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Regulation of Informal Financial Institutions: A Study of Money Lenders in Kerala

P. D. Jeromi*

Re-emergence of informal financial institutions (IFIs) in the provision of credit has been a policy challenge in recent years in India. Though they meet the credit requirements of a section of the society, who are not served by the formal financial institutions, their unbridled growth, unlawful activities and links with other institutions may pose threats to the stability of financial system and makes the monetary policy less effective. Furthermore, they create social problems when they charge usurious rates of interest and resort to unethical practices for recovery of loans, which in turn, leads to suicides committed by indebted farmers. In this context, the study attempts to analyse the working of money lenders in Kerala. Based on a sample survey, the paper has estimated the volume of deposits and credits of money lenders in Kerala and brought out the undesirable aspects of their working and its impact on the society. The paper finds that the existing legal provisions and regulatory and supervisory mechanisms are inadequate to protect the interests of both depositors and creditors. The paper calls for strengthening the Kerala Money Lenders Act by passing an Act for the protection of depositors and creating a separate wing for their registration, monitoring and supervision by the State Government. In the long-term, the strategy for financial inclusion, strengthening of co-operatives and promotion of self help groups will be helpful in bringing down the role of moneylenders.

JEL Classification : G18, G21

Keywords : Informal Financial Institutions, Money Lenders, Regulation, Supervision, Financial Inclusion

Introduction

In India, with the establishment of wide spread network of branches of commercial banks, the role of informal financial institutions (IFIs) has been on the decline for about four decades¹. However, there are some indications about the rise in their role during the last one and half decades² (Chavan, 2005, Mohan, 2006, and RBI, 2006). According to

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the National Sample Survey Organisation's (NSSO's) 'Situation Assessment Survey' 2003, the share of the institutional agencies in loans outstanding of farm households in India was only 57.7 per cent, which was 8.6 percentage points lower than the share of 66.3 per cent in 1991-92 (in respect of cultivator households). On the other hand, informal agencies provided 42.4 per cent of the outstanding loans of farm households in 2003 as against 30.6 per cent in 1991-92. The share of money lenders in total dues of rural households has increased from 17.5 per cent in 1991 to 25.7 per cent in 2003 (NSSO, 1998 and 2005). Furthermore, a Rural Finance Access Survey 2003, conducted by the World Bank and National Council of Applied Economic Research (NCAER), revealed that 79 per cent of the rural households had no access to credit from formal sources (Basu, 2005). The above facts point to the re-emergence of rising, *albeit* marginal, role of informal agencies in the provision of credit. It is, in this context, that the Reserve Bank of India (RBI) has taken measures for financial inclusion and constituted a technical group for review of legislations on money lending (RBI, 2006).

The above trend is visible in case of Kerala also - the share of formal sources in total debt outstanding of farmer households declined to 82.3 per cent in 2003 from 92.0 per cent in 1991-92. Despite strong presence of formal financial institutions like commercial banks and cooperatives, in Kerala, money lenders (informally known as 'blade companies') form an important segment of the financial sector of the State as they are engaged in deposit taking and money lending activities in a significant way. The operations of money lenders are not new to Kerala as they have been in existence for centuries in various forms. In recent years, however, developments like i) ban on accepting public deposits by Unincorporated Bodies (UIBs)³, ii) UIBs link with Non-Bank Finance Companies (NBFCs) and other entities⁴, iii) rising indebtedness and suicides⁵, iv) complaints from the public⁶ and v) emphasis on financial inclusion, warrants a thorough examination of working of these entities.

Review of Literature

It is surprising to find that while money lenders have been in existence in all parts of the country and they dominated the informal

credit market for a long time, there are not many studies on their operations. Perhaps, this is due to lack of data and information. The RBI's Report of the All India Rural Credit Survey Committee (1954), Report of the All India Rural Credit Review Committee (1966) and Decennial All India Debt and Investment Surveys provide some information about the extent of operations of money lenders. Studies by Timberg and Aiyar (1984), Ghate (1988), Dasgupta (1989), Bell (1990), Swaminathan (1991) and others examined various dimensions of working of informal financial sector in the country. The following inferences can be made from these studies; i) operations of money lenders are very prevalent and they account for a sizeable share of credit availed by people, ii) there is sizeable gap between lending rates and deposit rates, iii) there is extreme variability in the interest rates within the same sub-economy, iv) loan default level is low, v) main purposes of borrowings are for production, trade and consumption, vi) rich people borrow more and pay lower rate of interest, and vii) with the spread of network of banks since nationalisation and tightening of legal provisions some segments and activities of informal credit markets have declined, while others expanded in response to new needs of growing trade and industry.

There is a dearth of studies on the working of money lenders in Kerala. Some individual researchers at Universities/Colleges in Kerala have studied their operations, of which only a paper (Prakash, 1984) is available in published form. Prakash (1984) noted the phenomenal growth of money lenders since the 1980s and reported their total number at around 12,000. A study by the State Planning Board (2005) found that i) there were 5,696 registered money lenders in the State, which was more than the number of branches of banks at 3376, ii) growth of money lenders has intensified in the recent period, iii) 72.5 per cent of surveyed money lenders charged interest rates in the range of 15-20 per cent and iv) unregistered money lenders charge interest rates between 24 to 120 per cent and in extreme cases upto 180 per cent.

Objectives of the Study

The above studies are not sufficient to provide comprehensive information on working of money lenders and point out the regulatory

and supervisory issues. In view of the above mentioned developments and dearth of literature, the study attempts to analyse the working of money lenders in Kerala. It is essentially based on primary data collected from the balance sheets of 97 sample money lenders in Ernakulam district, available with the Office of the Inspecting Assistant Commissioner (IAC) [under the Commercial Taxes Department (CTD) of Government of Kerala], as on March 31, 2001. The sample consists of small, medium and big financiers, selected in terms of their total liabilities. To understand the temporal variations in their operations, three years balance sheet details were also collected in respect of 49 financiers.

The remaining part of the paper consists of five sections. Section I provides a profile of working of money lenders in Kerala. Section II is devoted for analysing the assets and liabilities of sample money lenders. A critical review of legal provisions applicable to money lenders is provided in the Section III. The section also examines the details of the existing regulatory framework and supervision. Section IV identifies the areas of concern, measures needed and future scenario. The final section summarises the major findings of the paper and offers some suggestions.

Section I

Profile of Money Lenders in Kerala

Relative Position of Money Lenders in the Financial Sector

The relative position of money lenders among the various financial institutions in the State are assessed here in terms of major indicators like number of branches, deposits and advances. It can be seen from Table 1 that the number of money lenders is quite high as compared to the branches of formal financial institutions. Money lenders account for 68.4 per cent of total number of branches of financial institutions in the State. It indicates wider accessibility to the customers and the consequent high penetration rate. Population covered per money lender is estimated at 5,590 as against 9,431 per branch of commercial banks (State Planning Board, 2005). In case

Table 1: Relative Position of Money Lenders in Financial Sector of the State - March 2001

Variable	Commercial Banks#	Cooperative Banks@	NBFCs	Money Lenders*	All Institution	% Share of Money Lenders
1	2	3	4	5	6	7
1. Branches (No.)	3,262	2,131	151	12,000	17,544	68.4
2. Deposits (Rs. crore)\$	42,178	8,926	36	2,864	54,004	5.3
3. Credit (Rs. crore)\$	18,355	8,457	120	6,057	32,989	18.4

: Including RRBs as on March 31, 2001. @ : Relate to SCB, DCCBs, PACs, SCARDB and PCARDBs.

\$: Outstanding. * : Projection made by this study - relates to March 2001.

Source: 1. State Level Bankers Committee, Canara Bank, Thiruvananthapuram.

2. Dossier on Co-operatives March 2000, NABARD, Mumbai.

3. Estimate based on primary data collected for the paper.

of deposits, their relative share is small (5.3 per cent of total deposits of all institutions). However, when compared with the deposits of NBFCs it is quite high. On the credit side, money lenders have a larger share (18.4 per cent) in total credit outstanding of all institutions.

Number and Features of Money Lenders

There is no official data available on the number of money lenders in Kerala. Though the offices of Inspecting Assistant Commissioner, located in various parts of the State, have the information on the money-lenders registered with them, they are not regularly compiled at the State level to get an aggregate picture. State Planning Board (2005) reported the number of registered (under the Kerala Money Lenders Act, 1958) money lenders in the State at 5,696 in March 2004. Table 2 provides the district-wise number of registered money lenders in the State.

Besides the registered firms, there are numerous unregistered firms, centred on individuals, who are engaged in deposit taking and lending business similar to the business done by money lenders. These unregistered units are mainly doing business from their own houses or from their business establishments. There is no estimate of the number of money lenders in the unorganised sector. Some of the

Table 2: District-Wise Number of Money Lenders in Kerala – March 2004

District	No. of Money Lenders
1	2
1. Thiruvananthapuram	570
2. Kollam	675
3. Pathanamthitta	785
4. Alapuzha	976
5. Ernakulam	225
6. Kottayam	366
7. Idukki	344
8. Thrissur	488
9. Palakkad	144
10. Malappuram	162
11. Kozhikode	601
12. Wayanad	128
13. Kannur	139
14. Kasaragod	93
State-Total	5,696

Source : State Planning Board (2005).

experts feel that the number of unregistered firms will be at least as equal to the total number of registered money lenders in the State. Therefore, it is reasonable to consider the total number of money-lenders in Kerala, both registered and unregistered, at around 12,000. Even people in the upper strata of the society like doctors, lawyers, bank employees, college teachers and politicians are reported to be involved in this business (some with unaccounted money) as it is very lucrative.

Money lenders in Kerala consist of both big and small firms. In terms of number of money lenders, majority of them are small firms run by individuals. On the other extreme, there are few business families having large number of money-lending firms across the State. For example, a business family is having around 220 firms across the State in the same name, all registered under Kerala Money Lenders Act KMLA, 1958 and their total liabilities would be around Rs. 900-1000 crore (our estimate based on the sample data collected).

Nature of Business

Though money lending firms are registered, under the KMLA, 1958, their nature of business is informal in the absence of well designed rules and procedures for the conduct of the business. It is left to financier to decide the modalities for accepting deposits and providing loans. The business is done in a very simple way with least paper work. From the accounting side also they are working like informal institutions as they are not recording all the transactions in the books of accounts.

One significant feature of the loans provided by the financier is its high frequency. The frequency of the loan is high because of two factors, *viz.*, i) very short duration of the loan and ii) daily collection of loan amount. Some of the loans are given for a short period of 100 days or not exceeding 6 months. Generally, the repayment period of loan will not exceed 12 months. In many cases, there is a practice of daily collection of loan amount. In case of 100 days' loan, the loan amount and interest is repaid daily in 100 equal installments. Daily collection is more prevalent among the traders and business people. It improves the liquidity position of the financiers and in turn more number of loans provided. Hence, the data on outstanding amount of loans, at the end of year, of a financier will not reflect the actual volume of business undertaken by the firm during that year.

In general, around two-third of the loans are given against security of gold. It is considered as a more secured business as they generally provide only around 80 per cent of the value of gold as loan. However, in case of gold loan also there is a risk. Some firms, who are very eager to expand loans, provide even more than 80 per cent (sometimes more than 100 per cent) of the value of gold as loan. In such cases, if the loan amount is not repaid within the stipulated time, the financier will loose money. There is also a practice of giving loans against promissory note, cheque, *etc.* Some financiers provide loans only on the basis of personal security.

Interest rates on the loans vary from customer to customer. Since customers approach money lender for urgent cash requirements, they

are not much bothered about the interest rates. Some of the customers do not even ask what the interest rate on the loan is. For official purpose, money lenders record only legally allowed interest rate (now fixed at 12 per cent) in their books of accounts. In reality, there will not be a single case in which a money lender is accepting only normal interest for their advances. The actual interest rate on loans varies from 24 per cent to 60 per cent depending upon the customer, nature of the loans, repayment period, security provided, *etc.* A survey conducted by the Government of Kerala, revealed that 42.5 per cent of the money lenders charge interest rates between 18-20 per cent. In case of unregistered firms, the interest rate can go up to 120 to 180 per cent. The above referred survey found that majority of the money lenders charge interest rates in the range of 30 to 70 per cent (State Planning Board, 2005).

In some of the areas of the State, individual financiers from the neighbouring state (Tamil Nadu) provide loans to people belonging to lower strata of the society, consisting of labourers, petty traders and unemployed, at an interest rate of Rs. 10 per Rs. 100 for a month (120 per cent in a year). The loans are given without any security. These individual financiers go around the villages and market places to get their customers. Another example of unregistered financing can be found in market places, where individual financiers provide loan to small traders. They provide block loans, in which they first block the interest by deducting it up-front from the loan amount. For example, from a loan of Rs. 100, the borrower will be given only Rs. 90, (interest Rs.10 is deducted at the source). At the end of the day, the borrower has to pay back Rs. 100 to the lender. In this case the interest rate on a yearly basis comes to a whopping 4055.6 per cent.

Why People Approach Money Lenders?

In general, there are many prejudices about money lenders and they are sometimes considered as an anti-social institution. The main prejudices are that: i) informal lenders exploit their clientele; ii) informal credit is used in an unproductive way; and iii) informal finance is not regulated and it may undermine monetary policy (Schrader, 1994).

The above prejudices are not totally unfounded as there is some element of truth in these observations depending upon the nature of the financier, place of business, and regulatory and supervisory environment. Nevertheless, they have a definite role in providing finance for a target group. Hence, of late, policy makers realised that formal and informal finance may not necessarily be in competition but indeed may complement each other, as both aim at different target groups.

In the literature, there is an increasing recognition of the role and strength of informal finance in meeting the credit requirements of small borrowers. The overwhelming view is that informal sector responds remarkably well to the short-term credit requirements of lower income people and it allows them to access services not available from the formal institutions. Informal sector works in an environment which is suited to the low income people. Both financier and borrower know each other by face and cultural affinity creates the feeling of confidence in each other. The services provided by informal lenders are considered as valuable by their clientele as many times these services would not be available from elsewhere. However, from an economic perspective, the services of informal lenders may not be efficient as they usually charge prohibitive rate of interest. Hence, they cannot make efficient reallocation of resources throughout the economy and contribute to economic growth as in the case of formal finance (Bouman and Hospes, 1994).

Though Kerala has a wide network of formal financial institutions and bank penetration rate is one of the highest in the country⁷, still, thousands of people approach money lenders for keeping deposits and taking loans. In case of deposits, the customers are mainly from the mid-income segment, who are very conscious about the interest rates that they want to get. A major section of the customers keep their deposits for the purpose of marriage of their daughters or for some other social functions. They are not much concerned about the risk involved in the deposits as many of the financiers are personally known to them for years. The earlier referred survey found that even unregistered money lenders are accepting deposits (State Planning Board, 2005).

In case of loans, customers prefer them as their operation is very informal, quick, without any time limit and gets adequate amount, unlike in the case of commercial banks and cooperatives where the whole process is cumbersome and one may not be sure of getting the loan. But, in case of money lenders, it is all simple and quick (of course, at a cost). In case of traders and business people, availability of adequate amounts in time is essential to gain from the business. Since, the profit from their activity is very high, they are not much concerned about the rate of interest charged by the financier. Thus, it is suitability, convenience, timeliness, adequacy and informal nature which attracts customers to money lenders. A section of the borrowers especially businessmen, are found to take loans from money lenders because they have already availed loan from formal institutions like commercial banks.

Failure of Money Lenders

There have been many reports about the failure of money lenders and the proprietors absconding from the place of business. There are also cases of financiers deliberately cheating the depositors. In some cases, the same financier will re-emerge in a new place by offering very attractive deposit schemes. Once they collect a good amount of deposits from that area, they simply vanish from the place of business. There is no systematic data on the number of firms closed down and amount lost by the depositors. In case of closure or failure of a firm, the offices of Inspecting Assistant Commissioner come into the scene only when it receives complaints from the public. By the time it acts on the complaint and starts some enquiry, the financiers would have taken enough precautions to make sure that they are caught free. Generally, the failure rate is high in case of firms run by individuals and when they are providing loans for highly risky business operations relating to real estate, share market, *etc.* As per a survey conducted by the 'All Kerala Blade Companies Abolition Front', about Rs.190 crore were cheated by private financiers in seven districts of the state during 1995-99 (State Planning Board, 2005).

Social Problems Associated with Money Lenders

Money lenders do meet the credit requirements of a section of the society, but easy availability of money often persuade the people to borrow even for wasteful expenditure. As it is a costly borrowing and many of the borrowers do not have regular income to pay back, often the repayment obligation multiplies beyond their capacity which leads to suicides, fleeing from homes or ends up in clashes and physical fights. One of the many reasons for the suicides committed by the farmers in districts like Wayanad was said to be due to harassment by money lenders. It is in this context that the Government of India had announced a scheme in 2004 to free farmers from the clutches of money lenders by providing loans by banks to farmers who are indebted to money lenders.

There have been some attempts by social organisations to deal with the problems created by the money lenders. 'Blade Nirmarjana Samithi' (organisation for eradication of blade companies), a social welfare agency in Kerala, had conducted a State-wide survey on the ill-effects of operations of money lenders in 1995-96. The survey revealed that 176 people committed suicide, 4,856 families fled from their homes and 86 persons, including 34 women, were arrested as they failed to repay the loans. A survey conducted in three districts of Kerala, *viz.*, Kannur, Kasargod and Kozhikode, in 1996-97 had revealed the rising trend in social problems associated with the operations of money lenders (Table 3). It is estimated that in Kerala around 50 lakh people are affected either mentally or physically by the evils of money lenders. Realising the wider social problems created by these financiers, the 'Blade Nirmarjana

Table 3: Number of People Affected by the Operations of Money lenders

Social Problem	Kannur	Kasargod	Kozhikode
1	2	3	4
i. Suicides	216	190	92
ii. Fled from homes	1303	2419	981
iii. Indicted by Court for bouncing of cheques	460	79	35

Source : Blade Nirmarjana Samithi, reported in Malayalam, (magazine), 2001.

Samithi' has filed a petition in the High Court of Kerala to curb the activities of these financiers (Malayalam, 2001). Social scientists, therefore, hypothesise that there could be a correlation between the number of suicides and the growth of money lenders.

The reasons for rising activities of money lenders can be found in: i) excessive consumerism of the people- people borrow heavily for purchasing consumer durables and vehicles; ii) borrowing for payment of dowry, construction of house and medical treatment; and iii) neglect of credit requirements of lower middle class by the nationalised banks.

Section II

Assets and Liabilities of Money Lenders

Data Limitations

As per KMLA, 1958, money lenders need to submit their balance sheet and profit and loss account as on March 31 of every year to the office of IAC. Although there is a prescribed format, the statements of accounts submitted by the money lenders are not uniform and some of the firms are not even providing the vital information required in a balance sheet. Furthermore, balance sheets submitted by them may not reflect the actual volume of business done by them (to avoid paying income tax and making adequate amount of security deposit). Despite these limitations, we are compelled to use the balance sheet data, for want of any other reliable data.

Liabilities

For the study, balance sheet data in respect of 97 money lenders as on March 31, 2001, were collected. It can be seen from Table 4 that the average total liability of the sample firms was Rs. 34.5 lakh and highest liability was Rs.378.8 lakh. Owner's capital accounts for about 57 per cent of total liabilities and share of deposits were around 35 per cent. Average outstanding deposit of the sample firms was Rs.15.9 lakh (per firm) and the highest deposit was Rs. 121.9 lakh.

The estimate made for all the financiers in the State (numbering 12,000) shows that their total liabilities would be around Rs. 4,135

Table 4: Liabilities of Sample Money Lenders and Estimate for All Financiers - March 2001

(Rs. lakh)

Sl.No.	Variable	Total Liabilities	Owner's Capital	Deposits
1	2	3	4	5
I	97 Sample Financiers (total)	3,343	1,906	1,158
	i) Average Liability	34.5	20.5	15.9
	ii) Lowest Liability	0.71	0.14	0.25
	iii) Highest Liability	378.8	295.0	121.9
II.	All Financiers (Estimate for 12,000)	4,13,544	2,35,846	1,43,197
	i) Scaled up by 1/4 of reported data	5,16,929	2,94,807	1,78,997
	ii) Scaled up by 1/3 of reported data	5,51,378	3,14,453	1,90,925
	iii) Scaled up by 1/2 of reported data	8,27,087	4,71,692	2,86,394

Source : Data compiled from the Office of the Inspecting Assistant Commissioner, Commercial Taxes Department, Government of Kerala, Ernakulam.

crore, of which outstanding deposits would be around Rs.1,432 crore. As the balance sheet figures submitted to the offices of IACs suffer from underreporting, we have blown up the data assuming that the underreporting may be around 1/4, or 1/3 or 1/2 of the reported data. As per this, the actual level of deposits of all firms would be in the range of around Rs.1,790 crore to 2,864 crore (Table 4).

Assets

The total loans and advances provided by the 97 sample firms were of the order of Rs.2,448 crore as at the end of March 31, 2001. The average amount of outstanding loans and advances of sample firms comes to around Rs.25 lakh. Among the sample firms, the highest amount of loans and advances was Rs. 320 lakh. Based on sample data, the estimated loans and advances of 12,000 firms comes to around Rs 3,029 crore. When underreporting is also taken into account (1/4, or 1/3 or 1/2 of the reported data), the total amount would in the range of Rs. 3,786 crore to Rs.6,057 crore (Table 5).

Table 5: Assets of Sample Money Lenders and Estimate for All Financiers - March 2001

(Rs. lakh)

Sl. No.	Variable	Total Liabilities	Owner's Capital	Deposits
1	2	3	4	5
I	97 Sample Financiers (total)	2,448	1,837	153
	i) Average	25.2	20.9	–
	ii) Lowest	0.3	0.3	–
	iii) Highest	320	236	–
II	All Financiers (Estimate for 12,000)	3,02,871	2,27,312	18,920
	i) Scaled up by 1/4 of reported data	3,78,589	2,84,140	23,651
	ii) Scaled up by 1/3 of reported data	4,03,818	3,03,075	25,227
	iii) Scaled up by ½ of reported data	6,05,743	4,54,624	37,841

Source : Data compiled from the Office of the Inspecting Assistant Commissioner, Commercial Taxes Department, Government of Kerala, Ernakulam.

Among the various types of loans and advances, gold loan is the major one accounting for about 75 per cent of total assets. Around 90 per cent of the sample financiers have provided gold loan. The average amount of gold loan provided by a financier was around Rs.21 lakh; the lowest and the highest being Rs. 0.3 lakh and 236 lakh, respectively. Very few financiers have reported loans against the security of promissory note and investment.

Inter Temporal Variation

We have also collected balance sheet information in respect of 49 firms for three consecutive years, viz., 1999, 2000 and 2001, to understand the changes in the business scenario over time. During these three years, total liabilities of 49 sample firms rose by Rs. 167 lakh or 18.7 per cent. However, deposits of sample firms rose by only Rs.37 lakh or 8.1 per cent from 1999 to 2001. On the other hand, owner's capital has gone up by Rs.152 lakh or 53.1 per cent during the same period. It appears that with the amendments to Section 45 S of the Reserve Bank of India (RBI) Act, 1934, financiers are not mobilising deposits from the public in a big way. It is also possible that deposits are shown as owner's capital. During the year ending 2001, there was considerable expansion in total loans and advances -

Table 6: Summary of Balance Sheet Data of 49 Sample Financiers

(Rs. lakh)

Variables	March 31, 1999	March 31, 2000	% Change	March 31, 2001	% Change
1	2	3	4	5	6
I. Total Liabilities	895	973	8.7	1062	9.1
i) Outstanding Deposits	457	463	1.3	494	6.7
ii) Owner's Capital	286	352	23.1	438	24.4
II. Total Loans & Advances	605	688	13.7	859	29.2
i) Gold Loan	578	626	8.3	670	7.0
III. Security Provided	23	26	8.3	26	0
IV. Income Tax Paid	1	1	0.0	4	400.0
V. Profit/loss	4	7	75.0	5	-28.6

Source: Data compiled from the Office of the Inspecting Assistant Commissioner, Commercial Taxes Department, Government of Kerala, Ernakulam.

Rs. 193 crore or 29.2 per cent (Table 6). Very few firms have paid income tax and the amount paid was very nominal.

Section III

Legal Provisions, Regulatory Framework and Supervision

This section reviews the relevant legal provisions contained in the RBI Act, 1934, and its amendments, Financial Companies Regulation Bill, 2000 and KMLA, 1958. The review is aimed at identifying the provisions which need to be strengthened for orderly working of money lenders.

Reserve Bank of India Act, 1934

i) Introduction of Chapter IIIC in 1984

Till 1984, the RBI Act, 1934 was silent on the deposit taking activities of Unincorporated Bodies (UIBs) like money lenders. However, Chapter IIIC on "Prohibition of Acceptance of Deposits by Unincorporated Bodies" was introduced in the RBI Act in 1984 (with effect from February 15, 1984). Under Section 45 S (in Chapter III C), no individual, firm or unincorporated association of individuals could accept deposits from more than 25 depositors per partner and not

exceeding 250 depositors in all, excluding deposits from relatives. In cases where individual, or firm or unincorporated association of individuals are having deposits from more number of people than as specified above, they are to be repaid within two years from the commencement of Section 10 of the Banking Laws (Amendment) Act, 1983 so as to bring down the number of depositors within the limits specified. However, this provision was not very effective in regulating deposit taking activities of UIBs as it was very easy for money lenders to suitably adjust the number of depositors without affecting the total amount of deposits held by them. Ideally, instead of fixing the number of depositors, the total amount of deposits should have been specified for better control and supervision. Another problem was that the RBI did not set up or designate any official machinery to see that the provisions are not violated.

ii) Amendments of Section 45 S in 1997

As the provisions of Chapter IIIC were very liberal and effective measures could not be taken for its implementation, UIBs continued to accept deposits without any problems. However, in 1997 the Government of India amended the RBI Act (Section 45 S) to prohibit deposit taking activities of UIBs. As per the RBI (Amendment) Act 1997, effective from April 1, 1997, UIBs are prohibited from accepting any deposits from the public. However, an individual or a partner of a firm is permitted to collect deposits from relatives (22 categories) as specified in the Act and also borrow from banks and financial institutions to carry on the business. Existing public deposits were required to be paid back either on maturity or within three years from April 1, 1997. Furthermore, UIBs are prohibited from issuing advertisement for mobilising deposits. As per the amendment, contravention of the provisions of Section 45 S is considered as an offence punishable with imprisonment or with fine.

Even though the RBI Act prohibits money lender from accepting deposits from public, due to lack of effective mechanism and machinery for the supervision and inspection, most of the money lenders continue to accept deposits from the public. However, in records submitted to the offices of IACs, deposits may be shown

against the names of specified relatives or simply shown as owner's capital. For effective implementation of RBI provisions, the State Government should have efficient machinery for monitoring and supervision of money lenders, which is lacking.

Financial Companies Regulation Bill, 2000

Another significant development in the area of regulation of deposit taking activities of UIBs is the Financial Companies Regulation Bill, 2000. It is an outcome of the Report of the Task Force constituted by the Government of India (Chairman: Shri C.M. Vasudev) to review the regulatory and supervisory framework for NBFCs and UIBs. To implement the recommendations relating to statutory amendments, the Government has framed the Bill. The Bill also consolidates the laws relating to NBFCs and UIBs with a view to ensure depositors protection. The Bill contains new legislation to amend and consolidate the provisions contained in Chapter III-B, III-C and V of the RBI Act, 1934. The Bill was introduced in the Parliament in 2000 and has since been referred to the Standing Committee on Finance and now it is pending in the Lok Sabha. Main provisions in the Bill relating to UIBs are: i) UIBs will continue to be prohibited from accepting deposits and unauthorised deposit taking will be a cognizable offence, ii) the role of exercising the powers for enforcement of the provisions will be exclusively entrusted to State Governments, iii) District Magistrates will be vested with powers to call for information and to proceed against delinquent UIBs, and iv) the issue of advertisement by UIB is banned. A significant feature of the Bill is entrusting the State Governments exclusively for the enforcement of the provisions. Another feature of the Bill is the provision for call for information and to proceed against delinquent UIBs by district magistrates.

