2.8	1.6	28.4	10.9
1997/98	18.0	13.2	10.7	30.9	15.1
1998/99	19.4	14.6	8.8	28.8	13.0
1999/2000	13.9	8.1	-3.8	15.6	16.6
2000/2001	16.2	8.3	6.5	18.8	14.3

Sources: RBI *Handbook of Statistics on Indian Economy, 2000* and RBI *Bulletin* various issues.

From 1996/97 onwards inflation in India has remained low, powerfully influenced by the prevalence of very low inflation in industrialized countries and (therefore) internationally traded manufactures, combined with an increasingly open trade regime in India. Core inflation, measured by WPI(MP), stayed around 3 per cent, except for a blip up to 4.4 per cent in 1998/99. Since manufactures have a weight of about 64 per cent in the WPI, low increases in WPI(MP) have translated into low inflation in the WPI. In two years there were sharp spikes in the indices for 'primary articles' and 'fuel, power, light', which temporarily raised the rate of WPI inflation. In 1998/99 the spike was due to the flare up in prices of a handful of agricultural commodities, especially onions and potatoes. In 2000/01 the major increases in petroleum prices were the main culprit.

The relatively low inflation in the second half of the decade also reflected two other factors : mostly moderate increases in money supply and, more worryingly, the apparent slack in autonomous investment demand.

The External Sector

The external sector of India's economy was the focal stress point of the 1991 balance of payments crisis. Perhaps for that reason it saw the most far-reaching reforms and successful responses to reform initiatives.

The 1991 crisis had manifold roots, including a series of high fiscal deficits, excessive regulation of industry and trade and a weakening financial sector. Within the external sector itself the key contributory factors included an overvalued exchange rate (aggravated by real appreciation of the rupee in the first half of the 1980s), foreign trade and payments policies biased against exports and growing recourse to various forms of external borrowing to finance a series of large trade and current account deficits in the latter half of the eighties.

The extent of anti-export bias in the trade and payments regime can be gauged by the fact that in 1985/86 merchandise exports accounted for only 4.1 percent of GDP, while imports were running more than 80 percent higher at 7.6 percent of GDP, entailing a trade deficit of 3.5 percent of GDP. Although an active policy of real exchange rate depreciation in the second half of the eighties induced good export growth in the later

years of the decade, it was a case of too little too late. Moreover, the growth of exports was offset substantially by a steady decline in net invisible earnings.

For the five year period 1985-90, the trade deficit averaged 3 per cent of GDP, while the current account deficit averaged 2.2 per cent of GDP (Table 9). These deficits were financed by growing recourse to various sources of external borrowing including external assistance, commercial borrowing and increasingly expensive NRI deposits. Foreign exchange reserves were also run down. Foreign investment was a negligible 0.1 per cent of GDP. By 1990/91, the trade deficit of 3.0 per cent of GDP was fully reflected in a peak current account deficit of 3.1 percent of GDP, since invisibles had turned marginally negative.

The growing recourse to external borrowing in the second half of the 1980s had led to a substantial deterioration in India's external debt indicators. The debt service ratio rose to a peak of 35 per cent in 1990/91 (Table 10). The external debt stock to GDP ratio peaked at 39 per cent at the end of 1991/92, as did the debt to exports ratio at 563 per cent. The proportion of short-term debt (by original maturity) in total external debt attained its highest level in March 1991 at 10.3 percent. As a ratio to foreign currency reserves, short-term debt soared to a dangerous 382 per cent, signalling the heightened fragility of India's external finances.

The Gulf War of 1991 and the associated oil price hike tipped India's fragile external finances into a full-blown balance of payments crisis. To contain the crisis and restore economic health, the new Congress government of June 1991 initiated a wide-ranging programme of stabilization and structural reform. Without going into the details of the programme, the salient thrusts which directly relate to the external sector may be summarized :

- The exchange rate was devalued and the system transformed in less than 2 years from a discretionary, basket-pegged system, to a market-determined, unified exchange rate, following a short intermediate period of dual rates.

Table 9: Balance of Payments Indicators

(As Percent of GDP at Current Market Prices)												
	1985-90 (Average)	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-2001
Exports, f.o.b.	4.8	5.8	6.9	7.3	8.3	8.3	9.1	8.9	8.7	8.2	8.3	9.5
Imports, c.i.f.	7.7	8.8	7.9	9.6	9.8	11.1	12.3	12.7	12.5	11.4	12.3	12.5
Trade Balance	-3.0	-3.0	-1.0	-2.3	-1.5	-2.8	-3.2	-3.9	-3.8	-3.2	-4.0	-3.0
Invisibles, net	0.79	-0.1	0.7	0.6	1.1	1.8	1.6	2.7	2.4	2.2	2.9	2.5
Current Account Balance	-2.2	-3.1	-0.3	-1.7	-0.4	-1.0	-1.7	-1.2	-1.4	-1.0	-1.0	-0.5
Capital Account Surplus	2.2	2.3	1.5	1.6	3.5	2.8	1.3	3.0	2.4	2.0	2.3	1.9
of which:												
Foreign Investment	0.10	0.03	0.05	0.23	1.55	1.53	1.38	1.60	1.31	0.58	1.15	1.07
External Assistance, net	0.68	0.70	1.13	0.77	0.69	0.48	0.28	0.29	0.23	0.20	0.20	0.10
Commercial Borrowings, net	0.57	0.71	0.58	-0.15	0.22	0.32	0.38	0.73	0.96	1.06	0.07	0.87
NRI Deposits, net	0.67	0.48	0.15	0.82	0.44	0.05	0.32	0.87	0.28	0.23	0.34	0.49
IMF, net	-0.26	0.38	0.32	0.45	0.07	-0.35	-0.48	-0.25	-0.15	-0.09	-0.06	-0.01

