SPEECH

INDUSTRIAL PROSPECTS AND OPPORTUNITIES DURING THE EIGHTH PLAN*

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1. It is indeed a pleasure to address your most distinguished group, this morning. We seem to be well into a period of major economic readjustment. A whole host of broadranging reforms have been initiated, essentially involving a program of economic stabilisation and undertaking of comprehensive and deep policy reforms to restructure the economy. Both these should pave the way for a sustainable economic growth with better macro-economic balance. The effort is towards accelerating the overall growth, which is the best answer to the multifarious problems, economic and social, that India confronts. While the intent and direction of the reform program are now amply clear, what is also becoming apparent is the enormity of the task still ahead of us in ensuring the real transformation of the system into a modern, efficient and a competitive one. I would therefore like to take this occasion and share with you, my assessment of the current Indian economic situation, the outlook for the future and comment on some of the recent monetary policy measures undertaken to ensure that adequate support is provided to spur economic recovery and growth.

Policy Environment

2. The stabilisation policies are aimed at correcting the lapses and putting the house in order in the short term. It is intended to bring about a better macro-economic management of the Indian economy in terms of low inflation, reduction in fiscal deficit, improved build up and quality of foreign exchange reserves. The structural reform policies, on the other hand, are intended to dismantle the structural rigidities and help the strengthening of competitive forces. Adequate care is being taken to ensure that the costs of adjustment for the Indian business and industry are kept to the minimum. The economic transformation aims at providing incentives for the Indian business and industry to reduce costs, upgrade technology and improve product and service quality. These policies, however, cannot succeed unless a degree of stabilisation has been brought about. But stabilisation by itself will not be adequate unless structural reforms are undertaken to avoid the recurrence of the problems faced in the recent period. The overall emphasis of the reform programme thus is to improve the economic efficiency of the system.

Economic Outlook

3. 1991-92 was a year of weak economic growth, mainly due to poor agricultural performance and collapse of industrial production which was largely due to severe import compression measures. As we came out of the short-term crisis management phase of 1991-92 and undertook stabilisation and structural reform measures, an improvement in the overall economic situation was noticeable during 1992-93. Economic recovery which began in 1992-93 is now expected to be maintained in 1993-94. The real GDP growth in 1993-94 is likely to be around 4.5 per cent. This will largely be based on the expected sustained growth of output in agriculture and some improvement in industry.

Industrial Production

4. The recovery of industrial output during 1992-93 was disappointing reflecting the slackness in real domestic demand. The industrial activity showed only a limited resilience as seen from the increase in index of industrial production

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of only 1.5 per cent. 1993-94 has begun no differently and the index of industrial production has remained stagnant in the first quarter. In fact the manufacturing segment shows a small decline. The available data on the index of industrial production for the period April-June 1993 show that in the case of groups with a weight of more than five per cent, decline in output is noted only in relation to 'Food products', 'Electrical machinery' and 'Transport equipment'. The decline in 'Food products' is however somewhat inexplicable. In fact, improved performance of agriculture should have had a favourable impact on industrial production. Agro-based industries in any case should not face any supply constraints during the current year. Electrical machinery group of industries has also suffered a set back mainly perhaps, on account of lower off-take by users such as the State Electricity Boards. The auto industry, of late has seen some improvement in output as well as sales of cars and light commercial vehicles.

5. As against the low performance of the overall industrial production, the infrastructure industries have done well, the growth rate being 6.3 per cent during the first five months of the current financial year as against 3.5 per cent in the corresponding period of last year. Among the infrastructure industries, electricity, coal and cement performed well, their output going up by 9.1 per cent, 6.6 per cent and 8.6 per cent, respectively. The fact that infrastructure industries have done fairly well shows that there is a potential for industrial sector revival.