Kerala Money Lenders Act, 1958

The Kerala Money Lenders Act, 1958 is an Act 'to provide for the regulation and control of the business of money-lenders in the State of Kerala'. The Act intends to regulate the interest to be charged by money-lenders and to afford protection to borrowers. Thus, the

original Act was passed basically for the interest of the borrowers. There had been 12 amendments to the Act till 2004. When the third amendment to the Act was proposed in 1983 (The Kerala Finance Act, 1983) it was challenged in a number of Original Petitions. On that occasion, the High Court held that the regulations introduced by the amendments were only measures necessary to safeguard both depositors and borrowers from the free dealing of money-lenders. Thus, the High Court considered that one of the purposes of the Act is also to safeguard the interest of depositors.

According to the KMLA, 1958, for the purpose of regulation of the money lending business and to ensure compliance with the conditions of the licence, the licence fee is collected, the penalty is imposed, the prosecution is ordered and the licence is cancelled. Furthermore, security is demanded and additional security is called for (Sugathan, 2005). However, all these provisions are either not very stringent or they can be easily violated without much punishment. Under the KMLA, 1958, the conditions for granting money-lending licence are very simple. They are: i) payment of a licence fee, ii) payment of security deposit (in relation to loans advanced), and iii) deposits shall be accepted only in accordance with the provisions of the RBI Act and rate of interest on deposits not exceeding the rates fixed by the RBI Act for NBFCs. Over the years, the licence fee has not been enhanced regularly, in tune with growth in the volume of business undertaken by money lender. Till March 1993, the licence fee was Rs.1,000, which has been enhanced to Rs.2,000 from April 1, 1993. Though there was an attempt to enhance the fee to Rs.10,000 in 1996, Government was forced to reduce it to Rs.5,000. The fee at present is only Rs.5,000 (revised in 1997), irrespective of volume of business undertaken.

According to the KMLA, 1958, the money-lender can charge interest on any loan at a rate not exceeding two per cent above the maximum rate of interest charged by commercial banks on loans granted by them. With the deregulation of interest rate on loans charged by the commercial banks, there was some ambiguity regarding the rate of interest which money-lenders can legally charge from borrowers.

Following this, in March 2005, Government of Kerala fixed the maximum interest rate on loans at 12 per cent per annum. Needless to mention, no financier provides loans at the prescribed interest rate. Ideally, if the Government wants to prescribe the interest rate on loans, it needs to notify a particular rate regularly (at least every year).

Under the Act, any inspector or licensing authority has the power to enter and search the places of business of the money-lender, but they are not allowed to enter or search in residential building or premises without specifically authorised in writing by the Member, Board of Revenue. This is a hindrance for conducting inspection in case of defaulting money-lenders. Under the Act, the punishment for charging higher rate of interest than what is shown in the accounts or Act, is imprisonment which may extend to six months or a fine which may extend to Rs.1,000 or both. In case money-lender molests or abets the molestation of any debtor for the recovery of any loan, the punishment is imprisonment (maximum 6 months) or with fine of maximum Rs.1,000. Furthermore, whoever undertakes business of money lending without a licence, the punishment is only a fine of Rs.1,000, which is paltry compared to the volume of business they are undertaking. In Kerala, where indebtedness to money lenders is very high, the role of the police in administering the Kerala Money Lenders Act, 1958 was very limited because none of the sections of the Act were effective. This was mainly because the punishment imposed was not severe enough. The concern of the police was that suicides had been taking place because of the pressure tactics adopted by money lenders. In view of the above drawbacks, it is imperative to amend the KMLA, 1958 to enhance the licence fee, prescribe higher amount as security deposit, impose more severe punishment for erring money-lenders and provide more powers to inspecting officers for search in residential buildings.

The security deposit prescribed under the KMLA, 1958 is not effective. It is a common practice that firms generally show very low amount for the proposed lending so as to avoid providing higher security amount. Since there is no effective way of checking the true volume of business undertaken by them, this practice has been taking place for years. Here it may be noted that security deposit is a

prudential measure and not a source of revenue for the State Government, as Government is paying interest on it. Furthermore, under KMLA, 1958 there are six slabs for deciding the amount of security deposit which is not fixed scientifically as the effective rate of security deposit vary from slab to slab and it declines after the third slab (in case of both minimum and maximum amount of loans in these slabs). In case of last slab, the effective rate is very low - less than one per cent in case of loans above 50 lakh (Table 7). Thus, the existing slabs of security deposits favours big financiers as they need to make less amount of security deposit proportional to their level of advances.

Present Status of Control and Supervision

The Commercial Taxes Department (CTD) treats money lenders simply as a source of small revenue for the State and it is not seriously involved in their monitoring and supervision. Since the main preoccupation of CTD is the collection of taxes in the State, it finds only a limited time to deal with the money lenders. The CTD only makes sure that firms pay the stipulated licence fee and provide the stipulated security deposit with the State Treasury, when the financiers approach for new licence or for renewing the existing

Table 7: Slabs of Security Deposits and its Effective Rate

(Rs. lakh)

Sl. No.	Amount of loans and advances (Rs)	Security Deposit (Rs)	Effective Rate on Maximum loan (Security deposit as % of loan amount)	Effective Rate on Minimum loan
1	2	3	4	5
1	Upto 1 lakh	5,000	5.0	20.0@
2	1 to 5 lakh	10,000	2.0	10.0
3	5 to 10 lakh	50,000	5.0	10.0
4	10 to 25 lakh	1,00,000	4.0	10.0
5	25 to 50 lakh	1,50,000	3.0	6.0
6	50 lakh and above	2,00,000	0.6*	4.0

* : Assuming total loan of Rs.320 lakh, which was the maximum reported among the sample financiers.

@ : Assuming total loan of Rs.25,000, which was the minimum reported among the sample financiers.

licence. In reality, there is no supervision, control and monitoring except collecting the registration fee and keeping the related documents. Offices of the IACs receive complaints from the public but it is difficult for them to enquire into the details as they are not equipped for conducting an enquiry. Moreover, even if a financier is found to be conducting illegal business, the punishment under the KMLA, 1958 is very low as mentioned earlier. It is essential that money lenders need to be supervised effectively to avoid illegal business practices, absconding cases, non-payment of depositor's money, harassment of borrowers, *etc.* Given the relatively small size of business per firm, it may not be desirable to consider regular on-site inspection of all the financiers. However, it is advisable to conduct an on-site inspection of big financier who is having liabilities above Rs.100 lakh. Besides, the regular returns submitted by them in the office of IACs need to be examined carefully and if they are found to be incorrect or not reporting the actual volume of business, appropriate action has to be taken against them. If the financiers are to be supervised effectively, the State Government has to start a separate wing with sufficient staff who is having some experience in handling financial matters. It is also desirable to promote self regulation by the association of money lenders. The association can better monitor the illegal and unethical business practices, and advice the erring financiers to stop such practices. Such self-regulation can help in improving the image of financiers as the one who are doing fair business in meeting the credit requirement of needy people. Another option in this area would be credit rating of financiers.

Section IV

Areas of Concern and Future Scenario

Areas of Concern

In contravention of provisions contained in RBI Act, 1934 and KMLA, 1958, money lenders continue to take deposits from the public (not officially reported). At present, there is no guarantee for the depositors in case of failure of a financier as they need not keep any

statutory reserves like CRR, invest funds in secured bonds/debentures like SLR. Furthermore, deposits are not guaranteed by any institutions unlike in the case of banks. The State Government or any other institutions are not responsible for compensating depositors. The security deposits made by the firms are based on amount of total advances and they are not related to the deposits raised by them. In the current situation, one cannot expect much change in the deposit taking activities of money lenders for the following reasons: i) the KMLA, 1958 is very weak with minor fine/punishment for accepting deposits; ii) there is no well equipped State machinery for control and supervision of financiers; iii) financiers are raising deposits in the name of their sister concerns (not registered under KMLA) which are engaged in trading, construction, business, *etc.*; and iv) the RBI is not involved in monitoring their deposit taking activities. It is logical from the above that the KMLA, 1958 need to be amended to provide more teeth to the State Government to plug the existing loopholes and create a well equipped State machinery for control and supervision of money lenders. As of now, deposits made by the public with the informal financial agencies like money lenders, chit funds, *etc.*, are not sufficiently protected by any of the laws in Kerala. It will be advisable for the State to pass an Act to protect the interests of depositors in line of similar acts passed by the States like Tamil Nadu⁸ and Maharashtra⁹.

In case of borrowers, the concerns are relating to charging of high rate of interest, (often cumulative), than prescribed in the KMLA, 1958, and use of force and other illegal means for the recovery of loans. Financiers charge different rate of interest depending on the customer and surety provided. There is no practice of making public the rate of interest the firm will be charging on loans, like Prime Lending Rate (PLR) in case of commercial banks. In the books of accounts submitted to the office of IACs, only normal interest rate is shown to avoid legal action. On the recovery side, use of force and other illegal means has been on the rise, especially in case of advances given for purchase of vehicle.

The concerns for the State Government arise from their deposit taking activities, failure of firms, not meeting the liabilities to the

depositors, the practice of charging high rate of interest and use of force power and illegal means for the recovery of loans. Basically, the State Government need to see the operations of financiers not as a source of revenue, as it is now, but an activity which needs to be controlled, regulated and supervised effectively so that the financial requirements of a target group will be met without creating much distortion in the financial sector of the State. Deposit taking activities of firms in violation of RBI provisions are to be viewed as a major concern for the State Government and measures need to be taken to control it.

The concerns for the RBI are the violation of Section 45 S of the RBI Act and less effectiveness of monetary policy. The general impression of the public is that the activities of registered firm are controlled either by the RBI or the State Government. Hence, when there is a failure of money lender, people tend to complain about the RBI as it is the regulator in the financial sector. Furthermore, the failure of money lenders can have its impact on the working of some of the NBFCs in the state, because in some cases both are owed by the same family or group of people. Therefore, the RBI needs to be concerned about the working of private financiers to ensure the stability of the financial system in the State. The other aspect is relating to monetary policy. To get best results from the monetary and credit policy, all segments of the financial sectors should have a link with the monetary authority so that the impulses emanating from the monetary and credit policy will have its impact on the economy. The presence of informal financial sector makes the transmission mechanism of monetary policy less efficient¹⁰.

What is the Future of Money Lenders?

The benefit of hindsight suggests that in developing economies both formal and informal financiers continue to do business, and over time, the role of informal financiers get reduced with the spread of more formal institutions. Since the provision of formal financial service is relatively costly, the process of replacing the informal financiers would take a long time and requires major improvements in

infrastructure and institutions. To be more realistic, informal financiers will not disappear all together, but they will occupy niches as formal finance is developed (Schrader, 1994, Bell, 1993 and Banerjee, 1996).

Literature suggests several possibilities in this regard (Sharma and Chamala, 2000). First, once the poor have been provided access to adequate credit under the micro finance schemes, the monopoly of money lenders would be weakened and, hence, their interest rates will come down. However, it is a very long process and it may take years to materialize. Second, link money lenders with the formal banking institutions as a conduit. Private and foreign banks may be interested in using this channel for disbursal of rural credit as the latter's outreach is higher than the former. Furthermore, these banks may prefer to do business with money lenders as compared to co-operatives, which are highly politicised, and NGOs/SHGs, who are disorganised and unregulated. However, before adopting this route, a thorough cleansing and introduction of control and supervision of these entities are needed. Third, evolve a chit fund model (a saving-*cum*-credit mechanism) which may be operated by money lenders. Fourth, to make money lenders a part of the micro-finance system.

All these options involve complex processes and it may take years to evolve a suitable model. Given the size of the country and magnitude of the problem, ideally, we should choose the best elements of all the options. There is a view that all these options legitimise the money lenders. Ideally, the strategy has to be to reduce the dependence on money lenders by developing microfinance institutions and SHGs and reviving the rural cooperatives credit structure. In the long-term, the strategy of financial inclusion, advocated by the RBI and implemented by banks, will be helpful in bringing down the role of money lenders.

In Kerala, role of money lenders is not getting reduced as fast as was expected. There were few reports that the role of money lenders has come down of late due to restrictions imposed by the RBI, declining interest rate regime and aggressive entry of banks into new areas of finance. However, State Planning Board (2005) found that there was a rise in the number of money lenders in the recent period in Kerala. One of the niche areas of the money lenders is the gold

loan business. Even after the formal financial institutions started giving gold loans in a bigger way, their business was not affected much. In fact, some of the money lenders are taking gold loan from banks and utilising the money for their own lending against gold. Given the small size of majority of financiers, it is not possible for them to become a non-banking financial company (NBFC) and work like a formal institution with supervision and regulation by the RBI. On the other side, big business families doing money lending business through several outlets, may not be interested in being converting into NBFC or a bank, as it will invite strict regulation and supervision by the RBI.

If the State Government strictly monitors the deposit taking activities of these firms, in accordance with Section 45 S of the RBI Act, their role may come down for want of funds. In such a scenario, the co-operative credit societies/banks can meet a portion of the credit requirements. Given the profile of customers and their credit requirements, the best suited arrangement to reduce the role of money lenders would be promotion of Self-Help Groups (SHGs) throughout the state. The State has made some progress in promoting SHGs, especially through the Kudumbashree, a State supported initiative for the formation of SHGs for women.

Section V

Major Observations and Some Suggestions

Money lenders work on the grey fringes of legality and illegality. Besides, some of the Informal Financial Institutions (IFIs) are having links with formal financial institutions. Hence, there are risks associated with their working which can pose challenges for financial stability and effectiveness of monetary policy. In this context, the paper analysed the working of money lenders in Kerala to draw insights for their regulation and control.

The above analysis enables us to put forth a few major observations. The total number of registered money lenders in Kerala is estimated at around 5,700 and the number of unregistered firms is

around 6,000, thus taking their total number to 12,000, which is quite high as compared to the number of branches of formal financial institutions. Some of the financiers are very big and widely spread out throughout the State. Money lenders have a share of around 18 per cent of total credit outstanding of all institutions. To evade the law, some of the registered money lenders are raising deposits in the name of their sister concerns engaged in real estate, housing, medical care, retail business, *etc.* Interest rates on loans vary from 24 per cent to 60 per cent. However, in case of unregistered firm, the interest rate can go up to 120 to even 180 per cent. Suitability, convenience, timeliness, adequacy, and informal nature are the factors which attracts customers to money lenders. There are many instances of failure of money lenders and absconding from the place of business. The failure rate is high in case of firms run by individuals and when they are providing loans for highly risky business operations in real estate, shares, *etc.* The activities of money lenders are flourishing on account of a) excessive consumerism of the people, b) borrowing for payment of dowry, construction of house, medical treatment, and c) neglect of credit requirements of petty traders and lower middle class by the formal financial institutions. The total liabilities of all money lenders in the State are estimated at Rs. 8,270 crore, of which outstanding deposits would be around Rs. 2,864 crore. The total loans and advances are estimated at Rs.6,057 crore.

With the amendments to Section 45 S of the RBI Act, it seems that financiers are not mobilising deposits from the public in a big way. However, some of the deposits from the public are showing as owner's capital. As per the proposed Financial Companies Regulation Bill, 2000, the Unincorporated Bodies will continue to be prohibited from accepting deposits and the role of exercising the powers for enforcement of the provisions has been exclusively entrusted to State Governments. It is doubtful whether the State Governments can shoulder the responsibility of enforcing the provisions. The KMLA, 1958 is very weak on the following counts: a) liberal conditions for the grant of licence, b) very nominal licence fee, c) inadequate security, d) insignificant punishment for violation of provisions, e) less powers for inspecting officials and f) silent on deposit taking

activities. It will be advisable for the State to pass an Act to protect the interests of depositors in informal financial institutions on line of similar acts passed by the States like Tamil Nadu and Maharashtra. The Commercial Taxes Department treats money lenders merely as a source of small revenue (registration fee). There is no system of regular inspection of their accounts and supervision of their activities. In case of erring money lenders, the punishment under the KMLA is very low- often leading to imposition of small fine. It is advisable to conduct on-site inspection of big financier who is having liabilities above Rs.100 lakh. If the State Government strictly monitors the deposit taking activities of these firms, their role may come down for want of funds. In such a scenario, co-operative credit societies/banks can meet the credit requirements if they encourage formation of SHGs and follow strategies for financial inclusion.

Some Suggestions

It is imperative to amend the provisions of KMLA, 1958 to effectively control and supervise the working of money lenders and pass an Act to protect to interests of depositors. In case of KMLA, 1958, the provisions relating to deposit taking activities, prudential norms (security requirement), supervision, compliance and punishment for erring firms need to be strengthened. It is suggested that the security deposits need to be fixed as a proportion of total loans and advances. As their deposit taking activity is prohibited, the Government may obtain more detailed information on the sources of funds of financier at the time of registration/renewal of registration. It is prudent to prescribe a minimum capital base for money lenders to avoid their mushrooming. Deposit taking activities of sister concerns of money lenders need to be examined and controlled. The Government may consider insisting for credit rating of financiers. More importantly, the Government may set up a separate wing for policy formulation, monitoring and supervision of money lenders. It can also examine the complaints from the public. On-site inspection may be conducted in case of big financiers and off-site inspection in case of small firms. Self-Help Groups need to be promoted throughout the State and they in turn linked with bank finance so as to reduce

the dependence of people belonging to the lower strata on money lenders. Cooperative institutions and formation of SHGs should be further strengthened, especially in remote areas and places where money lenders are flourishing.

Notes

- ¹ In India, the share of non-institutional sources in outstanding cash dues of cultivated households declined from 92.7 per cent in 1951 to 30.6 per cent in 1991.
- ² In fact, an indication about this trend was visible during the 1980s itself. Data available from the All-India Debt and Investment Survey (AIDIS) 1991-92, conducted by the National Sample Survey Organisation (NSSO), revealed that the share of institutional agencies in debt outstanding of rural areas has declined from 61.2 per cent in 1981 to 56.6 per cent in 1991. [To make meaningful comparison of results of AIDIS, 1991-92 with that of the similar survey relating to 1981, Reserve Bank prepared few tabulations in addition to those generated by the NSSO, relating to indebtedness of households. Reserve Bank estimated total debt position of households by considering both cash loans and current liabilities, the latter was not considered by the NSSO and, hence, their estimate is not comparable with that of 1981 result. As per NSSO estimate, the share of institutional agencies in outstanding debts of rural households has gone up from 61.2 per cent in 1981 to 64.0 per cent in 1991 (RBI, 2000 and NSSO, 1998)].
- ³ With the passing of Reserve Bank of India (Amendment) Act 1997, money lenders are prohibited from accepting deposits from public under Section 45 S. Since the lending operations of money lenders are mainly depended on the deposits mobilised from the public, the amendment may change their mode of operations.
- ⁴ With the introduction of control and supervision of NBFCs by the Reserve Bank, there is a growing tendency among NBFCs to mobilise deposits through money lenders and their sister concerns, which are promoted by the NBFCs themselves.

- ⁵ There is alarming rise in indebtedness of people in the State, especially among the farmers in rural areas. The number of people, who committed suicides, due to inability to payback the loans taken from money lenders (and also from formal institutions) at usurious rate of interests, is also rising in the State. The average amount of outstanding loan per farmer household was very high in Kerala at Rs.33,907 as against the national average of Rs.12,585 (NSSO, 2005). Rising indebtedness is believed to be one of the immediate reasons for suicides committed by farmers (Deshpande and Prabhu, 2005). As per an estimate by the State Government, from January 1999 to July 2006, a total of 549 farmers committed suicides in the State. [However, as per the State Planning Board, around 2,000 farmers committed suicide in the State (State Planning Board, 2006)]. Though the money lenders account for a lower share of the loans availed by farmers, the pressure exerted by them were too painful to withstand when compared to pressure by formal sources of borrowing (Mohanakumar and Sharma, 2006) and, hence, they are also held responsible for the suicides committed by farmers.
- ⁶ The authorities have been receiving numerous complaints from the public about the operations of money lenders. There are many instances of non payment of depositor's money and using unethical means to recover the loans (hence, they are called as 'blade mafia' in local parlance).
- ⁷ Average population per bank branch was 9,000 in Kerala as against 16,000 at the All-India level in June 2005.
- ⁸ The "Tamil Nadu Protection of Interests of Depositors (in Financial Establishments) Act, 1997" was passed to protect the interests of the depositors in financial establishments when they default on the return of deposits after the maturity period. The Act empowers the State Government to attach the money or other property alleged to have been procured either in the name of the financial establishment or in the name of any person from and out of the deposits collected by the financial establishment.
- ⁹ Maharashtra State has passed an Ordinance in 1999 [Maharashtra Protection of Interests of Depositors (in Financial Establishments) Ordinance, 1999]. The main objective of the Ordinance was the

realisation of the assets of a defaulted financial establishment and distributes the same in discharge of deposit liabilities. The provisions of the Ordinance will be brought in force in the event of failure to return deposits after maturity, failure to pay interest or other assured benefit to the depositor and failure to provide the services promised against the deposit (Government of Maharashtra, 1999).

- ¹⁰ There are divergent views on the effectiveness of monetary policy in the presence of informal credit markets. One view is that monetary policy has impact only on the formal credit markets and not in the informal market. Hence, the presence of a sizeable informal credit markets somewhat dilutes the effectiveness of monetary policy. The other view is that there are links between the formal and informal credit markets, and hence, depending upon the stance of the monetary policy, borrowers have the option to have alternate sources of funds. This will destabilise or frustrate the monetary policy. On this issue, while Acharya and Madhur (1983) found that monetary policy has substantial effects on the informal credit market, Sundaram and Pandit (1984) found that presence of informal credit markets are a threat to monetary policy.

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Competitiveness of India's Manufacturing Sector: An Assessment of Related Issues

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This paper provides an analytical abstract of various parameters of manufacturing competitiveness of the Indian economy. India's manufacturing exports have risen impressively in the past decade or so and found to be directly linked to the world GDP and inversely related to real effective exchange rate (REER). Indian manufacturing industries have certain inherent strengths and advantages in having a relatively inexpensive, adequate and skilled labour force, cost-effective and competitive prices of goods produced, large manufacturing base and proximity to fast growing Asian markets. India is one of the leading producers and exporters in a number of commodities and enjoys significant advantages in terms of lower labour costs as compared to other economies. Nevertheless, India's competitiveness is lost on account of lower labour productivity and higher input and material costs. To improve the competitiveness of the Indian manufacturing goods, issues like further diversification of export basket, upgradation of export quality, improvement in productivity, increased technology intensity in production, enhanced R&D activity, encouraging business environment, less cumbersome regulatory environment, flexible labour laws, removal of infrastructural bottlenecks and SME related issues need attention of all concerned.

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Introduction

Sustained increase in competitiveness of an economy is a hallmark of economic strength and stability of that economy. Worldwide, there has been an increasing awareness, especially among emerging market economies (EMEs), about the need to strive for

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improved competitiveness to face the realities of the globalised trading environment. In the case of India, such recognition is reflected during the recent years, particularly in the constitution of National Manufacturing Competitiveness Council.

At the current juncture, the Indian economy is at the threshold of entering the big league through a crucial turnaround in its performance. Such a turnaround has been reshaping India's image as one of the emerging economic powers in the world. India has recognised the opportunities stemming from globalisation and accordingly revamped its policies to promote industry and services sectors. India's ability to compete on the global stage is amply demonstrated by the boom in information technology and software services. India has emerged as a destination for outsourcing of not only information technology enabled services (ITES) but also a host of other services including certain manufacturing activities such as automotive components, pharmaceuticals, textiles, *etc.* India is fast establishing its image as a competitive economy the world over, which assures low-cost and high-quality products. In the recent years, it has achieved certain landmarks in the manufacturing sector. Amongst them, the most important has been the rise of Indian MNCs, which have been on expanding mode and acquiring companies abroad and developing their production base in other countries. In addition, Indian firms are exporting services ranging from call centres to medical diagnostics and tutoring American high school students. In this backdrop, Indian economy could be larger than all the countries in the world other than the US and China in another 30 years and India's growth will remain above 5 per cent through the period (Goldman Sachs, 2003).

Against this setting, this paper makes a modest attempt to assess the competitiveness of India's manufacturing sector, its relative position among the countries of comparable economic size, its strengths and vulnerabilities, the issues to be addressed to strengthen India's competitiveness and to suggest some policy preferences. The scheme of the paper is as follows. Concept and benchmark indicators of competitiveness based on some literature survey is presented in

Section I. Section II analyses the dynamics of India's manufacturing sector exports. Section III critically evaluates India's manufacturing sector competitiveness based on specific factors like openness, unit labour cost, labour productivity and national innovative capacity. A micro-level analysis on the competitiveness of select manufacturing commodities of export importance for India has been set out in Section IV. Section V identifies the critical issues faced by the Indian manufacturing sector while competing in the global market and suggests some measures to improve India's competitiveness. Concluding observations are drawn in Section VI.

Section I

Concepts and Benchmark Indicators of Competitiveness

At micro level, it is relatively easy to define competitiveness of a firm, which is the ability to do better than comparable firms in sales, market share or profitability; but competitiveness of a country is interpreted broadly on development or growth strategy. However, a narrower, more tractable, definition is to take the country's ability to compete in international trade. Thus, a country may be termed competitive if it is able to sell its products at a lower (or same) price and earn the same (or higher) return as its competitors. Variables such as remuneration of factors of production, exchange rate and productivity through the use of better technical skills and human resource development as also economies of scale are having greater influence in deciding the extent of competitiveness of export products in the globalised setting.

OECD defines competitiveness as the degree to which a nation can, under free trade and fair market conditions, produce goods and services, which meet the test of international markets, while simultaneously maintaining and expanding the real incomes of its people over the long-term. The World Economic Forum (WEF) defines competitiveness as the ability of a country to achieve sustained high rates of growth in GDP per capita. According to National Competitiveness Council (in USA), competitiveness is the ability to achieve success in markets leading to better standards of living for

all. According to it, competitiveness is a concept that is important at a range of levels, from the level of an individual firm to the level of an industry, from the level of a small local region to the level of an association of nation states.

The concept of competitiveness, thus, can contribute to an understanding of the distribution of wealth, both nationally and internationally, if it is recognised that it can be applied at both the enterprise and the country level; when applied at the enterprise level, it relates to profits or market shares; when applied at the country level, it relates to both national income and international trade performance, particularly in relation to specific industrial sectors that are important in terms of employment or productivity and growth potential (UNCTAD, 2004a).

Benchmark Indicators and Competitiveness of the Indian Economy

There are two leading surveys on competitiveness at global level that document competitiveness of economies on a regular basis, *viz.*, Global Competitiveness Report [by the World Economic Forum (WEF), Switzerland] and World Competitiveness Yearbook [by International Institute for Management Development (IMD) of Lausanne, Switzerland]. The WEF first introduced Global Competitiveness Report 2001-2002 in 2002, which has since then become an annual publication. The report uses two concepts of competitiveness: Global Competitiveness Index (GCI) and Business Competitiveness Index (BCI). The GCI aims specifically at gauging the world's economies in achieving sustained economic growth over the medium to long-term. Three indices are used for computing GCI, *viz.*, the macroeconomic environment index, the public institutions index, and the technology index. BCI complements the GCI, with its special emphasis on the underlying microeconomic conditions defining the current sustainable level of productivity in each of the countries covered. The underlying concept being that, while macroeconomic and institutional factors are critical for national competitiveness, these are necessary but not sufficient factors for creating wealth. Wealth is actually created at

microeconomic level by the companies operating in the economy. The BCI evaluates two specific areas, which are critical to the business environment in each country - the sophistication of the operating practices and strategies of companies, and the quality of the microeconomic business environment in which a nation's companies compete.