Table 9: Balance of Payments Indicators (continued)**Memo Items**

	1985-90 Average	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-2001
Forex Reserves, year end (US \$ million)	5616.2	5834.0	9220.0	9832.0	19254.0	25186.0	21687.0	26423.0	29367.0	32490.0	38036.0	42281.0
Increase in Reserves (US \$ million)	-398	1872	3386	612	9422	5932	-3499	4736	2944	3123	5546	4245
Forex Reserves as months of Import Cover	3.4	2.5	5.3	4.9	8.6	8.4	6.0	6.5	6.9	8.2	8.2	8.6
Exchange Rate (Rs / US \$)	13.82	17.94	24.47	30.65*	31.37	31.40	33.45	35.50	37.17	42.07	43.33	45.68
Growth of Exports (in US\$); %	11.4	9.0	-1.1	3.3	20.2	18.4	20.3	5.6	4.5	-3.9	9.5	19.6
Growth of Imports (in US\$); %	9.4	14.4	-24.5	15.4	10.0	34.3	21.6	12.1	4.6	-7.1	16.5	7.0
Growth of Non- oil Imports; %	12.3	3.4	-21.9	12.0	11.2	29.5	28.3	-0.2	14.5	8.0	3.2	-8.5
Foreign Investment (US \$ million)	279.2	103.0	133.0	557.0	4235.0	4807.0	4805.0	6153.0	5390.0	2412.0	5191.0	5102.0
Direct (US \$ million)		97.0	129.0	313.0	668.0	983.0	2057.0	2841.0	3562.0	2473.0	2155.0	2339.0
Portfolio (US \$ million)		6.0	4.0	244.0	3567.0	3824.0	2748.0	3312.0	1828.0	-61.0	3036.0	2763.0

* The average official exchange rate for the year 1992-93 was 25.97.

Sources: RBI, *Handbook of Statistics on Indian Economy, 2000*, *RBI Annual Report 2000-2001* and DGCIS (for non-oil imports)

Table 10: External Debt Indicators

(percent)

	Debt Stock- GDP Ratio	Debt- Service Ratio	Debt- Exports Ratio	<u>Proportion of Short Term Debt to Total Debt</u>	<u>Proportion of Short Term Debt to Foreign Currency Reserves</u>
<u>1990/91</u>	28.7	35.3	491.7	10.3	382.3
<u>1991/92</u>	38.7	30.2	563.0	8.2	141.6
<u>1992/93</u>	37.6	27.5	512.7	7.1	98.3
<u>1993/94</u>	33.8	25.6	408.2	3.9	24.1
<u>1994/95</u>	30.9	26.2	369.6	4.3	20.4
<u>1995/96</u>	27.1	24.3	295.7	5.2	28.5
<u>1996/97</u>	24.7	21.2	277.1	7.2	30.1
<u>1997/98</u>	24.4	19.0	278.6	5.4	19.4
<u>1998/99</u>	23.5	18.0	287.0	4.5	14.8
<u>1999/2000</u>	22.0	16.0	258.6	4.1	11.5

Sources: RBI, *Handbook of Statistics on Indian Economy, 2000* and *India's External Debt A Status Report*, Government of India, Ministry of Finance, Department of Economic Affairs, May, 2000.

Note: Flows relate to fiscal year indicated; stocks pertain to the end of the year indicated.

- The heavy anti-export bias in the trade and payments regime was also reduced substantially by a phased reduction in the exceptionally high customs tariffs and a phased elimination of quantitative restrictions on imports.
- Policies were initiated to encourage both direct and portfolio foreign investment.
- Short-term debt was reduced and strict controls put in place to prevent future expansion. Medium-term borrowing from private commercial sources was made subject to annual caps and minimum maturity requirements.
- Growth of NRI deposits was moderated through reduction of incentives.

- Foreign exchange reserves were consciously accumulated to provide greater insurance against external sector stresses and uncertainties.

As a result of these measures and other reforms in industrial, fiscal and financial areas, the performance of the external sector over the last decade has been generally strong. The stabilization measures of 1991/92 reduced sharply imports, the trade deficit and the current account deficit. Import growth recovered and surged in the mid-nineties, but the current account deficit remained well below 2 per cent of GDP because of the concomitant buoyancy of exports and the strong recovery of net invisible earnings (Table 9). This surge in net invisibles to an average level of over 2 per cent of GDP in the last five years may be attributed in part to the strength of the world economy, in part to the rational incentives embedded in a market-determined exchange rate system and in part to the strong growth of software service exports.

Exports grew at about 20 per cent a year in dollar terms for three successive years between 1993/94 and 1995/96 and then decelerated to negative growth in 1998/99 before recovering again to record 20 per cent growth in 2000/01. Despite the sluggish performance of exports between 1996/97 and 1998/99, the trade deficit remained below 4 per cent of GDP thanks to the equally subdued growth of imports, especially non-oil imports. The continuing deceleration in non-oil import growth largely reflects the slow growth of industry in recent years.

