LESSONS FROM THE NATIONAL EXPERIENCE OF INDIA IN MOBILIZING DOMESTIC AND EXTERNAL RESOURCES FOR ECONOMIC DEVELOPMENT

*V.R. Panchamukhi**

This paper attempts to give an overview of various aspects of the national experience of India in mobilizing domestic and external resources for economic development. It attempts to present not only a statistical profile of the facts about the mobilization and disbursement of resources, but also tries to provide information about the institutional framework and the policy issues relating to the problem of resource mobilization.

SAVINGS AND INVESTMENT

Historical profile

Domestic savings constitute perhaps the most important single financial resource for economic development. Normally, in the early stages of development domestic savings are not adequate for the level of investment that is required to realizing a target rate of growth. Total investment required to achieve a desired growth rate of GDP is derived by using the capital output ratio that reflects efficiency in the use of investment resources. The macroeconomic formula for estimating the investment required is as follows:

$$I = \beta \times G \times Y,$$

where I is investment, β is capital output ratio, G is growth rate of GDP and Y is the base-year value of GDP.

I – S, where S stands for savings, gives the external resources required to realize GDP growth.

In India the savings-to-GDP ratio was 10.4 per cent in 1950/51. It rose to 12.7 per cent in 1960, 15.7 per cent in 1970, 21.2 per cent in 1980 and 24.3 per cent in 1990 (table 1). It declined in the period 1991-1993 but again increased to 25.5 per

* Director General, Research and Information System for the Non-Aligned and Other Developing Countries, New Delhi, India.

Table 1. Savings and investment rates
(as a proportion of GDP)

Year	*Domestic savings (S/Y)*	*Gross investment (I/Y)*	*External resources (I-S)/Y*
1950	10.4	10.2	-0.2
1960	12.7	15.7	3.0
1970	15.7	16.6	0.9
1980	21.2	22.7	1.5
1990	24.3	27.7	3.4
1991	22.9	23.4	0.5
1992	22.0	23.9	1.9
1993	22.5	23.1	0.6
1994	25.0	26.1	1.1
1995	25.5	27.2	1.7
1996	23.3	24.6	1.3
1997	24.7	26.2	1.5
1998	22.3	23.4	1.1

Source: Government of India, *Economic Survey 1999-2000.*

cent in 1995. The years after 1995 have once again experienced a decline in the savings rate. Against this, the gross-investment-to-GDP ratio was 10.2 per cent in 1950. It increased to 15.7 per cent in 1960, when India launched itself effectively on the path of planned development. After that, the investment rate increased to reach 27.7 per cent in 1990. There was a decline in the investment rate during the period 1991-1993 and it was only in 1995 that the investment rate reached the level of 27.2 per cent. The post-1995 period has once again seen a decline in the gross investment rate.

The difference between investment and savings as a proportion of GDP began at -0.2 per cent in 1950, but reached its highest level of 3.0 per cent in 1960. The investment-savings gap in GDP remained modest throughout the period from 1970 to 1998 except in 1990, when this ratio reached 3.4 per cent.

Table 2 gives the savings rates and the investment rates in a comparative framework for different developing countries. The table shows that savings and investment rates in India are much lower than those prevailing in many other developing countries. The investment-savings gap as a proportion of GDP in India is rather small. But this ostensibly small need for external resources has been maintained only at relatively low levels of investment and the gross savings rate is also low. The lesson from this experience is that more concerted efforts should be made to increase the savings rate to levels beyond 30 per cent and investment rates also to beyond

Table 2. Savings, investment and inflation rates of selected developing countries
(Percentage)

	1996	*1997*	*1998*	*1999*
China				
Savings/GDP	39.5	40.1	41.5	41.0
Investment/GDP	39.6	38.2	39.0	40.0
Inflation rate	8.3	2.8	-0.8	-1.4
India				
Savings/GDP	26.1	24.7	22.3	24.8
Investment/GDP	27.3	26.2	23.4	26.5
Inflation rate	9.4	6.8	13.1	7.0
Pakistan				
Savings/GDP	14.2	12.6	16.0	12.2
Investment/GDP	18.6	17.8	17.1	14.8
Inflation rate	10.8	11.8	7.8	5.7
Sri Lanka				
Savings/GDP	15.5	21.4	19.3	20.8
Investment/GDP	24.2	24.4	26.6	28.6
Inflation rate	15.9	9.6	9.4	6.0
Indonesia				
Savings/GDP	30.1	31.0	26.2	25.4
Investment/GDP	30.7	31.3	26.6	25.4
Inflation rate	6.5	11.1	77.6	20.4
Malaysia				
Savings/GDP	42.6	43.9	48.1	46.4
Investment/GDP	41.6	42.5	25.8	27.4
Inflation rate	3.5	2.7	5.3	3.0
Philippines				
Savings/GDP	14.6	14.0	12.4	13.5
Investment/GDP	24.0	24.9	20.3	20.3
Inflation rate	8.4	5.1	9.0	7.0
Singapore				
Savings/GDP	49.3	50.4	49.9	50.0
Investment/GDP	37.0	38.7	33.5	34.5
Inflation rate	1.4	2.0	..	0.4
Thailand				
Savings/GDP	35.8	35.1	38.7	33.2
Investment/GDP	41.7	35.0	23.7	24.7
Inflation rate	5.8	5.7	8.1	0.3
Republic of Korea				
Savings/GDP	34.0	33.7	33.4	34.1
Investment/GDP	37.9	34.2	20.9	27.3
Inflation rate	4.9	4.4	7.5	0.9

Source: United Nations, ESCAP, Economic and Social Survey of Asia and the Pacific 2000.

Table 3. Compound growth rate of investment, savings and GDP

	Investment	*Savings*	*Gross domestic product at market prices*	*Gross domestic product at constant prices*
1950-1960	7.662	6.114	4.677	3.2
1960-1970	7.912	7.467	4.979	3.669
1970-1980	12.187	10.013	5.8	3.696
1980-1990	12.363	10.383	5.678	3.301
1990-1999	11.806	10.365	7.744	3.382

Source: Calculated from data given in Government of India, *Economic Survey 1999-2000.*

35 per cent. An investment-savings gap as a proportion of GDP could then be sustained at a level of 2 to 3 per cent, as is the case in many fast-growing developing economies.

Table 3 gives average annual growth rates of savings, investment and GDP for the periods 1950-1970, 1970-1990 and 1990-1999. The growth rate of savings was 6.1 per cent during the period 1950-1960. It increased to 7.4 per cent in the period 1960-1970 but declined slightly to 7.3 per cent in the period 1990-1999, which was characterized by a programme of intensive reforms such as liberalization and globalization. It is, however, rather puzzling that the growth rate of savings declined at a time when the Indian economy was becoming rapidly integrated into the world economy and flows of external capital were becoming liberalized. The growth rate of investment was 7.7 per cent in the 1950s and rose to 12.2 per cent in the 1980s. The growth rate of investment declined marginally in the 1990s to 7.6 per cent.

GDP grew 4.7 per cent in the 1950s, 5.0 per cent in the 1960s and 5.8 per cent in the 1980s. The growth rate of GDP in current prices in the 1990s reached 7.4 per cent. The growth rate of GDP in constant prices is obviously much lower than that current prices. The growth rate of GDP at factor cost in constant prices was 3.2 per cent in the 1950s, 3.6 per cent in the 1960s, 3.7 per cent in the 1970s and 3.3 per cent in the 1980s. In the 1990s, GDP in constant prices grew at 3.3 per cent.