In terms of global benchmarking parameters, Global Competitiveness Report 2006-2007 has ranked India at the 43rd position among 125 economies in terms of the GCI (Table 1). Thus, India has moved two steps higher than the ranking received during 2005. The Indian economy has been progressively integrating with the global market since the initiation of economic reforms in the early 1990s. This has facilitated substantial improvement in the competitiveness of the economy. According to GCI, Singapore, Korea, Malaysia and Thailand are more growth competitive than India. India received significantly higher rankings with regard to Business Competitiveness Index at 27th amongst 121 economies, recording an improvement by 4 positions. India's business competitiveness as in 2006 was better than some of the EMEs such

Table 1: Competitiveness Index - Ranking of Select Economies

Country	Global Competitiveness Index			Business Competitiveness Index		
	2004	2005	2006	2001	2005	2006
1	2	3	4	5	6	7
Singapore	7	5	5	9	5	11
Korea	29	19	24	26	24	25
Malaysia	31	25	26	37	23	20
Thailand	34	33	35	38	37	37
India	55	45	43	36	31	27
South Africa	41	40	45	25	28	33
Indonesia	69	69	50	55	59	35
China	46	48	54	43	57	64
Mexico	48	59	58	52	60	57
Russia	70	53	62	56	74	79
Brazil	57	57	66	30	49	55
Philippines	76	73	71	53	69	72

Note : GCI Ranking among 104 Countries for 2004.

Source : *Global Competitiveness Report, 2005, 2006-07, WEF.*

as China, Mexico, Indonesia, Philippines and Russia, though it lagged behind other economies such as Singapore, Korea and Malaysia.

According to the World Competitiveness Yearbook 2006, India ranked 29th among 60 major countries and regions in the world. This is 10 notches up from the 39th rank India achieved in the previous year (Table 2). As per the rankings, Singapore, Malaysia and China are more competitive than India.

In addition to the overall competitiveness of economies assessed by the WEF and IMD, United Nations Industrial Development Organisation (UNIDO) also published in its annual report, the competitiveness of the industrial sector of a number of economies and their ranking. The UNIDO's Competitive Industrial Performance (CIP) ranking is a benchmark for industrial activity comprising four variables, viz., manufacturing value added per capita, manufactured exports per capita, industrialisation intensity and export quality. Industrial competitiveness ranking of a majority of the South East Asian countries are higher than India. India's rank has slipped down from 36 in 1990 to 40 in 2000 among the list of 93 countries (Table 3).

**Table 2: World Competitiveness Ranking by IMD –
Select Countries**

Country	2006	2005	2004	2003
1	2	3	4	5
Singapore	3	3	2	4
China	19	31	24	29
Malaysia	23	28	16	21
India	29	39	34	50
Thailand	32	27	29	30
Korea	38	29	35	37
South Africa	44	46	49	47
Philippines	49	49	52	49
Brazil	52	51	53	52
Mexico	53	56	56	53
Russia	54	54	50	54
Indonesia	60	59	58	57

Source : IMD World Competitiveness Yearbook, Various issues.

Table 3: Competitive Industrial Performance of Select Countries - Rank

Economy	1980	1990	2000
1	2	3	4
Singapore	2	1	1
Japan	5	4	6
Korea	23	18	10
United States	13	14	11
Malaysia	40	23	15
United Kingdom	12	13	17
Thailand	47	32	23
China	39	26	24
Philippines	42	43	25
Mexico	31	29	26
Brazil	24	27	31
South Africa	36	44	35
Indonesia	75	54	38
India	38	36	40

Note : Ranking among 93 countries for all the years.

Source : UNIDO Annual Report 2004.

Section II

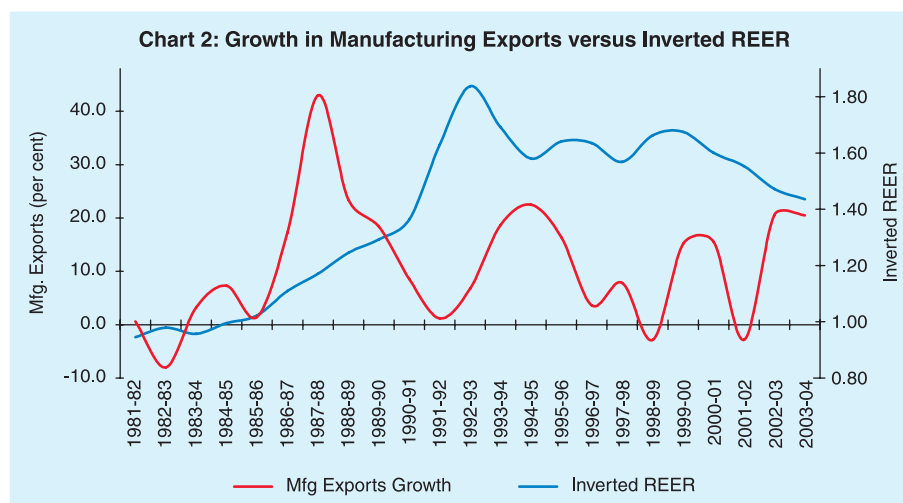
The Dynamics of India's Manufacturing Sector Exports

Before analysing the parameters that determine the competitiveness of the Indian manufacturing sector, it would be useful to understand the dynamics of growing export performance of the Indian manufacturing sector. Manufacturing exports dominate the export basket of the Indian economy and account for nearly 70 per cent of the total merchandise exports. The Indian manufacturing exports have risen faster since the Indian economy started opening up in the 1980s. The manufactured exports as a percentage of India's GDP has increased from 2.5 per cent in 1983-84 to 9.1 per cent in 2006-07 (Chart 1). The depreciation of Indian Rupee since the 1980s, along with liberalisation measures in the trade and exchange rate regimes have contributed to the growth of manufacturing exports of the country. Furthermore, growing integration with the world economy has also aided the expansion of the manufactured exports. It would be worthwhile to revisit the factors that have contributed to the growing exports of the economy.



Several studies have established a significant relationship between export performance and the real exchange rate in India. Joshi and Little (1994) attributed a considerable part of the success in export expansion during the second half of the 1980s to the real exchange rate depreciation. They argue that the depreciation of the real exchange rate by about 30 per cent between 1985-86 to 1989-90 was a critical factor in driving India's exports. Srinivasan (1998) analysed India's exports over 1963-94 and found that real exchange rate appreciation negatively affects export performance. Besides exchange rate, global GDP has also been found to have a positive association with increasing exports of India. In the light of these studies, we would assess the role of these variables in driving India's manufacturing exports.

To begin with, the role of Real Effective Exchange Rate (REER) in driving India's manufacturing sector exports is assessed. For analysing this relationship, we take inverted-REER, which is the reciprocal of REER. The inverted-REER eases the visual introspection so that an increase in REER reflects depreciation, while a decrease appreciation. The near co-movement of manufacturing sector exports and inverted-REER for most of the period (during 1980-81 to 2003-04), validates that REER has been one of the factors in determining our exports (Chart 2). The correlation between the manufacturing



exports and inverted REER is found to be high at 0.66. This indicates that change in REER significantly affects the manufactured exports. The years 2002-03 and 2003-04, however, appear to be aberrations, wherein the exports have increased despite the appreciation of the Rupee. This perhaps suggests that India's manufacturing sector exports are becoming more competitive in the global economy.

Apart from REER, global GDP has also been found to be affecting the India's manufacturing sector exports. It is observed that for most of the period since 1980s, there has been a co-movement of growth in manufacturing exports and global GDP growth (Chart 3). During 1999-2000 to 2004-05, a significant correlation of 0.56 was observed between India's manufacturing sector exports and the global GDP growth, which suggests that the former has started depending upon the latter.

We tried to estimate an empirical relationship among manufacturing exports, REER, and world GDP for the period 1980-81 to 2003-04 through a regression analysis using ordinary least squares (OLS). In the estimate, we found a relationship wherein the manufactured exports (dependent variable) depend positively on world GDP, and negatively on the real effective exchange rate. In the estimation exercise, the variables were log-transformed. A dummy



variable (DUM) was also introduced to capture the effects of devaluation of Indian Rupee (in 1991) on manufacturing exports. DUM assumes a value equal to 1 in 1991 and is 0 for the rest of the years. The estimated relationship is as follows:

$$\text{LMFGX}_t = 0.45 \text{ LWGDP}_t - 0.37 \text{ LREER}_t + 0.71 \text{ LMFGX}_{t-1} - 0.15 \text{ DUM}$$

(2.73) (-2.61) (6.26) (-2.05)

$$\text{Adj. } R^2 = 0.988,$$

$$\text{DW-Statistics} = 1.33$$

where, figures in parentheses indicate the t-statistics.

LMFGX = Log of Export Volume (expressed in US dollars)

LWGDP = Log of World GDP

LREER = Log of Real Effective Exchange Rate

DUM = Dummy to capture the devaluation of Indian Rupee in 1991.

The results are on expected lines. Manufacturing exports were found to be positively associated with global GDP. The elasticity estimate suggests that a 10 per cent rise in global GDP enhances India's manufacturing exports by 4.5 per cent. The negative elasticity of export demand with respect to REER during the period implies that the real appreciation of the rupee adversely affects India's manufactured exports.

Section III

Measuring the Competitiveness of Indian Manufacturing Sector

At a micro level, several studies have been made to assess the competitiveness of India's manufacturing sector. The CII and the World Bank jointly carried out a study in 2002 using various parameters such as investment climate (Government effectiveness, rule of law, graft, and political instability and violence); labour costs; regulatory regime; interest costs; energy costs; delays at custom houses, *etc.*, to measure the competitiveness of the Indian manufacturing sector. For the present study, we have used the following parameters to make a comparative analysis of India's competitiveness *vis-à-vis* other economies of comparable economic size, particularly the Asian countries.

A. Openness of the Indian Economy

Openness of an economy can be related to its permissiveness towards cross border movement of goods, services and other factors of production. An increased openness implies higher trade flows and availability of wider range of goods and services to choose from, often at more competitive prices. Also, international trade and investment flows will increase the access to newer and more innovative technologies, which can, in turn, lead to productivity improvements.

Trade openness of an economy has two distinct dimensions - *ex-post* openness and *ex-ante* openness. *Ex-post* openness of an economy refers to the actual inflow of imports and outflow of exports. *Ex-ante* openness of trade of an economy, on the other hand, relates to the permissiveness of its policy towards exports and imports like levels of tariff and non-tariff measures applied by the country on cross-border trade flows.

We first begin with *ex-post* openness analysis, which is simply based on the actual trade flows such as the share of trade in GDP or the growth rates of imports and exports. Trade openness measured as

the ratio of sum of exports and imports to GDP reveals a continuous increasing trend in India's trade openness since 1987-88. India's openness increased sharply from 15.7 per cent in 1990 to 31.8 per cent in 2003 in the aftermath of economic reforms in the country. However, when compared to other EMEs in Asia such as China, Korea, Malaysia, Thailand, Vietnam, *etc.*, India was not found to be a highly open economy as its trade-GDP ratio is much lower. Even the average tariff rate in India is much higher than these economies. Nevertheless, in terms of economic freedom, when compared with other EMEs in Asia, India is found to be at par with these economies. In terms of investment flows as well, India has lagged behind many of these EMEs (Table 4).

The *ex-ante* openness is measured by trade barriers. The direct measure of trade barriers includes *inter alia* average tariff rates or

Table 4: Comparative Openness Indicators

(Per cent)

Indicator	China	India	Korea	Malaysia	Thailand	Vietnam
1	2	3	4	5	6	7
Trade						
(Exports+Imports)/GDP, 1990	31.9	15.7	59.4	147.0	75.8	81.3
(Exports+Imports)/GDP, 2003 (%) ^a	65.0	31.8	73.8	204.8	122.3	115.0
Export growth, 1990–2003 ^b	18.0	11.2	9.3	11.3	10.3	13.2
Average tariff rate, 2002 ^c	12.4	28.0	4.9	5.2	10.5	15.0
Index of Economic Freedom (2005) ^d	3.5	3.5	2.6	3.0	3.0	3.8
Investment						
FDI as % of total capital inflows, 1990–1996 ^e	90.0	15.0	7.0	147.0	16.0	81.0
FDI as % of total capital inflows, 1997–2001 ^f	92.0	22.0	34.0	32.0	-57.0	82.0
Total FDI stock as % of GDP, 1990	7.0	0.5	2.3	23.4	9.6	4.0
Total FDI stock as % of GDP, 2000	32.3	4.1	13.7	58.8	20.0	46.7
FDI as % of GDP, 1990–00 (annual average)	4.1	0.4	0.8	6.4	2.2	6.6

Notes : a Data for Vietnam are for the year 2002.

b Data for Vietnam are for the period 1997-2002.

c Average import tariff (MNF) for manufactured goods, ores, and metals.

d Index of Economic Freedom ranges from 0 (mostly free) to 5 (highly restricted).

e Data for India refer to the period 1991–1996; for Vietnam 1996.

f Data for India refer to the period 1997–2000; for Korea and Thailand 1997–2002; for Malaysia 1999 and 2000 are not available.

Source : Asian Development Report 2004 and Asian Development Outlook 2005, ADB.

coverage ratios for non-tariff barriers. India's customs tariff rates have been declining since 1991. The peak rate has come down from 150 per cent in 1991-92 to 40 per cent in 1997-98. In compliance with the WTO requirements, the basic customs duty has further been reduced to make it at world competitive level. The Union Budget 2007-08 has reduced the basic customs duty to 10.0 per cent. Average customs tariff rates, however, remain among the highest in the world. As per the World Development Indicator 2007, out of a set of 132 countries for which data on (simple) average customs tariffs were available, India had one of the highest average tariff rates (Table 5). In terms of weighted mean tariffs also (weighted by the country's trade with each of its trading partner), India has the highest tariff in terms of all products including manufactured products.

Table 5: Tariff Barriers - Cross-Country Comparison

(Per cent)

Countries	Year	All Products				Primary Products		Manufactured Products	
		Simple Mean Tariff	Weighted Mean Tariff	Share of lines with international peaks	Share of lines with specific tariff	Simple Mean Tariff	Weighted Mean Tariff	Simple Mean Tariff	Weighted Mean Tariff
1	2	3	4	5	6	7	8	9	10
Argentina	1992	14.2	12.7	31	0	8.1	5.8	14.7	13.6
	2005 ^b	10.6	5.2	22.6	0.0	8.0	1.8	10.8	5.7
Brazil	1989	43.0	31.0	92.2	0.5	31.5	18.6	44.0	37.1
	2005 ^b	12.3	7.1	27.7	0.0	7.9	1.5	12.6	9.2
China	1992	40.4	32.1	77.6	0.0	36.1	14.1	40.6	35.6
	2005 ^b	9.2	4.9	19.1	0.0	8.8	3.4	9.2	5.3
Indonesia	1989	19.2	13.0	50.3	0.3	18.2	5.9	19.2	15.1
	2005 ^b	6.5	6.0	8.7	0.0	7.2	3.5	6.4	6.7
Korea	1988	18.6	14.0	72.8	10.3	19.3	8.3	18.6	17.0
	2004 ^b	9.0	9.3	5.6	0.0	20.3	17.7	7.2	4.5
Malaysia	1988 ^b	14.5	9.7	46.1	7.2	10.9	4.6	14.9	10.8
	2005 ^b	7.5	4.4	22.4	0.0	3.4	2.3	8.2	4.8
Thailand	1989	38.5	33.0	72.8	22.0	30.0	24.3	39.0	35.0
	2005 ^b	10.6	4.9	22.1	0.9	13.1	2.3	10.0	5.7
India	1990^b	79.0	56.1	97.0	0.9	69.8	34.1	79.9	70.8
	2005^b	17.0	14.5	15.5	3.5	24.4	16.5	15.9	12.8

b : Rates are either partially or fully recorded applied rates. All other simple and weighted tariff rates are most favored nation rates.

Source: World Development Indicators, 2007, World Bank.

The collection rate indicates the incidence of customs duty and also levies/duties other than customs tariffs, which are not in the protective tariffs, *viz.*, special additional duty on imports levied to offset the incidence of domestic trade taxes other than union excise duty borne by domestic producers, countervailing duty on import of goods meant to offset incidence of excise duty on similarly produced indigenous goods. It not only captures the element of protection due to customs duties but also the incidence of other duties/levies, which are in the nature of offsets to mitigate the impact of host of domestic levies for which producers cannot avail of any credit. Collection rates since the 1990s have declined substantially across all commodity groups in India. The most significant reduction in collection rates was observed in 'chemicals', 'man-made fibre' and 'metals' (Table 6).

Table 6: Collection Rates for Selected Import Groups*

(Per cent)

Commodity Groups	1990-91	1995-96	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06 (Prov.)
1	2	3	4	5	6	7	8	9
1. Food Products	47	23	31	40	30	19	22	32
2. POL	34	30	16	10	11	11	10	6
3. Chemicals	92	44	38	29	28	24	22	20
4. Man-made fibres	83	36	49	31	31	46	39	34
5. Paper & newsprint	24	8	8	6	7	7	7	9
6. Natural fibres	20	12	18	8	10	13	11	12
7. Metals	95	52	48	36	36	32	26	25
8. Capital goods	60	33	36	28	23	19	16	12
9. Others	20	13	12	9	9	8	6	5
10. Non POL	51	28	23	19	17	14	12	11
11. Total	47	29	21	16	15	14	11	10

* Collection rate is defined as the ratio of realised import revenue (including additional customs duty/countervailing duty (CVD), and special additional duty) to the value of imports of a commodity.

S.No.1 includes cereals, pulses, tea, milk and cream, fruits, vegetables, animal fats and sugar.

S.No. 3 includes chemical elements, compounds, pharmaceuticals, dyeing and colouring materials, plastic and rubber.

S.No. 5 includes pulp and waste paper, newsprint, paperboards and manufactures and printed books.

S.No. 6 includes raw wool and silk.

S.No. 7 includes iron and steel and non-ferrous metals.

S.No. 8 includes non-electronic machinery and project imports, electrical machinery.

Source: Economic Survey 2006-07, Government of India.

Import duty collection rates in India remain one of the highest in the world. According to the World Trade Report 2003, (WTO), the ratio of duties collected to imports in India, even during the post 1990s, has been far higher than those levied by other comparable countries. The average import duties collection ratio was much lower at around 3 - 5 per cent in China, Malaysia, Indonesia, Korea and Thailand whereas in India, it was about 24.5 per cent in 1995-2000 (Table 7).

As regards non-tariff barriers (NTBs), any levy other than customs duty or charges may be categorised as non-tariff barriers, which is generally grouped into: (i) import policy barriers; (ii) standards, testing, labelling and certification requirements; (iii) anti-dumping and countervailing measures; (iv) export subsidies and domestic support; (v) Government procurement; (vi) service barriers; (vii) lack of adequate protection to intellectual property rights; (viii) other barriers. Over the years, the NTBs applied by India have been drastically pruned. NTBs in the form of prohibited, restricted, canalised imports and imports requiring special import

**Table 7: Import Duty Collected by Developing Countries
1985-2000**

Country	Import Value (US \$ bn)	Ratio of Duties Collected to Imports (Period Averages)		
		2000	1985-89	1990-94
1	2	3	4	5
Mexico	183	5.2	5.7	2.0
Malaysia	82	6.4	4.0	2.3
Indonesia*	34	5.2	5.0	2.4
China	225	10.3	4.7	3.2
Korea	160	8.0	5.3	3.6
Thailand	62	11.3	9.0	5.0
Brazil	59	8.2	8.1	8.0
India*	51	54.8	38.4	24.5

* : Data pertains to fiscal year.

Source : *World Trade Report, 2003*.

Table 8: Different Types of NTBs on India's Imports, 1996-97 - 2000-01[#]

Type of NTBs	1996	1997	1998	1999	2000	2001
1	2	3	4	5	6	7
Prohibited	59	59	59	59	59	59
Restricted	2984	2322	2314	1183	968	479
Canalised	127	129	129	37	34	–
SIL	765	1043	919	886	226	–
Free	6161	6649	6781	8055	8854	9611 **

** : Including 29 tariff lines shifted to State Trading. # : As on April 1.

Note : Number of tariff lines, 10 digit level - As per Harmonised System of India's Trade Classification, HS-ITC classification of export & import. SIL : Special Import Licence

Source : DGFT, Ministry of Commerce.

license have been cut down and an increase in number of items have been put in the list of freely importable items (Table 8).

Notwithstanding this cut in NTBs, India has one of the highest levels of NTBs among the EMEs. As per the WDI 2005, India had the highest *ad valorem* equivalent of NTBs at 3.2 per cent followed by Brazil at 2.4 per cent (Table 9).

Taking into account various measures of openness, it is inferred that though India is increasingly becoming an open economy, it lags behind some of the EMEs owing to its higher tariff, import duty, and collection ratio and high level of NTBs.

Table 9: Level of Non-Tariff Barriers in Select Countries

Country	All Products - Ad valorem equivalent of NTBs ^a
1	2
Brazil	2.4
China	1.5
India	3.2
Indonesia	0.5
Malaysia	1.7
South Africa	0.5
Thailand	0.3

a: Ad valorem equivalents of non-tariff barriers are calculated for 2000 only.

Source: World Development Indicators, 2005, World Bank.

B. Unit Labour Cost and Labour Productivity

Another important indicator of competitiveness is the unit labor cost in manufacturing, since labour represents the most important non-traded input in manufacturing activity. Labour costs are also the most easily quantifiable, compared to the cost of capital. Unit labour cost (ULC) is defined as total compensation, C, per hour employed, H, divided by productivity, where the latter is measured as total output (O) per hour employed (Hooper and Larin, 1989). It could be represented as $ULC = (C/H) / (O/H)$.

A rise in a country's ULC relative to other countries leads to a decline in its competitiveness, which would translate into lower global market share. However, empirical evidence suggests that over the long-term, market share for exports and relative unit costs or prices tend to move together (Kaldor paradox). The central problem concerning inter-country comparisons of labour costs is how to translate the costs calculated for individual countries into comparable or common currency units. For the present analysis, the wage rate and ULC, as published in a research article by the Asian Development Bank, has been used. In terms of ULC, as in 2000, India had a competitive edge over Singapore and Korea (Table 10).

Table 10: Unit Labour Cost in Manufacturing Industry in Select Asian Economies

Country	1980	1990	2000
1	2	3	4
Singapore	0.244	0.300	0.225
Korea	0.157	0.183	0.107
Malaysia	0.211	0.139	na
Thailand	na	0.063	na
India	0.203	0.106	0.046
China	0.100	na	na
Indonesia	0.128	0.043	0.036
Philippines	0.060	0.051	na

na : Not Available.

Source : ADB Economic and Research Department Working Paper Series No. 53, June 2004.

On comparing the unit labour cost of few commodities in some EMEs, it is found that except clothing, unit labour cost in India is higher in commodities like food products, textiles, electrical machinery and transport equipments (Table 11). In the case of food products, though unit labour cost in India has declined from 1.74 in 1980 to 1.29 in 2000, it is still higher as compared to other competitors. In textiles, unit labour cost in India not only increased during 1980-2000 but also remained high among some of the EMEs. The unit labour cost in case of electrical machinery though decreased during 1980-2000, it remained higher than Brazil, Indonesia, Philippines, Korea and Thailand. In transport equipment as well, unit labour cost has not only increased in India during the period but also remained the highest amongst these economies.

Table 11: Unit Labour Costs in Select EMEs, 1980 and 2000

(Ratios to the United States level)

Country	Food products		Textiles		Clothing		Electrical machinery		Transport equipment	
	1980	2000	1980	2000	1980	2000	1980	2000	1980	2000
Economy	2	3	4	5	6	7	8	9	10	11
Brazil	0.53 ^a	0.74 ^b	0.42 ^c	0.65 ^b	0.39 ^c	0.47 ^b	0.52 ^c	0.81 ^b	0.60 ^c	0.53 ^b
China	0.68	..	0.26	..	0.08	..	0.59	..	0.42	..
India	1.74	1.29	1.25	1.57	0.96	0.47	1.01	0.98	1.24	1.43
Indonesia	0.97	0.71	0.61	0.42	0.95	0.45	0.49	0.62	0.4	0.26
Malaysia	0.60	1.08	0.75	0.59	0.82	0.84	0.71	1.01	0.67	0.69
Mexico	1.00	0.90	0.85	0.88	0.69 ^h	0.64	0.73	1.06	0.49	0.43
Philippines	0.63	0.65 ^d	0.60	0.67 ^d	0.80	0.59 ^d	0.6	0.80 ^d	0.47	0.40 ^d
Korea	0.81	0.73	0.74	0.63	0.71	0.62	0.82	0.56	0.78	0.71
Thailand	0.46 ⁱ	0.92 ^j	0.46 ⁱ	0.87 ^j	0.67 ⁱ	1.07 ^j	0.35 ^k	0.65 ^j	0.48 ^k	0.41 ^j

Note : a : 1984. b : 1995. c : 1985. d : 1997. e : 1999. f : 1996. g : 1998. h : 1984. i : 1979. j 1994. k 1982.

Unit labour costs calculated as wages (in current dollars) divided by value added (in current dollars).

Source : UNCTAD Secretariat calculations, based on UNIDO, Industrial Statistics Database, 2002.

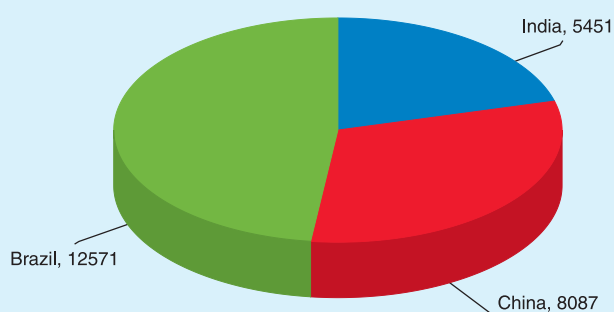
A comparison of annual wage rates in India with other EMEs reveals that it is much lower than that of Thailand, Singapore, Philippines, Malaysia and Korea (Table 12). However, as in 2000 annual wage rate in Indonesia was found to be much lower than that of India. Labour productivity in Indian industry is also found to be lower. The Investment Climate Survey data (Chart 4 & 5), show that the manufacturing value added per worker and

Table 12: Annual Wage Rates in Select Asian Countries

(US \$)

Year	Thailand	Singapore	Philippines	Malaysia	Korea	Indonesia	India
1	2	3	4	5	6	7	8
1980	na	4,141	1,127	2,075	2,837	743	976
1981	na	4,942	1,241	2,204	3,019	897	973
1982	2,230	5,550	1,301	2,496	3,153	1,066	1,023
1983	na	6,338	1,350	2,796	3,256	905	1,143
1984	2,362	6,920	1,180	3,025	3,499	879	1,170
1985	na	7,235	1,258	3,087	3,476	921	1,155
1986	na	7,005	1,285	2,959	3,629	877	1,255
1987	na	7,162	1,482	2,985	4,545	746	1,331
1988	1,885	7,749	1,704	2,836	6,120	817	1,367
1989	2,288	9,093	1,900	2,858	8,286	865	1,308
1990	2,503	10,803	1,803	2,976	9,353	674	1,355
1991	2,904	12,352	1,913	3,169	10,947	736	1,131
1992	na	14,357	2,534	3,769	11,824	875	1,148
1993	2,995	15,633	2,471	3,989	12,811	929	1,059
1994	3,344	17,665	2,848	4,286	14,328	945	1,161
1995	na	20,313	3,105	4,811	17,129	1,458	1,306
1996	na	21,703	3,120	5,383	18,660	1,503	1,281
1997	na	22,002	2,966	5,470	16,615	n.a.	1,347
1998	na	20,026	na	na	10,964	543	1,169
1999	na	19,621	na	4,189	13,489	849	1,299
2000	na	21,042	na	na	15,134	925	1,322

Source : ADB Economic and Research Department Working Paper Series No. 53, June 2004.

