CHAPTER - III

THE INDIAN ECONOMY AND THE ECONOMY OF GUJARAT: AN OVERVIEW

The growing integration of economies and societies around the world has been one of the most hotly-debated topics in international economics over the past few years. Rapid growth and poverty reduction in China, India, and other countries that were poor 20 years ago, has been a positive aspect of Liberalisation Privatisation and Globalisation. In the last thirty years we have witnessed a process of deepening economic integration or *globalisation*, moving towards a world where production, trade and investment know no frontiers. Globalisation has many meanings depending on the context and on the person. Accordingly, one of the meanings says that the process of globalisation not only includes opening up of world trade, development of advanced means of communication, internationalisation of financial markets, growing importance of MNC's, population migrations and more generally increased mobility of persons, goods, capital, data and ideas but also infections, diseases and pollution. The term globalisation refers to the integration of economies of the world through uninhibited trade and financial flows, as also through mutual exchange of technology and knowledge. Ideally, it also contains free inter-country movement of labour. Globalisation has opened up vast new opportunities for economic and social progress in developing countries through greater integration into the world economy. The ability to import ideas, technology, investment, intermediate inputs and goods and services from more advanced countries can boost economic growth. Increased trade and capital flows have generated gains in productivity and efficiency that have spurred growth and created jobs. Access to foreign capital markets has helped developing countries mitigate the serious obstacle to rapid growth caused by meager domestic savings.

The year 1991 marked the beginning of this process in India. Having been depleted of its economic reserves, India was left with no other alternative than to include the LPG package (Liberalisation, Privatisation and Globalisation) in its economic policy. Thus, in context to India, globalisation implies opening up the economy to foreign direct investment by providing facilities to foreign companies to invest in different fields of economic activity in India, removing constraints and obstacles to the entry of MNCs in India, allowing Indian companies to enter into foreign collaborations and also encouraging them to set up joint ventures abroad; carrying out massive import liberalisation programs by switching over from quantitative restrictions to tariffs and import duties. Therefore globalisation has been identified with the policy reforms of 1991 in India.

1. INDIA - PAST, PRESENT AND FUTURE

A long period of colonial rule had left India an impoverished country with more than half of its population illiterate and living below poverty line. Jawaharlal Nehru, the independent country's first prime minister, took office with the mission to "*...end poverty and ignorance and disease and inequality of opportunity...*" and to restore India to its pre-industrial revolution eminence as one of the world's great economic powers and major manufacturers.

1.1 The Pre-Liberalisation Phase

A policy of rapid industrialisation based on central planning, public investment, subsidies and a highly restricted import policy with import tariffs that were the highest in the world and the government's main source of income, was considered by the authorities to be the means to achieve the above goal. Import substitution, and the protection this afforded to domestic industry, was a policy deeply rooted, at that time, in the Indian belief that export-led growth strategies were nothing but a colonial contrivance to dump British manufactures on the country and thus deprive it of valuable capital necessary for its industrialisation. Much emphasis was laid on self reliance. This emphasis led to thereby alienating the policy of competitiveness for a considerable length of time. Also an unprecedented importance was attached to the public sector and the foreign aid/investment was kept at bay. Mobilisation of domestic resources was considered as a viable alternative than relying on foreign aid.

In the closed economies of the post-world war II period, central planning was able to demonstrate reasonable success, adopted by countries such as South Korea and Taiwan, many times under the blessing of the World Bank. It enabled India to sustain a yearly growth of 4 per cent –the Hindu rate of growth as it came to be known- that was much higher than that of its ex-colonial master; a growth rate that made many western economists hail India as a country that had nothing to learn from the free-marketers of the west.

India's Soviet type "5-year plan" central planning was based on a strict licensing system of production, prices and employment. Without the benefit of present day computers and advances in mathematical programming, the State would, in an effort to rationalize scarce economic resources according to national priorities, avoid wasteful duplication of activity, and control –through price policy- income distribution and the inequitable accumulation of wealth, thus determine what should be produced, how much and by whom.