Table 4 gives the composition of savings in the broad categories of the household, private corporate and public sectors as a proportion of GDP at current market prices. The household sector savings to GDP ratio was 7.7 per cent in 1950/51 and 8.4 per cent in 1960/61. There was a significant rise in the household sector savings to GDP ratio to 11.3 per cent in 1970/71, 16.1 per cent in 1980/81 and 20.5 per cent in 1990/91. The data of new series reveal that the household sector savings to GDP ratio was 18.5 per cent in 1998/99. The ratio of private corporate sector savings to GDP increased from 1.0 per cent in 1950/51 to 1.7 per cent in 1980/81, 2.8 per cent in 1990/91 and 3.8 per cent in 1998/99. The ratio of public sector savings to GDP started at a level of 1.8 per cent in 1950/51 and reached a high

Table 4. Savings composition

(Millions of rupees)

Year	*Household sector*	*Private corporate sector*	*Public sector*
1950	71 800	8 900	16 800
	(73.64)	(9.13)	(17.23)
1960	136 200	27 600	42 500
	(66.02)	(13.38)	(20.6)
1970	487 300	65 700	125 300
	(71.28)	(9.69)	(18.47)
1980	2 184 800	228 400	465 400
	(75.9)	(7.93)	(16.17)
1990	10 962 300	1 494 000	543 600
	(84.33)	(11.49)	(4.18)
1998	2 885 500	6 478 600	2 107 900
	(77.07)	(17.30)	(5.63)
1999	32 545 600	6 757 300	57 200
	(82.69)	(17.17)	(0.15)

Source: Government of India, *Economic Survey 1999-2000.*

Note: Figures in parentheses indicate shares in total.

of 4.9 per cent in 1976/77. Thereafter, it has declined consistently, reaching a level of 1 per cent in 1991, 1.5 per cent 1992/93 and almost 0 per cent in 1998/99.

Household sector savings constitute a major proportion of total savings in the economy. The share of household sector savings in total savings in the economy was 84.3 per cent in 1990/91 and was estimated to be 82.7 per cent in 1998/99. The share of private corporate sector savings in total savings was 11.5 per cent in 1990/91 and was estimated to be 17.2 per cent in 1998/99. It is important to note that the share of public sector savings in total savings has been consistently declining, from 18.5 per cent in 1970/71 to 16.2 per cent in 1980/81 and 4.2 per cent in 1990/91. It is estimated that in 1998/99 the share of public sector savings in total savings was just 0.1 per cent.

The inferences that follow from this information are the following: the household sector is the most important sector for generating savings in the economy. Next in importance is the private corporate sector. In view of the increase in the number of the loss-making public sector enterprises and also on account of increasing privatization of public sector enterprises, the share of public sector savings has been declining consistently.

Lessons from the experience

From the analysis of the trends and patterns of savings and investments for the past few decades, the following lessons and guidelines can be drawn: (a) even though the savings rate has shown an increase over the past three to four decades, it is still far below the rates realized in other developing countries which have shown a spectacular growth performance. For example, savings rates in most of the South-East Asian and East Asian economies have been in the range of 30 to 35 per cent or even more for a long period of time. India could have achieved much higher savings rates in the 1980s and 1990s; (b) the investment rates in the Indian economy have also been much lower compared with the other successful economies of the region. India could have realized much higher investment rates along with a much higher savings rate in the 1980s and in the 1990s; (c) the rate of capital formation in both the private and public sectors has not shown an increasing trend over time. However, there have been disturbing fluctuations on a year-to-year basis which have resulted in a number of intersectoral imbalances; (d) India adopted the policy of reserving the commanding heights of the economy for the public sector for a long period as part of its overall development paradigm. Many studies have shown that the trend in private sector investments was highly correlated with the trend in public-sector investments. In other words, any sluggishness in public-sector investments has had a significant negative effect on private-sector investments. In a way, public-sector investment was functioning as an engine of growth of investment activity in the economy until the beginning of the reform process in the 1990s; (e) with the gradual slowing down of public-sector investment and the opening up of the economy for private-sector investment, even in the areas of infrastructure, mining and services, which were formerly reserved for the public sector, the inverse relationship between public-sector investment and private-sector investment has considerably weakened. Private-sector investment is expected to respond positively to this new policy environment despite the slowing down of public-sector investments and the increase in disinvestment activity in the public sector; and (f) the analysis of the instability indices of select macroeconomic parameters like savings rate, investment rate, export to GDP ratio and growth rate of GDP shows that there is an inverse relationship between growth and stability. There is thus an increasing challenge of realizing growth with stability in the coming decades.

BANKING AND FINANCIAL SYSTEM

An overview

The institutional framework for the mobilization of financial resources has been one well-developed feature of the Indian economic system over the past several decades. The financial system is essentially aimed at mobilizing financial savings

and intermediating between the suppliers of savings and the demanders of resources. The financial system is supposed to facilitate financial transactions by providing facilities for payments, clearance and settlement mechanisms. It is only the efficiency of the financial system which determines whether the full potential of resources has been mobilized at any particular stage of development. An efficient financial system facilitates mobilization of the full potential of resources, promotes productive investment and thereby generates high economic growth.

The institutions falling within the framework of the financial system are, in general, the following: (a) commercial banks, (b) development finance institutions, (c) cooperative banks, (d) various types of mutual funds, (e) venture capital funds for industry and technology, (f) non-banking financial intermediaries, (g) specialized rural banks, (h) specialized development banks for industry, external trade, housing, etc. and (i) various types of social security institutions such as insurance companies and pension and provident funds.

In addition to the above institutions, India has a well-established capital market with suitable regulatory and monitoring capacity. Different varieties of financial instruments for money and capital markets have also evolved over time to make the capital market system one of the most important institutions for overall resource generation.

Commercial banking sector

The commercial banking sector in India has been one of the well-established institutions for the mobilization and intermediation of financial resources. It was way back in 1969 that the banking system was nationalized with the objective of promoting the scope and content of resource mobilization in different parts of the country and also for influencing the sectoral allocation of resources for balanced social and economic development in the country. The Government was the principal owner of the nationalized banks and the functioning of the banks was governed by the rules, norms and stipulations laid down by the Ministry of Finance of the Government of India and the Reserve Bank of India, which was the custodian of the banking system in the country. The mandates given to the nationalized banks included the following stipulations: (a) banks should expand their branch network to the different parts of the country to cover rural areas and other remote areas which do not normally have access to institutionalized facilities for resource mobilization and resource supplies; (b) banks were obliged to lend a stipulated proportion of their total advances to selected pre-specified sectors like agriculture, small industries, rural development, social sectors, housing, and backward regions and sections of society. This stipulation included the provision of credit for special social security schemes, like the Prime Minister’s Rozgar Yogana (PMRY) and Jawahar Rozgar Yogana; and (c) banks were required to conform to the interest rates fixed by the Reserve Bank of India as part of the overall monetary

policy of the Government. They were also required to adhere strictly to various prudential norms such as cash reserve ratio and statutory liquidity ratio, and invest in government securities as prescribed from time to time. Bank nationalization was heralded as a major revolutionary step in the financial system of India in conformity with the perceived goals of socialism, in particular, the objective of growth with equity.

Banks mobilize the savings of individuals, households, societies, corporate entities, etc. in the form of various types of deposits. Returns in terms of interest income and the security of financial assets have been the major factors facilitating the task of the banking sector in mobilizing resources and performing the function of intermediaries for resource transfer. It is interesting to analyse the growth of the commercial banking infrastructure in the country over the past 30 years. Table 5 presents an overview of the growth profile of commercial banking from 1969 to 1998. There were only 89 commercial banks in 1969 and this number increased to 276 in 1991, 284 in 1995 and 300 in 1998. For instance, there was a significant upsurge in the number of commercial banks that came on the scene after bank nationalization. There were no regional rural banks (RRBs) in 1969, while there were 196 RRBs by March 1991.

The number of bank offices in India was only 8,262 in June 1969. This number increased to 60,220 in 1991, 62,267 in March 1995 and 64,218 in March 1998. The number of bank offices in the rural sector was only 1,833 in June 1969 and by March 1991 there were 35,206 rural bank offices, an increase of 19 times in the course of about two decades since 1969. The rate of expansion of bank offices in the semi-urban, urban and metropolitan centres was less spectacular compared with the expansion in the rural sector. The number of bank offices in sectors other than the rural sector was 6,429 in 1969 and this increased to 25,014 in March 1991, an increase of about 400 per cent.