Chart 4: Manufacturing Value Added per Worker per Annum (US \$ 1999 prices)

manufacturing wages per worker were lower when compared to China and Brazil. Nevertheless, India is fast catching-up with other economies as there have been impressive gains in labour productivity growth in the country. Labour productivity growth in India during 1995 to 2001 has all along been better than some countries like Korea, Philippines, China, Japan, Malaysia and Singapore, thus, indicating an increasing level of competitiveness *vis-à-vis* these economies (Table 13).

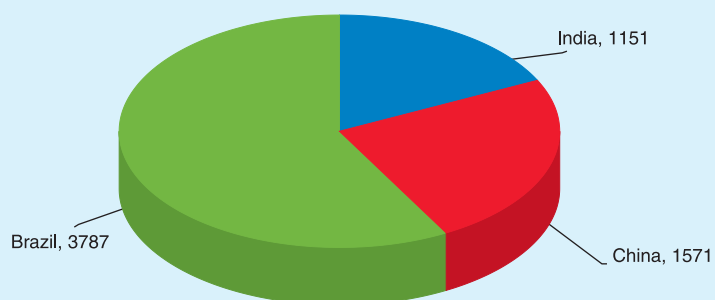
Chart 5: Manufacturing Wages per Worker per Annum (US \$ 1999 prices)

Table 13: Labour Productivity Growth

(Per cent)

Country / year	1995	1996	1997	1998	1999	2000	2001
1	2	3	4	5	6	7	8
India	6.42	6.84	3.74	5.37	4.90	3.12	4.21
Korea	6.55	4.70	4.43	1.15	9.07	2.80	3.39
Philippines	2.05	0.42	2.72	-1.29	-0.49	10.28	2.80
China	2.74	7.49	5.64	4.40	5.35	4.57	1.97
Japan	1.79	3.00	0.79	-0.47	0.95	2.93	0.89
Malaysia	6.62	5.70	5.60	-1.79	3.86	6.10	0.29
Singapore	4.69	5.30	3.63	-2.94	5.51	-1.51	-0.08

Note : Growth in real GDP per person employed.

Source : APO Asia Pacific Productivity data & Analysis 2003, Tokyo, Japan.

C. National Innovative Capacity

International competitiveness increasingly depends on innovation. Local companies' ability to acquire and deploy technology from around the world cannot sustain competitiveness over a longer period. With the erosion of traditional barriers to entry, competitiveness flows from the ability of companies in a nation to create and then globally commercialise novel products and processes and shift higher-up the innovation frontier as fast as rivals catch up. According to WEF, national innovative capacity is composed of four broad elements, *viz.*, common innovative infrastructure, cluster-specific conditions, quality of linkages and company innovative orientation that define how location shapes the ability of a company to innovate at the global frontier. Overall, it is observed that there exists a strong co-relation between Innovative Capacity Index (ICI) and Business Competitiveness Index (BCI), with some exception. India's ICI as in 2003 lagged behind Korea, Malaysia, and China. However, in terms of innovation in policy, linkages and strategy, India is ahead of China. In terms of innovative capacity, India also has a competitive edge over Thailand and Indonesia. On the whole, India's weakness in innovative capacity highlights the fact that it has to put in strenuous efforts to transform from a low technology producer to a high technology cost effective producer (Table 14).

Table 14: National Innovative Capacity Index and Sub-indices

Country	Innovative Capacity Index 2003		Proportion of Scientists & Engineers Index		Innovation Policy Index		Cluster Innovation Environment Index		Innovative Linkages Index		Operations & Strategy Index		ICI 2002	BCI 2003	GDP per capita 2002
	Rank	Index	Rank	Index	Rank	Index	Rank	Index	Rank	Index	Rank	Index	Rank	Rank	Rank
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Korea	20	31.13	20	7.75	24	4.74	16	6.67	18	5.79	21	6.19	22	23	27
Malaysia	35	26.85	59	5.07	16	5.04	18	6.47	37	4.78	31	5.48	39	26	42
China	40	25.86	43	6.3	45	3.99	26	6.2	40	4.65	56	4.71	36	46	65
India	44	25.5	60	5.06	38	4.13	28	6.12	28	5.32	50	4.89	43	37	74
Thailand	47	24.74	69	4.3	34	4.37	30	5.98	45	4.53	28	5.56	46	31	53
Indonesia	50	24.04	48	5.89	42	4.3	50	5.11	62	4.18	52	4.83	59	60	73

ICI : Innovative Capacity Index. BCI : Business Competitiveness Index.

Note : Represents the ranking of 95 countries.

Source : The Global Competitiveness Report 2003-2004, WEF.

Section IV

Commodity-wise Competitiveness of India's Manufacturing Products

India is one of the leading producers of a number of commodities in the world. India has been a leading producer of textiles, non-metallic mineral products, chemical and chemical products and basic metals amongst the developing countries. It is placed among the top-15 producers in the world in textiles, apparel, leather products, wood products, paper, chemicals, petroleum products, rubber products, non-metallic mineral products, basic metals, metal products, and transport equipments (Table 15). However, the country is facing close and stiff competition from a host of countries, including China, Korea, Singapore, Thailand, Malaysia, Brazil, Mexico, *etc.*, for these commodities (Table 16).

When we look at the commodity-wise labour productivity, it is observed that India has the lowest labour productivity among the select countries in the case of *food products* (Table 17). It is also observed that input and material cost remained the highest accounting for more than 88 per cent of total value of the output in India. The operating surplus remained the lowest – even less than 10 per cent of the total value of output. On the other hand, except Singapore, the operating surplus in case of other countries had been in excess of

Table 15: India's Share and Rank in the Production of Select Commodities in World and Developing Countries

Commodities	World		Developing Countries	
	1995	2003	1995	2003
1	2	3	4	5
Textiles	3.2 (8) *	4.8 (4)	9.4 (2)	11.8 (1)
Wearing apparel, leather, footwear	3.0 (10)	2.0 (14)
Leather, Leather Products and footwear	1.5 (15)	2.9 (11)	4.6 (7)	7.6 (5)
Coke, Refined Petroleum, nuclear fuel	1.6 (15)	2.4 (8)	4.5 (8)	6.3 (4)
Chemicals and Chemical Products	2.1 (9)	2.9 (7)	12.4 (3)	15.3 (2)
Non-metallic mineral products	1.3 (15)	2.2 (11)	5.8 (5)	8.8 (3)
Basic metals	2.2 (11)	2.9 (8)	12.9 (2)	14.1 (2)
Machinery and Equipment	..	1.3 (13)	8.9 (3)	10.8 (3)
Office, Accounting and Computing Machinery	..	0.2 (15)	3.6 (8)	2.5 (7)
Electrical Machinery and Apparatus	0.9 (10)	1.8 (5)	12.7 (3)	21.8 (1)
Other Transport Equipment	1.8 (11)	3.3 (9)	12.1 (3)	16.3 (3)
Motor Vehicles, Trailers, Semi-Trailers	..	1.2 (12)	7.3 (5)	9.2 (3)

* : Figures in parentheses indicate the ranks. .. : Not in Top 15 Rankings.

Source: International Yearbook of Industrial Statistics, 2005, UNIDO.

one-fifth of the value of output. The higher input cost and lower operating surplus deter firms from exploiting economies of scale, which explains why India has not been able to emerge as one of the leading producers of food products.

In the case of *textiles*, labour productivity in India remains low, while the input costs remains abnormally high, which, in turn, has eaten away the operating surplus margin. This again leaves India at a competitive disadvantageous position *vis-à-vis* Argentina, Malaysia, Mexico, Korea, Singapore, *etc* (Table 18).

The Indian *iron and steel* industry is highly matured. Though, India is one of the leading producers of iron and steel, it has to improve its performance from its lower labour productivity and higher input cost (Table 19).

Table 16: India's Main Competitors in Exports of Select Manufactured Goods – 2001-02

Commodity at the SITC Revision 2 group (3-digit) level	India's Share in World Exports	India's Main Competitors Among Developing Economies
1	2	3
322 Coal, Lignite and Peat	0.27	China, Indonesia, South Africa, Colombia, Venezuela, and Vietnam.
334 Petroleum Products, Refined	1.58	Singapore, Republic of Korea, Saudi Arabia, Kuwait, United Arab Emirates, Bahrain, Venezuela, Algeria, and China.
541 Medicinal, Pharmaceutical Products	1.04	China, Mexico and Singapore
582 Product of Condensation, etc.	0.51	China, Singapore, Thailand, Malaysia, Indonesia and Mexico.
611 Leather	2.82	China, Korea, Brazil, Argentina, Thailand, Pakistan and Bangladesh.
651 Textile Yarn	5.29	China, Korea, Indonesia and Pakistan.
652 Cotton Fabrics, Woven	4.25	China, Pakistan, Korea, Turkey, Indonesia, Thailand and Mexico.
653 Woven Man-Made Fib Fabric	2.40	China, Korea, Indonesia, UAE, Turkey, Thailand and Pakistan.
658 Textile Articles NES	6.46	China, Pakistan, Turkey, Korea, Mexico, Brazil, and Indonesia.
667 Pearl, Precious, semi-Precious Stones	12.46	South Africa, China, Botswana and Thailand.
672 Iron, Steel Primary Forms	1.27	Brazil, Korea, Turkey, China, South Africa and Mexico.
674 Iron, Steel Plate, Sheet	1.44	Korea, China, Brazil and Mexico.
728 Other Machinery for Specified Industry	0.28	Korea, China, Singapore, Mexico, Malaysia, Brazil and South Africa.
749 Non-electrical Machinery Parts, Accessories	0.34	China, Mexico, Singapore, Korea, Brazil, Thailand and Malaysia.
785 Cycles, etc, Motorised or not	1.58	China, Thailand, Singapore, Indonesia and Korea.
793 Ships, Boats, etc.	0.17	Korea, China, Trinidad and Tobago, Singapore, Turkey, UAE and Malaysia.
843 Women's Outwear Non-knit	3.82	China, Mexico, Turkey, Indonesia, Philippines, Morocco, Bangladesh and Sri Lanka.
844 Under Garments Non-knit	6.93	China, Bangladesh, Indonesia, Korea, Turkey, Sri Lanka and Philippines.
846 Under Garments Knitted	4.18	China, Turkey, Mexico, Indonesia, Thailand, Bangladesh, Korea and Pakistan.
848 Headgear, Non-Textile Clothing	2.59	China, Malaysia, Thailand, Pakistan, Turkey, Korea and Indonesia.
851 Footwear	0.98	China, Viet Nam, Brazil, Indonesia, Thailand, Korea, Mexico and Tunisia.
897 Gold, Silver ware, Jewellery	5.34	China, Thailand, Korea, Turkey, Malaysia, Mexico, Singapore and UAE.
898 Musical Instruments and Parts	0.74	China, Korea, Mexico, Malaysia, Indonesia, and Thailand.

Source : UNCTAD Handbook of Statistics, 2004.

Table 17: Labour Productivity and Cost Component of Food Products in Select Economies

Country	Latest Year (LY)	Labour Productivity (Current 1000 dollars)		Percentage in Output					
				Inputs and Materials Cost		Cost of Labour		Operating Surplus	
		1995	LY	1995	LY	1995	LY	1995	LY
1	2	3	4	5	6	7	8	9	10
Argentina	1999	37.3	29.2	55.6	60.3	12.1	16.5	32.2	23.2
Brazil	2002	..	12.2	..	59.1	..	9.6	..	31.3
India	2001	..	2.8	..	79.9	..	6.3	..	13.8
Indonesia	2002	..	4.2	..	62.5	..	7.0	..	30.4
Malaysia	2001	..	13.5	..	68.3	..	9.0	..	22.7
Mexico	2000	23.3	38.6	60.8	58.1	8.0	9.1	31.2	32.7
Korea	2001	55.1	62.9	52.4	52.5	11.3	8.8	36.3	38.7
Singapore	2002	45.3	29.0	65.3	73.0	14.1	14.2	20.6	12.8

Source : International Yearbook of Industrial Statistics 2005, UNCTAD.

India compares favourably *vis-à-vis* other EMEs in the case of *industrial chemicals* (Table 20). Since the 1990s, labour productivity in chemical industry in India has improved, while the input and material cost has come down, leading to generation of higher operating surplus.

Table 18: Labour Productivity and Cost Component of Textiles Industry in Select Economies

Country	Latest Year (LY)	Labour Productivity (Current 1000 dollars)		Percentage in Output					
				Inputs and Materials Cost		Cost of Labour		Operating Surplus	
		1995	LY	1995	LY	1995	LY	1995	LY
1	2	3	4	5	6	7	8	9	10
Argentina	1999	20.3	21.0	60.7	63.3	18.9	18.1	20.4	18.6
Brazil	2002	..	10.0	..	55.3	..	13.1	..	31.6
India	2001	..	3.3	..	77.3	..	6.1	..	16.5
Indonesia	2002	..	1.7	..	69.3	..	14.3	..	16.4
Malaysia	2001	..	8.4	..	53.3	..	15.5	..	21.2
Mexico	2000	9.2	14.3	68.3	66.5	11.5	12.2	20.2	21.3
Korea	2001	41.1	37.5	56.7	59.5	14.4	12.3	28.8	28.2
Singapore	2002	31.9	15.4	53.4	68.1	24.2	25.1	22.5	6.9

Source : International Yearbook of Industrial Statistics 2005, UNCTAD.

Table 19: Labour Productivity and Cost Component of Basic Iron and Steel Industry in Select Economies

Country	Latest Year (LY)	Labour Productivity (Current 1000 dollars)		Percentage in Output					
				Inputs and Material Cost		Cost of Labour		Operating Surplus	
		1995	LY	1995	LY	1995	LY	1995	LY
1	2	3	4	5	6	7	8	9	10
Argentina	1999	52.6	45.0	71.5	69.7	10.2	15.4	18.3	14.9
Brazil	2002	..	55.6	..	56.3	..	6.7	..	36.9
Turkey	2000	39.1	41.1	74.4	72.6	5.9	8.7	19.7	18.7
Philippines	1999	..	14.9	..	67.5	..	5.4	..	27.1
India	2001	..	6.8	..	83.5	..	5.9	..	10.7
Indonesia	2002	..	25.0	..	72.6	..	3.1	..	24.3
Malaysia	2001	..	15.4	..	85.8	..	5.5	..	8.7
Mexico	2000	63.6	83.7	69.2	70.3	3.0	3.9	27.8	25.8

Source : International Yearbook of Industrial Statistics 2005, UNCTAD.

In the case of electrical machinery and transport equipments, India enjoys the advantage of lower labour cost. However, the competitive advantage is lost on account of higher input and material cost and lower operating surplus (Table 21).

Table 20: Labour Productivity and Cost Component of Basic Chemicals in Select Economies

Country	Latest Year (LY)	Labour Productivity (Current 1000 dollars)		Percentage in Output					
				Inputs and Materials Cost		Cost of Labour		Operating Surplus	
		1995	LY	1995	LY	1995	LY	1995	LY
1	2	3	4	5	6	7	8	9	10
Brazil	2002	..	64.4	..	69.0	..	4.7	..	26.3
India	2001	..	15.4	..	79.0	..	3.6	..	17.4
Indonesia	2002	..	24.7	..	74.5	..	3.2	..	22.3
Korea	2001	171.3	149	60.1	71.5	5.6	4.2	34.3	24.3
Philippines	1999	..	12.9	..	70.7	..	6.9	..	22.4
Malaysia	2001	..	78.6	..	65.5	..	3.9	..	30.5
Mexico	2000	63.2	61.3	63.8	70.9	4.4	6.4	31.8	22.8
Singapore	2002	138.2	122	64.9	76.7	8.8	7.1	26.4	16.2

Source : International Yearbook of Industrial Statistics 2005, UNCTAD.

Table 21: Labour Productivity and Cost Component of Electric Motors, Generators and Transformers in Select Economies

Country	Latest Year (LY)	Labour Productivity		Percentage in Output					
				Inputs and Materials Cost		Cost of Labour		Operating Surplus	
		1995	LY	1995	LY	1995	LY	1995	LY
1	2	3	4	5	6	7	8	9	10
Brazil	2002	..	20.0	..	53.7	..	13.8	..	32.5
India	2001	..	7.0	..	75.9	..	8.6	..	15.5
Indonesia	2002	..	12.6	..	44.0	..	9.4	..	46.6
Korea	2001	45.0	41.3	59.7	63.0	13.5	12.1	26.8	24.9
Malaysia	2001	..	7.0	..	73.6	..	12.3	..	14.1
Mexico	2000	14.6	21.4	63.8	63.8	13.3	14.4	22.8	21.8
Singapore	2002	34.5	33.3	70.1	83.2	14.9	11.4	15.0	5.5
Turkey	2000	42.8	31.1	55.8	56.4	9.0	14.4	35.2	29.2

Source : International Yearbook of Industrial Statistics 2005, UNCTAD.

India is having the advantage of low cost labour in respect of automobile parts and accessories. However, the labour productivity in India relating to automobiles is low while its input and material cost are high (Table 22).

Table 22: Labour Productivity and Cost Component of Parts/ Accessories for Automobiles in Select Economies

Country	Latest Year (LY)	Labour Productivity (Current 1000 dollars)		Percentage in Output					
				Inputs and Materials Cost		Cost of Labour		Operating Surplus	
		1995	LY	1995	LY	1995	LY	1995	LY
1	2	3	4	5	6	7	8	9	10
Argentina	1999	23.1	21.2	66.4	67.9	18.9	21.9	14.7	10.1
Brazil	2002	..	19.5	..	56.7	..	13.0	..	30.3
India	2001	..	5.9	..	73.4	..	8.2	..	18.4
Indonesia	2001	..	8.1	..	69.7	..	5.7	..	24.5
Malaysia	2001	..	15.5	..	65.6	..	10.0	..	24.4
Mexico	2000	19.0	28.5	64.4	68.9	8.8	9.0	26.0	22.1
Korea	2001	54.3	49.2	57.7	63.9	13.8	10.8	28.5	25.4
Singapore	2002	54.0	34.9	59.1	56.1	18.4	26.5	22.5	17.5

Source : International Yearbook of Industrial Statistics 2005, UNCTAD.

In the last decade or so, merchandise trade in office machines and telecom equipments has expanded significantly. With the growing opportunity in trade in these equipments, some EMEs have taken advantage of this opportunity to expand their exports. In countries like Malaysia, Philippines and Singapore, such exports comprise about half of the merchandise exports. However, in India such exports accounted for only 1.1 per cent of total merchandise exports in 2006 (Table 23).

The global trade in automotive components has also expanded very fast since the 1990s. India has made progress in the trade of automotive components as its share in total global exports of automotive products has increased from 0.06 per cent in 1990 to 0.32 per cent in 2006 (Table 24). Nevertheless, India's share in global

Table 23: Exports of Office and Telecom Equipments of Select Economies

Country	Value (Million dollars)						Share in Economy's Merchandise Exports (%)	
	1990	1995	2000	2004	2005	2006	2000	2006 ^a
1	2	3	4	5	6	7	8	9
Brazil	692	749	2,376	2,030	3,722	3,979	4.3	2.9
China ^b	3,126	14,506	43,498	171,782	225,964	287,331	17.5	29.7
India^{c,d}	182	465	480	850	985	1,373	1.1	1.1
Indonesia	124	2,281	7,280	6,454	6,810	6,178	11.1	6.0
Korea	14,339	33,217	58,686	82,584	82,991	83,671	34.1	25.7
Malaysia ^b	8,207	32,721	52,382	56,172	60,091	67,874	53.3	42.2
Mexico ^b	4,535	11,616	34,042	36,232	38,044	46,625	20.5	18.6
Philippines ^{b,d}	1,835	7,564	25,138	23,990	23,792	26,057	63.2	55.4
Singapore	19,235	60,322	73,820	92,465	101,683	118,023	53.6	43.4
South Africa		211	409	598	607	764	1.4	1.3
Thailand	3,520	11,660	18,653	21,215	23,910	29,390	27.0	22.5
World's Total	298,550	604,730	966,828	1,150,790	1,279,262	1,451,376	15.4	12.3

a Or nearest year.

b Includes significant exports from processing zones.

c Figures refer to fiscal year.

d Includes Secretariat estimates.

Source : *International Trade Statistics (2007), WTO.*

Table 24: Exports of Automotive Products of Select Economies

Country	Value (Million dollars)						Share in Economy's Merchandise Exports (%)	
	1990	1995	2000	2004	2005	2006	2000	2006 ^a
1	2	3	4	5	6	7	8	9
Argentina	200	1,374	2,108	2,185	3,047	4,178	8.0	9.0
Brazil	2,034	2,955	4,682	8,699	11,983	13,038	8.5	9.5
China ^b	258	621	1,581	6,272	9,957	14,411	0.6	1.5
India^{c,d}	198	568	640	1,863	2,732	3,242	1.4	2.6
Indonesia	22	130	369	875	1,340	1,724	0.6	1.7
Korea	2,301	9,166	15,194	32,320	37,748	43,059	8.8	13.2
Malaysia ^b	121	279	307	554	725	920	0.3	0.6
Mexico ^b	4,708	14,258	30,655	31,906	35,424	42,632	18.4	17.0
Philippines ^{b,d}	23	218	583	1,351	1,538	1,506	1.5	3.2
Singapore	348	886	678	1,951	2,310	2,396	0.5	0.9
South Africa	249	730	1,708	3,702	4,352	4,970	5.7	8.5
Thailand	108	486	2,417	5,548	7,983	9,901	3.5	7.6
World's Total	318,960	459,190	577,113	860,287	920,408	1,015,941	9.2	8.6

a Or nearest year.

b Includes significant exports from processing zones.

c Figures refer to fiscal year.

d Includes Secretariat estimates.

Source : *International Trade Statistics (2007)*, WTO.

exports of automotive products is very less as compared to Brazil, China, Mexico, Korea and Thailand.

Against this backdrop, it is observed that across a variety of commodities, as compared to other economies, mainly Asian countries, Indian manufactured products suffer from lower labour productivity, higher inputs and materials cost, lower operating surplus, despite having one of the lowest labour cost. Higher input cost in India is attributable to cascading effect of indirect taxes on selling prices of commodities; higher cost of utilities like power, transport and high transactions costs. Multiplicity and high level of taxes, high cost of capital and poor quality and excessive user charges of support infrastructure services impose additional costs to the tune of 12.2 per cent of the cost of production (FICCI, 2005). Higher input and material costs account for a major part of the value added thereby

rendering the lower labour cost advantage of the economy ineffective. Lower operating surplus leaves little incentive for industrialists to expand their capacity and grow big. At the same time, it is found that India's share in trade of those commodities, which are traded the most in the world such as office machines and telecom equipments, automotive components, and other machinery and transport equipments, is very low. Nevertheless, there exists substantial opportunities for India to expand its global share in exports of these commodities.

Section V

Issues to be Addressed in Boosting up India's Manufacturing Sector Competitiveness

Indian manufacturing industries have certain inherent strengths and advantages in having a relatively inexpensive, adequate and skilled labour force, cost-effective and competitive prices of goods produced, large manufacturing base and proximity to fast growing Asian markets. In general, India has one of the largest pool of scientists and engineers, thereby giving the country a competitive edge in pursuing R&D activities. Furthermore, the presence of a number of high quality R&D institutions also imparts a competitive edge. Some of the manufacturing industries have their own sector specific inherent strengths when compared to other economies. With its cheap and skilled labour force and impressive design expertise, India stands a better chance in expanding its textile exports. Abundant supply of quality raw material will enable the Indian textile industry to produce quality consumer products at a competitive rate. In pharmaceuticals, the success stories of Indian companies combining two very unique Indian characteristics: a large pool of talented chemists and good entrepreneurial ability augur well for its growth. A sizeable export business of US \$ 350 million has already been built in active ingredients for generic drugs and formulations.

With the rise of the Indian firms at the international level, it is argued that Indian companies have some key fundamental strength that will help them dominate not just their domestic markets, but

parts of the global market as well. India is no longer seen as a laggard and the country is now well on the road to become the world's favourite destination for outsourcing for R&D, engineering design, telecommunications, super-specialty healthcare and a manufacturing hub for high technology products. India is among the world leaders in the production of textiles, non-metallic mineral products, basic metals, *etc.*, and steadily capturing the world export markets in the services like software exports, BPO, ITES, in addition to pharmaceuticals.

Certain generic issues that affected the competitiveness of the Indian manufacturing sector such as a dynamic competitive environment supported by market institutions and law have been addressed by the Government in the recent years. The Government enacted a new modern competition law in the form of Competition Act, 2002 to uphold competition in the Indian market. The Central Government established the Competition Commission of India on October 14, 2003 to carry out the objectives of the Act. The limitations in the MRTP Act have been adequately covered in the new Competition Act, 2002.

Furthermore, the National Manufacturing Competitiveness Council (NMCC) was set up in September 2004 to provide a continuing forum for policy dialogue to energise and sustain the growth of manufacturing industries. As a first step towards developing a strategy for manufacturing growth, a Strategy Paper on "National Strategy for Manufacturing" was prepared by the NMCC, which attempted to identify the key policy initiatives to make the Indian manufacturing become competitive to realise higher level of growth and employment in the country. The NMCC has identified certain deficient areas, which require immediate attention and policy initiation not only from the Government side but also from other stake holders like firms, industrial associations, trade bodies, *etc.*, to attain the required growth in the manufacturing sector.

The Investment Commission has been constituted to find out ways and means of attracting certain level of secure investments.

The Commission will make recommendations both on policies and procedures to facilitate greater FDI flows into India. A High Level Committee on Manufacturing was constituted in April 2006 with the Prime Minister as the Chairman. The Committee would address macroeconomic issues impinging on the growth and competitiveness of the manufacturing sector in India, and create a policy framework for necessary reforms covering all the aspects of manufacturing competitiveness. The Committee would also ensure coordination among the various Ministries which deal with manufacturing sub-sectors and review the implementation of time-bound action plans to achieve the objective of 12 per cent growth in manufacturing sector. The Committee would initiate steps to make India a manufacturing hub for areas having potential for global competitiveness such as textiles, automobiles, leather, food processing, steel, metals, chemicals and petroleum products. This is a positive step towards encouraging manufacturing sector growth, which would improve the competitiveness of the Indian manufactures.

Despite these institutional developments to boost the India's manufacturing competitiveness, India's comparative performance *vis-à-vis* some of the EMEs is low due to various reasons as seen in the earlier sections. There is a need to address the following important issues appropriately to improve the competitiveness of the Indian manufacturing sector.

Further Diversification of Manufacturing Export Basket

It has been found that the manufacturing exports accounted for about 70 per cent of the total exports of the country. Of which, five sectors, *viz.*, gems and jewellery, textiles and garments, engineering goods, chemicals, leather and leather goods alone accounted for over 68.0 per cent of India's exports (Table 25). While India's manufacturing sector exports have shifted from leather and textiles to chemicals and engineering goods over the years, there appears to be considerable scope for further diversification of manufacturing sector exports and concentrate on high value manufactured goods to further improve its competitiveness.