6. It is to be expected that some segments of the industrial sector will face problems in the process of transition. The attempt to reduce gross fiscal deficit, which implies reduction in government expenditure, will necessarily adversely affect the demand for certain goods. These sectors will have to adjust themselves to the changing demand pattern. The domestic capital goods sector has also come under some pressure, since imports of these goods have been placed under OGL and there has been a substantial downward revision in the import tariff on these goods. The extent to which the capital goods sector can adjust itself to the new situation also depends on the relative rates of tariff on imported raw materials and components and final goods. The three sources of demand acting on industrial production are consumption, investment and exports. As rural incomes pick up, it should create more demand for industrial consumption goods. Export growth has shown a strong buoyancy in the current year and should have a favourable impact on industrial production.

Investment

7. As regards investment demand, perhaps public investment, both of the Centre and States may suffer some decline in the current year. On the other hand, all available evidence shows that corporate investment will be strong. During April-September 1993, the primary issues in the capital market amounted to Rs. 10,303 crores as compared with Rs. 7,690 crores in the corresponding period of the previous year. This is some indication that corporate investment will be maintained at a reasonable level in 1993-94. Taking all factors into account it should still be possible for the industrial sector to record a growth of around 4.5 per cent in 1993-94. It should however, be noted that this will be well below the trend rate of eight per cent for industrial production achieved in 80s.

Inflation

8. The price situation has shown a significant improvement since 1991-92. The Wholesale Price Index on a year-on-year basis as on October 9, 1993 showed an increase of 7.4 per cent as against 10.4 per cent a year ago. However there are certain disturbing elements in the price situation. The price increase in the current fiscal year so far has been a shade higher than in the corresponding period in the previous year. There has been a spurt in the prices of primary articles this year as compared with last year. Containing inflation is a key element of a strategy aimed at fostering maximum sustainable long-run growth of the economy. Inflation should be held at a level where anticipated changes in the price level do not affect the parameters of economic and

financial planning by the various economic units. Possibility of build up of inflationary pressure therefore continues to be under close watch, specially in recognition of the fact that such a development could destabilise the reform process.

Trade and Balance of Payments

9. Our estimates show, that during 1993-94 the balance of payments situation will remain manageable. In the first five months of the year, exports have recorded a robust growth of 24.3 per cent in US dollar terms, although the August figures show sharp decline in the rate of growth, attributable, in part to the nationwide truckers' strike.

10. If the export performance during the first five months is any indicator, it may be safely observed that the Indian economy would be able to achieve a 20 per cent rise in exports in dollar terms stipulated for 1993-94. There has occurred a significant turnaround in primary products exports, which recorded a striking improvement of 49.3 per cent growth during the first quarter. This stands in sharp contrast to a decline of 23.0 per cent in the comparable quarter of the last year. Agriculture and allied products, a subgroup, recorded a 55.3 per cent increase over the same period of the preceding year. Thus, from all indications, the exports of agricultural products have responded positively to the tilt imparted in the new EXIM Policy, in favour of agriculture and allied products. Similarly, exports of manufactured goods recorded a rise of 21.8 per cent during the period. Most of the commodities belonging to the 'extreme focus category', the exports of which are projected to achieve a 30 per cent growth per annum over the medium term, such as, raw cotton, sugar and molasses, tea, jute etc. recorded high export growth. Exports are thus expected to build upon the resilience exhibited in the preceding years on the whole.

11. Imports, however, during the first five months have declined by about 3.7 per cent over those in the corresponding period of 1992-93. Import demand, is however, expected to rise as economy expands.

12. Even with a pick-up in imports, the trade deficit is expected to be substantially lower than in the preceding year. Already, the trade deficit during the first five months of the current year has narrowed down to $255 mio as compared with $2,301 mio last year. Some improvement in the invisible account is also expected as earnings from tourism revive and inward remittances increase in response to the exchange rate. Thus, the current account deficit during 1993-94 is expected to be considerably lower than in 1992-93, reflecting mainly the improvement in the trade account.