There was one bank office for a population of 64,000 in 1969, whereas by 1991 there was one bank office for a population of 14,000. The deposits of the scheduled commercial banks and the credit advanced by these banks also expanded significantly after 1969. Deposits of scheduled commercial banks increased from Rs 46,460 million in 1969 to Rs 2,011,990 million by March 1991. Deposits further increased to Rs 3,868,590 million by 1995 and Rs 6,054,100 million by March 1998. That means that deposits increased 43 times in the period 1969-1991 and 3 times between 1991 and 1998. The credit advanced by the scheduled commercial banks also expanded significantly from 1969 to 1991 and thereafter as well. The credit of scheduled commercial banks increased from Rs 36 billion in 1969 to Rs 1,218,650 million by 1991, an increase of 34 times over the course of 22 years. The deposits of scheduled commercial banks as a percentage of national income in current prices amounted to only 15.5 per cent in 1969. This increased to 48.1 per cent in 1991 and reached 50.1 per cent in 1997. The share of priority-sector advances in the total

Table 5. Progress of commercial banking

Important indicators	*June 1969*	*March 1991*	*March 1995*	*March 1998*
No. of commercial banks	89	276	284	300
Number of bank offices in India	8 262	60 229	62 367	64 218
Rural	1 833	35 206	33 004	32 878
Semi-urban	3 342	11 344	13 341	13 980
Urban	1 584	8 046	8 868	9 597
Metropolitan	1 503	5 624	7 154	7 763
Population per office (in thousands)	64	14	15	15
Deposits of scheduled commercial banks in India (millions of rupees)	46 460	2 011 990	3 868 590	6 054 100
Credits of scheduled commercial banks in India (millions of rupees)	35 990	1 218 650	2 115 600	3 240 790
Deposits of scheduled commercial banks as percentage of national income (in current prices)	15.5	48.1	51.7	N.A.
Share of priority-sector advances in total credit of scheduled commercial banks (percentage)	14.0	37.7	33.7	N.A.
Credit/deposit ratio	77.5	60.6	54.7	53.5

Source: Reserve Bank of India, *Basic Statistical Returns*, vol. 25, March 1996.

credit of scheduled commercial banks increased from 14 per cent in 1969 to 37.7 per cent in 1991. This share declined marginally to 34.8 per cent in 1997. The credit-deposit ratio of the commercial banks was 77.5 per cent in 1969 and came down to 60.6 per cent in 1991 and 53.5 per cent in March 1998. The cash-deposit ratio increased from 8.2 per cent in 1969 to 17.6 per cent in 1991 and came down to 10.1 per cent in 1998.

The lessons that can be drawn from the experience of the banking sector over a period of about three decades since bank nationalization in 1969 are the following: (a) given the spurt of policy support, the expansion of bank offices in the rural and urban areas of the economy was extremely fast and helped to mobilize savings in different parts of the country through the banking system; (b) both deposits and advances of the banking sector have increased significantly over the period and this

has given a boost to production and trading activities in different parts of the country; and (c) as mandated by the Reserve Bank of India and the Government, the banks had to honour certain obligations in terms of lending to priority sectors of the economy, such as agriculture, small industry and backward regions and classes. The share of priority-sector lending thus increased significantly over the period 1969-1991. The positive impact of this priority-sector lending is seen in the expansion of agricultural infrastructure, small-scale industries, development of backward regions and empowerment of backward sections of the society.

Rural banking

One feature of the banking system in India which deserves special mention is rural banking. Conscious efforts were made to spread banking facilities to the rural sector in order to facilitate development and diversification of the activities in the rural economy. There are currently three major players in the rural credit scene: (a) rural branches of the commercial banks; (b) regional rural banks (RRBs); and (c) cooperative credit agencies. The rural credit delivery system has been extensively streamlined by the establishment of the RRBs since 1975. The National Bank for Agriculture and Rural Development (NABARD) has been playing the role of sponsor for a large number of rural credit institutions. The RRBs cater to select specific target groups in the rural sector. The rate of interest charged on rural credit is much lower than the market rate of interest charged by the commercial banks. Even though the rural banking system has grown extensively in the economy, rural credit institutions are facing significant problems of viability and sustainability. These problems are caused by the low income levels of the target groups to which they cater, the limited banking facilities offered by these institutions to non-target groups and a high default rate among the clientele of the rural credit system. Even though these institutions have been playing a crucial role in the banking system, their sustainability in the medium and long term is now in great doubt unless some remedial measures are taken to streamline their activities and improve their operational efficiency.

Weaknesses of the banking system

While bank nationalization brought about a significant upsurge in banking activities in the country, a number of weaknesses also developed simultaneously. The critical appraisal of the banking system carried out by various expert groups in the post-1991 period revealed the following deficiencies of the banking system in the country: (a) in view of the rapid expansion of banking offices and also owing to the obligations of priority-sector lending and other statutory obligations, the profitability of the banks started declining; (b) even though the banks performed project appraisal in a scientific manner before extending advances to the different enterprises, a number of factors contributed to the growth of defaulters in loan repayment and the “sickness”

of industry and these resulted in the expansion of the banking sectors' non-performing assets (NPAs). The obligations of priority-sector lending and other investment norms also contributed to an increase in loan losses and non-performing assets. This tended to weaken the banking sector gradually over time; (c) in view of the decline in the profitability of the banks and the increase in NPAs, the ability of the banking system to build its own capital base dwindled. Gradual erosion of the capital base obviously implied weakening of the banking sector and curtailment of its growth potential; (d) in view of the direct involvement of the Government and the RBI in the management and operations of the banking system, the competitive environment was adversely affected. As a result of the erosion of the competitive environment, there was no incentive to improve efficiency and bring about innovation in the management of the banks. The rapid expansion of branches also implied indiscriminate growth of bank staff and a gradual decline in the quality of human resources and hence the erosion of the work culture in the banking system; and (e) the banking system was not exposed to modernization techniques such as computerization, professional management and commercial decision-making. All this implied a decline in the competitive strength of the banking system.

Banking-sector reforms

Realization of the emerging weaknesses in the banking system has led to the adoption of reforms in the banking sector since the early part of the 1990s. The famous Committee on the Reforms of the Financial System (Narasimham Committee), which submitted its report in 1992, made a number of far-reaching recommendations for financial-sector reforms. There was also a second committee (again under Narasimham's chairmanship) in 1998 which reviewed the progress of the reforms and made further recommendations.

Table 6. Non-performing assets as a proportion of net advances

(Percentage)

	1995/96	*1996/97*	*1997/98*	*1998/99*
Public-sector banks	8.90	9.18	8.15	8.13
I. State Bank of India group	6.88	7.70	6.89	7.74
II. Nationalized banks	10.14	10.07	8.91	8.35
Indian private-sector banks	..	5.37	5.26	6.92
I. Old private-sector banks	4.51	6.65	6.46	8.42
II. New private-sector banks	..	1.97	2.63	4.15
Foreign banks	0.81	1.92	2.25	2.03

Source: Reserve Bank of India, *Report on Trends and Progress of Banking in India*, 1998/99.

The Narasimham Committee found that the stipulations of SLR (statutory liquidity ratio) and CRR (cash reserve ratio) together accounted for 50 per cent of the aggregate deposits of the banking system. This implied a diversion of the funds of the banking system to the activities of the Government which included payment of salaries and many non-developmental purposes. The Committee felt that this was one of the major causes of the decline in the profitability of the banking system. It was therefore recommended that the SLR and CRR should be reduced over time.

The SLR requires banks to invest a predetermined proportion of their net demand and time liabilities (NDTL) in government and other approved securities. These requirements serve as an instrument of monetary control. However, they end up by pre-empting the lendable resources of banks and thereby distort their portfolio patterns. These reserves also earn either nil or relatively low rates of interest and hence impinge upon the income-earning potential of the banks. The CRR stipulates that a bank must hold a certain percentage of its NDTL as reserves with the Reserve Bank in order to ensure the liquidity of the banking system. This also results in the reduction of the volume of the banks' lendable resources and hence adversely affects profitability.