Table 25: Changing Composition of India's Export - Share

(Per cent)

Commodity	1990-91	1995-96	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06 P
1	2	3	4	5	6	7	8	9
Primary products	23.8	22.8	16.0	16.3	16.5	15.5	16.2	16.0
Agriculture and allied products	18.5	19.1	13.4	13.5	12.7	11.8	10.1	9.9
Ores and minerals	5.3	3.7	2.6	2.9	3.8	3.7	6.1	6.0
Manufactured goods	71.6	74.7	77.1	76.1	76.3	76.0	72.7	69.9
Leather and manufactures	8.0	5.5	4.4	4.4	3.5	3.4	2.9	2.6
Chemicals and Related products	9.5	11.3	13.2	13.8	14.1	14.8	14.9	14.1
Engineering goods	12.4	13.8	15.3	15.9	17.1	19.4	20.8	21.0
Textile and Textile Products	23.9	25.3	25.3	23.3	22.0	20.0	16.2	15.6
Gems and jewellery	16.1	16.6	16.6	16.7	17.1	16.6	16.5	15.1
Handicrafts *	1.2	1.4	1.5	1.3	1.5	0.8	0.5	0.4
Other Manufactured Goods	0.4	0.8	0.8	0.9	0.9	1.0	1.0	1.1
Petroleum products	2.9	1.4	4.2	4.8	4.9	5.6	8.4	11.2
Others	1.7	1.1	2.8	2.7	2.3	2.9	2.7	2.9
Total exports	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

P : Provisional. * : Excluding handmade carpets.

Source : Directorate General of Commercial Intelligence and Statistics, Government of India.

Improvement in Export Quality

Poor quality of products plays a crucial role in determining export competitiveness of an economy. In terms of export quality indices provided by the UNIDO², India does not fare well and significantly lags behind many of the EMEs such as China, Thailand, Philippines, Malaysia and Singapore (Table 26).

Improvement in Productivity

As observed earlier, labour productivity in respect of many of the manufacturing goods in India is very low when compared to other EMEs. The need of the hour is to identify fast-track industries on the basis of comparative advantage or raw material availability or process capabilities or local product development capability or specific skills

Table 26: Export Quality Indices of Some Economies

Country	1980	1990	2000
1	2	3	4
Philippines	0.341	0.446	0.960
Singapore	0.614	0.843	0.943
Malaysia	0.392	0.696	0.896
Mexico	0.572	0.638	0.878
Thailand	0.413	0.606	0.781
China	0.254	0.590	0.727
Brazil	0.476	0.618	0.672
South Africa	0.265	0.302	0.596
Indonesia	0.162	0.359	0.568
India	0.417	0.509	0.545

Source : *Industrial Development Report, 2004, UNIDO.*

or a combination of these and encourage them to achieve better competitiveness. Change in productivity can come by introducing and entrenching Total Productive Maintenance (TPM) process in every business activity. The essence of TPM is business process improvement through working teams and cutting across organisational layers, which yields significant benefits. Concerted efforts could be made to disseminate the concept and its implementation.

Increase in Technology Intensity

Technology intensity of exports is another factor determining competitiveness of the manufacturing sector exports of an economy. India's manufacturing exports largely comprise low-technology induced goods. High-technology exports, according to World Bank, are products with high R&D intensity in aerospace, computers, pharmaceuticals, scientific instruments, and electrical machinery. In the world trade where primary products and resource-based manufactures have steadily lost their importance, high technology exports are the largest foreign exchange earners for various countries. In India, though ITES is considered as the main driver of growth, the share of high-technology items in its exports as compared with other EMEs is one of the least - about one-sixth of that of China (Table 27).

Table 27: High Technology Exports of Select Economies

Country	2002		2005	
	US \$ million	As a % of Manufactured Exports	US \$ million	As a % of Manufactured Exports
1	2	3	4	5
Philippines	23,868	74.1	26,077	71.0
Malaysia	43,544	58.2	57,376	54.7
Korea	46,600	31.3	83,527	32.3
United States	191,123	33.5	233,079	31.8
China	68,182	23.3	214,246	30.6
Japan	94,730	24.5	122,680	22.5
Indonesia	5,070	16.4	6,571	16.3
Brazil	5,340	16.8	8,007	12.8
Australia	2,945	16.4	3,276	12.7
Russia	2,897	13.3	3,690	8.1
South Africa	740	5.1	1,739	6.6
India^s	1,879	4.8	2,840	4.9

^s : Latest data relate to 2004.

Source : World Development Indicators, 2007.

High technology exports in the case of India constituted only 4.9 per cent of total manufacturing exports in 2004. The low level of technological sophistication of India's exports undermines its competitiveness.

Research and Development Efforts

Science and technology sheds light on countries' technological base - the availability of skilled human resources, the competitive edge the country enjoys in high-technology exports, sales and purchases of technology through royalties and licenses, and the number of patent and trademark applications filed. India lags behind a number of economies in terms of manpower for research and development as well as efforts towards R&D (Table 28).

Improvement in Business Environment

Countries differ widely in their business environment. In some countries the process is straightforward and affordable, while in others

Table 28: Research and Development Efforts

Countries	Researchers in R&D (per million people)	Technicians in R&D (per million people)	Expend- itures for R&D (% of GDP)	Royalty and license fees in \$ Million		Patent applications filed	
				Receipts	Payments	Residents	Non- residents
	2000-04	2000-04	2000-04	2005	2005	2004	2004
1	2	3	4	5	6	7	8
Argentina	720	316	0.41	54	635	786	3,816
Brazil	344	332	0.98	102	1,404	3,892	14,800
China	708	–	1.44	157	5,321	65,586	64,798
India	–	–	0.85	25	421	6,795	10,671
Japan	5,287	528	3.15	17,655	14,653	362,342	60,739
Indonesia	207	–	0.05	263	961	226	3,441
Korea	3,187	567	2.64	1,827	4,398	105,027	35,088
Malaysia	299	58	0.69	27	1,370	–	–
Mexico	268	96	0.40	70	111	531	12,667
Philippines	48	8	0	6	265	157	2,539
Russia	3,319	557	1.17	260	1,593	22,944	7,246
South Africa	307	73	0.76	45	1,071	–	–
Thailand	287	208	0.26	17	1,674	681	4,329
United States	4,605	–	2.68	57,410	24,501	185,008	171,935

Source : World Development Indicators, 2007, World Bank.

it is complex and costly. The World Bank uses some key indicators in order to measure the ease or difficulty of operating a business - starting a business, hiring and firing workers, registering property, getting credit, protecting investors and enforcing contracts. When entrepreneurs start a business, the first obstacle they face is the administrative and legal procedures required to register the new firm. According to the World Bank's indicator, in India, entrepreneurs have to go through 11 steps to launch a business over 35 days on an average, at a cost of 73.7 per cent of per capita income, compared with the region's average of 8 steps, over 33 days on average, at a cost equal to 46.6 per cent of per capita income (Table 29). Thus, India does not enjoy a favourable business environment *vis-à-vis* other EMEs, which calls for policy intervention.

Removal of Infrastructure Bottlenecks

India's weak infrastructure, especially of export infrastructure in the ports, congestion problems, insufficient bulk terminals, etc.,

Table 29: Business Environment of Select Countries as in April 2006

Country	Starting a business		Registering Property		Getting Credit			Hiring and Firing Workers	Enforcing Contracts	
	No. of start up procedures	Time to start a business days	No. of Procedures	Time Required Days	Index of borrower and lender rights 0 (less access) to 10 (more access)	Public registry coverage	Private registry coverage	Rigidity of employment index 0 (less rigid) to 100 (more rigid)	No. of procedures	Time Required Days
1	2	3	4	5	6	7	8	9	10	11
Argentina	15	32	5	44	3	254	1,000	41	33	520
Brazil	17	152	14	47	2	92	430	42	42	616
China	13	35	3	32	2	102	0	24	31	292
India	11	35	6	62	5	0	61	41	56	1,420
Indonesia	12	97	7	42	5	84	2	44	34	570
Japan	8	23	6	14	6	0	–	29	20	242
Korea	12	22	7	11	6	0	766	34	29	230
Malaysia	9	30	5	144	8	422	–	10	31	450
Philippines	11	48	8	33	3	0	48	39	25	600
Russia	7	28	6	52	3	0	0	44	31	178
South Africa	9	35	6	23	5	0	530	41	26	600
Thailand	8	33	2	2	5	0	217	18	26	425

Source : World Development Indicators, 2007, World Bank.

needs to be improved/rationalised. High cost of power with restricted and unreliable supply affects the industrial performance. Space is a major constraint in big cities. Therefore, more industrial estates in the rural and semi-urban areas with required basic infrastructure facilities are the need of the hour. Transport infrastructure - highways, railways, ports and waterways, airports and air traffic control systems - and the services that flow from them also determines the efficiency in the movement of goods and services in the economy. The higher efficiency reduces the transportation cost, thereby giving a competitive edge to the economy. Railway sector in India is one of the largest in the world. Nevertheless, employee productivity of railways in India is very low as compared to China, Korea, Brazil, Indonesia, etc. Similarly, port container and air freight traffic is also very less in India as compared to other Asian economies except Philippines (Table 30). Inadequate transport infrastructure undermines the competitiveness of Indian economy *vis-à-vis* its competitors. New

**Table 30: Comparison of Transport Infrastructure
in Select Countries**

Countries	Roads		Railways			Ports	Air
	Paved roads (%)	Goods hauled (million tonne-km)	Rail Lines total route – km	Passengers carried (million passenger-km)	Goods hauled (million tonne-km)	Container traffic (000' TEU)	Air freight (millions tonne-km)
	2000-04 ^a	2000-04 ^a	2000-05 ^a	2000-05 ^a	2000-05 ^a	2005	2005
1	2	3	4	5	6	7	8
Brazil	5.5	–	29,314	–	221,600	5,598	1,531
China	81.0	784,090	62,200	583,320	1,934,612	88,549	7,579
India	474.0	–	63,460	575,702	407,398	4,938	773
Indonesia	58.0	–	–	25,535	4,698	5,503	440
Japan	77.7	327,632	20,052	145,957	22,632	16,777	8,549
Korea	86.8	518	3,392	31,004	10,108	15,113	7,433
Malaysia	81.3	–	1,667	1,181	1,178	12,027	2,578
Mexico	49.5	199,800	26,662	74	2,145	390	–
Philippines	21.6	–	–	–	–	3,634	323
Russia	–	5,702	85,542	164,262	1,801,601	1,803	1,541
Singapore	–	100	–	–	–	23,192	7,571
South Africa	17.3	–	20,247	991	108,513	2,868	923
Thailand	98.5	–	4,044	9,195	4,037	5,115	2,002

Note : a : Data are for the latest year available in the period shown.

Source : *World Development Indicators, 2007, World Bank.*

initiatives for encouraging entry of more private sector participation and public-private partnership (PPP) in important sectors like electricity distribution, aviation, roads, railways, ports and airports should be explored.

The experience in privatising the PSUs in the infrastructure sector has been very encouraging. Privatisation will not only enhance efficiencies and bring down costs, but also generate more earnings, in addition to the annual revenue streams for Government. Encouragement for more PPP in infrastructure development would improve the infrastructure in the country, which would in turn increase the export competitiveness.

Legal and Regulatory Environment

Multiplicity of laws and frequent amendments restrict and create impediments in the way of growth and necessitates a need for unified laws to lessen the grey areas in the policy environment. Procedural

hurdles need to be liberalised. Furthermore, complicated taxation laws and procedures come in the way of consolidating/ restructuring the industrial units due to the concessions that hitherto availed by them. Adoption of uniform tax laws could facilitate fair competition and growth. The Government's endeavour to reduce the central sales tax rate in recent time is an effort in the right direction. There is a need to address the policy and institutional barriers, which impede growth in manufacturing. Furthermore, myriad laws and regulations that govern the manufacturing sector need to be pruned down and replaced with simplistic laws.

Liberalisation of Labour Laws

The economic reforms that started in the 1990s have left the labour market untouched, which has led to various problems such as lower productivity, inefficient allocation of resources, *etc.* Rigid labour laws have resulted in underinvestment in some industries such as textile industry. India's inflexible labour law is not market driven; thus, the problem of unskilled labour and its low standard reduces the competitiveness of the country. Simplification of laws relating to retrenchment, and replacement of non-performing workers at a time when the unit is in trouble could enable the reorganisation/ consolidation in the industry. So, it becomes important that labour reforms be carried out in order to accelerate investment, enhance productivity, competitiveness and employment generation in the economy.

SME Sector related Issues

Historically, India has had a highly fragmented industrial structure. The manufacturing sector in India is characterised by a significant number of small scale and unregistered manufacturing firms. The Small and Medium Enterprises (SMEs) sector in the Indian economy has been a very vital organ and it has a share of over 40.0 per cent of the gross industrial value added in the economy. About 44 per cent of the country's exports directly or indirectly pertain to this sector. Given its contribution in the export basket of

the country, improvement of competitiveness of the manufacturing sector is not possible without paying adequate attention to the SMEs. Small Scale enterprises in India have received significant preferential treatment – both in terms of specific sectors being reserved exclusively for them and in terms of preferential excise and other fiscal concessions. Since the preferential treatment is contingent on these units remaining small, there is no incentive for these units to expand eroding the competitiveness of Indian manufacturing. This has prevented India's market size from being translated into scale for manufacturing. Industry – research institute interaction is low in India, thereby reducing the chances of creation of commercially viable technologies.

India's huge potential lies in the SMEs to expand employment opportunities, further develop the industry and boost the exports. But, there is no broad-based market information network to coordinate and develop the SME sector. There is an urgent need to develop more industrial clusters to facilitate better information network among the SMEs. Unavailability of information on the reliability of potential buyers and sellers tends to increase transaction costs. There is significant scope for improving productivity levels in different manufacturing industries through cluster approach. On the lines of identified SSI clusters, clusters may also be identified for other manufacturing sector with improved infrastructure facilities that may improve the competitiveness of the industries.

At present, about 114 commodities are reserved for exclusive manufacturing by the SSI sector. Production of some of these items requires modernisation and technology upgradation to achieve economies of scale and de-reservation alone would help enhance competitiveness of these products. Removal of all restrictions on investment in labor-intensive small-scale industries needs to be done. The control has led to various sets of inefficiency in these industrial sectors. There is a need for improving appropriate linkages with education, infrastructure, human and natural resources and environment for long-term sustainable development and facilitating value-addition and self-reliance approach towards manufacturing.

Sector Specific Issues

Lack of strong patent protection is a deterrent to attract sizeable investment in R&D, foreign direct investment (FDI) and introduction of newer and better products in the drugs and pharmaceuticals industry. Deferred or delayed payments, non-availability of power, and lack of orders/demands are problems plaguing most of the sugar industry, which needs to be addressed urgently. High tariff barrier coupled with stringent sanitary and phyto-sanitary measures, including animal health and residues of contaminants by the export destination countries like Europe and the US affected the domestic production and export competitiveness of the India's milk products.

India's low quality and low technology intensity of exports are more vulnerable in the competitive environment, which needs to be improved with quality products and the share of high technology intensity exports to be increased. Basic infrastructure, particularly transport infrastructure is vital for any products to compete in the market, which needs to be improved to attain cost competitiveness. Business environment also needs improvement by eliminating procedural hurdles to attract more investment in the manufacturing sector, particularly FDI.

Section VI**Concluding Observations**

As seen earlier, the competitiveness of the Indian economy has been improving on the whole, so has the competitiveness of manufacturing sector. Sharp rise in the share of manufacturing exports in GDP since the 1990s bears testimony to this. India's manufacturing sector is becoming increasingly integrated with the global economy as we found that the world GDP was positively affecting India's manufacturing exports. India is found to be one of the leading producers and exporters in respect of various commodities as also the country enjoys significant advantages in terms of lower labour costs as compared to other EMEs.

However, our analysis brings out that India's performance in the manufacturing sector is not so impressive as that of other

comparable EMEs. This could largely be attributable to lesser export-orientation coupled with low technology exports of Indian manufacturing sector. Given the urgent need to improve competitiveness, one cannot refrain from being prescriptive. It is found that India is concentrating largely on exporting processed goods such as gems and jewellery and petroleum products, which have high import content. This is reflected in sharp increase in the share of petroleum products in India's exports during the recent years, which has increased nearly ten fold from 1.4 per cent in 1995-96 to 14.8 per cent in 2006-07. On the contrary, the share of traditional export items such as leather, textiles, *etc.*, has declined over the years. Against this backdrop, there is an urgent need for further diversifying India's export basket towards high value goods such as office and telecom equipments, high technology goods, *etc.*, to improve India's competitiveness. Furthermore, India needs to rationalise the tariff and non-tariff barriers in order to sharpen its competitive strength. Ultimately, the issues relating to poor export quality, infrastructural bottlenecks, lower efforts at research and development that have taken a toll on the country's competitiveness should be addressed from a holistic perspective. There should be widespread awareness and concerted efforts among the constituents of the manufacturing sector and decision making layers about the need to achieve sustained increase in Indian manufacturing sector's competitiveness, which is not a discreet event but a continuous saga.

Notes:

- ¹ China is not included due to non-availability of information.
- ² It is the simple average of the share of manufactured exports in total exports and the share of medium and high-technology (MHT) products in manufactured exports.

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Current Issues in Agriculture Credit in India: An Assessment

Ramesh Golait*

This paper attempts to analyse the issues in agricultural credit in India. The analysis reveals that the credit delivery to the agriculture sector continues to be inadequate. It appears that the banking system is still hesitant on various grounds to purvey credit to small and marginal farmers. The situation calls for concerted efforts to augment the flow of credit to agriculture, alongside exploring new innovations in product design and methods of delivery, through better use of technology and related processes. Facilitating credit through processors, input dealers, NGOs, *etc.*, that are vertically integrated with the farmers, including through contract farming, for providing them critical inputs or processing their produce, could increase the credit flow to agriculture significantly.

JEL Classification : F 361, 362, Q14

Keywords : Agriculture, Credit, Rural

Introduction

Agriculture plays a crucial role in the development of the Indian economy. It accounts for about 19 per cent of GDP and about two-thirds of the population is dependent on the sector. The importance of farm credit as a critical input to agriculture is reinforced by the unique role of Indian agriculture in the macroeconomic framework and its role in poverty alleviation. Recognising the importance of agriculture sector in India's development, the Government and the Reserve Bank of India (RBI) have played a vital role in creating a broad-based institutional framework for catering to the increasing credit requirements of the sector. Agricultural policies in India have been reviewed from time to time to maintain pace with the changing

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requirements of the agriculture sector, which forms an important segment of the priority sector lending of scheduled commercial banks (SCBs) and target of 18 per cent of net bank credit has been stipulated for the sector. The Approach Paper to the Eleventh Five Year Plan has set a target of 4 per cent for the agriculture sector within the overall GDP growth target of 9 per cent. In this context, the need for affordable, sufficient and timely supply of institutional credit to agriculture has assumed critical importance.

The evolution of institutional credit to agriculture could be broadly classified into four distinct phases - 1904-1969 (predominance of co-operatives and setting up of RBI), 1969-1975 [nationalisation of commercial banks and setting up of Regional Rural Banks (RRBs)], 1975-1990 (setting up of NABARD) and from 1991 onwards (financial sector reforms).

The genesis of institutional involvement in the sphere of agricultural credit could be traced back to the enactment of the Co-operative Societies Act in 1904. The establishment of the RBI in 1935 reinforced the process of institutional development for agricultural credit. The RBI is perhaps the first central bank in the world to have taken interest in the matters related to agriculture and agricultural credit, and it continues to do so (Reddy, 2001).

The demand for agricultural credit arises due to i) lack of simultaneity between the realisation of income and act of expenditure; ii) lumpiness of investment in fixed capital formation; and iii) stochastic surges in capital needs and saving that accompany technological innovations. Credit, as one of the critical non-land inputs, has two-dimensions from the viewpoint of its contribution to the augmentation of agricultural growth *viz.*, availability of credit (the quantum) and the distribution of credit. In this paper, the trends in agricultural credit are analysed in Section I; Section II covers State-wise distribution of institutional credit; Section III deals with recent policy initiatives; issues and concerns are dealt with in Section IV; Section V draws implications for the future followed by the concluding observations in Section VI.

Section I

Agricultural Credit: Discernible Trends

In India a multi-agency approach comprising co-operative banks, scheduled commercial banks and RRBs has been followed for purveying credit to agricultural sector. The policy of agricultural credit is guided mainly by the considerations of ensuring adequate and timely availability of credit at reasonable rates through the expansion of institutional framework, its outreach and scale as also by way of directed lending. Over time, spectacular progress has been achieved in terms of the scale and outreach of institutional framework for agricultural credit. Some of the major discernible trends are as follows:

- Over time the public sector banks have made commendable progress in terms of putting in place a wide banking network, particularly in the aftermath of nationalisation of banks. The number of offices of public sector banks increased rapidly from 8,262 in June 1969 to 68,355 by March 2005.
- One of the major achievements in the post-independent India has been widening the spread of institutional machinery for credit and decline in the role of non-institutional sources, notwithstanding some reversal in the trend observed particularly in the 1990s.
- The share of institutional credit, which was little over 7 per cent in 1951, increased manifold to over 66 per cent in 1991, reflecting concomitantly a remarkable decline in the share of non-institutional credit from around 93 per cent to about 31 per cent during the same period. However, the latest NSSO Survey reveals that the share of non-institutional credit has taken a reverse swing which is a cause of concern (Table 1).
- Notwithstanding their wide network, co-operative banks, particularly since the 1990s have lost their dominant position to commercial banks. The share of co-operative banks (22 per cent) during 2005-06 was less than half of what it was in 1992-93 (62 per cent), while the share of commercial banks (33 to 68 per

Table 1: Relative Share of Borrowing of Cultivator Households from Different Sources

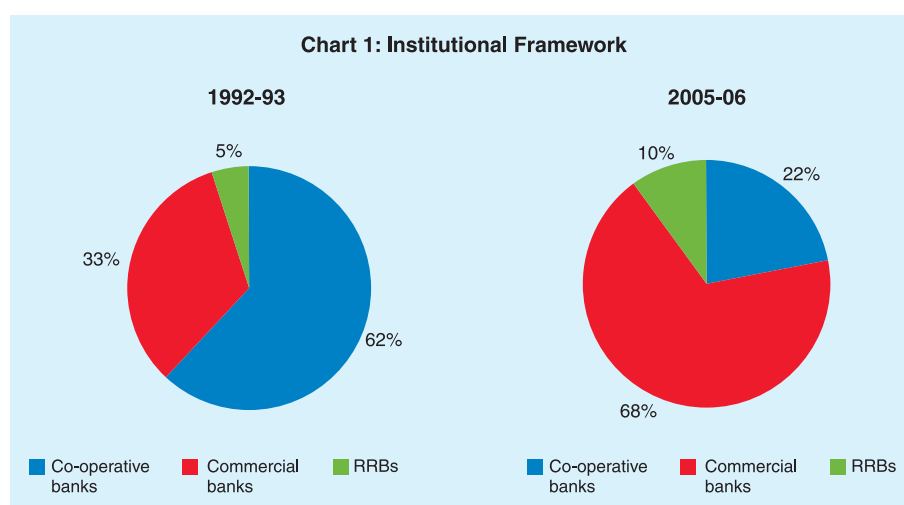
(Per cent)

Sources Credit	1951	1961	1971	1981	1991	2002
1	2	3	4	5	6	7
Non-Institutional	92.7	81.3	68.3	36.8	30.6	38.9
<i>of which</i>						
Money Lenders	69.7	49.2	36.1	16.1	17.5	26.8
Institutional	7.3	18.7	31.7	63.2	66.3	61.1
<i>of which</i>						
Cooperatives Societies / Banks	3.3	2.6	22.0	29.8	23.6	30.2
Commercial Banks	0.9	0.6	2.4	28.8	35.2	26.3
Unspecified	–	–	–	–	3.1	–
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source : All India Debt and Investment Survey and NSSO.

cent) including RRBs (5 to 10 per cent) almost doubled during the above period (Chart 1).

- The efforts to increase the flow of credit to agriculture seems to have yielded better results in the recent period as the total institutional credit to agriculture recorded a growth of around 21 per cent during 1995-96 to 2004-05 from little over 12 per cent during 1986-87 to 1994-95. In terms of total credit to agriculture, the commercial banks recorded a considerable



growth (from around 13 per cent to about 21 per cent), while co-operative banks registered a fall (over 14 per cent to over 10 per cent) during the above period (Table 2).

- However, the growth of direct finance to agriculture and allied activities witnessed a decline in the 1990s¹ (12 per cent) as compared to the 1980s (14 per cent) and 1970s (around 16 per cent). Furthermore, a comparative analysis of direct credit to agriculture and allied activities during 1980s and since 1990s reveals the fact that the average share of long-term credit in the total direct finance has not only been much lower but has also decelerated (from over 38 per cent to around 36 per cent), which could have dampening effect on the agricultural investment for future growth process (Chart 2).

Table 2: Institutional Credit to Agriculture

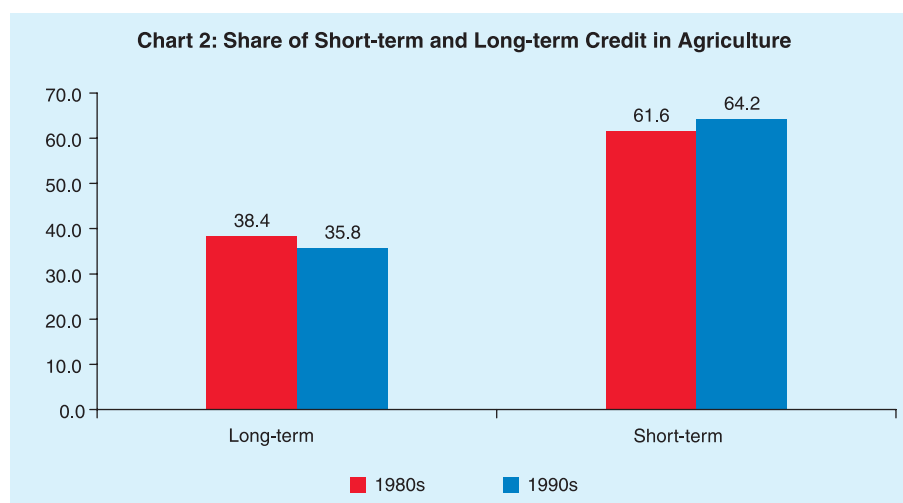
(Rs. crore)

Year	Institutions						Total	Per cent increase
	Co-op Banks	Share (per cent)	RRBs	Share (per cent)	Commercial Banks	Share (per cent)		
1	2	4	5	6	7	8	9	10
1985-86	3,874	55	–	–	3,131	45	7,005	–
1986-87	4,207	52	–	–	3,809	48	8,016	14
1987-88	4,420	52	–	–	4,009	48	8,429	5
1988-89	4,851	53	–	–	4,233	47	9,084	8
1989-90	5,082	52	–	–	4,719	48	9,801	8
1990-91	3,408	39	–	–	5,438	61	8,846	-10
1991-92	5,800	52	596	5	4,806	43	11,202	27
1992-93	9,378	62	831	5	4,960	33	15,169	35
1993-94	10,117	61	977	6	5,400	33	16,494	9
1994-95	9,406	50	1,083	6	8,255	44	18,744	14
1995-96	10,479	48	1,381	6	10,172	46	22,032	18
1996-97	11,944	45	1,684	6	12,783	48	26,411	20
1997-98	14,085	44	2,040	6	15,831	50	31,956	21
1998-99	15,916	43	2,538	7	18,443	50	36,897	15
1999-00	18,363	40	3,172	7	24,733	53	46,268	25
2000-01	20,801	39	4,219	8	27,807	53	52,827	14
2001-02	23,604	38	4,854	8	33,587	54	62,045	17
2002-03	23,716	34	6,070	9	39,774	57	69,560	12
2003-04	26,959	31	7,581	9	52,441	60	86,981	25
2004-05	31,424	25	12,404	10	81,481	65	1,25,309	44
2005-06	39,404	22	15,223	8	1,25,859	70	1,80,486	44
2006-07*	33,174	22	15,170	10	1,00,999	68	1,49,349	–

* : up to December 2006.