The massive nationalisations of the 1980s, public investment and industrial subsidies eventually took their toll on India amidst the relentless demands of the global economy. Financed by a borrowing spree, internal and external, public spending had grown explosively while subsidies grew from 8.2 per cent of GDP in 1977-78 to almost 15 per cent in 1987-88. Indian economy was in deep crisis in July 1991, when foreign currency reserves had plummeted to the bottom; inflation had roared to a dangerously high level; fiscal deficit was very high and had become unsustainable; foreign investors and NRIs had lost confidence in Indian Economy. Capital was flying out of the country and we were close to defaulting on loans. The general budget and trade deficits reached unsustainable levels, foreign debt quadrupled in the 1980s. The current account deficit as a percentage of GDP peaked at a high of 3.1 per cent (compared to an average level of 1.4 percent in the early 1980s). The inflation rate (as measured by point-to-point changes in the Wholesale Price Index) had also climbed to the socially and politically dangerous double-digit level, hitting 12.1 per cent in 1990-91. Fiscal deficit, in particular the revenue deficit and the monetised deficit were unsustainably high. The central government's fiscal deficit alone peaked at 7.9 per cent as a percentage of GDP in 1989-90. Thus growing fiscal profligacy (and irresponsibility) and the unviable financing patterns of the fiscal deficit prevailing in the 1980s made high levels of annual GDP growth (peaking at 5.6 percent in 1989-90) unsustainable. Foreign-exchange reserves dwindled to a low of US$2.2 billion (with less than 15 days' cover against annual imports). India stared bankruptcy in the face as it struggled to meet external debt obligations.

Along with these bottlenecks at home, many unforeseeable changes swept the economies of nations in Western and Eastern Europe, South East Asia, Latin America and elsewhere, around the same time. As a result, the country was at the brink of a liquidity crisis in 1991.

1.2 The Process of Liberalisation

The economic compulsions at home and abroad called for a complete overhauling of our economic policies and programs. In the 90s, India began an ambitious program aimed at the transformation of its economy towards a market driven export oriented system. The economic reforms of 1991-92 started to dismantle the licensing system, giving more leeway to the private sector. This period since the early 1990s has witnessed a fundamental repositioning of the State versus the Market in the Indian economy. Essentially, the transition has been characterised by a strong push towards a neo-liberal reform programme, resulting in a very substantial degree of internal and external economic liberalisation. A rapid and sharp shift in the economic policy regime was officially enunciated, which justifies the view of a transition from a State-led development model to a neo-liberal paradigm. The year 1991 marks a watershed year in India's trade history as the economy went through a process of formal liberalisation.

1.2.1 Disinvestment

In order to make the process of globalisation smooth, privatisation policy needs to move along as well. Under the privatisation scheme, most of the public sector undertakings have been/ are being sold to private sector.

1.2.2 Reforms in the Industrial Sector

The reforms saw a dismantling of the government control over the industrial sector in the form of abolishing of industrial licensing, reducing the number of industries reserved for public sector, replacing the MRTP Act by the Competition Act and dereservation of 108 items from the small-scale sector.

- **Dismantling of The Industrial Licensing Regime** At present, only six industries are under compulsory licensing, mainly on accounting of environmental safety and strategic considerations. A significantly amended locational policy in tune with the liberalised licensing policy is in place. No industrial approval is required from the government for locations not falling within 25 kms of the periphery of cities having a population of more than one million.

- **Throwing Open Industries Reserved For The Public Sector to Private Participation.** Now there are only three industries reserved for the public sector.

- **Abolition of the (MRTP)** ***Act,*** This Act, which necessitated prior approval for capacity expansion, no longer exists and capacity expansion can be freely undertaken.

1.2.3 External Sector Reforms

- **Devaluation:** The first step towards globalisation was taken with the announcement of the devaluation of Indian currency by 18-19 percent against major currencies in the international foreign exchange market. In fact, this measure was taken in order to resolve the BOP crisis.

- **Wide-ranging financial sector reforms** in the banking, capital markets, and insurance sectors, including the deregulation of interest rates, strong regulation and supervisory systems, and the introduction of foreign/private sector competition.

In a globalising world, domestic savings can be supplemented by investment flows from abroad and India has reoriented policies towards foreign investment to welcome such flows. This was the period when the extensive government controls which existed earlier on private investment and technology decisions began to be liberalised. Indian private companies were encouraged to expand in scale and induct contemporary technology. Access to foreign technology was made easier and foreign investment began to be viewed as a mechanism for injecting new technology into the economy.