Table 7 presents the profile of the CRR and the SLR from 1991/92 onwards and shows the nature of the reductions that have been brought about in the banking system in recent years as part of the reform process. The Committee felt that the directed-credit programmes stipulated by the Reserve Bank of India and the Government of India contributed to the increase in the NPAs of the banking system. The Committee recognized the purpose of distributive justice implied in the directed-credit programme but felt that fiscal measures rather than the credit system should be used to pursue the goals of distributive justice. It also felt that directed-credit programmes led to the segmentation of the credit market and introduced inflexibility in bank operations, which further implied severe restrictions on the availability of bank funds to the productive sectors. It therefore urged that the stipulation of directed credit should be considerably reduced and, in due course, phased out.

In order to improve the competitive environment for the banking system, the Committee recommended that new private-sector banks be allowed to enter the market and also that greater autonomy be permitted to public-sector banks for their operational effectiveness. As a result of the implementation of the Narasimham Committee report, many reforms have been introduced in the financial sector, thereby facilitating increased efficiency and profitability in the banking system. Some of the elements of the reforms are recounted in the following paragraphs: (a) SLR has been reduced from 38.5 per cent to 31.5 per cent and has moved towards the target of 25 per cent. The medium-period target of 10 per cent for CRR has already been achieved and it is hoped that it will be further reduced by 3 to 5 per cent of the total deposits as recommended by the Committee; (b) a number of private-sector banks have started functioning as a result of the easing of the norms of entry and exit of private-sector

Table 7. Trends in cash reserve ratio (CRR) and statutory liquidity ratio (SLR), 1991/92 to 1997/98

	CRR (as percentage of NDTL)*	*Base SLR (as percentage of NDTL*)*
1991/92	15	38.5
1992/93	15	37.75
1993/94	14	34.75
1994/95	15	33.75
1995/96	14	31.5
April 1996	13	31.5
July 1996	12	31.5
October 1996	11.5	31.5
January 1997	10	31.5
October 1997	9.75	25.0
January 1998	10.5	25.0
April 1998	10.0	25.0

Source: Reserve Bank of India, *Annual Report*, various issues, and Reserve Bank of India, *Credit Policy*, October 1997 and April 1998.

Note: * Net demand and time liabilities.

banks; (c) the nationalized banks have been allowed direct access to the capital market to mobilize funds from the public while the Government would continue to hold 51 per cent of the equity of the banks. Interest rates have been rationalized and simplified and considerably deregulated; (d) the interest yield on government securities is moving towards market-related rates; (e) the branch licensing policy has been extensively liberalized; (f) the accounting and prudential norms relating to income recognition and capital adequacy have been stipulated in conformity with international standards; (g) a number of debt tribunals have been set up in order to facilitate and expedite the adjudication and recovery of the debts; and (h) the Government has been providing capital to the banking system for its recapitalization by making budgetary provisions for this purpose. The Reserve Bank of India has set up a Board for Financial Bank Supervision for strengthening the supervisory function of RBI.

Efficiency of the banking system

A comparison of selected efficiency measures introduced between 1993/94 and 1996/97 is presented in table 8. Four important efficiency measures were introduced. They are: (a) net interest margin (NIM), defined as the difference between interest income earned and interest payments expended divided by average total assets, which measures a bank's core earning capacity; (b) operating profit to staff expense

Table 8. Trends in efficiency of bank groups, 1993/94 and 1996/97

	1993/94				*1996/97*				
	SBI&A	*NB*	*PV*	*FR*	*SBI&A*	*NB*	*PV*	*NPV*	*FR*
Net interest margin as percentage of average assets	3.2	2.3	3.4	5.6	3.5	3.0	3.0	2.9	4.1
Operating cost as percentage of average assets	3.1	2.9	3.1	2.1	2.9	2.9	2.5	1.9	3.0
Staff expenditure as percentage of average assets	2.1	2.0	2.2	0.7	2.1	2.1	1.5	0.3	1.0
Operating profit/staff expenses	0.9	0.4	0.9	11.8	1.0	0.6	1.2	1.0	3.4

Source: Computed from Indian Banks' Association, *Performance Highlights of Banks*, several issues.

Notes: SBI&A: State Bank of India and associates; NB: nationalized banks; PV: old domestic private banks; NPV: new domestic private-sector banks; FR: foreign banks.

(OPSE), defined as operating profit divided by total staff expense, which is an indicator of labour productivity; (c) operating cost ratio (OCR), defined as total operating cost divided by average total assets, which measures a bank's ability to economize on total costs; and (d) staff expense ratio (SER), defined as total staff expense divided by average total assets, which is a measure of manpower expenses. These data show that there has not been much improvement in the efficiency of any bank group over the years of the reform process. However, it should be stressed that the efficiency impact of the reform process will require a longer period than is available in this analysis.

Development finance institutions

While the commercial banks are expected to provide funds essentially for the working capital needs of the industrial sector, the development finance institutions are supposed to provide funds for major capital investments. However, this focus of functions has declined over time.

Resource mobilization and the disbursement of funds for investment are carried out by various financial institutions, mutual funds and non-banking companies. Among the financial institutions, the following are the major institutions with a significant role in the task of resource mobilization and resource disbursement: (a) the Industrial Development Bank of India – functioning since 1964; (b) the Industrial Finance Corporation of India (first national-level development bank established in India in 1948); (c) the Industrial Credit and Investment Corporation of India – established in 1955 as a public limited company; (d) the Small Industries Development Bank of

India (SIDBI) – functioning since 1990/91; (e) the Industrial Investment Development Bank of India Ltd. (called the Industrial Reconstruction Bank of India before 1997); (f) the Shipping Credit Investment Corporation of India (SCICI); (g) the Risk Capital and Technology Finance Corporation Limited (RCTC); (h) the Trade Development and Investment Company of India Ltd. (ICICI Venture Funds Management Company Ltd.); (i) the Tourism Finance Corporation of India; (j) the Life Insurance Corporation of India; (k) the Unit Trust of India; (l) the General Insurance Co; (m) state-level finance corporations; and (n) small industries development corporations (SIDCs).

These different financial institutions have been sanctioning and disbursing funds for different activities in the economy. Some institutions have been created with specific objectives from time to time and they have been serving their purposes with well-designed organizational structures and operational modalities. These institutions draw their capital base, either from the Government, or from some of the well-established financial institutions, or from the market. Out of these, IDBI, IFCI and ICICI, in general, cater to the long-term financial requirements of medium- and large-scale industrial enterprises. They have well-established project appraisal departments and a highly trained manpower with technical, financial and managerial expertise. The industrial enterprises which approach these institutions for financial support have to submit very detailed project reports, containing an economic and financial appraisal of their project proposals. They have to provide detailed estimates of the economic rates of return, various financial ratios, internal rate of return, estimates of domestic resource cost, estimates of effective rates of protection, payback period, debt service coverage ratio, profile of capacity utilization, analysis of market potential and technological and managerial feasibility analysis. These institutions adopt the approach of rigorous project appraisal techniques to decide on the viability of the proposed projects and the reliability of the estimated demand for funds. These institutions also have well-structured departments for monitoring the performance of the companies established with their financial assistance. They have their own nominees on the boards of directors of these assisted companies and they monitor their performance to derive advance signals of any impending sickness of the enterprises.

SIDBI is an institution which was specially created in 1990 to provide financial assistance to small industries. RCTC, functioning since 1988 (RCTC was originally established as a society named Risk Capital Foundation sponsored by IFCI in 1975), is a specialized institution for providing capital to new entrepreneurs and for the development of new technologies. TFCI, started in 1989, has the purpose of promoting tourism-related investment activities.

Table 9 provides information about the total sanctions and disbursements made by all the financial institutions taken together, in the years 1980/81, 1990/91 and 1998/99. The sanctions increased from Rs 29.3 billion in 1980/81 to Rs 192.0 billion in 1990/91 and to Rs 945,220 million by 1998/99. The amounts disbursed also

Table 9. Assistance sanctioned and disbursed by all financial institutions

(Millions of rupees)

Year (April-March)	Total	
	Sanctions	*Disbursements*
1980/81	29 260.9	18 470.9
1990/91	192 020.4	128 100.1
1995/96	641 620.7	386 490.5
1998/99P	945 210.9	590 720.3

Source: Reserve Bank of India, *Handbook of Statistics on Indian Economy*, 1999.
Notes: Totals are adjusted for interinstitutional flows.
P = Provisional.

registered commensurate increases over these periods. The disbursement-to-sanction ratio increased from 64 per cent in 1980/81 to 67 per cent in 1990/91. However, this ratio came down to 63 per cent in 1998/99 and reached a low of 57 per cent in 1994/95. The ratio of disbursements to sanctions indicates the absorption by the corporate sector of the funds made available by the financial institutions.