13. Over the medium term, export growth of the order of 15 per cent per annum can considerably narrow the trade deficit. The improvement in trade performance would also be supported by some improvement in net invisible earnings. The current account deficit would, therefore, benefit from these positive developments. The external financing requirement on current account alone can thus be expected to decline although it needs to be reiterated, that the annual export growth rate of at least 15 per cent in the US dollar terms is a requirement. Nevertheless, the overall financing requirement would be larger because of the repayments to the IMF as well as the repayments of borrowings under the India Development Bonds. Exceptional financing would be required until access to commercial markets opens up. As the fundamentals of the Indian economy improve and the level of foreign exchange reserves remains at a reasonable level, it should be possible to return to the international commercial markets.

Exchange Rate and Foreign Exchange Reserves

14. In March this year, the dual exchange rate system was replaced by the unified exchange rate system, under which the exchange rate came to be fully determined by the forces of supply and demand for foreign exchange. Under the new system, exchange rate will play an important role in equilibrating demand and supply. The first seven months, since its introduction, have seen the system function remarkably well. The average of the reference rate of the Rupee during March was Rs. 31.33 per dollar. The rate has strengthened

since then, and has been steady at around Rs. 31.37 per dollar. There has been no similar period in recent history when the rupee has remained so stable over a period of more than six months. This reflects not only the improvement in the economic fundamentals but also the guidance provided by RBI to the foreign exchange market.

15. There has been a build-up of foreign exchange assets during the first seven months of 1993-94, along with a healthy reorganisation of the composition of the foreign currency assets. As of today, the foreign exchange reserves are around $7.8 bio. The volatile components have declined substantially. This positive development would considerably support the management of the balance of payments during 1993-94. Since April 1993, RBI has bought $4.9 bio while it has sold $1.3 bio. The next purchases have thus amounted to around $3.6 bio. These purchases have also enabled the RBI to improve the quality of reserves.

16. The reserves today are composed of more stable elements. The volatile components, such as swaps and deposits in FCBOD scheme have declined substantially from their levels at the end of March 1993. The swaps have been completely extinguished from a level of US$1,243 mio in March 1993, and Foreign Currency (Banks and Others) Deposits (FCBOD) from US$1,039 mio to US$821 mio. Furthermore, the State Bank of India's (SBI) short-term liabilities abroad on account of Public Sector Units (PSU) declined from US$1,030 mio to US$168 mio. It is therefore gratifying that even after meeting all these liabilities, we have been able to add substantially to our reserves. In the recent period there has also occurred some restructuring of the Foreign Currency Non-Resident Accounts (FCNRA) scheme under which the RBI provides exchange guarantees. Exchange risk on deposits of less than two years is no longer borne by the RBI. While there was a net outflow of US$941 mio under the FCNRA scheme, between the end of March and October 22, 1993, it was more than compensated for by inflows under the two new schemes viz. Foreign Currency Non-Resident (Banks) (FCNR{B} scheme and Non-Resident (Non Repatriable) Rupee Deposit (NR{NR}RD) scheme. As such the restructuring of the FCNRA scheme is being achieved without a net outflow under all the non-resident deposit schemes taken together without curtailing the facilities to non-resident depositors.

Fiscal Developments

17. A crucial concern in the area of macro-economic management at present however is in respect of the evolution of the fiscal position. Integral to the process of restoration of macro economic stablisation and consolidation is the containment of fiscal deficit at a reasonable level. Currently, the budget deficit is running at level much higher than the budgeted year-end level. Net RBI credit to Central Government is also far above the postulated year-end figure. As such, appropriate fiscal measures need to be taken to contain net RBI credit to Central Government so that monetary policy has enough head room to support the growth of output.

Monetary Policy

18. Containment of inflationary pressures and supporting productive activities with adequate credit have remained the cornerstone of Reserve Bank's monetary and credit policies. In the recent period, while formulating the monetary and credit policies, measures have been introduced to revive industrial and agricultural production while keeping in mind the primacy of the objective of inflation control.

19. The credit policy for the first and second half of 1993-94 has considerably enlarged the availability of credit. The total resources available for extending non-food credit, after the release of pre-empted resources, have been the highest in the recent period. Non-food credit however, has shown a contraction in the first half of the current financial year. This is attributable to factors such as, the cautious approach of banks to lending to avoid increase in non-performing assets, write-off of large amounts of loans by banks, large investments by banks in Government securities, comfortable liquidity position of corporate sector due to large mobilisation of resources from the

capital market, gradual reduction in inventory build-up, easy access to suppliers' credit abroad and a sharp spurt in issue of commercial paper by a large number of companies.