Portfolio foreign investment responded smartly to new initiatives and climbed quickly to a peak of \$ 3.8 billion in 1994/95. Direct foreign investment rose more slowly but steadily to a peak of \$ 3.6 billion in 1997/98, before falling off significantly thereafter. Taken together, foreign investment peaked at \$ 6.2 billion 1996/97 or just 1.6 per cent of GDP, which compares quite unfavourably with the record of a number of East Asian and Latin American countries, including China and Brazil, where FDI has attained 5 per cent of GDP in recent years.

Comparing the latest decade to the late eighties, three sources of foreign borrowing have clearly declined in significance : external assistance, NRI deposits and IMF financing. On the other hand, net external commercial borrowings have fluctuated,

reaching peak levels in 1998/99 and 2000/01 because of exceptional recourse to Resurgent India Bonds and India Millennium Deposits, respectively.

Taking the constituent elements together, it is noteworthy that the capital account surplus reached its peak in 1993/94 (at 3.5 per cent of GDP) and has been well below that level in all subsequent years. Nevertheless, except for 1995/96, the capital account surplus has been large enough in relation to the corresponding current account deficit in each of the last ten years, to ensure accretion to foreign exchange reserves. Such reserves have increased from \$ 5.8 billion in March 1991, representing 2.5 months of import cover to \$ 42.6 billion ten years later, amounting to more than 8 months of import cover.

We noted earlier how external debt indicators clearly signalled in 1991 the fragility of India's external finances. Table 10 brings out the sustained and remarkable improvement in these indicators over the decade, reflecting the success of India's external sector policies, in general, and prudent approach to external debt, in particular. By March 2000 the debt service ratio had more than halved (from its peak) down to 16 per cent. The external debt to GDP ratio had fallen to 22 per cent. The proportion of short-term debt (by original maturity) was at a comfortable level of 4.1 per cent. Perhaps most telling, the ratio of short-term debt to foreign currency assets had plunged from its perilous height of 382 per cent in March 1991 to a sanguine 11.5 per cent in March 2000.

International comparisons with 14 other large external debtor developing countries for December 1999 also show India in a very favourable light (Table 11). By each significant debt yardstick India ranks among the best.

Table 11: External Debt Indicators for 15 Top Debtors, 1999

	Country	Total External Debt (US \$ billion)	Increase in Debt between 1990 and 1999 (US \$ billion)	Debt to GNP (percent)	Debt Service Ratio (percent)	Proportion of Short-term to Total Debt (percent)
1	Brazil	244.7	124.8	33.5	110.9	12.1
2	Russian Federation	173.9	114.6	46.3	13.5	9.1
3	Mexico	167.0	62.6	35.5	25.1	14.4
4	China	154.2	98.9	15.9	9.0	11.5
5	Indonesia	150.1	80.2	113.3	30.3	13.3
6	Argentina	147.9	85.7	53.7	75.8	21.3
7	Korea, Rep.	129.8	94.8	32.3	24.6	26.8
8	Turkey	101.8	52.4	54.3	26.2	23.1
9	Thailand	96.3	68.1	79.9	22.0	24.3
10	India	94.4	10.7	21.3	15.0	4.3
11	Poland	54.3	4.9	35.6	20.4	11.0
12	Philippines	52.0	26.8	64.8	14.3	11.0
13	Malaysia	45.9	30.6	62.5	4.8	16.4
14	Chile	37.8	18.6	55.9	25.4	14.6
15	Venezuela, RB	35.9	2.7	35.6	23.2	6.3

Source: *Global Development Finance, 2001*, World Bank.

A critical instrument in bringing about healthy outcomes in the external sector has been exchange rate policy. The transition from the prevailing (undisclosed) basket-pegged system in June 1991 to an unified, market-determined system was accomplished in a phased manner and with considerable finesse. By August 1994 India had committed to current account convertibility under Article VIII of the IMF. Following the unification of the exchange rate in March 1993, the authorities (especially the RBI) operated the “managed float” of the rupee with the twin objectives of fostering India’s international competitiveness while containing day to day market volatility. Table 12 and Figure 2 present data on nominal and real export-weighted exchange rate indices of the rupee. The profile of the 10-country REER suggests that the real exchange rate generally prevailed a

little higher than the low point of 1993-94, but not by much (except in 1997/98 when the REER index rose 10 per cent above the 1993/94 base thanks to virtual stability in the nominal exchange rate index over two years). Occasional bouts of modest appreciation have usually been corrected. The instruments deployed by RBI to manage the float have included exchange market intervention, occasional administrative measures and monetary policy.