Resources mobilized by mutual funds

The institutional approach of mutual funds has also been utilized in the country's financial system to mobilize resources from a large number of savers and make them available for investment purposes. The Unit Trust of India is one of the most well-established and successful mutual funds in the country. There are a large number of bank-sponsored mutual funds, financial institution-sponsored mutual funds and private-sector mutual funds. The resources mobilized by the Unit Trust of India constitute more than 77 per cent of the total resources mobilized by all the mutual funds. Table 10 presents a brief profile of the resources mobilized by the mutual funds for the years 1990/91, 1995/96 and 1998/99. The resources mobilized by mutual funds stood at Rs 75.1 billion in 1990/91. However, by 1995/96, UTI had unloaded a large portion of its units and hence its resource mobilization had become negative. In 1997/98 and 1998/99 it once again achieved positive resource mobilization.

Capital market

India has a well-established capital market which has grown in scope and content over the past several years. However, in recent years since the beginning of the reforms in 1991, the operations of the capital market have been extensively liberalized and this has led to significant expansion in the Indian economy's capital market. Analysts have observed that the Indian capital market is becoming increasingly

Table 10. Resources mobilized by mutual funds

(Millions of rupees)

Year (April-March)	*UTI** *(1)*	*Bank-sponsored mutual funds (2)*	*FI-sponsored mutual funds (3)*	*Private-sector mutual funds (4)*	*Total (1+2+3+4)*
1990/91	45 520.95	23 510.94	6 030.54	–	75 080.43
1995/96	-63 140.00	1 130.30	2 340.81	1 330.03	-58 320.86
1998/99P	1 700.00 (-1 300.00)	2 530.18	5 760.42	20 900.37	30 890.97

Source: Unit Trust of India and respective mutual funds.

P = Provisional.

– = Not applicable.

FI = Financial institution.

* For Unit Trust of India (UTI), the figures are gross value (with premium of net sales under all domestic schemes. Figures in brackets pertain to net sales at face value (excluding premium). Data from 1970/71 to 1990/91 relate to July-June period.

well organized with a reduction in transaction costs and an increase in the efficiencies of market operations and information flows. In order to bring discipline and orderliness to the capital markets, India has established a powerful institution called the Securities and Exchange Board of India (SEBI) to supervise, monitor and guide the operations of the stock markets and the behaviour of stockbrokers. A number of over-the-counter exchange facilities (OTCs) have been established and well-equipped credit rating agencies have also come into being with the objective of guiding investors in managing their investment portfolios. The primary market and also the secondary and derivatives market have been growing significantly in the capital market over the past few years. The Bombay Stock Exchange, the National Stock Exchange and various other stock exchanges have become the venues for intense capital-market operations. The growth in the size of the primary capital market can be gauged from the consistent increase in the number of primary issues and growth in the capital raised over the period 1992/93 to 1996/97, as shown in table 11. The emergence of various mutual funds and venture capital funds has also facilitated the growth of the capital market by linking the large number of small investors with the transactions of these institutions. Table 12 shows that resource mobilization from the primary market during April to December 1999 was Rs 57,230 million, a 46 per cent increase over the amount raised in the comparable period of the previous financial year. Banks and financial institutions were the largest beneficiaries of the resources mobilized through the primary market operations. The other indicators of the growing strength of stock market operations are the Sensex indices, price-earnings ratios and average daily turnover. Table 13

Table 11. Size of the domestic primary capital market

Nature of offering	1992/93		1993/94		1994/95		1996/97		1997/98	
	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.
Public	546	107	773	155	1 342	210	1 426	142	773	130
Rights	488	60	370	89	324	66	299	66	208	92
Total	1 034	167	1 143	244	1 666	276	1 725	208	981	222

Source: Nayak, P. Jayendra, "Regulation and Market Microstructure", in James A. Hanson and Sanjay Kathuria, eds., 1999. *India: A Financial Sector for the Twenty-First Century*, Oxford University Press, New Delhi.

Note: Up to September 1997, as estimated from market reports.

Table 12. Resource mobilization from the primary market

(Millions of rupees)

Type of issue	1998/99		April-December 1998/99		April-December 1999/2000	
	No.	Amount	No.	Amount	No.	Amount
Public	32	50 190	23	35 190	38	43 400
Rights	26	56 800	18	41 000	22	13 830
Total	58	55 870	41	39 290	60	57 230
(Debt)	(18)	(47 300)	(13)	(32 240)	(7)	(22 210)
(Equity)	(40)	(8 570)	(28)	(7 050)	(53)	(35 020)

Source: Government of India, *Economic Survey 1999-2000.*

clearly brings out the significance of stock operations in the context of resource mobilization for investment in the economy.

The issues of concern in the context of capital-market operations are the following: (a) there is significant volatility in the Sensex indices and the price-earnings ratios. The volatility is caused by the speculative activities of a few brokers and also by the volatile behaviour of foreign institutional investors and other hot money operators in the stock markets; (b) the securities scam of 1992/93 caused by the misuse of "bankers' receipts" for spurious inter-bank transactions and speculative investments in the stock market raised a number of issues related to monitoring and regulation of stock markets which together were termed issues of systemic failure. The steps taken in response to the securities scam in terms of strengthening the institutional framework and tightening the surveillance of the behaviour of stockbrokers seem to have yielded the desired result of bringing about greater orderliness and

Table 13. Stock market indicators

Year/month	*Index*[1]		*Price/earnings ratio*	*Average daily turnover (millions of rupees)*	
	Sensex	*S&P CNX*	*BSE Nifty Sensex*	*BSE*	*NSE*
1998/99					
April	4 006.81	1 159.35	16.11	14 040	16 340
May	3 686.39	1 063.15	14.84	13 020	17 920
June	3 250.69	941.65	12.94	10 230	13 430
July	3 211.31	931.40	12.69	9 240	12 840
August	2 933.85	852.80	11.13	9 110	11 510
September	3 102.29	904.95	11.30	12 570	14 220
October	2 812.49	824.00	9.83	12 430	14 350
November	2 810.66	817.75	11.12	10 110	11 540
December	3 055.41	884.25	12.08	12 130	15 650
January	3 315.57	966.20	13.10	17 110	23 510
1999/2000					
April	3 325.69	978.20	13.50	14 210	17 970
May	3 963.56	1 132.30	15.76	17 250	23 930
June	4 140.73	1 187.70	16.53	15 110	18 400
July	4 542.34	1 310.15	18.40	21 200	25 210
August	4 898.21	1 412.00	19.87	22 730	24 410
September	4 764.42	1 413.10	20.41	22 180	26 610
October	4 444.56	1 325.45	21.01	28 850	34 390
November	4 622.21	1 376.15	19.99	24 560	31 590
December	5 005.82	1 480.85	20.91	35 650	44 810
January	5 205.39	1 546.20	N.A.	N.A.	N.A.