Note : Commercial Banks and RRBs were clubbed together up to 1990-91.

Source : Economic Survey and NABARD various issues.



- The disaggregated picture as per size-wise distribution of credit reveals that the growth of direct finance to small and marginal farmers witnessed a marked deceleration from about 24 per cent in the 1980s to little over 13 per cent during the 1990s.
- Sectoral deployment of gross bank credit reveals that the share of agriculture since the second half of 1990s has ranged between 11-12 per cent. As at end March 2006, the share stood at around 11.9 per cent (Table 3).

Table 3: Sectoral Deployment of Gross Bank Credit

(Rupees crore)

Sectors	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
I	2	3	4	5	6	7	8	9	10	11
Gross Bank Credit	2,58,991	3,00,283	3,42,012	4,00,818	4,69,153	5,36,727	6,69,534	7,64,383	10,40,909	14,45,837
A. Priority Sector	84,880	99,507	1,14,611	1,31,827	1,54,414	1,75,259	2,11,609	2,63,834	3,81,476	5,09,910
I. Agriculture	31,442	34,869	39,634	44,381	51,922	60,761	73,518	90,541	1,25,250	1,72,279
<i>Share of Agriculture in Total</i>	<i>12.14</i>	<i>11.61</i>	<i>11.59</i>	<i>11.07</i>	<i>11.07</i>	<i>11.32</i>	<i>10.98</i>	<i>11.84</i>	<i>12.03</i>	<i>11.92</i>
II. Small Scale Industries	35,944	43,508	48,483	52,841	56,002	57,119	60,394	65,855	74,588	90,239
III. Other Priority Sector	17,494	21,130	26,494	34,362	46,490	57,299	77,697	1,07,438	1,81,638	2,47,379
B. Industry	1,02,604	1,17,350	1,30,516	1,47,319	1,62,837	1,72,324	2,35,168	2,47,210	3,52,304	4,58,808
<i>Share of Industry in Total</i>	<i>39.62</i>	<i>39.08</i>	<i>38.16</i>	<i>36.75</i>	<i>34.71</i>	<i>32.11</i>	<i>35.12</i>	<i>32.34</i>	<i>33.85</i>	<i>31.73</i>

Source : Report on Trend and Progress of Banking in India, Various issues.

Section II

State-wise Distribution of Institutional Credit

There are wide variations in the availability of institutional credit per hectare of gross cropped area in different States. It was as high as Rs.9,403 in Tamil Nadu, Rs.7,666 in Kerala, Rs.5,352 in Punjab and Rs.4,604 in Andhra Pradesh, while it was as low as Rs.311 in Assam, Rs.667 in Rajasthan and Rs.698 in Madhya Pradesh during 2001-02 (Table 4).

Table 4: Distribution of Flow of Institutional Agricultural Credit in Different States of India

Region/States	1990-91		2001-02		Annual Increase (per cent)	Percentage GCA (1998-99)	Rs./hectare of GCA		Annual Increase (per cent)
	Rs. Crore	Per cent	Rs. Crore	Per cent			1990-91	2001-02	
1	2	3	4	5	6	7	8	9	10
Northern	1,314	12.9	8,236	19.9	43.9	20.25	377	2,132	38.9
Punjab	642	6.3	4,304	10.4	47.5	4.22	856	5,352	43.8
Haryana	285	2.8	1,821	4.4	44.9	3.22	482	2,964	42.9
Rajasthan	326	3.2	1,490	3.6	29.7	11.70	168	667	24.7
Himachal Pradesh	20	0.2	248	0.6	93.2	0.51	207	2,555	94.5
Jammu and Kashmir	20	0.2	83	0.2	25.5	0.57	191	764	25.0
North-Eastern	41	0.4	207	0.5	34.0	2.90	96	374	31.4
Assam	20	0.2	124	0.3	42.4	2.09	54	311	39.9
Eastern	846	8.3	3,062	7.4	21.8	14.71	463	1,092	22.8
Orissa	306	3.0	414	1.0	3.0	4.53	319	479	4.2
West Bengal	285	2.8	1,573	3.8	37.6	4.83	329	1,708	34.9
Bihar (includes Jharkhand)	245	2.4	1,076	2.6	28.3	5.25	233	1,075	30.1
Central	1,722	16.9	5,835	14.1	19.9	27.57	349	1,110	18.2
Madhya Pradesh (includes Chhatisgarh)	746	7.5	1,821	4.4	11.5	13.67	320	698	9.9
Uttar Pradesh (includes Uttaranchal)	958	9.4	4,056	9.8	27.0	13.90	376	1,529	25.6
Western	1,386	13.6	5,959	14.4	27.5	7.06	430	1,831	27.4
Gujarat	520	5.1	2,980	7.2	39.5	5.56	501	2,809	38.3
Maharashtra	846	8.3	2,938	7.1	20.6	11.40	387	1,352	20.8
Southern	4,880	47.9	18,127	43.8	22.6	17.51	1,410	5,426	23.8
Andhra Pradesh	1,477	14.5	5,587	13.5	23.2	6.36	1,120	4,604	25.9
Karnataka	642	6.3	4,041	9.7	43.8	6.13	546	3,432	44.1
Kerala	835	8.2	2,276	5.5	14.4	1.56	2,766	7,666	14.8
Tamil Nadu	1,895	18.6	6,166	14.9	18.8	3.44	2,857	9,403	19.1
All-India	10,188	100.0	41,385	100.0	25.5	100.00	549	2,169	24.6

GCA refers to gross cropped area.

Source : Report of the Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System, RBI, Mumbai, 2004.

The accessibility to institutional credit is higher in the Southern region where the level of agricultural development is also higher. Similar results were reported in the studies conducted earlier during the 1980s (Rao, 1994). It is kind of vicious cycle operating in less developed States. Less availability of credit influences adversely the adoption of modern technology and private capital investments, which in turn lowers the productive capacity of the agricultural sector and results in lower productivity and production, and also pushes the farmers to borrow from non-institutional sources. Consequently, the demand for agricultural credit for short and long-term purposes is dampened.

The extent of deployment of credit out of deposits in a given State could be measured by Credit-Deposit Ratio (CDR). The proportion of districts having CDR less than 40 is higher (66 per cent) in less developed States as compared to the developed States (32 per cent) indicating growing migration and wide disparities in the deployment of credit in major States (Table 5).

During Tenth Five Year Plan, the total credit flow to agriculture and allied activities was projected at Rs.7,36,570 crore. Accordingly, the ground level credit flow to agriculture has grown to reach over Rs.2,60,540 crore (36 per cent of the projected level) during the first three year period (2002-03 to 2004-05) of Tenth Plan, indicating a wide gap in supply of credit, requiring a large increase in credit, particularly in investment credit to achieve the desired growth level.

Table 5: Credit Deposit Ratio in Major States

(Rupees crore)

Description	Number of States	Number of Districts	<40	40-50	>50
1	2	3	4	5	6
States with per capita SDP less than national average	9	196 (100)	129 (66)	26 (13)	41 (21)
States with per capita SDP more than national average	11	187 (100)	60 (32)	33 (18)	94 (50)
Total	20	383 (100)	189 (50)	59 (15)	134 (35)

Figures in the brackets represent percentages. Credit is taken on utilization basis.

Source : Report of the Expert Group on Investment Credit, RBI, 2005.

Section III

Recent Policy Initiatives

The Finance Minister in his Union Budget 1995-96 speech stated that, “Inadequacy of public investment in agriculture is today a matter of general concern. This is an area which is the responsibility of States. But many States have neglected investment in infrastructure for agriculture. There are many rural infrastructure projects which have been started but are lying incomplete for want of resources. They represent a major loss of potential income and employment to rural population.”

Rural Infrastructure Development Fund (RIDF) was set up in NABARD². Since then, 11 tranches of allocations have been made towards the Fund. Commercial banks make contributions towards the Fund on account of the shortfalls in their priority/agriculture sector lending. The scope of RIDF has been widened to enable utilisation of loan by Panchayati Raj Institutions (PRIs), Self-Help Groups (SHGs), Non-Government Organisations (NGOs), *etc.*, since 1999-2000.

The Fund has continued with additional corpus being announced every year in the Union Budget. The RIDF XI was announced in the Union Budget for 2005-06 with an allocation of Rs.8,000 crore making a total corpus of Rs.50,000 crore. RIDF XI accorded special emphasis for setting up of Village Knowledge Centres by providing Rs.100 crore out of the corpus of Rs.8,000 crore (Table 6).

Two innovations, *viz.*, micro-finance and Kisan Credit Card Scheme (KCCS) have emerged as the major policy developments in addressing the infirmities associated with the distributional aspects of credit in the recent years. The KCCS has emerged as the most effective mode of credit delivery to agriculture in terms of the timeliness, hassle-free operations as also adequacy of credit with minimum of transaction costs and documentation.

Around 59.09 million KCCs were issued till end-March 2006. The cooperative banks (51.5 per cent) had a major share followed

Table 6: RIDF: Tranche-wise Size of Corpus

(Rs. crore)

RIDF Tranche	Year	Corpus
1	2	3
RIDF I	1995-1996	2,000
RIDF II	1996-1997	2,500
RIDF III	1997-1998	2,500
RIDF IV	1998-1999	3,000
RIDF V	1999-2000	3,500
RIDF VI	2000-2001	4,500
RIDF VII	2001-2002	5,000
RIDF VIII	2002-2003	5,500
RIDF IX	2003-2004	5,500
RIDF X	2004-2005	8,000
RIDF XI	2005-2006	8,000
TOTAL	—	50,000

Source : NABARD.

by commercial banks (36.9 per cent) and RRBs (11.6 per cent) (Table 7).

The micro credit programme, which was formally heralded in 1992 with a modest pilot project of linking around 500 SHGs has made rapid strides in India exhibiting considerable democratic

Table 7: Agency-wise and Year-wise KCC

(Numbers in Millions)

Year	Co-operative Banks	RRB's	Commercial Banks	Total
1	2	3	4	5
1998-99	0.16	0.01	0.62	0.78
1999-2000	3.6	0.17	1.37	5.13
2000-01	5.61	0.65	2.39	8.65
2001-02	5.44	0.83	3.07	9.34
2002-03	4.58	0.96	2.7	8.24
2003-04	4.88	1.27	3.09	9.25
2004-05	3.56	1.73	4.4	9.68
2005-06	2.60	1.25	4.17	8.01
Total	30.41	6.88	21.80	59.09
Share in Total (per cent)	51.5	11.6	36.9	100.0

Source : Report on Trend and Progress of Banking in India, RBI.

functioning and group dynamism. The programme has now assumed the form of a micro finance movement in many parts of the country.

There was a massive expansion during 2004-05 with the banking system establishing credit linkage with 539 thousands new SHGs, taking the cumulative number of such SHGs to 2.9 million at end-March 2007. Banks extended loans aggregating Rs.18,041 crore at end-March 2007 registering a growth of 58.3 per cent over the previous year (Table 8).

Several Committees were set up from time to time to look into the various issues relating to credit delivery for agriculture, the recent one being Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System (Chairman: Prof. V.S. Vyas, June, 2004)³.

Table 8: SHG-Bank Linkage Programme

Year	Total SHGs Financed by Banks Number in '000		Bank Loans (Rs. crore)		Refinance (Rs. crore)	
	During the Year	Cumulative	During the Year	Cumulative	During the Year	Cumulative
1	2	3	4	5	6	7
1999-00	81.78 (147.9)	114.78 (247.9)	136 (138.6)	193 (238.6)	98 (88.5)	150 (188.5)
2000-01	149.05 (82.3)	263.83 (129.9)	288 (111.8)	481 (149.2)	251 (156.1)	401 (167.3)
2001-02	197.65 (32.6)	461.48 (74.9)	546 (89.6)	1,026 (113.3)	396 (57.8)	797 (98.8)
2002-03	255.88 (29.5)	717.36 (55.4)	1,022 (87.2)	2,049 (99.7)	622 (57.1)	1,419 (78.0)
2003-04	361.73 (41.4)	1079.09 (50.4)	1,856 (81.6)	3,904 (90.5)	705 (13.3)	2,125 (49.7)
2004-05	539.39 (49.1)	1,618.48 (50.0)	2,994 (61.4)	6,899 (76.7)	968 (37.3)	3,092 (45.5)
2005-06	620 (15.0)	2,239 (38.3)	4,449 (50.3)	11,398 (65.2)	1,068 (10.3)	4,160 (34.5)
2006-07	686 (11.0)	2,924 (30.6)	6,643 (47.6)	18,041 (58.3)	1,299 (21.6)	5,459 (31.2)

Notes : 1. Figures in parentheses indicate percentage variations over the previous year.

2. Data for 2006-07 are provisional.

Source : Report on Trend and Progress of Banking in India, various issues.

The Government has since approved rehabilitation package for the identified districts in the States of Andhra Pradesh, Karnataka, Kerala, and Maharashtra. Altogether, the rehabilitation package for the four States involves a total amount of Rs.16,978 crore consisting of Rs.10,579 crore as subsidy/grants and Rs.6,399 crore as loan.

In order to give further fillip to micro-finance movement, the RBI has enabled Non-Governmental Organisations (NGOs) engaged in micro-finance activities to access external commercial borrowings (ECBs) up to US \$ 5 million during a financial year for permitted end-use, under automatic route, as an additional channel of resource mobilisation. Besides, as a follow-up of the Union Budget proposals, modalities for allowing banks to adopt the agency model⁴ for providing credit support to rural and farm sectors and appointment of micro-finance institutions (MFIs) as banking correspondents are also worked out.

The Government of India announced a host of measures in June 2004 to double the flow of agricultural credit during the period 2004-05 to 2006-07 by all the financial institutions. Towards this end, it was proposed to increase the agricultural credit by 30 per cent to about Rs.1.05 lakh crore in 2004-05. While the target set for 2004-05 was achieved, the Union Budget for 2005-06 proposed to increase the credit flow to agriculture by another 30 per cent by all the institutions concerned.

The Reserve Bank has undertaken several policy initiatives in pursuance of the objective set in the Union Budget 2004-05 to achieve a doubling of flow of credit to agriculture. On the issue of farmers' suicide in the country, the Government has realised that indebtedness is one of the major reasons for suicide by farmers in the country. To prevent and save the farmers from the clutches of private money lenders, several measures were taken. Banks were advised in particular :

- i) To increase the agricultural credit flow at the rate of 30 per cent per year.
- ii) To restructure the outstanding debt of the farmers under the following heads in accordance with the guidelines issued by RBI/NABARD:

- Farmers in distress – Rescheduling/restructuring of the outstanding loan of the farmers as on March 31, 2004 in the districts declared as calamity – affected by the State Government. Rescheduled loan shall be repayable over a period of five years, at current interest rates, including an initial moratorium of two years.
 - Farmers in arrears - Loans in default of farmers who have become ineligible for fresh credit as their earlier debts have been categorised as sub-standard or doubtful shall be rescheduled as per the guidelines so that such farmers become eligible for fresh credit.
- iii) To grant a one-time settlement (OTS) including partial waiver of interest or loan to the small and marginal farmers who have been declared as defaulters and have become ineligible for fresh credit. Banks have also been advised to review cases where credit has been denied on the sole ground that a loan account was settled through compromise or write offs.
- iv) In some parts of the country, farmers face acute distress because of the heavy burden of debt from non-institutional lenders (*e.g.*, moneylenders). Banks have been permitted to advance loans to such farmers to provide them relief from indebtedness.
- v) All the Public Sector banks have been advised to reduce their lending rate for agriculture to a single digit rate of not more than 9 per cent per annum on crop loans upto a ceiling of Rs.50,000. This rate will benefit most of the crop loan account holders and will cover almost all the small and marginal farmers.
- vi) To waive margin/security requirements for agricultural loans up to Rs.50,000 and agri-business and agri-clinics up to Rs.5 lakhs.

With a view to further increasing the flow of credit to agriculture, several measures were announced by RBI in its Annual Policy Statement 2005-06. These include i) setting up of an Expert Group to formulate strategy for increasing investment in agriculture, ii) conducting a survey with the help of an outside agency to make an assessment of customer satisfaction on credit delivery in rural areas by banks, iii) to increase the

limit on loans to farmers through the produce marketing scheme from Rs.5 lakh to Rs.10 lakh under priority sector lending.

Special Rehabilitation Package for the Districts Severely Affected by Farmers' Suicide

The incidents of suicide by farmers have been mainly reported from the States of Andhra Pradesh, Karnataka, Maharashtra, and Kerala. Such incidents have also been reported from the States of Orissa, Gujarat, and Punjab. To mitigate the distress of farmers, the Government of India decided to launch a special rehabilitation package in 31 Districts in the States of Maharashtra, Andhra Pradesh, Karnataka, and Kerala. The 31 Districts⁵ were identified based on the severity and magnitude of the incidence of farmers' suicide, as reported by the State Governments. The intent is to initially solve the problem and correct the situation in those areas reporting high number of suicides so that an effective dent on the problem is made and the incidence of farmers' suicide which is of national concern could be curbed.

The package aims at establishing a sustainable and viable farming and livelihood support system through debt relief to farmers, improved supply of institutional credit, crop-centric approach to agriculture, assured irrigation facilities, watershed management, better extension and farming support services, improved marketing facilities and subsidiary income opportunities through horticulture, livestock, dairying, fisheries. For alleviating the hardships caused to debt stressed families of farmers in the affected districts, ex-gratia assistance from Prime Minister's National Relief Fund (PMNRF) was also proposed.

Section IV

Issues and Concerns

Despite the significant strides achieved in terms of spread, network and outreach of rural financial institutions, the quantum of flow of financial resources to agriculture continues to be inadequate. One of the major impediments constraining the adoption of new technological practices, land improvements and building up of

irrigation and marketing infrastructure has been the inadequacy of farm investment capital. Farmers seem to borrow more short-term credit in order to meet input needs to maintain continuity in agricultural operations without much worrying about long-term capital formation in the face of agricultural bountiness. It might be the case from supply side that short-term credit bears low credit risk, lower supervision and monitoring costs, and a better asset liability management.

The flow of investment credit to agriculture is constrained by host of factors such as high transaction costs, structural deficiencies in the rural credit delivery system, issues relating to credit worthiness, lack of collaterals in view of low asset base of farmers, low volume of loans with associated higher risks, high man power requirements, *etc.*

The large proportion of population in the lower strata, which is having major share in the land holdings receives much less credit than its requirements. The growing disparities between marginal, small and large farmers continues to be a cause for concern. This observed phenomenon may be attributed, *inter alia*, to the “risk aversion” tendency of the bankers towards small and marginal farmers as against the large farmers, who are better placed in offering collaterals.

Notwithstanding the rapid spread of micro-finance programme, the distribution of SHGs is skewed across the States. More than 50 per cent of the total SHG credit linkages in the country are concentrated in the Southern States. In the States, which have a larger share of the poor, the coverage is comparatively low.

The tragic incidents of farmers’ suicides in some of the States have been a matter of serious concern. A study⁶ was conducted in some regions of Andhra Pradesh to go into the causes of such tragedies and to suggest short and long term measures to prevent such unfortunate incidents. The study has identified crop losses, consecutive failure of monsoon, recurrent droughts, mounting debts, mono-cropping, land tenancy, as some of the main causes which led many distressed farmers to commit suicide. Of the total number of suicide cases reported, 76 per cent of the victims were dependent on rain-fed agriculture and 78 per cent were small and marginal farmers. An important finding of the study was that 76 to 82 per cent of the

victim households had borrowed from non-institutional sources and the interest rates charged on such debts ranged from 24 to 36 per cent. The study has recommended several measures to tackle the situation. These include improvement irrigation coverage; crop diversification; promotion of animal husbandry as an alternate source of income; better accessibility to institutional credit and overall improvement of the marketing infrastructure.

Section V

Implications for the Future

Indian agriculture still suffers from: i) poor productivity, ii) falling water levels, iii) expensive credit, iv) a distorted market, v) many intermediaries who increase cost but do not add much value, vi) laws that stifle private investment, vii) controlled prices, viii) poor infrastructure, and ix) inappropriate research. Thus the supply leading approach with mere emphasis on credit in isolation from the above factors will not help agriculture to attain the desired growth levels. Furthermore, agriculture being a State subject, States are required to play a more pro-active role in agriculture development by putting in place adequate infrastructure through means such as RIDF.

As noted above, the share of marginal and small farmers in the total credit (both disbursed and outstanding) has been shrinking. The need to augment the credit flow to the lower strata of the farming community, which has more share in the total operational land holdings becomes all the more important.

This underscores the scope for supplementing the land inputs of marginal and small farmers with the non-land inputs such as credit with a view to enhancing the productivity and thereby the production performance of Indian agriculture. In this context, the need for linking credit supply to input use assumes importance. There is also a need for exploring new innovations in product design and methods of delivery, through better use of technology and related processes. It needs to be seen whether credit going to farmers especially small and marginal is in sufficient quantity and if so whether it will have

any meaningful effect in the absence of other supportive measures for ensuring their economic viability. In this context, creation of production and employment opportunities in the rural sector through public investment assumes critical importance. The SHG-Bank Linkage model is an outstanding example of an innovation leveraging on community-based structures and existing banking institutions.

In future, concerted efforts have to be made for enhancing the flow of credit to critical infrastructure areas such as irrigation, marketing and storage, *etc.*, and also to areas such as watershed/wasteland development, wind energy, allied activities such as poultry, horticulture, dairying, *etc.*

With regard to KCCS, there is a need to upscale its outreach to cover all the eligible farmers by creating greater awareness and giving greater publicity to the scheme. Updation of land records and sensitisation of bank staff through training programmes will further add to the spread of the scheme. The exercise of preparing special agricultural credit plans with higher component of direct finance with a special thrust on small and marginal farmers should also receive high priority.

The success of KCC scheme depends on less stipulated norms. High value agriculture needs higher working capital and also entails higher risks. Facilitating credit through processors, input dealers, NGOs, that are vertically integrated with the farmers, including through contract farming, for providing them critical inputs or processing their produce, could increase the credit flow to agriculture significantly.

Section VI

Concluding Observations

The co-operative credit structure needs revamping to improve the efficiency of the credit delivery system in rural areas. In case of co-operatives, the Vaidyanathan Committee concluded that having regard to its outreach and potential, recapitalisation could be undertaken so that the credit channels for agricultural credit which

are presently choked could be declogged. The Committee has, however, made it clear that recapitalisation should only be considered if it is preceded by legal and institutional reforms by State Governments aimed at making co-operatives democratic and vibrant institutions running as per sound business practices, governance standards and regulated at the upper tiers by the RBI. In this connection, it may be suggested that the State Governments' performance in bringing about the reforms in co-operative banks should form one of the yardsticks for sanctioning assistance/grants by the Central Government.

The competition and search for higher returns has made commercial banks to explore profitable avenues and activities for lending such as financing of contract farming, extending credit to the value chain, financing traders and other intermediaries, which needs to be encouraged. While the institutional systems and products such as futures markets, and weather insurance have great potential to minimise the risk of lending, the process of their development needs to be carried forward.

Merging and revamping of RRBs that are predominantly located in tribal/backward regions is seen as a potentially significant institutional arrangement for financing the hitherto unreached population. Such an exercise is currently on and the State Governments and Sponsor Banks have to come together and cooperate in this area. The experience of micro finance proved that the "poor are bankable" and they can and do save in a variety of ways and the creative harnessing of such savings is a key success factor. The SHG-Bank linkage programme is built upon the existing banking infrastructure, it has obviated the need for the creation of a new institutional set-up or introduction of a separate legal and regulatory framework. Policy making bodies have an important role in creating the enabling environment and putting appropriate policies and interventions in position, which enable rapid up scaling of efforts consistent with prudential practices.

There is also a need to explore the possibility how SHGs can be induced to graduate into matured levels of enterprise. The SHG Bank-Linkage programme also needs to introspect whether it is sufficient

for SHGs to only meet the financial needs of their members, or whether there is a further obligation on their part to meet the non-financial requirements necessary for setting up business and enterprises. In the process, ensuring the quality of SHGs warrants priority attention. State Governments have to make critical assessment of the manpower and skill sets available with them for forming, and nurturing groups and handholding and maintaining them over time. There is a need to study the best practices in the area and evolve a policy by learning from them. Since, the access of small and marginal farmers to credit has been constrained by their inability to offer the collaterals, micro finance, which works on social collaterals, can go a long way in catering to their requirements. Hence, there is need to promote micro finance more vigorously on a widespread basis.

To conclude, an assesment of agriculture credit situation brings out the fact that the credit delivery to the agriculture sector continues to be inadequate. It appears that the banking system is still hesitant on various grounds to purvey credit to small and marginal farmers. The situation calls for concerted efforts to augment the flow of credit to agriculture, alongside exploring new innovations in product design and methods of delivery, through better use of technology and related processes.

Notes

- ¹ 1990s referred wherever covers the period from 1990-91 to 2001-02, the latest year for which the data are available.
- ² RIDF was setup under the initiative of the Government of India in 1995-96 with an initial corpus of Rs.2,000 crore to provide loans to State Governments for financing rural infrastructure projects.
- ³ 32 recommendations (out of 99 recommendations made by the Committee) have been accepted and implemented by the Reserve Bank. The major recommendations are i) A comprehensive review of mandatory lending to agriculture by commercial banks to enlarge direct lending programmes for greater integration of investment credit and production credit. ii) A road map for public sector and private sector banks to reach a level of direct lending at 13.5 per cent of net bank credit-within the overall limit of 18.0 per cent of total agricultural

lending -within a period of four years with an interim target of 12 per cent in two years. Special Agricultural Credit Plan (SACP) to be restricted to direct lending and extended to private sector banks. iii) The share of small and marginal farmers in agricultural credit to be raised to 40 per cent of disbursements under the Special Agricultural Credit Plan (SACP) by the end of the Tenth Plan period. iv) Expanding the outreach of banks in rural areas by enlarging retail lending to agriculture, externalising retailing through corporate dealer networks, organisational innovations, offering hedging mechanisms to the farmers, providing legal backing to tenancy to facilitate access to credit, capacity building of borrowers, greater use of information technology, procedural simplifications and modifications in the service area approach. v) Reductions in cost of agricultural credit through enhancing the cost effectiveness of agricultural loans, especially in terms of cost of raising funds, transaction cost and risk cost. vii) Impediments to the flow of credit to disadvantaged borrowers to be mitigated through reduction in cost of borrowing, revolving credit packages, procedural simplifications, involvement of Panchayati Raj institutions and extension of micro finance.

- ⁴ In agency model, banks adopt the infrastructure of civil society organisation, rural kiosks and village knowledge centres to provide credit support to rural and farm sector
- ⁵ Maharashtra (6): Akola, Wardha, Amaravati, Buldhana, Washim, and Yawatmal. Karnataka (6): Belgaum, Hasan, Chitradurga, Chikmagalur, Kodagu, and Shimoga. Kerala (3) : Wayanad, Palakkad, and Kasargod. Andhra Pradesh (16) : Prakasam, Guntur, Nellore, Kadapa, Chittoor, Ananthapur, Kurnool, Adilabad, Karimnagar, Khammam, Mahabubnagar, Medak, Nalgonda, Nizamabad, Ranga Reddy, and Warangal.
- ⁶ As per the information available in a speech delivered by the Union Minister of Agriculture at the National Development Council, New Delhi on June 27, 2005.