Table 12: Real and Nominal Exchange Rate Indices

(Base: 1993/94=100)

	Nominal Effective Exchange Rate (NEER)		Real Effective Exchange Rate (REER)	
	5-cty Index	10-cty Index	5-cty Index	10-cty Index
1985	334.3	341.7	187.6	194.3
1986	284.3	284.2	173.6	175.3
1987	254.8	250.7	165.1	164.1
1988	228.5	225.5	156.9	156.4
1989	204.0	202.3	143.5	143.3
1990	182.1	176.8	135.2	132.3
1991	139.5	136.3	115.8	113.8
1990/91	175.3	169.1	132.4	128.8
1991/92	130.6	127.9	110.9	109.1
1992/93	107.8	105.4	100.6	98.7
1993/94	100.0	100.0	100.0	100.0
1994/95	96.5	95.9	105.9	105.1
1995/96	88.5	87.4	102.6	101.0
1996/97	86.8	85.6	105.9	104.1
1997/98	86.2	86.7	110.1	109.9
1998/99	76.3	76.6	105.8	105.3
1999/2000	73.9	75.4	104.4	105.3
2000/2001	72.9	75.8	103.5	106.3

Source: *Economic Survey, 2000/2001.*

- Notes:**
1. These are export-weighted indices with weights based on direction of India's exports during 1992-97.
 2. The U.S.A., Japan, the U.K., Germany and France are included in the 5-country index and Netherlands, Italy, Belgium, Switzerland, and Australia are included, in addition, in the 10-country index.

Figure 2 A

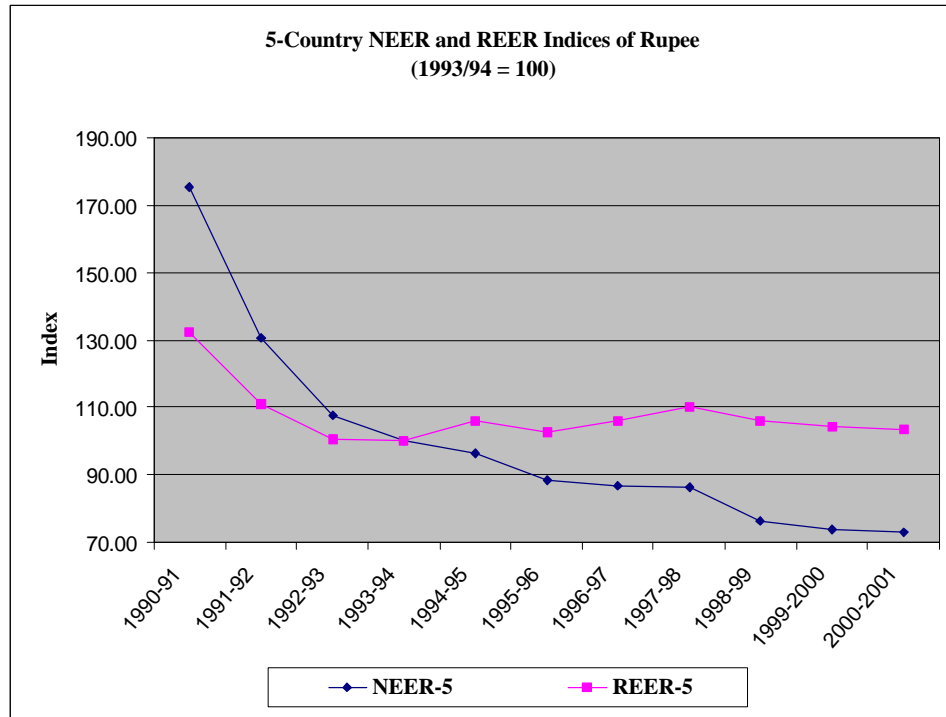
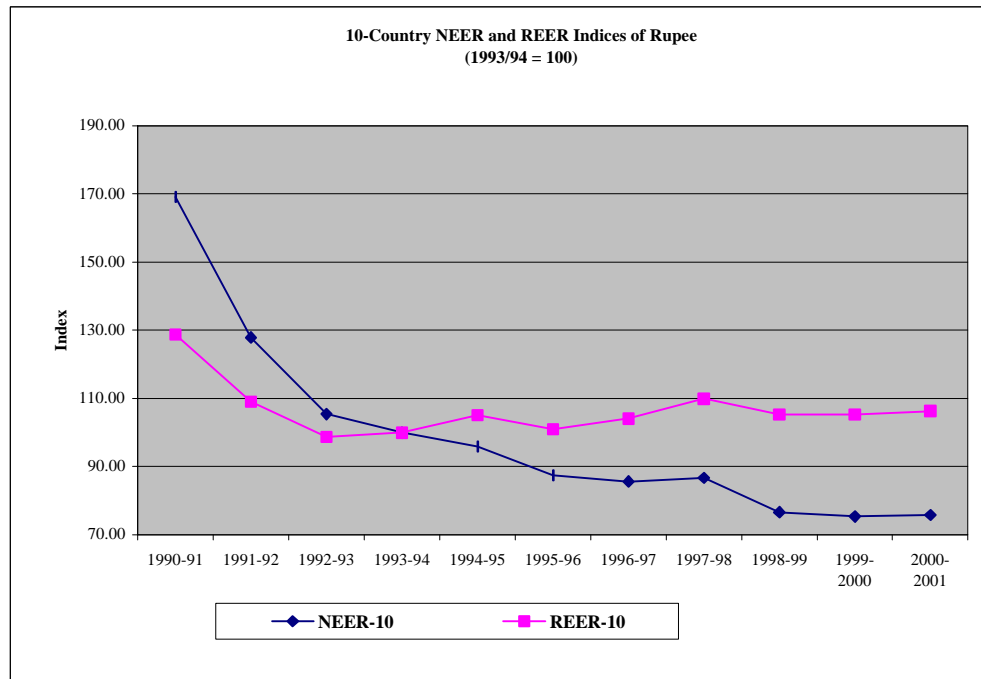


Figure 2 B



However, these partner country REER indices fail to capture possible deterioration in India's competitiveness in major markets relative to a number of East Asian competitors (notably, Thailand, Malaysia, Phillipines and Indonesia) whose nominal exchange rates underwent substantial depreciation during the East Asian crisis of 1997-98 (see Krueger and Chinnoy (2001)). If this dimension is factored in, it is quite possible that the rupee's prevailing exchange rate in the closing years of the decade has been somewhat overvalued from the vantage point of India's export competitiveness.