Source: Government of India, *Economic Survey 1999-2000.*

1. Monthly closing; Sensex (1978/79 = 100) and S&P CNX Nifty (1995 = 100).

discipline in the stock markets. However, there is much more that needs to be done to regulate and discipline stock market operations; (c) the information system aimed at facilitating the decisions of small investors and brokers and regulating organizations like SEBI and RBI has yet to be streamlined. Despite the establishment of OTCs, there are a large number of investors who operate on the stock markets with highly inadequate information and poor analytical knowledge; (d) the failure of a large number of non-banking financial companies (NBFCs) in the period 1995-1998 and the delay in settling the claims of a large number of investors and punishing the guilty has also caused significant damage to the image of the capital market in the Indian economy;

and (e) the Indian capital market was saved from the shock effects caused by the collapse of the capital market and banking system in the East Asian and South-East Asian economies in 1997-1998, largely because of the cautious approach adopted with regard to capital-account convertibility and also the limited opening up of the financial sector to foreign operators. In recent months, however, there has been a significant increase in the presence of foreign operators in the Indian capital market. Further, with increasing liberalization of the banking sector and the opening up of the insurance sector as well as the power and telecom sectors to foreign investors, the nexus between the financial sector and the real sector of the economy and that between the domestic sectors and the international sectors seems to have increased significantly. Some analysts have pointed out that this new scenario has good potential for the expansion of resource mobilization activities, but also has the danger of increasing the inherent instabilities in the Indian economy. In view of this, a vigilant policy maker and an efficient surveillance system seem to be the urgent requirements of the emerging scenarios in the economy.

GOVERNMENT FINANCES

In a federal set-up as in India one has to consider essentially two layers of government. One, the central Government, and the other, the governments of the various states of the federal set-up. Of course, there are organizations of governance at still lower levels like panchayats, district administrations and municipalities. In fact, in the new wave of decentralization of economic power, the panchayat-level administration is also given responsibility for executing certain development projects and disbursing funds for development purposes. However, resource mobilization and disbursement are essentially done at the level of the central Government and the state governments.

The accounts of the Government are maintained in two types: the revenue account and the capital account. The revenue account shows revenue receipts and revenue expenditure and the difference between these two heads of accounts is termed revenue surplus or deficit. Similarly, the capital account presents receipts on capital accounts and expenditure on capital accounts and the difference between the two becomes the capital-account surplus or deficit. The gross fiscal position of the Government, which is in deficit, is financed through various sources which include external finances, market borrowings and other liabilities like small savings, provident funds, special deposits and reserve funds. Whatever is not met through these sources is termed the budget deficit.

Table 14 gives the major components of central government receipts from different sources for the past few years. These major sources include tax revenue consisting of direct taxes and indirect taxes and non-tax revenues as well as capital receipts. There are two major components of direct taxes, namely, personal income

Table 14. Central government receipts: major components

(Millions of rupees)

Year	*Tax revenue (net)*	*Direct tax*	*Indirect tax*	*of which--- custom duties*	*Non-tax revenue*	*Revenue receipts*	*Total receipts*	*Direct tax/ tax rev.*	*Indirect tax/ tax rev.*	*Custom duties/ indirect tax*	*Tax rev./ rev. receipts*	*Rev. receipts/ total receipts*
1970/71	24 510	5 110	19 400	5 240	8 420	32 930	53 390	0.21	0.79	0.27	0.74	0.62
1980/81	93 580	18 930	74 650	34 090	30 150	123 730	202 910	0.20	0.80	0.46	0.76	0.61
1990/91	429 780	69 030	360 750	206 440	119 760	549 540	939 510	0.16	0.84	0.57	0.78	0.58
1995/96	819 390	222 870	596 520	347 570	281 910	1 101 300	1 684 680	0.27	0.73	0.58	0.74	0.65
1996/97	937 010	253 740	683 270	428 510	325 780	1 262 790	1 878 230	0.27	0.73	0.63	0.74	0.67
1997/98	956 720	271 720	685 000	401 930	382 290	1 339 010	2 320 680	0.28	0.72	0.59	0.71	0.58
1998/99 (RE)	1 095 370	353 560	741 810	426 480	481 280	1 576 650	2 819 120	0.32	0.68	0.57	0.69	0.56
1999/2000 (BE) @	1 323 650	422 480	901 170	503 690	504 750	1 828 400	2 838 820	0.32	0.68	0.56	0.72	0.64

Source: Reserve Bank of India, *Handbook of Statistics on Indian Economy,* 1999.

RE = Revised estimates.

BE = Budget estimates.

\# = Net of states' share.

@ = Includes the effects of budget proposals.

tax and corporate tax. Indirect taxes consist of excise duties and custom duties. The major components of non-tax revenue are the interest receipts on various deposits and advances made by the Government. All these together constitute revenue receipts. The major heads of capital receipts are market borrowings, small savings, provident funds, special deposits, recovery of loans, disinvestment receipts and external loans. It can be seen that tax revenue was just Rs 93.6 billion in 1980/81; it increased to Rs 429.8 billion in 1990/91 and shot up to Rs 1,095.4 billion in 1998/99. The budget estimates for 1999/2000 put tax revenue at Rs 1,323.7 billion. Direct tax revenue as a percentage of total tax revenue was 20 in 1980/81, 16 in 1990/91, 27 in 1995/96, 28 in 1997/98 and 32 in 1998/99. Within direct tax revenue, the share of corporate tax rose from 69 per cent in 1990/91 to 96.5 per cent in 1998/99. The share of indirect taxes in total tax revenue was 80 per cent in 1980/81; it increased to 84 per cent in 1990/91 and fell to 68 per cent in 1998/99. Customs duties revenue constituted 56 per cent of total indirect tax revenue in that year.

It is interesting to examine the composition of the expenditure of the central Government. Once again the expenditures are categorized as revenue expenditure and capital expenditure. Table 15 presents the revenue expenditure and capital expenditure along with their major components. It can be observed that in revenue expenditure the burden of interest payments and subsidies increased significantly after 1990/91. The share of interest payments in total expenditure was 18.1 per cent in 1980/81. It increased to 20.2 per cent in 1990/91 and 35.4 per cent in 1998/99. However, the share of subsidies in total revenue expenditure decreased from 14.1 per cent in 1980/81 to 11.3 per cent in 1998/99. The share of capital outlays in total governmental expenditure has been declining over the years and this has contributed to a reduction in the investment expenditure of the central Government. The gross fiscal deficit as a proportion of GDP was 5.7 per cent in 1980/81; it increased to 8.3 per cent in 1990/91 but there was a decline to 5.9 per cent in 1998/99.

Ever since the reforms were intensified, a crucial issue of debate has been the role of the Government in the management of resources and the development process in the economy. As is well known, India started its development process in the 1950s in the framework of a mixed economy in which the private sector and the public sector coexisted. The development paradigm chosen in India also implied coexistence of planning and the market, a blend of physical controls and fiscal measures, growth of private-sector profits and expansion of social sectors, etc. However, since the beginning of the reform process in 1991, a shift has been taking place in the development paradigm and this has generated a debate on a number of issues of analytical and policy importance. The question of redefining the role of the State and restructuring its functions has been one of the major issues at the forefront of the debate. The new perceptions that have been emerging in this context and the new challenges of government finance are the following: (a) the State should withdraw from those economic sectors where its presence is not warranted and also where the

Table 15. Major heads of expenditure of the central government

(Millions of rupees)

Year	*Revenue expenditure*	*of which--- interest* payments	*Subsidies*	*Capital expenditure*	*Capital outlays*	*Total expenditure*	*Subsidies/ rev. exp.*	*Interest pay./rev. exp.*	*Rev. exp./ total exp.*	*Capital exp./total exp.*	*Gross fiscal deficit/exp.*
1970/71	31 300	6 060	940	24 940	9 420	56 240	0.030	0.194	0.557	0.443	--
1980/81	144 100	26 040	20 280	83 580	30 730	227 680	0.141	0.181	0.633	0.367	5.7
1990/91	735 160	214 980	121 580	317 820	121 300	1 052 980	0.165	0.292	0.698	0.302	8.3
1995/96	1 398 610	500 450	133 720	384 150	140 990	1 782 750	0.096	0.358	0.785	0.215	5.8
1996/97	1 589 330	594 780	163 640	420 740	141 960	2 010 070	0.103	0.374	0.791	0.209	4.7
1997/98	1 803 500	656 370	194 870	517 190	175 260	2 320 680	0.108	0.364	0.777	0.223	5.7
1998/99 (RE)	2 181 390	772 480	246 830	637 730	195 190	2 819 120	0.113	0.354	0.774	0.226	5.9
1999/2000 (BE)	2 369 870	880 000	238 380	468 950	244 000	2 838 820	0.101	0.371	0.835	0.165	4.0