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A Comparative Study on Private Consumption Expenditure Estimates in India

Joice John*

The estimates of private consumption expenditure are generated in India by two agencies, *viz.* Central Statistical Organisation (CSO) and National Sample Survey Organisation (NSSO). CSO estimates in National Account Statistics (NAS) are obtained using commodity flow approach, while NSSO estimates are based on Household Consumption Expenditure Surveys (HCES). The studies comparing two sets of estimates done earlier revealed that the gap between the two sets of estimates was widening over time. The present study is an exploration into the group level differences among the estimates and their contribution to the overall differences in the years 1972-73, 1977-78, 1983-84 and 1993-94, based on the earlier conducted studies. In 1972-73 and 1977-78 the major groups, which showed the difference, include 'food grains', 'fuel and light' 'sugar and gur', 'fruits and vegetables' 'transport' and 'recreation education and cultural services'. In 1993-94 the major contributors towards the divergence between the estimates of expenditure were 'fruits and vegetables', 'transport' and 'clothing and foot wear'. The important factors, which lead to the divergence, include the differential implicit prices of the consumer goods, varied reference periods, differences in the classification schemes, differences in the estimation procedure followed by two agencies, inclusion of notional elements in NAS estimate and possible discrepancy in the official and directly reported information.

JEL Classification : E01, E21

Keywords : Consumption, National Accounts Statistics, Household Consumption Expenditure Survey

Introduction

In India, the private consumption expenditure is mainly estimated by the two Government organizations, *viz.*, Central Statistical Organisation (CSO) and National Sample Survey Organisation

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(NSSO), following two entirely different methodologies. The estimates of Private Final Consumption Expenditure (PFCE) are compiled annually as apart of the National Account Statistics (NAS) by CSO using commodity flow approach. This approach makes use of the estimates of quantum and value of different commodities produced and available, flowing finally into the consumption process of houses and the private Non-Profit Institution Serving Household (NPISH) during the accounting year, which is generally the financial year. The sum of the commodity-wise estimates gives the aggregate estimates of the PFCE. On the other hand, NSSO estimates are based on Household Consumption Expenditure Surveys (HCES), which are conducted in every five years with a much larger sample and annually with a relatively thin sample. In this sample survey, the consumption expenditure of a random sample of households is ascertained directly by canvassing a well-designed schedule of enquiry. Even though HCES directly does not provide the countrywide total consumption expenditure, the NSSO estimate of total household consumption expenditure of the domestic economy can be obtained as the product of estimates of annual per capita consumption expenditure and the population projections based on the population census.

Traditionally private consumption expenditure estimated by the two agencies differed. Factors attributed to the differences include coverage, reference time frames and concepts and methods of estimation in the very approaches employed by the two agencies. In the past, several attempts were made to compare the two sets of estimates. The studies comparing estimates in the disaggregate level - Minhas *et. al.*, (1986) and Minhas (1988; with 1972-73 and 1977-78 estimates), Minhas *et. al.*, (1990; with the estimates of 1983) and NSSO-CSO (2005; with estimates of 1993-94) - revealed that the gap between the two sets of estimates was widening over time. The study by Sundaram and Tendulkar (2001) also strengthened the results from the above-mentioned articles. The present paper is a survey to explore into the widening gap of these estimates at group level based on the studies by Minhas *et. al.* (1986), Minhas (1988), Minhas *et. al.* (1990) and NSSO-CSO (2005).

The paper is organised as follows. Section I presents the details of the methodological differences at the aggregate level. Item-group level differences of the selected common items are worked out and presented in Section II across four time points, *viz.*, 1972-73, 1977-78, 1983-84 and 1993-94 and analyzed in detail. Concluding remarks are presented in Section III.

Section I

Methodological Differences at the Aggregate Level

Minhas (1988) had done a comprehensive analysis of the limitations in comparing the two estimates. NSSO-CSO (2005) also discussed the matter in a detailed manner. Discussed below is a brief description of the differences in coverage, time periods, and concepts and estimation procedure adopted by two organisations in reaching their respective estimates of consumption expenditure.

Coverage

The HCES of NSSO excludes the houseless and the institutional population while the consumption of these persons is included in the NAS estimates. Also included in the NAS estimates is the consumption expenditure of non-profit institutions serving households (NPISH), which are not covered in HCES. This limitation is virtually of no consequence as proportion of houseless and institutional population in the total population is negligibly small. The share of NPISHs in the estimate of PFCE, owing to absence of data, are also believed to be small (NSSO-CSO, 2005).

Time Period

For HCES, the NSSO normally uses an agriculture year as the survey period. The NAS estimates, on the other hand, are compiled for the financial year. The data on the agricultural production used for national accounting, however, pertain to the agriculture year. The comparability will not be seriously affected by this factor, if the output of food crops of two successive years doesn't differ much. Otherwise, the magnitude of

discrepancy accounted for the difference in the time frames of NAS and NSSO estimates are to be assessed (Minhas *et. al.*, 1986).

Estimation Procedure

The NSSO collects the detailed item-wise consumption data in quantity and value terms for the last 30 days (365 days for durable items) from sample households by interviewing the head of the household. The survey period usually is divided into four sub rounds of 3 months duration each, to overcome the seasonal effects. The CSO consumption estimates are based on the production data of various consumer goods and services, which are compiled basically for the net domestic product for India. These are adjusted for exports and imports, intermediate services and changes in stock, to arrive at the availability of various goods and services for final consumption.

Inclusion of Notional Elements

Among the differences, the notional components in the NAS estimate, however, accounts for a substantial part of the divergence between the two estimates. Only the rent on dwellings actually paid is included in the NSSO estimate, while the NAS estimate includes all imputed rentals of owner-occupied dwellings. Other such notional component in the NAS estimate is the Financial Intermediation Services Indirectly Measured (FISIM). This is being included in PFCE since the 1980-81 series of national accounts.

Official Records versus Directly Reported Consumption

The NAS consumption estimates for various consumer goods are based on the official data of production, exports and imports, which lead to deliberate under recording of production of certain items. On the other hand, consumers are likely to report the purchases of all such items irrespective of whether or not their production was entered into records of the enterprise (Minhas, 1988).

Unmatched Classification Schemes

There are many differences in the classification scheme of the two data sets. As discussed in the subsequent section, it can be seen

that these differences are significant. Some of the differences cited in Minhas (1988) and also the NSSO-CSO (2005) are mentioned below.

Prior to 1980-81 series of NAS, the expenditure on hotels and restaurants was classified under non-food consumer services, while it was included in the food group in the NSSO estimate. Since 1980-81 it was included in food group for NAS estimates also. In NAS estimates, rice retained by farmers are put entirely under rice consumption, whether or not part of it are converted into rice products. But in the NSSO estimate, rice products are not included in estimates of rice. Expenditure on purchase and repairs of transport and equipment is classified as durables in NSSO estimates, while it is included in the transport group in PFCE. The expenditure on cooked food given to domestic servants is included under food group in the NSSO. In the NAS, on the other hand, all payments given to the domestic help are taken as expenses incurred for consumption of personal expenses.

Section II

Item-Group Level Differences of the Selected Common Items

Before examining the differences at micro level, let briefly elaborate the trend of aggregate differences. As per Table 1, quoted from the studies undertaken earlier, it can be noted that the gap between the two sets of estimates had been widening progressively. For example, 5.5 per cent difference in 1972-73 increased to 10.4 per cent in 1977-78; which further went up to 25.6 per cent and 38.1 per cent, respectively in 1983-84 and 1993-94. That is within a period of two decades the per cent difference increased almost seven fold. A divergence to this extent is indeed beyond expectations, taking into account that the NSSO estimates are based on quinquennial surveys and conducted on a larger sample.

Examination of subgroup level differences and their contribution to overall differences, based on the studies mentioned earlier is fraught with some difficulties due to the grouping of the items under different heads. Minhas (1988) has aggregated the

Table 1: Divergence between NSSO and NAS estimates (Rs. crore)

Year	Source	Total Expenditure
1	2	3
1972-73	NSSO	33210
	NAS	35160
	Per cent difference	-5.5
1977-78	NSSO	56530
	NAS	63080
	Per cent difference	-10.4
1983 -84	NSSO	108668
	NAS	146084
	Per cent difference	-25.6
1993-94	NSSO	355770
	NAS	574772
	Per cent difference	-38.1

Per cent difference = (NSSO-NAS)/NAS expressed in percentage.

Source : NSSO-CSO (2005).

expenditure into nine broad groups under food and non-food categories. In NSSO-CSO (2005), there are 18 groups under food while the non-food category contains 10 groups. One of the major differences in the classification schemes followed by Minhas, *et. al.* (1986) and NSSO-CSO (2005) is that, the latter classifies pan, tobacco and beverages under food while Minhas, *et. al.* (1986) classifies it under non-food. However, for the present study, only those groups that contributed significantly towards the divergence in the estimates of total consumption expenditure are included.

Food Grains

The NSSO estimate of expenditure on food grains was considerably higher than NAS in 1972-73. The difference decreased in 1977-78. In 1983-84, the NAS estimate was found to be higher and the difference increased further in 1993-94.

As per Table 2, the per cent contribution of food grain consumption expenditure to the total consumption expenditure was declining over the years for both NSSO and NAS estimates. This reflected the changing pattern of food grain consumption in the overall

consumption basket of the people, as against the increase in per capita income. In 1972-73, the difference in the NSSO and NAS estimates of food grain consumption expenditure was -1.6 times than that of the difference of total consumption expenditure. In other words, the actual difference in the estimates of food grain consumption expenditure was more than that of the difference in the total consumption expenditure. The negative sign indicates that, when in total consumption expenditure, NAS estimate was more than NSSO estimate, the food grain consumption estimate was more in NSSO. The contribution of the difference in NSSO and NAS estimates of food grain consumption expenditure to the total consumption expenditure was 2.1 per cent in 1993-94. As argued by Minhas (1988), it is apprehended that adjustments for seeds, feeds wastages and other assumptions about certain ratios in NAS framework may had lead to systematic under estimation of private consumption of food grains in the CSO data set in 1972-73 and 1977-78. Since the subgroup of cereals and pulses have major shares in total consumption expenditure, it is necessary to undertake a comparison for cereals and pulses consumption.

Table 2: Difference² in the food grain consumption expenditure in NSSO and NAS estimates

Year	Per cent difference of NSSO and NAS estimates@	Per cent contribution of food grain expenditure (NSSO) to total (NSSO)#	Per cent contribution of food grain expenditure (NAS) to total (NAS)\$	Per cent contribution of the food grain difference in expenditure to total difference*
1	2	3	4	5
1972-73	29.5	40.4	29.5	-156.7
1977-78	9.9	34.1	27.8	-26.6
1983-84	-1.0	31.5	23.7	0.9
1993-94	-5.0	24.2	15.7	2.1

² @ Per cent difference = $(\text{NSSO}-\text{NAS})/\text{NAS}$, expressed in percentage.

Per cent contribution NSSO = $\text{NSSO}_{\text{sub group}}/\text{NSSO}$, expressed in percentage.

\$ Per cent contribution NAS = $\text{NAS}_{\text{sub group}}/\text{NAS}$, expressed in percentage.

* Per cent contribution difference = $(\text{NSSO}_{\text{sub group}} - \text{NAS}_{\text{sub group}})/(\text{NSSO}-\text{NAS})$, expressed in percentage.

The similar notion is followed in all other Tables.

Cereals and Pulses

Table 3 gives a comparison of NSSO and NAS estimates of consumption expenditure of cereals. It also provides the per cent contribution of the difference in the cereals consumption expenditure, to the difference in total consumption expenditure estimated by NSSO and NAS.

The NSSO estimate for the cereals consumption expenditure was more than NAS estimate in 1972-73, 1977-78 and 1983-84, but it got reversed in 1993-94. Also the per cent contribution of cereals consumption expenditure to the total consumption expenditure was declining over the years for both NSSO and NAS estimates. In 1972-73 the difference in the NSSO and NAS estimates of cereals consumption expenditure was –1.3 times than that of the difference in the total consumption expenditure, which means that the actual difference in the estimates of cereals consumption expenditure was more than that of total consumption expenditure. The NAS estimates of the cereals was naturally on the lower side owing the exclusion of other rice products from the NAS estimates. The contribution to the difference in NSSO and NAS estimates of cereals consumption expenditure to the difference in total consumption expenditure was only 2.5 per cent in 1993-94.

In contrast to cereals, the contribution of pulses to total consumption expenditure had not witnessed any remarkable change

Table 3: Difference in the cereals consumption expenditure in NSSO and NAS estimates

Year	Per cent difference of NSSO and NAS estimates	Per cent contribution of subgroup expenditure (NSSO) to total (NSSO)	Per cent contribution of subgroup expenditure (NAS) to total (NAS)	Per cent contribution of the subgroup difference (NSSO-NAS) to total difference
1	2	3	4	5
1972-73	27.7	35.9	26.5	-132.3
1977-78	10.8	29.9	24.2	-25.2
1983-84	0.9	28.1	20.7	-0.8
1993-94	-7.1	20.3	13.5	2.5

even though it reduced marginally (Table 4). The per cent difference between the NSSO and NAS estimates had come down over the years. But it still had a difference of 26 per cent in 1993-94. Another noticeable feature is that, for pulses NSSO estimate was always more than that of NAS estimate. The higher value of the NSSO estimate for pulses was due to higher implicit price in NSSO estimate and downward bias of NAS value estimate (NSSO-CSO, 2005).

Sugar and Gur

This item-group had shown consistently significant difference between the two sets of estimates of consumption expenditure for all the years compared. Table 5 provides the details of the difference between the estimates of sugar and gur over the years.

The difference between the NSSO and NAS estimates of sugar and gur consumption expenditure was significantly on the higher side in all the four years. In 1972-73, 52.6 per cent of the difference shown in the total consumption expenditure was due to the difference in consumption expenditure on this item-group. Since then, the per cent contribution to the total difference had decreased significantly. This was due to the fact that the total difference in the consumption expenditure between the two estimates had widened considerably over the years. The major factors responsible for the inter-agency

Table 4: Difference in the pulses consumption expenditure in NSSO and NAS estimates

Year	Per cent difference of NSSO and NAS estimates	Per cent contribution of subgroup expenditure (NSSO) to total (NSSO)	Per cent contribution of subgroup expenditure (NAS) to total (NAS)	Per cent contribution of the subgroup difference (NSSO-NAS) to total difference
1	2	3	4	5
1972-73	55.0	3.8	2.3	-22.7
1977-78	38.9	3.5	2.2	-8.4
1983-84	30.9	3.1	1.7	-2.1
1993-94	26.4	3.3	1.6	-1.1

Table 5: Difference in the sugar and gur consumption expenditure in NSSO and NAS estimates

Year	Per cent difference of NSSO and NAS estimates	Per cent contribution of item-group expenditure (NSSO) to total (NSSO)	Per cent contribution of item-group expenditure (NAS) to total (NAS)	Per cent contribution of the item-group difference (NSSO-NAS) to total difference
1	2	3	4	5
1972-73	-45.4	3.7	6.4	52.6
1977-78	-38.3	2.7	3.9	14.5
1983-84	-54.2	2.7	4.4	9.4
1993-94	-49.9	2.8	3.5	4.5

difference in the estimate for the group as a whole, as per the earlier studies, were the low ratio of intermediate consumption of sugar and gur used for deriving the NAS estimates, under reporting of consumption of sugar and gur in HECS and over estimation of sugarcane production.

Milk

For milk and milk products consumption, it can be seen from Table 6 that the per cent difference between NSSO and NAS estimates was about 28 per cent in 1993-94, which was below 10 per cent in 1972-73 and 1977-78. In 1983-84 it was showing a difference of 35 per cent. The contribution of the difference in the estimates of milk and milk products consumption expenditure to the total difference was lowest at 1993-94 even though the actual difference was remarkably high (Table 6).

The difference in the estimates of consumption expenditure between two agencies was mainly due to the overestimation of consumption of milk products by CSO. One reason for this could be the assumption regarding the part of milk used for butter and lassi production. This could infact be used as intermediate consumption in enterprises producing commodities like tea and coffee, hotel and restaurant services and sweets shops, consumption of which were estimated separately in the NAS (NSSO-CSO, 2005).

Table 6: Difference in the milk and milk products consumption expenditure in NSSO and NAS estimates

Year	Per cent difference of NSSO and NAS estimates	Per cent contribution of item-group expenditure (NSSO) to total (NSSO)	Per cent Contribution of item-group expenditure (NAS) to total (NAS)	Per cent Contribution of the item-group difference (NSSO-NAS) to total difference
1	2	3	4	5
1972-73	-5.8	7.9	7.9	8.2
1977-78	-9.1	8.4	8.3	7.3
1983-84	-35.1	8.1	9.2	12.7
1993-94	-27.6	9.5	8.1	5.9

Edible Oils

Table 7 provides the details regarding the difference in the consumption expenditure of edible oils. The per cent difference in the estimates by two agencies was found to be widening. The contribution of this difference to the total difference, however, had come down to a level of 3.4 per cent in 1993-94.

For this item-group, the estimates of both quantity and price differed widely. The difference in the quantity consumed could be due to the consumption of vanaspati and edible oils used in hotels and restaurants, which were included in NAS consumption expenditure but excluded from NSSO estimate (NSSO-CSO, 2005).

Table 7: Difference in the edible oils consumption expenditure in NSSO and NAS estimates

Year	Per cent difference of NSSO and NAS estimates	Per cent contribution of item-group expenditure (NSSO) to total (NSSO)	Per cent Contribution of item-group expenditure (NAS) to total (NAS)	Per cent Contribution of the item-group difference (NSSO-NAS) to total difference
1	2	3	4	5
1972-73	-12.2	3.9	4.2	9.2
1977-78	-27.1	3.9	4.9	12.7
1983-84	-38.8	4.2	5.1	7.8
1993-94	-32.5	4.4	4.0	3.4

Fruits and Vegetables

The NSSO estimate on the consumption expenditure of this item-group was always found to be considerably lower than the corresponding NAS estimate. The per cent contribution of the difference in the estimates of this group was found to be very high in 1972-73 (64.7 per cent). Even though this value had declined, the difference between two sets of estimates had increased (Table 8).

The item specific estimates from the two sources reveal that the difference between the estimates for this group was mainly due to the diverging estimates of fruit consumption. Part of this big difference was due to classification problem. On one hand, NAS estimate of fruit consumption appeared to be on higher side, while on other hand NSSO estimate seemed to suffer from under estimation due to the non-inclusion of after purchase wastages in HECS. In the case of vegetables, not only the difference between the NSSO and NAS estimates were smaller but also the former was higher than latter in 1993-94 (NSSO-CSO, 2005).

Meat, Fish and Egg

This is another item-group for which the estimates for 1993-94 from the two sources vary widely. In 1972-73 and 1977-78 the differences between the two estimates as well as the contribution of the item-group difference to the total difference were negligible. In

Table 8: Difference in the fruits and vegetables consumption expenditure in NSSO and NAS estimates

Year	Per cent difference of NSSO and NAS estimates	Per cent Contribution of item-group expenditure (NSSO) to total (NSSO)	Per cent contribution of item-group expenditure (NAS) to total (NAS)	Per cent contribution of the item-group difference (NSSO-NAS) to total difference
1	2	3	4	5
1972-73	-40.8	5.5	8.8	64.7
1977-78	-41.5	5.7	8.8	35.0
1983-84	-36.3	6.3	7.4	10.4
1993-94	-57.6	8.1	11.8	17.9

1983-84 the per cent difference rose nearly to 27, which further increased to 45 per cent in 1993-94.

The item-wise analysis reveals that this high level of discrepancy in 1993-94 was mainly because of the differences in the items – ‘chicken’, ‘egg and egg product’ and ‘fish’. The main reason for discrepancy could be that the intermediate consumption for most of these items were taken as nil in NAS, particularly for eggs and chicken, while large volumes of these were actually used as input in the food processing industries, hotels and restaurants (NSSO-CSO 2005).

Tobacco

This is yet another item-group for which the NAS estimates had always been higher than NSSO estimates. The year-wise comparison, provided in Table 10, reveals that the estimates for this item-group were diverging further apart.

The NSSO estimates were likely to be on the lower side since the data collected through interviews were expected to be adversely affected by under reporting resulting from inhibitions against consumption of tobacco. Also the member from whom data was collected could be unaware about the tobacco consumption habits of the other members of the household (NSSO-CSO, 2005).

Table 9: Difference in the meat fish and egg consumption expenditure in NSSO and NAS estimates

Year	Per cent difference of NSSO and NAS estimates	Per cent contribution of item-group expenditure (NSSO) to total (NSSO)	Per cent contribution of item-group expenditure (NAS) to total (NAS)	Per cent contribution of the item-group difference (NSSO-NAS) to total difference
1	2	3	4	5
1972-73	-2.6	2.7	2.6	1.2
1977-78	-0.8	3.0	2.7	0.2
1983-84	-26.7	3.2	3.2	3.4
1993-94	-45.2	3.4	3.8	4.5

Table 10: Difference in the tobacco consumption expenditure in NSSO and NAS estimates

Year	Per cent difference of NSSO and NAS estimates	Per cent contribution of item-group expenditure (NSSO) to total (NSSO)	Per cent contribution of item-group expenditure (NAS) to total (NAS)	Per cent contribution of the item-group difference (NSSO-NAS) to total difference
1	2	3	4	5
1972-73	-45.2	1.9	3.2	25.9
1977-78	-34.8	1.8	2.4	8.1
1993-94	-52.3	1.7	2.1	2.9

Clothing and Footwear

The NSSO estimate of clothing and footwear had always been less than NAS estimate. In 1970s, the gap was low, but grew wider in the later periods to reach a per cent difference of 39 in 1993-94.

The difference between the two estimates in this item-group was mostly due to the difference in the clothing expenditure estimate, as it has the major share in this item-group.

Fuel and Light

For this item-group, the NSSO estimates of consumption expenditure were always high than that of NAS estimates as it is indicated by the sign of the values in the first column in Table 12.

Table 11: Difference in the clothing and foot wear consumption expenditure in NSSO and NAS estimates

Year	Per cent difference of NSSO and NAS estimates	Per cent contribution of item-group expenditure (NSSO) to total (NSSO)	Per cent contribution of item-group expenditure (NAS) to total (NAS)	Per cent contribution of the item-group difference (NSSO-NAS) to total difference
1	2	3	4	5
1972-73	-9.9	7.5	7.8	14.0
1977-78	-12.3	9.7	9.9	11.7
1983-84	-37.0	9.4	11.0	16.0
1993-94	-38.9	6.0	6.1	6.2

Table 12: Difference in the fuel and light consumption expenditure in NSSO and NAS estimates

Year	Per cent difference of NSSO and NAS estimates	Per cent contribution of item-group expenditure (NSSO) to total (NSSO)	Per cent contribution of item-group expenditure (NAS) to total (NAS)	Per cent contribution of the item-group difference (NSSO-NAS) to total difference
1	2	3	4	5
1972-73	48.6	5.4	3.5	-30.3
1977-78	61.8	6.1	3.4	-20.0
1983-84	31.9	7.1	4.0	-5.0
1993-94	14.7	6.9	3.7	-1.4

The gap between the two estimates and the group level contribution to the total difference as seen in Table 12, had progressively narrowed down from 62 per cent in 1977-78 to 15 per cent in 1992-93.

Out of the difference in the estimates for fuel and light, the item 'other fuel' - which includes firewood and chips - accounted for the major portion of the difference in all the years. Since 1980s, however, the per cent difference came down to a large extent. This was mainly because, from 1980-81 NAS consumption expenditure estimate on firewood was based on the consumption data available from HCES of the NSSO. The reason for the differences in the electricity, LPG and kerosene estimates was because of the fact that NAS estimates were obtained based on official data and thus represented the prices set by regulatory authorities and NSSO estimates were the prices actually paid by the consumers (NSSO-CSO, 2005).

Furniture, Furnishing, Appliances and Services

For 1993-94, the NAS estimate for this item-group was found to be substantially higher than the NSSO estimate. In 1972-73 and 1977-78 also, the NAS estimate of this group was higher than NSSO estimate, but the difference between the two was less pronounced (Table 13).

The subgroup 'glassware tableware and utensils' was the main contributor towards the item-group level divergence between two sets

Table 13: Difference in the furniture, furnishing, appliances and services consumption expenditure in NSSO and NAS estimates

Year	Per cent difference of NSSO and NAS estimates	Per cent contribution of item-group expenditure (NSSO) to total (NSSO)	Per cent contribution of item-group expenditure (NAS) to total (NAS)	Per cent contribution of the item-group difference (NSSO-NAS) to total difference
1	2	3	4	5
1972-73	-35.0	2.0	2.9	18.0
1977-78	-25.4	2.6	3.2	7.7
1993-94	-65.9	1.7	3.1	5.3

of estimates in 1993-94. In addition, the subgroup 'services' also contributed to the difference in the group. The differences in this subgroup could be because of the following reasons. The estimate of expenditure on non life insurance services, which was considered by NAS, but was not included in HCES. The cooked meals served to the domestic servants were not recorded as consumption of services in the HECS. The wages paid in cash to the full time domestic servants, whom NSSO surveys treat as household members were included in NAS estimate (NSSO-CSO, 2005).

Transport

This was the one item-group that contributed highest to the overall difference in the estimates in 1993-94. The difference between NSSO and NAS estimates for this group was as high as 74 per cent in 1993-94. Divergence between the estimates for this group had been high even in the past. Table 14 provides the details of the divergence in the estimates in different years. As evident from the table, the per cent difference as well as the per cent contribution to overall difference was very large for this group across the years compared.

Since 1972-73, the per cent difference between two sets was above 60. The item-wise analysis revealed that 'transport services' was one of the main contributors for the divergence between the estimates. The difference in the estimates of taxi and auto rickshaw fare was so different that the NSSO estimate was only about one-

Table 14: Difference in the transport consumption expenditure in NSSO and NAS estimates

Year	Per cent difference of NSSO and NAS estimates	Per cent contribution of item-group expenditure (NSSO) to total (NSSO)	Per cent contribution of item-group expenditure (NAS) to total (NAS)	Per cent contribution of the item-group difference (NSSO-NAS) to total difference
1	2	3	4	5
1972-73	-63.0	1.8	4.7	52.9
1977-78	-71.0	2.0	6.1	41.4
1983-84	-70.2	2.5	6.1	16.8
1993-94	-74.3	4.4	10.6	20.6

twentieth of the NAS estimate. In NAS, the estimate of transportation was based on the total passenger earnings for each mode and proportion of private consumption in total passenger earnings obtained from official sources. Reliability of these proportions could be a source of divergence in the estimates (NSSO-CSO, 2005). Another reason for the difference in the estimates is the possibility of the under estimation of the conveyance charges in HCES (Minhas 1988). Also the NSSO estimate excluded the expenses incurred for official and business purpose travels thus leaving aside the consumption of NPISHs. The item 'transport equipment and operational costs' also had a major share in the divergence in the transport group estimates. This item includes expenses for the purchase and repair of motor vehicles and parts, tyres and tubes, road tax and cost for petrol and diesel.

Recreation, Education and Cultural services

In all the years, for this item-group, the NAS estimates were found to be higher than NSSO estimates (Table 15).

The main contributor to the divergence between two agency estimates was 'education'. The NAS estimate covers the expenses of the NPISHs on education and related activities. Since NPISHs had fairly large share in educational activities, the NAS estimate was found to be higher than that of NSSO.