On the other hand, India's exchange rate policy has achieved considerable success in damping volatility in nominal rates, especially during periods of international currency market turbulence and contagion that prevailed in 1997 and 1998.

Fiscal Deficits, Savings and Investment

Growth, inflation and external balance are the main **ultimate** targets of macroeconomic policy. These are the aggregate variables by which an economy's macro performance is most commonly evaluated. However, there is almost as much interest in a set of **intermediate** target variables which lie at the heart of macroeconomic policy, namely fiscal deficits, savings and investment. Each of these, especially fiscal deficits, warrant some commentary.

It is generally agreed (though not unanimously) that a series of large fiscal deficits is inimical to macroeconomic performance.⁴ Such deficits tend to crowd out private investment, increase inflationary potential, weaken the balance of payments, render financial sector reform more difficult and impose a serious burden of adjustment on future generations. The series of high fiscal deficits in the late eighties were clearly a major cause of the 1991 economic crisis in India. We will revert to the issue of effects of fiscal deficits later. First let us look at the trends.

This is easier said than done. Obtaining a comparable and consistent series of even the Centre's fiscal deficit is bedevilled by changes in the treatment of small savings (intermediated through the budget) and significant revisions in GDP data (see Govinda Rao and Amar Nath (2000)). Here we focus on the definition of deficit net of small

⁴ Rakshit (2000) is one of the few proponents of the minority view.

savings transferred to States. The GDP series with 1993/94 base is used throughout. Furthermore, we give prominence to the consolidated deficit of the Centre and States. We do not deploy a PSBR concept since official Indian data is not compiled on this basis. Nor do we attempt adjustments for extrabudgetary items such as the Oil Pool Account deficit/surplus or contingent liabilities of either the Centre or the States. We recognize that the fiscal deficit in recent years would be larger if such elements were factored in.⁵

Tables 13 present time series for fiscal, primary and revenue deficits of Centre and States consolidated. The following trends are noteworthy:

- The gross fiscal deficit increased significantly from an average of 7.2 per cent in the 5 years 1980-85 to 8.9 per cent in the next quinquennium, 1985-90, and even further to 9.4 per cent in 1990/91.
- There was a reduction of over 2 per cent of GDP in the gross fiscal deficit in 1991/92, brought about essentially by the Central budget of that year and in the context of an IMF loan programme initiated to help cope with the balance of payments crisis of 1991.
- This correction was largely negated by a very large Central government fiscal slippage (relative to budget targets) in 1993/94, timed, perhaps not coincidentally, with the end of the IMF programme in spring 1993.
- The lost ground was quickly recovered and further consolidated in the next three years, with the lowest consolidated fiscal deficit for the decade of 6.4 per cent of GDP recorded in 1996/97. This coincided with and was largely a result of the Centre's achieving its lowest deficit in the decade (indeed in 20 years) of 4.1 per cent of GDP.
- This was also the year in which the consolidated primary deficit achieved a nadir of 1.3 per cent of GDP, thanks mainly to the only year of primary surplus achieved by the Centre in the last 20 years.

⁵ Strictly speaking, contingent liabilities of government should not be counted in the fiscal deficit until they became actual liabilities. However, as recent events in the financial sector have shown, the notion of contingent liabilities is elastic and undefined commitments of government support to financial institutions can quickly translate into sizable actual calls on the budget.

Table 13: Consolidated Deficits of Central and State Governments
(As percent of GDP at current market prices)

	Fiscal Deficit	Primary Deficit	Revenue Deficit
1980/81	7.5	5.4	0.4
1981/82	6.3	4.1	-0.6
1982/83	5.9	3.4	0.2
1983/84	7.3	4.8	1.1
1984/85	9.0	6.2	2.1
1985/86	8.0	4.9	1.9
1986/87	9.9	6.5	2.4
1987/88	9.2	5.5	2.9
1988/89	8.5	4.6	2.9
1989/90	8.9	4.6	3.2
1990/91	9.4	5.0	4.2
1991/92	7.0	2.3	3.4
1992/93	7.0	2.1	3.2
1993/94	8.3	3.3	4.3
1994/95	7.1	1.9	3.7
1995/96	6.5	1.6	3.2
1996/97	6.4	1.3	3.6
1997/98	7.3	2.2	4.1
1998/99	8.9	3.7	6.3
1999/2000	9.4	3.8	6.2
2000/2001 RE	9.1	3.4	5.9
Averages			
1980/81-1983/84	6.8	4.4	0.3
1984/85-1990/91	9.0	5.3	2.8
1991/92-1996/97	7.1	2.1	3.6
1997/98-2000/01	8.7	3.3	5.6

Source: Reserve Bank of India

Note: RE: Revised Estimate

- In the next three years, propelled principally by government pay increases following the Fifth Pay Commission, the consolidated fiscal deficit rose sharply to 9.4 per cent of GDP by 1999/2000, equal to the pre-crisis level of 1990/91. The small improvement in 2000/01 may prove illusory as it is based on budget estimates for States and revised estimates for the Centre, both of which could worsen in the final accounting.
- By 1999/2000 the consolidated primary deficit had almost tripled (relative to the 1996/97 nadir) to 3.8 per cent of GDP and the revenue deficit had risen sharply to 6.2 per cent of GDP.
- Figure 3 clearly shows that while trends in the consolidated deficit indicators were largely dominated by trends at the Centre up to 1996/97, the recent deterioration is due to adverse trends in both the Centre and States but predominantly in the latter.