Source: Reserve Bank of India, *Handbook of Statistics on Indian Economy,* 1999.
RE = Revised estimates.
BE = Budget estimates.

private sector can do a better job; (b) the State should concentrate on the task of infrastructure development, in particular, the social infrastructure, and function as a facilitator of development with appropriate regulatory and monitoring responsibilities; (c) the State should gradually reduce the subsidies given to such economic sectors as power, railways, food distribution, agriculture, exports and economic services and pricing in these sectors should be based upon economic principles rather than highly costly social considerations; (d) there should be gradual downsizing of the government sector (sometimes termed "rightsizing") by a gradual reduction in manpower, curtailment of unproductive expenditure and a moratorium on additional employment; (e) the Government should disinvest in a number of sectors so that the burden of managing these sectors is reduced over time. In fact, the present Government has a separate ministry of disinvestment to expedite the process of disinvestment in public-sector enterprises (it should be noted, however, that the pace at which the disinvestment is taking place has been so rapid in recent months that many questions and doubts have been raised about the advisability of such a rapid disinvestment process); (f) the Government's initiatives to reduce subsidies in a number of sectors have not made significant progress owing to various political and social compulsions. In fact, some state governments have indulged in populist measures which have brought about a great setback to the subsidy reduction programme of the central government; (g) the Government has the major task of reducing the fiscal deficit to reasonable levels. While there has been some success in the process of reducing fiscal deficits, the central and state governments are still faced with the problem of large outstanding liabilities due to internal and external debts. The total outstanding liabilities of the Government were placed at 56.6 per cent of GDP in 1998/99 and this is very large by any standard. The Government also has yet another burden of subtle liabilities called contingent liabilities, in the form of guarantees provided by the Government. As a proportion of GDP, these outstanding contingent liabilities are estimated to have been in the range of 5 to 5.5 per cent in recent years; (h) in the context of reducing fiscal deficits, the Government has the dilemma of identifying the areas for increase in revenues and reduction in expenditures. It has been observed that the Government introduces cuts in capital expenditure, thereby adversely affecting the growth potential and creating infrastructural bottlenecks. Cuts in social-sector spending are also effected, thereby frustrating the basic goals of government expenditure; (i) one of the problems of government finance in a federal set-up is that of devolution of funds from the central Government to the state governments and from state governments to the lower levels of economic decision-making like municipalities and panchayats. The devolution of funds from the central Government to the state governments is done through two institutions, namely, the Planning Commission, which is a permanent statutory body set up by Act of Parliament, and the Finance Commissions, which are set up every five years by the President of India to make recommendations for the devolution of shares of central taxes and duties to the states. The allocation of funds by the Planning

Commission pertains to the size of the development plan drawn up by each state government and is termed plan grants. The devolution done according to the recommendations of the Finance Commissions takes into account the non-plan requirements of the different states and factors such as the size of the state, stage of development and revenue-raising capacity, and considerations of inter-state equity and overall stability and development are taken into consideration while making the devolution of funds from the centre to the state. It may be mentioned, incidentally, that the recent report on the Eleventh Finance Commission has raised a number of controversies and debates on the ground that states which have done well in managing their resources efficiently have not been given due credit in terms of increased allocation of funds to facilitate their rapid growth.

EXTERNAL RESOURCES

An overview

One of the significant segments of resource management pertains to the external sector. The external sector consists of seven major dimensions: (a) balance of trade with regard to goods; (b) balance of trade with regard to invisibles on the current account; (c) transactions on the capital account; (d) bilateral and multilateral capital flows; (e) resources raised in capital markets abroad; (f) foreign direct investment in productive sectors; and (g) portfolio capital flows in the domestic capital markets. In recent years, India has initiated many reform measures which involve extensive liberalization of economic activities and increasing globalization aimed at integrating the Indian economy into the global economy.

On the trade front, India has significantly reduced its tariff and non-tariff barriers in conformity with its commitments to the World Trade Organization. Many initiatives have also been taken at the bilateral, regional and subregional levels – for example, in the SAARC region – to liberalize the movement of goods and services and investment flows. India has also opened up its market for imports of consumer goods by removing the quantitative restrictions (QRs) on such imports and also by streamlining the tariff rates on them. By March 2001, almost all consumer goods were to be opened up for import without QRs. Table 16 presents an overview of India's balance of payments in US dollars for the years 1980/81, 1985/86, 1990/91, 1993/94, 1995/96 and 1998/99. India had a negative merchandise trade balance all these years and this negative trade balance has been increasing in size, particularly in the post-liberalization period. The main observations on the phenomenon of external balance are the following: (a) there has been slow growth in exports and relatively faster growth in imports; (b) net invisibles on the current account have always been positive and this has significantly increased in recent years, owing to exports of software services; (c) the current account as a whole continues to be in negative balance and

Table 16. India's overall balance of payments

(Millions of US dollars)

Item	*1980/81*	*1985/86*	*1990/91*	*1993/94*	*1995/96*	*1998/99*
I. Merchandise						
(A) Exports f.o.b.	8 445	9 461	18 477	22 683	32 311	34 298
(B) Imports c.i.f.	16 314	17 294	27 914	26 739	43 670	47 544
Trade balance (A-B)	-7 869	-7 834	-9 437	-4 056	-11 359	-13 246
II. Invisibles, net	5 065	2 967	-243	2 898	5 449	9 208
III. Current account (I+II)	-2 804	-4 867	-9 680	-1 158	-5 910	-4 038
IV. Capital account (A to F)	1 665	4 506	7 188	9 695	4 689	8 260
(A) Foreign investment	...	...	103	4 235	4 805	2 412
(B) External assistance, net	1 409	1 370	2 210	1 901	883	820
(C) Commercial borrowings, net	252	954	2 248	607	1 275	4 362
(D) Rupee debt service	...	...	-1 193	-1 053	-952	-802
(E) NRI deposits, net	226	1 444	1 536	1 205	1 103	1 742
(F) Other capital	-222	738	2 284	2 800	-2 425	-274
V. Overall balance (III+IV)	-1 140	-361	-2 492	8 537	-1 221	4 222
VI. Monetary movements (VII+VIII+IX)	1 140	361	2 492	-8 537	1 221	-4 222
VII. Reserves (Increase -, decrease +)	654	577	1 278	-8 724	2 936	-393
VIII. IMF, net	336	-216	1 214	187	-1 715	-3 829
IX. SDR allocation	150	0	0	0	0	0

Source: Reserve Bank of India, *Handbook of Statistics on Indian Economy,* 1999.

remains a source of anxiety for the policy makers; (d) on the capital account, the inflow of foreign investment has significantly increased, although it is much less than what would have been expected in response to the policy changes initiated in the economy; (e) net commercial borrowings have been showing an increasing trend, resulting in increasing future liabilities and burden of repayment. Another source of major resource flow has been NRI deposits in response to the various alternative NRI deposit schemes, including the most successful resurgent India bonds, etc.; (f) in view of the increase in foreign capital movements for both long-term investments and portfolio investments, the foreign exchange reserves of the country have increased. Additions to foreign exchange reserves were particularly significant in 1993/94 and 1996/97 while there was a depletion of the reserves in 1995/96; and (g) the annual changes in the reserves position indicate considerable volatility in the flow of short-term capital. The impact of these volatilities is to be seen in the frequent fluctuations in the Sensex

indices of the stock markets and also in the fluctuations in the exchange rate and the gradual depreciation of the rupee in the foreign exchange market.