Table 15: Difference in the recreation, education and cultural services consumption expenditure in NSSO and NAS estimates

Year	Per cent difference of NSSO and NAS estimates	Per cent contribution of item-group expenditure (NSSO) to total (NSSO)	Per cent contribution of item-group expenditure (NAS) to total (NAS)	Per cent contribution of the item-group difference (NSSO-NAS) to total difference
1	2	3	4	5
1972-73	-57.0	1.8	4.0	41.0
1977-78	-37.6	2.3	3.3	12.0
1993-94	-33.0	3.3	3.1	2.7

In order to put the item-group level divergences together, Table 16 presents per cent difference between the two sets over two decades. Only those item-groups that have shown significant difference in the estimated figures are included in the table. It is observed that, almost all the item-group level estimates are showing a diverging trend. Few

Table 16: Item-group level per cent differences

Item-Group	1972-73	1977-78	1983-84	1993-94
1	2	3	4	5
Food Grain	29.5	9.9	-1.0	-5.0
Sugar and Gur	-45.4	-38.3	-54.2	-49.9
Milk and Milk products	-5.8	-9.1	-35.1	-27.6
Edible Oils	-12.2	-27.1	-38.8	-32.5
Fruits and Vegetables	-40.8	-41.5	-36.3	-57.6
Meat, Fish and Egg	-2.6	-0.8	-26.7	-45.2
Tobacco	-45.2	-34.8	NA	-52.3
Clothing and Foot wear	-9.9	-12.3	-37.0	-38.9
Fuel and Light	48.6	61.8	31.9	14.7
Furniture, Furnishing, Appliances and Services	-35.0	-25.4	NA	-65.9
Transport	-63.0	-71.0	-70.2	-74.3
Recreation, Education and Cultural services	-57.0	-37.6	NA	-33.0
Overall	-5.5	-10.4	-25.6	-38.1

Per cent difference = (NSSO-NAS)/NAS expressed in percentage.

exceptions include, food grain, fuel and light and recreation, education and cultural services.

Section III

Concluding Observations

The discrepancy in the estimates of total consumption expenditure for households provided by NAS and NSSO was found to be increasing rapidly during the period considered. The NAS estimates were found to be moving at a faster rate than that of NSSO estimates. In this paper an attempt is made to examine the factors responsible for the divergence between the two sets of estimates of consumption expenditure based on the different studies undertaken earlier.

Comparison of group-wise estimates of consumption expenditure for the years 1972-73, 1977-78, 1983-84 and 1993-94 of NAS and NSSO estimates presented in this paper looks into the change in the underlying factors responsible for the divergence between two sets of estimates. In 1972-73 and 1977-78 the major groups contributed to the divergence in the total consumption expenditure included 'sugar and gur', 'fruits and vegetables' 'transport' and 'recreation education and cultural services'. In all these subgroups NAS estimates were more than NSSO estimates by huge margins. In contrast, NSSO estimates of 'food grains' and 'fuel and light' were remarkably higher than NAS estimates. In the case of food grains the difference between the estimates was even higher than the total difference. In 1993-94 the major contributors towards the divergence between the estimates of expenditure were 'fruits and vegetables', 'transport' and 'clothing and footwear'. Besides, the important factors, which lead to the divergence as per the earlier studies include, the inclusion of notional elements like imputed rent and FISIM in NAS estimate, differential implicit prices of the consumer goods, varied reference periods (especially in 1972-73 and 1977-78), differences in the classification schemes, differences in the estimation procedure followed by two agencies and possible discrepancy in the official and directly reported information.

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**Creativity@Work_ – S. Ramachander 2006 – Publisher:
Response Books, (A Division of Sage Publications) New Delhi,
Pages 203 Price Rs 320**

Creativity@Work is a slim reasonably priced document (194 pages) and is a treasure of information. It is divided into 15 chapters and has 15 engaging illustrations, which draw out and encapsulate the written word. The book can serve as a guide to the creativity latent in all of us. It encourages the reader to see things differently, to look at the familiar from a new perspective, and to approach everyday situations without the screen of judgment and conditioning. The author's basic premise is that the roots of creativity lie within each of us, not outside. The way to discover these wellsprings is to remove mental blocks and leave the mind open to different perceptions to stimulate associative and divergent thinking. The book is an intellectual adventure.

Human resources are the only renewable resources in organizations but we regrettably still invest much less in building human capital. The book encourages the use of tools to stimulate creativity at work to optimize productivity and build innovative problem solving scenarios. It is about the use of creativity in leadership, teamwork and innovation. It recommends the use of color, laughter and freedom to enhance creativity at work. At its deepest level the book is about fundamental unlearning without which learning, be it personal or organizational is likely to be short-lived and deceptive. The author argues that to unlearn and let go old mental models is a concomitant of learning. It is not a separate act. Learning afresh is the secret of creating new options. Seeing with fresh eyes as if for the first time how the consumer buys where, when and why; in general terms, 'drinking in the reality' with no filters of the past whatsoever, determining 'what is' without pre-determined frameworks to fit the facts into (page 19-24).

Much managerial thinking, even when not numerical, is linear extrapolation. The reason is that, ultimately, all such tools work on the assumption that the future will be akin to the past. The author

argues that “because scientists look for explanations for everything and respect knowledge only if they can measure it, managers too fall in the same trap of thinking they practice exactly what is taught in B-school as management science”. This is a dangerous mental model for managers to adopt, even unconsciously. Reason being: their work, unlike that of physicists and engineers, is not in the realm of the inanimate. It involves dealing with heads and hearts of human beings – diverse, complex and changeable – as consumers, employees, managers and associates of the organization all around. The facile assumptions of the exact sciences can prove problematic when transferred to human resources, but this, alas, is an all-too-common error. In reality, not everything has a cast-iron solution or has an impregnable rationale, to adopt a heuristic approach saying, ‘Let’s try this and see if it works’ is not such a bad way to deal with many things in life. This is nothing to be ashamed of. It may well be the way to creative discovery, as Einstein said, of not knowing the right answer all the time but, of finding the right questions to ask.

Scenarios are alternative futures of what can happen. They can be built around external events in markets, around consumer behavior and institutions, as well as political and technological arenas. These are a sound basis for new product and new business creation. The methods of market research must change in keeping with this new, more open, tentative and experimental approach to the manager’s tasks. Insight rather than data is the key ingredient for developing a different vision of where the business ,category, product, model or brand can go. It also lends itself to sensitivity – towards opposing possible outcomes – and can alert the manager not to be wedded to one point of view or conventional wisdom.

Willingness to experiment by trusting people is a great asset. Else, one can wait eternally as in the game theory of the “Prisoner’s Dilemma” – wondering if the other person would indeed reciprocate and can be trusted. **Letting people have their head, have their say and giving them the freedom to try is a leader’s job.** Innovation is not just another managerial fad – like Six Sigma, TPM, Kaizen, re-engineering, or decentralization – that had their glory days and faded

out, only to be replaced by other theories. Innovation is about acknowledging change, both external and personal, which is a perennial aspect of life as Heraclitus explained “one cannot step into the same river twice”. All the physical sciences point to indeterminacy of phenomena and the need to accept probabilistic conclusions. The applied human science of managing people must start with this realization. The author quotes poet-philosopher-President Vaclav Havel’s definition of education as developing the ability ‘to make the hidden connections between phenomena’, from which physicist and eclectic scholar Fritjof Capra drew the title of his book “Hidden Connections”.

Creativity@Work also offers an insight into the fascinating and wide intellectual canvas of the writer whose writing ranges over a wide intellectual canvas from advances in non-linear dynamic force field diagrams Myres Briggs Indicators (MBTI) to meditation techniques, Vipassanna, Pranayam, Yoga, Tai-chi, which enable channelising creativity and energy. He refers to the recommendation of Kautilya’s *Arth Shasthra*, that essentially “All leaders must be Yogis”. At the other end of the scale (on Page 153), he ranges over Waugh, Botham and Don Bradman and explains how Bradman discovered in a test match in 1932, why he fell a victim – to a ball slightly short of length from Bill Bowes, the English fast bowler, making a rare first-ball duck. As soon as he took guard he was determined to throw the bowler off stride by pulling the first ball from just outside the stump across to mid wicket yet building the pre-meditated sort of shot he succeeded only in dragging the ball round to his stumps. He forgot to stay in the present, free of unnecessary thoughts.

The book is on creativity and action in the manager’s life. Our preconceived idea is that the right brain comprises creativity, intuition, humour, poetry and non-linear ways of thinking, while the left is the seat of reason, logic, structure, formality, linear thought, order, discipline, and powers of deduction as opposed to flights of fancy. Today, neuroscience, psychology and medicine have seriously questioned the dichotomy. They have concluded that the brain is a good example of a Hologram in which the characteristics of the whole are contained in the part.

Drawing on Indian Philosophy the author explains that the ancient Indians termed this “Advaita” or the lack of a duality –a false belief that there is a finite and separate agent called ‘the self’ stressing the unitary nature of all things which we are usually not conscious of, in our everyday lives. This is also termed ‘reductionist’ thinking as it reduces every phenomenon into something we can handle easily. Applied to innovation, this implies that we accept that a number of people in the professional world still tend to think naturally in functional silos of the mind.

For years now, to take a major example, it has been *de rigueur* for writers on management to place all choices in a two variable, binary situation, with a high and a low end on either of the two dimensions so that you get typically four quadrants to choose from. Hence, people for a job may be chosen on the basis of capabilities and competencies on one dimension and on the other, adaptability, acceptability and possible ‘fit’ with the team and the department concerned. A similar two-by-two matrix may be used to evaluate alternative media plans, project investment opportunities and so on. The author furnishes the insight that Asking questions is essentially about freeing the mind from the restraints of experience and the conditioning due to all our influences alternatively.

Kepner and Tregoe introduced a Potential Problem Analysis (PPA) stage just to take care of all sorts of hiccups, which occur as soon as someone attempts the task of implementing decisions. It is the overwhelming verdict of social scientists and management academics that change programmers flounder not so much on the rocks of people’s resistance to change, as it is usually labeled, but as a result of poor ‘thinking through’ to likely consequences i.e. potential further problems that could arise by taking any action that suggests itself now. It may be easy to avoid this stage by saying, ‘Oh enough of talk, let’s get on with it!’ but this is fraught with serious traps.

Tony Buzan has developed an approach called “Mind Mapping” that helps in thinking differently at length. This involves thinking in color, symbols and pictures, besides using the mind’s natural tendency to associative thinking. It is not by any means a rigid formula, which would be the antithesis of creativity, but rather a general approach or

even attitude, an attempt to release the innovative urges and capabilities rather than put the thinker into a straitjacket. The mind finds such frameworks very friendly; a part of one's comfort zone, the most familiar part of life, so to speak. Yet, one of the definitions of living and managing creatively is to embrace the territory beyond one's comfort zone, which we are usually reluctant to do. The author has given an example of a Mind Map on Page. 67.

According to the renowned physicist Fritjof Capra, whose interests go far beyond Physics, the network is the dominant paradigm of life itself. This, not surprisingly, is also true of organizations in society today. The networks appear everywhere, as people networks, news networks, power networks of both political and electrical varieties and telecommunication, to name a few. What is the reason for this underlying mega trend across diverse fields of human activity? Why has this happened more recently?

The very nature of being creative is to find what one's true nature is and live in consonance with it – for conflict within oneself divides the person artificially and is the ultimate unforgivable sin.

The author with candor admits that he can provide a glimpse of what some great thinkers have said on the subject he has made extensive references to the works of David Bohm, Thich Nhat Hanh, Rimpoché, Peter Senge, Fritjof Capra, among others, and has thoughtfully appended a detailed reading list at the end of the book.

Other sources of inspiration to the author are the philosopher Jiddu Krishnamurti and David Bohm, the famous scientist whom Einstein considered his intellectual heir. Bohm and Krishnamurti engaged in several dialogues over a number of years in the 1970s and the 1980s on some profound questions, many of which resonate with the themes of this book, particularly the value of dialogue and the meanings of insight, intelligence and listening that 'holds the key' to the quality of attention that must begin the enlightening process. There is a necessary caveat in that the word 'process' is used only as a matter of convenience since their key contribution is the irrelevance of psychological time.

This book is therefore not to be read at one go but to be dipped into as and when one wishes - taking in a few chapters at a time, some, more than once, it is to be savored over the years. This book is not divided into compartments, which would be against the very spirit of the book. It contains a mix of principle and practice, of philosophy and precept.

A management graduate from the Indian Institute of Management, Ahmedabad, the author is associated with the Harvard Business School, USA. An independent management consultant, columnist and mentor to senior managers, he was Director of the Institute for Financial Management & Research in Chennai (1998-004) and is a member of the Reserve Bank of India's Southern Area Local Board.

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A Sustainable Fiscal Policy For India - An International Perspective Edited by Peter S. Heller and M. Govinda Rao, Oxford University Press, New Delhi, 2006 pages 454

The fiscal policy assumes centre stage in policy deliberations as the continuous fiscal imbalances and rising levels of public debt pose risks to the prospects for macroeconomic stability, and accelerating and sustaining growth. Appropriate and timely fiscal policy measures can promote growth by setting efficient and effective use of scarce resources and by creating the right incentive signals. The well designed fiscal strategy would help to move an economy like India towards a higher growth path without high inflation or inter-generational transfers of the burden of public debt. India's democratic system and federal structure present challenges to fiscal policy that are also common across all federal democracies and are well recognised in theoretical terms. The fiscal experts in India and outside contributed from time to time in revealing the strengths and weaknesses of the India's fiscal policy and suggested future course of action. Set against the above backdrop, the book under review, which is a selection of 10 papers presented in a conference jointly organised by the International Monetary Fund and the National Institute of Public Finance and Policy highlights various aspects of India's fiscal policy, its sustainability and its impact on the other sectors of the economy and draws lessons and priorities taking into account the international experiences.

The book examines how India's fiscal situation evolved over the years, the role played by reforms, Central-State fiscal relations, risks of high public debt and the critical areas for reforms. It explores ways of meeting challenges including reduction of public debt and adoption of sound fiscal policies which assumes critical role in realising the economic ambitions. Interestingly, India's economy has grown rapidly since the beginning of the 1990s despite a large and growing fiscal imbalances and debt levels and it would be of great interest to examine whether India has found a way to reconcile sustained expansionary fiscal policies with relative macroeconomic

stability. The analysis indicates that the India's fiscal policy requires immediate attention in order to have sound and sustainable fiscal situation in the long run as high growth and low interest rate may not be able to take care of the problem of long term debt sustainability nor risks of a crisis in the short and medium term. The focus on the budget deficit alone may be misleading as the problem of off-budget and contingent liabilities is serious and needs to be addressed. Keeping in view the growth implications in long run, there is a need to examine public consumption, investment, taxation and deficits in a framework that recognises that these are all endogenously determined, along with the growth rate.

As the fiscal imbalances continue to exist and debt level is rising, the reforms mainly aimed to enhance government revenues are critical. While there is ample room for improving the structure of indirect taxes, in particular, improved tax administration and enforcement remains one of the most critical areas for reform. Tax reform is an essential step towards increasing government revenue, as well as reducing microeconomic distortions. On the expenditure side, the quality of expenditure at both Centre and State level has deteriorated, and the same needs to be addressed on priority basis. Institutional reforms such as improvements in the intergovernmental transfer system, borrowing mechanisms for State governments, and budgeting practices and norms are all technically possible and may well be politically feasible.

The opening chapter, 'Fiscal Developments and Outlook in India', by Indira Rajaraman focuses on the factors underlying the continued weak fiscal position during the previous one and half decades as well as the prospects of recent fiscal reforms. The author identifies that the impact of trade liberalisation measures and their associated loss of tariff revenue remained the major factor underlying the weakened fiscal position since the early 1990s. Unlike other countries which undertook tariff rate reductions, India did not compensate the loss of revenue by a commensurate increase in domestic taxes. The author is of the view that buoyant growth in India is essential for fiscal reforms to be possible and this requires

that the kinds of physical and social infrastructure should go up in both quality and quantity. The author finds two strands to the fiscal imbalance path in India. First, high interest rates on public debt which started rising sharply in the 1980s and details the political economy pressure that fuelled this rise. Second, non-interest fiscal indicators which worsened sharply in 1998 with the real wage hike introduced that year for government employees and pensioners raising the consolidated salary bill substantially. An econometric exercise investigates whether this event was endogenous to the political economy. The regression equations show an election year response, which has become more marked in the last 30 years. The author recognises the importance of two major reforms, *i.e.*, the reforms of the interest rates guaranteed under the NSSF and passage of the Fiscal Responsibility Legislation.

The issues relating to the scope, nature and conduct of fiscal policy, particularly in the context of maintaining macroeconomic stability and enhancing growth, assume importance. The paper, 'India: Macroeconomic Implications of the Fiscal Imbalances', by Kalpana Kochhar examines both the evolutions of fiscal imbalances and key developments in major macroeconomic variables in order to assess the macroeconomic impact of the growing fiscal imbalances. Keeping in view the persistent fiscal imbalance and indebtedness, arguably, the fiscal situation is the single biggest threat to macroeconomic stability. The rising fiscal imbalances and debt reflects a weakening in revenue mobilisation, persistent deficit at Centre and State level and narrowing of the gap between real interest rate and growth rate. The author interestingly finds that on account of high fiscal imbalance there were hidden costs on the economy in terms of the foregone potential for even higher economic growth than that has recently been experienced. The large and increasing fiscal deficit led to a crowding out of productive public expenditure and constrained the scope for further structural reforms and liberalisation and rooms for macroeconomic policy manoeuvre – adversely impacting the growth prospects. In order to avoid the crisis, the author feels that there is strong need of revenue mobilisation efforts and reorientation of

expenditure away from subsidies and towards physical and social infrastructure projects. India's medium term economic prospects, among others depend critically on progress with the closely intertwined tasks of fiscal consolidation and structural reforms. The rising level of fiscal imbalances and resultant high level of debt may create a vicious circle inducing a fall in the ratio of private to total credit, rising inflation and falling economic growth. In this regard, William Easterly in his paper, 'The Widening Gyre: The Dynamics of Rising Public Debt and Falling Growth', examines that fiscal policy variables affect growth and finds suggestive evidence, in line with the previous literature, that fiscal policy variables – or variables affected by the fiscal policy such as budget deficit, inflation and the share of private in total credit do affect growth.

Sustainability of public debt has emerged as an important issue in public policy discussions and academic debates among policy makers, economists, credit rating agencies and multi-lateral institutions. It has been widely recognised that unsustainable debt often tends to impact on Governments' ability to undertake developmental activities and also may crowd out the private investment. Richard Hemming and Nouriel Roubini in their paper, 'A Balance Sheet Crisis in India?', use a balance sheet approach to assess India's vulnerability to a crisis as a result of its high fiscal imbalances. The authors explore the question of the financeability of a country debt position, the vulnerabilities associated with the way in which India's public debt is financed and the experience from other emerging market economies which face high debt ratios in recent years. The authors find that India's debt is clearly financeable over the short term, reflecting such important strengths as modest rollover/liquidity risk, lack of currency mismatches and limited liability dollarisation, small current account imbalances and low external debt, financial repression and capital controls. In principle, these are insulating factors to the large deficit and high share of debt to GDP. The paper concludes that a failure to tackle fiscal consolidation in the near term will only increase India's vulnerability in the future.

Peter S. Heller in his paper, 'India: Today's Fiscal Policy Imperatives Seen in the Context of Long-Term Challenges and Risks', provides an alternative perspective on why India needs to move soon to address the fiscal imbalances. A continuation of current fiscal policies, the level of fiscal deficits and character of government expenditure, would put India on an unsustainable course in terms of the constraints that it would impose, in the future, on the role that public sector would be able to play in effectively addressing these longer term challenges. The author emphasises on undertaking the appropriate reforms in order to placing fiscal house in order today so that India have sufficient fiscal leeway in the future to address the long term fiscal challenges including those of demographic developments in the population at large, the demographics of civil service and military pensions, the imperatives of social insurance reforms and urbanization patterns and the effects of the globalization. The paper states that India now has a fiscal policy framework that neither offers that futures fiscal leeway, nor provides an appropriate expenditure programme that is responsive to the obvious and immediate needs of the economy of the coming decades. Current fiscal policy is recognised by most analyses as unsustainable. An important policy message may be drawn from the paper is that India should be cautious about how it formulates new policy commitments so as to avoid excessive preemption of future budgetary resources and thereby avoiding the mistakes of industrial economies.

In order to enhance the revenue performance, the strategies focusing on rationalisation of tax rates, better tax compliance, improved efficiency in tax administration and review of tax exemptions/incentives would be helpful. Over the last decade, income tax rate at the Central Government level has undoubtedly been made internationally comparable, central excise duties have been converted to a truncated VAT (CENVAT) up to the manufacturing stage and custom tariffs on imports have been sequentially scaled back to approach comparable international level. The various exemptions, however, have affected the quality of tax administration and revenue performance. For a couple of decades, services sector has grown

rapidly and now represent more than half of the GDP. In view of its increasing role in GDP, the taxation of service sector assumes importance. It is imperative to introduce comprehensive taxation of services at the Central level and the selected services should also be seriously considered for appropriate assignment for taxation to the States and local bodies. On taxation of services, India can draw important lessons from Brazil, which was one of the first countries to introduce a comprehensive Value added tax (VAT) on both goods and services in the mid-1960s. Parthasarathi Shome in his paper 'India: Resource Mobilization through Taxation' finds that though there have been significant changes in the tax structures in the 1990s, however, the insufficiency in streamlining the wide prevalent incentives and exemptions has adversely affected the full potential of revenue productivity in both individual and corporate income tax. It was recognised that competitive sales tax reductions by States aimed at attracting investments had led to revenue losses without commensurate gains. The author emphasises on the reforms on both tax policies and revenue administrations.

In their paper, 'Subsidies and Salaries: Issues in the Restructuring of Government Expenditure in India', Stephen Howes and Rinku Murgai find that while there are ways to reduce subsidies through a combination of efficiency improvements and tough decisions, however, attempts so far to reduce subsidies have met with little success. The paper examines the agricultural power subsidy as a case study and situates India's growing subsidy bill within the context of a trend towards agricultural protectionism. There is no assured path forward and sustained reduction in the expenses towards subsidy will require institutional experimentation. The authors suggest that there is potential of decline of salary bill of Government sector (Centre and State Governments) by 2 per cent of GDP over the next decades – *via* both wage and hiring restraint without sacrificing expenditure quality. There is also a need to address the growing pension's outlays. The usual emphasis on expenditure restructuring through subsidy reduction is complemented in the paper by an equal emphasis on salary bill reduction. The authors are of the view that a

reduction in the salary bill is not likely to come about by active downsizing but by a combination of hiring and wage restraint. With regard to the power sector, the authors stress the importance of privatization as perhaps the only way to bring commercial discipline into the rural segment of the power sector, however, at the same time acknowledge the associated risks and difficulties.

Ricardo Hausmann and Catriona Purfield in their paper, 'The Challenges of Fiscal Adjustment in a Democracy: The Case of India', provide thought provoking views and find that India's tendency to run large deficit and accumulate debt has deep institutional roots embedded in its highly decentralized democratic system. The paper mainly studies three aspects of fiscal consolidation. First, it accounts for the lack of symptoms of an impending crisis by pointing to some aspects. However, the lack of symptoms is double-edged sword: it makes crisis less likely for any level of debt, but society is less responsive to fiscal imbalances, thus making the eventual problems much larger. Second, it analyses possible implications of the fiscal responsibility legislation on India's imbalances. Third, it studies India's federal system and the role of States in the fiscal adjustment effort. The authors find that India's ability to tolerate high deficit and debt without encountering the types of crises experienced by many other emerging economies is a mixed blessing. It reflects the comparatively large and closed nature of its economy as well as its deep domestic capital market and large, *albeit* captive, pool of domestic savings. The last has allowed the Government to finance deficits with long term fixed rate debt instruments. The authors recognise the recent institutional reforms based on legal backing. The authors suggest a State level fiscal consolidation plan including those of imposition of borrowing ceiling on States to constrain their deficits and reforms to the system of intergovernmental transfers to give a more stable and reliable source of revenue.

In a federal set up, stable and reliable sources of flow of funds helps in formulating the future strategies at sub national levels governments. For sound fiscal management, however, the efforts should be undertaken by both the Central and State Governments.

The federal budgetary systems bring especially difficult challenges. For example, the Argentina made significant economic progress on a wide range of issues in the 1990s. However, the complicated financial relations between the federal Government and provinces crucially undermined attempts at fiscal control as the provinces had little incentives to control their spending. Eduardo Refineppi Guardia and Daniel Sonder in their paper, 'Fiscal Adjustment and Federalism in Brazil', draws the lessons from the another large federal Brazil. The authors emphasise that during the time of fiscal adjustment the fiscal-federal system needs to be respected as an integral element of policy design, though the system itself may need to be adapted if situation requires to maintain macroeconomic stability and to achieve the objectives of fiscal adjustment. The authors emphasise on major elements of a fiscal-federal system and the ways in which these were adapted in the context of Brazil' fiscal adjustment experience during the late 1990s. Among others, these include assignment of revenue and expenditure responsibilities between the Centre and the States and the rules determining the control of sub-national debt. The paper assumes importance in the sense that it sets priority for Indian policy makers to reconsider the scope for adapting their own system.

In the concluding chapter, 'Fiscal Policy in India: Lessons and Priorities', Nirvikar Singh and T.N. Srinivasan assesses India's current fiscal situation, its likely future evolution and impacts on the economy. The authors examine possible reforms of macroeconomic policy and broader institutional reforms that will bear on the macroeconomic situation. The authors also take into account the factors such as political feasibility of possible reforms. They also examine both medium and longer run scenarios, fiscal sustainability and adjustment going beyond conventional government budget deficits, to include off-budget liabilities, both actual and contingent. The chapter concludes that some short run fiscal adjustments are clearly necessary to avoid any possibility of a crisis, but at the same time more fundamental adjustments- in the tax system, the structure of the expenditure and the financial sector must be on the agenda for reforms.

The book, a major contribution to the fiscal literature, is thought provoking, timely and pertinent to India's fiscal affairs. The various aspects of India's fiscal policy, related issues, implications on growth, feasibility of implementations of reforms in the existing democratic and federal set up are well recognised and addressed. It provides adequate insights and suggests a road map, taking into fiscal policy and its linkages with other macroeconomic policies, for a sound and sustainable fiscal policy for India. The reforms in tax administration, expansion of tax base through more services in tax net, introduction of transparency in fiscal matters and channelisation of expenditure along productive lines among others reforms are suggested to be initiated on priority basis. Several fiscal policy measures have already been initiated in India during 1990s covering most of these areas. Furthermore, the book provides very useful insights on the optimal level of fiscal decentralisation for India. The discussion on linkages of fiscal policy with other sectors and its implications including on growth is very relevant and will provide valuable inputs to the policy makers in India to further facilitate the fiscal reforms process with a view to strengthening fiscal situation.

Growth implications of the fiscal policy could have been addressed more adequately taking into account the more disaggregated information and also simultaneously the impact of taxation, expenditure and budget deficits components on the growth. The analysis on India's fiscal situation with an international perspective and its linkages with other sectors provides adequate insights to policy makers and provokes researchers to take further work in this area. In this regard, a phase-wise analysis of various aspects of fiscal policy could have been more useful to understand the strengths and weaknesses of policies in different phases. The issues like rigidities in bringing expenditure to a lower level or in channelising it towards productive lines apart from sustainability of public debt, which continue to pose problems for the on-going process of fiscal consolidation could have been addressed adequately. Keeping in view the problems as highlighted in number of papers, there needs to be some short run fiscal adjustment to avoid any

probability of a crisis. In this context, the future course of action meant for short run and long run could have been provided adequately keeping in view India's democratic and federal set up. Nevertheless, the book remains an important contribution to the India's fiscal literature. It may be concluded that the book provides very useful insights for policy makers to undertake appropriate and timely policy measures in order to strengthen fiscal position and avoid any crisis in the short and medium term and for sustainable fiscal situation in the long run.

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