This is not the place for a detailed decomposition of the factors explaining the trends in deficits over the decade. However, Tables 14 and 15 support several broad points :

- Revenue receipts (tax and non-tax) did not contribute to the improvement in the Centre's fiscal position between 1990/91 and 1996/97. In fact, there was some decline in the ratios to GDP.
- The entire improvement in the Centre's fiscal situation up to 1996/97 was due to a reduction in the expenditure to GDP ratio from 17.3 per cent in 1990/91 down to 13.9 per cent GDP in 1996/97, with most of the reduction being concentrated in capital expenditure.
- Similarly, the deterioration in the Centre's fiscal position after 1996/97 is wholly attributable to a rise in the expenditure to GDP ratio to 15.2 per cent by 1999/2000. The difference is that this increase is almost entirely because of the rise in the share of revenue expenditure to GDP, in large part to accommodate a higher bill for government pay and pensions.

Figure 3A

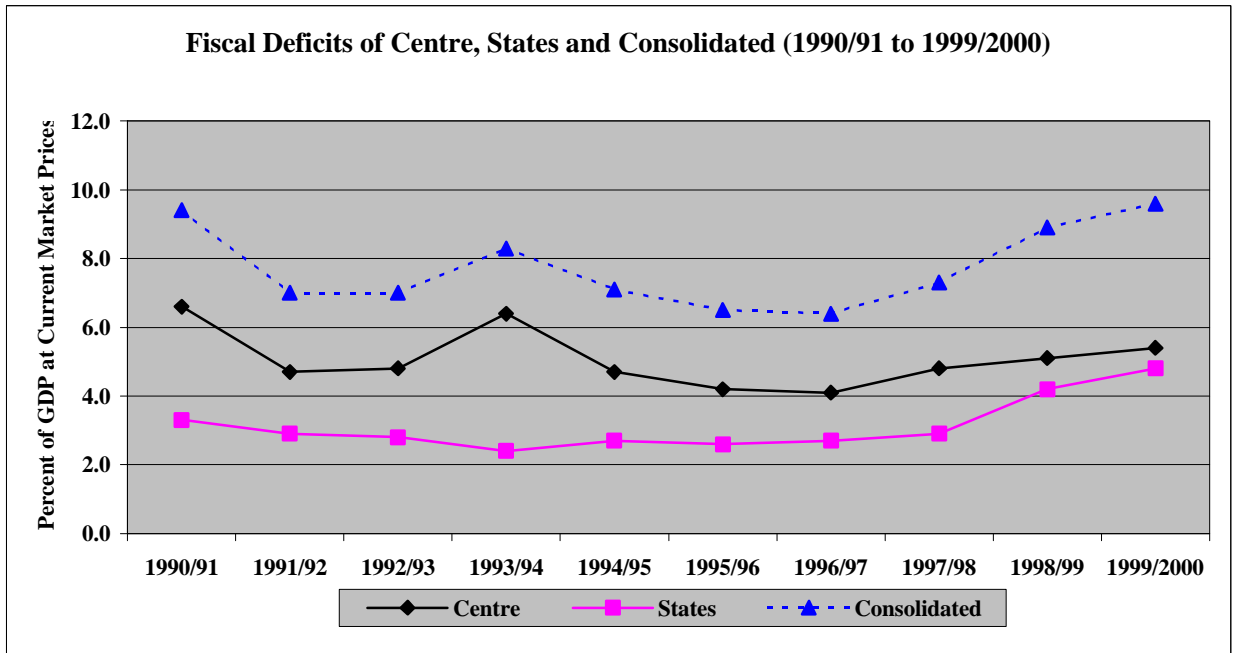


Figure 3B

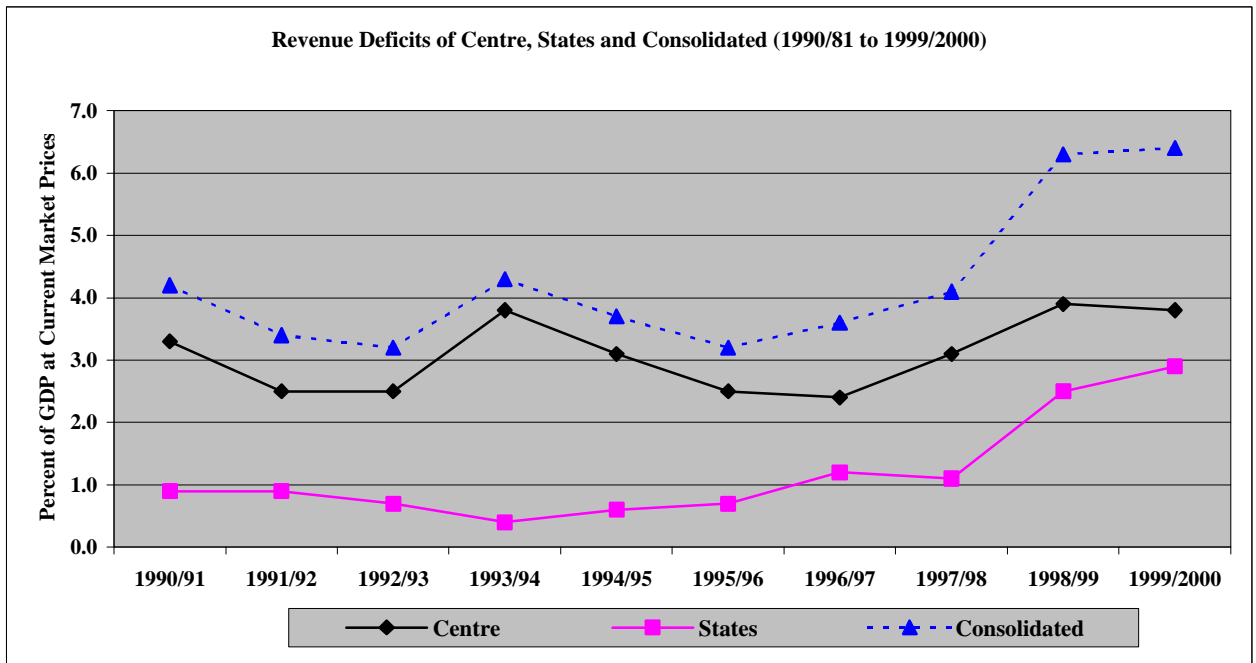


Table 14: Centre's Fiscal Position: A Summary View

(As percent of GDP at current market prices)

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/2001 P
1. Revenue Receipts	9.7	10.1	9.9	8.8	9.0	9.3	9.2	8.8	8.5	9.3	8.8
2. Tax Revenue (Net to Centre)	7.6	7.7	7.2	6.2	6.7	6.9	6.8	6.3	6.0	6.6	6.2
3. Non-Tax Revenue	2.1	2.4	2.7	2.6	2.3	2.4	2.4	2.5	2.5	2.7	2.6
4. Expenditure	17.3	16.2	15.8	15.9	14.9	14.2	13.9	14.2	14.5	15.2	14.8
5. Revenue Expenditure	12.9	12.6	12.4	12.6	12.1	11.8	11.6	11.8	12.3	12.7	12.6
6. Capital Expenditure	4.4	3.6	3.4	3.3	2.9	2.4	2.3	2.4	2.2	2.5	2.2