India's external debt

Another index of the country's resource position is given by the external debt situation. Table 17 presents a broad overview of India's external debt position categorized into long-term debt and short-term debt. The table also presents some select debt indicators such as debt stock to GDP ratio and debt-service ratio. Some significant observations on the table provide revealing insights: (a) the share of concessional debt as a percentage of total debt declined consistently over the period 1990-1999. It came down from 46.7 per cent in 1990 to 37.9 per cent in 1999; (b) the share of short-term debt in total debt was in the range of 7 to 10 per cent during 1990-1993 and it has declined considerably in subsequent years, except in 1997, when it reached 7.2 per cent; (c) the debt stock to GDP ratio has been fluctuating: it

Table 17. India's external debt

(Millions of US dollars)

Item	*1990*	*1993*	*1995*	*1997*	*1999P*
Total long-term debt	68 356	83 683	94 739	86 744	93 902
Short-term debt	7 501	6 340	4 269	6 726	4 329
(a) NRI deposits (up to 1-year maturity)	3 244	2 603	2 278	3 773	2 199
(b) FC(B&O)D (up to 1-year maturity)	0	779	0	0	0
(c) Others (trade-related)**	4 257	2 958	1 991	2 953	2 130
of which short-term debt of 6 months	2 004	1 793	1 991	2 953	2 130
Gross total	75 857	90 023	99 008	93 470	98 231
Concessional debt	35 443	40 097	44 845	39 489	37 244
As percentage of total debt	46.7	44.5	45.3	42.2	37.9
Short-term debt	7 501	6 340	4 269	6 726	4 329
As percentage of total debt	9.9	7.0	4.3	7.2	4.4
Debt indicators:					
Debt stock – GDP Ratio (percentage)	28.5	39.8	30.0	23.8	23.7
Debt-service ratio (percentage) (for fiscal year) (including debt servicing on non-civilian credits)	30.9	27.5	26.2	21.2	18.0

Source: Reserve Bank of India, *Handbook of Statistics on Indian Economy*, 1999.

Note: Multilateral loans do not include revaluation of IBRD pooled loans and exchange rate adjustment under IDA loans for pre-1971 credits. Debt-service ratio from the year 1992/93 includes the revised private transfer contra-entry on account of gold and silver imports.

P = Provisional.

** Does not include suppliers' credit of up to 180 days.

reached its highest level of 41 per cent in 1992. However, in recent years it has been showing a declining tendency; (d) the debt-service ratio was above 25 per cent until 1995. However, it has been consistently declining in subsequent years and reached a low of 18 per cent in 1999.

The above profile of India's external debt seems to suggest that the policy initiatives taken by the Government to deal with the external debt situation have been satisfactory. However, the issues of concern pertain to the high degree of volatility in the debt and the persistence of a high debt stock to GDP ratio and a rather high debt-service ratio. In recent months, the increasing volatility of the exchange rates and the stock market indices have also been of great concern to the policy makers.

ECONOMIC STABILITY

It has been accepted both in the analytical literature and in the policy literature that macroeconomic stability is a prerequisite for the realization of the full potential of savings and investment in the economy. Of course, macroeconomic stability may be only a necessary precondition and not a sufficient condition to sustain high growth and avoid crisis situations. The recent experience of the East Asian and South-East Asian economies seems to suggest that financial and economic crises frustrating the growth effort could emerge even though all the macroeconomic fundamentals were in good shape. The health of a country's macroeconomic situation can be gauged by the analysis of four or five select macroeconomic indicators, namely, inflation, the gross fiscal deficit as a proportion of GDP, the internal and external debt liabilities of the Government, the current account deficit to GDP ratio and the import cover of reserves. In an economy like India's, where agriculture constitutes the most significant sector for the generation of income and employment, the growth rate of agriculture and its annual fluctuations also need to be taken into account in examining the stability of the economy. Further, growth of the social sectors like education and health and indicators of inequality and unemployment rates also need to be considered in the analysis of the stability of an economic system.

Using inflation measured by the wholesale price index (WPI), it can be observed that the period 1990/91 to 1994/95 – the initial period of the reform process – experienced very high inflation rates of above 10 per cent on average. In the period from 1995/96 onwards, however, the inflation rate has been significantly lower and has been fluctuating between 4.8 per cent and 7.7 per cent. The inflation rates measured by the consumer price index (CPI) number are higher than those indicated by the wholesale price index numbers. In 1998/99, for example, the inflation rate measured by the CPI was 13.1 per cent while the same measured by WPI was only 6.9 per cent.

With regard to the gross fiscal deficit (GFD) to GDP ratio, the symptoms of instability still seem to be very high, as indicated by the high GFD ratios and their high annual volatility.

The ratio of current account deficit to GDP reached a high of -2.3 per cent 1990/91 but thereafter it has been kept under control at a reasonable level, below -1.5 per cent, owing to the favourable movement of invisibles. However, the trade deficit to GDP ratio continues to remain high in a range of -3.2 per cent to -3.7 per cent of GDP.

As indicated earlier, the internal and external debt liabilities of the Government still remain at very high levels, causing concern about longer-term stability. Further, the health of the banking sector and the financial system as a whole are also a source of concern for stability since some of the indicators of the health of the banking system, in particular, non-performing assets, profitability rates and capital adequacy ratios do not seem to provide very favourable signals of stability. To this could be added the volatility of the capital markets as indicated by the fluctuations in the Sensex indices and the volatility of the foreign exchange markets as indicated by the fluctuations in the exchange rates, which are other causes for concern with regard to the overall Indian economic situation. Since investments by foreign institutional investors have played a significant role in the Indian capital market in recent years, the increasing volatility on a month-to-month basis in the net investment by foreign institutional investors (FIIs) could also be a source of concern with regard to the overall stability of the economy. In the year 1998/99, for example, there was a net outflow of Rs 8.1 billion of FII investment, while in 1997/98 there was a net inflow of Rs 59,780 million. The year 1997/98 also experienced some months of net outflows in FII investments.

On the whole, the financial and economic scene of the Indian economy seems to be characterized by many symptoms of instability and since the policy makers have yet to strengthen their expertise in dealing with the emerging new situations of liberalization and globalization these symptoms deserve to be taken seriously so that appropriate preventive measures are initiated much before the symptoms manifest themselves in the form of a crisis situation. If the past record of policy makers in dealing with various external shocks such as the Asian and Latin American crises has any relevance, it is legitimate to ask what the policy responses would be in dealing with instabilities and averting the emergence of a new crisis.

CONCLUDING OBSERVATIONS

This paper has dealt with a large number of diverse issues pertaining to the very complex theme of mobilization of resources for development. It has attempted to present a historical perspective of different macroeconomic variables and also of the institutional framework of the Indian economy with a view to drawing lessons from past experience. The paper has dealt with topics such as savings and investment, the banking and financial system, government finances, the challenges of the external sector and the problems of economic stability. The paper has aimed at being both

informative and analytical. It should be underlined that the problem of resource mobilization raises such complex issues that it is difficult to do justice to all aspects of the subject in a short paper like this. However, in each section the paper has highlighted the broad orders of magnitude and certain major lessons of past experience and indicated policy directions that deserve special consideration for the future.

REFERENCES

Government of India, 2000. *Economic Survey 1999-2000*.

Government of India, 2000. *Report of the Eleventh Finance Commission for 2000-2005*.

Hanson, J.A. and Sanjay Kathuria, eds., 1999. *India: A Financial Sector for the Twenty-First Century*, Oxford University Press, New Delhi.

Kapila, R. and Uma Kapila, eds., 1995. *Banking and Financial Sector Reforms, Recent Developments in Indian Economy,* Part V, Academic Foundation, New Delhi.

Rangarajan, C., 1998. *Indian Economy – Essays on Money and Finance*, UBS Publishers' Distributors Ltd., New Delhi.

Reddy, Y.V., 2000. *Monetary and Financial Sector Reforms in India: A Central Banker's Perspective*, UBS Publishers' Distributors Ltd., New Delhi.

Reserve Bank of India, *Handbook of Statistics on Indian Economy,* 1999.

_________, 1996. *Basic Statistical Returns*, vol. 25, March 1996.

_________, 2000. *Reserve Bank of India Bulletin*, June 2000.

Sarkar, Jayati, 1999. "India's Banking Sector: Current Status, Emerging Challenges, and Policy Imperatives in a Globalized Environment", in James A. Hanson, and Sanjay Kathuria, eds., 1999, *India: A Financial Sector for the Twenty-First Century.*

Subramanian, K. and T.K. Velayudham, eds., 1997. *Banking Reforms in India – Managing Change*, Tata McGraw-Hill Publishing Company Limited, New Delhi.

United Nations, ESCAP, 2001. *Economic and Social Survey of Asia and the Pacific 2000.*