20. The overall objective of the latest credit policy announced for the second half of 1993-94, is to ensure that adequate credit support is provided by the banking sector to the revival of output. Steps have been taken to further carry forward the medium term policy framework relating to reserve requirements, enhance credit support for agricultural operations, relaxation of certain selective controls and widening of access to the money market. The lendable resources of the banking system have been further increased significantly and measures are taken to enhance credit facilities for borrowers so as to ensure that inadequate credit does not hinder the growth of the economy. Banks have been advised that while observing prudential norms, they must not slow down their lending activities and must meet the genuine and felt requirements of borrowers. Lending on viable basis should continue and the hesitancy of banks in taking credit decisions in the aftermath of the securities irregularities must be overcome. Bank managements have been asked to ensure that the delegated credit sanctioning powers are duly exercised and the pending proposals for new loans, as also renewals, are processed within a maximum period of three months.

21. Committed to a reduction in the preemption levels, we are continuing to persevere with the medium-term policy objective of reducing the SLR to 25 per cent and CRR to 10 per cent over the next three years. As budget and fiscal deficits come down and as we move away from automatic monetisation of deficits, monetary policy will come into its own. The regulation of money and credit will be determined by the overall perception of the central monetary authorities on what the appropriate level of expansion of money and credit should be, depending on how the real factors in the economy are evolving.

22. Greater operational autonomy has been accorded to banks in determining the credit requirements of borrowers. This should help promote larger and more effective flow of credit. Measures have also been taken to enlarge the borrowers entitlements as well as to remove some of the structural rigidities relating to lending and ensuring smooth flow of credit.

Financial Sector Reform

23. The productive sectors of the economy need for their successful functioning an efficiently operating banking and financial system which while transferring funds from the surplus units to deficit units will do so at minimal operating costs. We have therefore embarked on a programme of financial sector reform.

24. The ongoing financial sector reforms are designed to make the financial system more viable, more efficient and more responsive. The major policy thrust is to improve the operational and allocative efficiency of the financial system as a whole by correcting many of the exogenous and structural factors affecting the performance of financial institutions. Easing of external constraints such as the administered structure of interest rates and reserve requirements for banks, strengthening the capital base of financial institutions, facilitating the entry of new institutions, exploring indirect monetary policy instruments and strengthening prudential regulations and supervision, are some of the items in the agenda of financial sector reform. These reforms should help financial institutions to act as autonomous business units, fully responsible for their performance.

25. The major component of the restructuring program of public sector banks undertaken by the Government and the RBI involves an aggressive program to recapitalise them. But this has to be supplemented by a time bound fulfilment of "performance criteria" by each bank. Allocations have been made conditional to the banks drawing up a business restructuring plan aimed at achieving viability over the medium term of 2 to 3 years. Banks are making specific commitments to ensure that capitalisation exercise is carried out on a sustainable basis. These agreements are presently being concluded between the RBI, Government and the management of each bank.

Conclusion

26. The time has however come for the Indian firms to respond adequately to the positive changes ushered in by the new Economic Policy and the structural reform programme. Entrepreneurial spirit of the Indian industry must rise to the occasion. The key to India's growth lies in improving productivity and efficiency. This has to permeate all walks of our life. Contrary to the general impression, the natural resources of our country are not large. In fact from the point of view of long range sustainability the need for greater efficiency in the management of natural resources of land, water, minerals etc. has become urgent. In a capital scarce economy like ours, there can be no excuse for under-utilisation of capacity. Undoubtedly, improving productivity is the function of many factors. The policy environment has to be correct; the organisational structure has to be appropriate and the attitude to work and work technology right. As I have mentioned the policy environment is undergoing a dramatic change. The very objective is to create an environment in which firms, big and small, will be compelled to improve productivity and reduce costs.

Thank you.