7. Revenue Balance (1-5)	-3.3	-2.5	-2.5	-3.8	-3.1	-2.5	-2.4	-3.1	-3.8	-3.5	-3.8
8. Fiscal Balance	-6.6	-4.7	-4.8	-6.4	-4.7	-4.2	-4.1	-4.8	-5.1	-5.4	-5.3

Sources: *Economic Survey* (various issues), and Ministry of Finance.

Note: P: Provisional Estimate.

The Provisional Estimate for 2000-01 has been formulated using fiscal data taken from www.cga.nic.in and the provisional estimate of GDP from the CSO 'Press Note on Revised Estimates of Annual National Income and Quarterly Estimates of GDP, 2000-01'.

Table 15: States' Fiscal Position: A Summary View
(As percent of GDP at current market prices)

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000 RE	2000/2001 BE
1. Revenue Receipts	11.7	12.3	12.2	12.3	12.1	11.5	11.2	11.2	10.0	11.0	11.2
2. Tax Revenue (Net to Centre)	7.8	8.1	8.1	8.0	8.0	7.8	7.8	8.0	7.3	7.7	8.1
3. Non-Tax Revenue	3.8	4.3	4.1	4.3	4.1	3.7	3.4	3.2	2.7	3.3	3.1
4. Expenditure	16.0	16.5	15.9	15.7	16.0	14.9	14.8	15.0	15.1	16.6	16.1
5. Revenue Expenditure	12.6	13.2	12.9	12.7	12.7	12.2	12.3	12.3	12.5	13.9	13.3
6. Capital Expenditure	3.4	3.3	3.1	2.9	3.3	2.7	2.5	2.7	2.6	2.8	2.8
7. Revenue Balance (1-5)	-0.9	-0.9	-0.7	-0.4	-0.6	-0.7	-1.2	-1.1	-2.5	-2.9	-2.1
8. Fiscal Balance	-3.3	-2.9	-2.8	-2.4	-2.7	-2.6	-2.7	-2.9	-4.2	-4.8	-4.1

Source: RBI, *Handbook of Statistics on Indian Economy, 2000*.

Notes: RE: Revised Estimate
BE: Budget Estimate

- At the States level, there is no really significant trend in the fiscal deficit ratio until the sharp deterioration of 1998/99 and 1999/2000. This is largely explained by the ratcheting up of revenue expenditure, partly because of pay revisions following the Pay Commission.

Before leaving the subject of fiscal deficits, a quick glance at international comparisons of fiscal deficits reveals that India's deficit is emphatically on the high side. Out of 74 countries with population more than 10 million for which the IMF has fiscal data, only 7 recorded a general government deficit higher than 7 per cent of GDP in 2000⁶ (Table 16). India is one of this "magnificent seven". And of these seven, only two countries, Turkey and Zimbabwe had a higher deficit than India.

Savings and Investment

As we would expect, the trends in the overall fiscal position, especially in revenue deficits, find reflection in India's public savings performance. Table 17 shows that public savings in the nineties reached its peak of 2.0 per cent of GDP in 1995/96, the year when the consolidated revenue deficit was at its lowest mark in the decade. Subsequently, as the consolidated revenue deficit nearly doubled to 6.2 per cent of GDP in 1999/2000, an increase of 3 per cent points of GDP, public savings fell by almost the same percentage of GDP, becoming negative 1.2 per cent of GDP by 1999/2000.

⁶ "General government" consolidates government fiscal accounts across all levels of government, not just Centre and States.

Table 16: International Comparison of Fiscal Deficits**(Countries with General Government Deficits of more than 7 percent in 2000)**

Country	Deficits (percent of GDP)
Ethopia	9.8
Ghana	8.4
India	10.5
Japan	8.2
Sri Lanka	7.7
Turkey	12.0
Zimbabwe	12.7

Source: IMF, World Economic Outlook (WEO) Database**Note:** Only countries with population above 10 million (in 1999) are included. Of these there were 74 in the IMF database.**Table 17: Savings and Investment****(As percent of GDP at current market prices)**

	GDCF	GDS	Public Savings	Private Savings	Household Savings	Corporate Savings
Average 1985-90	22.7	20.4	2.4	18.0	16.0	2.0
1990/91	26.3	23.1	1.1	22.0	19.3	2.7
1991/92	22.5	22.0	2.0	20.1	17.0	3.1
1992/93	23.6	21.8	1.6	20.2	17.5	2.7
1993/94	23.1	22.5	0.6	21.9	18.4	3.5
1994/95	26.0	24.8	1.7	23.2	19.7	3.5
1995/96	26.8	25.1	2.0	23.0	18.1	4.9
1996/97	24.5	23.2	1.7	21.5	17.0	4.5
1997/98	25.0	23.5	1.5	22.0	17.8	4.2
1998/99	23.0	22.0	-0.8	22.8	19.1	3.7
1999/2000 Q	23.3	22.3	-1.2	23.5	19.8	3.7

Source: *Economic Survey, 2000-2001***Notes:** Q: Quick Estimate

GDCF: Gross Domestic Capital Formation

GDS: Gross Domestic Saving

This sharp decline in public savings between 1995/96 and 1999/2000 fully explained the drop in the ratio of gross domestic savings from its peak of 25.1 per cent of GDP in 1995/96 to 22.3 per cent in 1999/2000. Table 19 underscores the point that private savings was at its highest in the decade in 1999/2000 at 23.5 per cent of GDP; indeed it was a little higher than in 1995/96. Furthermore, this was achieved essentially through continued buoyancy of household savings and despite some reduction in corporate savings.

Not surprisingly, the gross investment ratio mirrors the trend in the savings ratio, attaining a peak level of 26.8 per cent of GDP in 1995/96 and then dropping by 3.5 per cent points of GDP to 23.3 per cent in 1999/2000. It is quite uncanny how the deterioration of 3 per cent points of GDP in the consolidated revenue deficit between 1995/96 and 1999/2000 is reflected almost exactly in the worsening of aggregate savings and investment ratios over the period. It would be hard to find more telling presumptive evidence of the adverse impact of fiscal deficits on savings and investment. Another way to look at this is that if the fiscal deterioration since 1995/96 had not occurred, savings and investment might well have been higher by at least 3 per cent points of GDP in 1999/2000. Indeed the beneficial impact might well have been greater because of the effect of lower real interest rates on the buoyancy of private, especially corporate, investment and savings.

Concluding Remarks

Looking back, India's macroeconomic performance in the nineties was exceptionally strong, especially in the quinquennium following the balance of payments crisis of 1991. During these five years economic growth averaged an unprecedented 6.7 percent, investment and savings attained new peaks, exports and private capital inflows surged to bring about a sea-change in external sector performance and even inflation subsided to moderate levels by the end of the five years.

Unfortunately, a slowdown in economic reforms after the mid-nineties, the resurgence of high fiscal deficits (propelled by large pay increases for government employees) , higher business uncertainty associated with coalition governance and a

deterioration of the international economic environment all combined to weaken macroeconomic performance in the final four years of the decade. Investment and exports decelerated, economic growth slowed markedly and external sector performance lost its earlier lustre. Only inflation remained low, moderated by a more open foreign trade regime and the manifest loss of dynamism in the economy.

Looking ahead, the key challenge is to recapture the growth momentum of the mid-nineties. Most of the policy initiatives necessary to achieve this overarching objective are of a sectoral or structural nature. They entail reforms in agriculture, health and education, infrastructure, energy sector, industrial policy, labour laws, public enterprises and the financial sector. Some of the reforms have already been announced and await the necessary political agreement for implementation. Others have been identified but not yet acted upon. At the level of macro policy, the key elements for restoring the growth momentum are successful fiscal consolidation, the evolution of a more flexible, market-responsive exchange rate policy and a supportive monetary policy.

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