The trade policy characterised by extremely high tariffs and import restrictions was also liberalised by abolishing import licenses, introducing a flexible exchange rate system, removing quantitative restrictions on imports of capital as well as manufactured consumer goods and agricultural products and reducing tariff protection. Major reforms were undertaken which did away with import licensing on all but a handful of intermediate inputs and capital goods. A major step was taken towards tariff reduction. The reduction in tariffs was accomplished through a gradual compression of the top tariff rates with a simultaneous rationalisation of the tariff structure through a reduction in the number of tariff bands. In 1991, the highest tariff rate stood at 355 per cent which was drastically reduced to 85 per cent in 1993-94 and to 50 per cent in 1995-96. This was gradually phased down and currently the peak duty rate on non-agricultural goods has been reduced to 12.5 per cent. Apart from their favourable effect on production costs, the reduction in tariffs exposed Indian products to world competition and, in addition, by squeezing domestic margins, it forced Indian producers to re-orient their production with emphasis on exports. Quantitative restrictions (QRs) on most imports have been abolished as of April 1, 2001. At the same time, the Rupee was devaluated and made convertible for trade, government borrowing was curtailed, financial services partly liberalised and the taxation system simplified. Other concrete changes involved removal of export controls, lifting of exchange controls.

1.2.4 Service Sector

Another major change the liberalisation brought with it was in the service sector. The service sector had been subject to heavy state intervention prior to the 90s. But after 1991, major steps were taken to permit private sector participation as well as foreign investment in the service sector, especially telecommunications, banking and insurance.

- **Allowing Foreign Direct Investment** (FDI) across a wide spectrum of industries and encouraging non-debt flows. A liberal and transparent foreign investment regime, where most activities are open to foreign investment through the automatic route without any limit on the extent of foreign ownership, has been put in place. Some of the recent initiatives taken to further liberalise the FDI regime, inter alias, include opening up of sectors such as Insurance (upto 26 per cent); development of integrated townships (upto 100 per cent); defence industry (upto 26 per cent); tea plantation (upto 100 per cent subject to divestment of 26 per cent within five years to FDI); enhancement of FDI limits in private sector banking, allowing FDI upto 100 per cent under the automatic route for most manufacturing activities in SEZs; Internet Service Providers (ISPs) without Gateways; electronic mail and voice mail to 100 per cent foreign investment subject to 26 per cent divestment condition; etc. The Department has also strengthened investment facilitation measures through Foreign Investment Implementation Authority (FIIA).

- **Non Resident Indian Scheme** The general policy and facilities for foreign direct investment as available to foreign investors/ Companies are fully applicable to NRIs as well. In addition, Government has extended some concessions especially for NRIs and overseas corporate bodies having more than 60 per cent stake by NRIs.

1.2.5 Financial Sector

At the onset of reforms, the heavy hand of government had been omnipresent in the financial sector and there was very limited market based decision making. Government, in order to sustain a strategic platform of public sector dominated industrial structure with direct discretionary controls on private investment for economic development, had no other way to undertake large developmental expenditures that required long-term finance for long-gestation projects. There was strong government control over all financial institutions, realized through directed credit programmes, pre-emption of funds through the Statutory Liquid Ratio (SLR) and the Credit reserve Ratio (CRR), controls over pricing of financial assets, barriers to entry into different sectors, and restrictions on transactions and flows. Bank deposit and lending rates were mostly controlled. The provision of fiscal accommodation through ad hoc treasury bills led to high levels of monetisation of fiscal deficit during the major part of the eighties. In fact, monetisation of government deficit was automatic. In order to check the monetary effects of such large-scale monetisation, the CRR was increased frequently as an instrument to control liquidity. Also, there was no secondary market of Government securities. Both the money and capital markets were underdeveloped. There were no debt markets as such; the government's debt issues were structured in a primarily "administrative" manner by the RBI. The Controller of Capital Issues (CCI) used to determine the pricing and magnitude of primary issues and broker-owned stock exchanges reportedly manipulated share prices. The foreign exchange market was also extremely thin, mainly due to stringent restrictions laid by Foreign Exchange Regulation Act (FERA) and the basket-linked exchange rate.

It was realised early on by the Indian planners that deregulated activity required liberalised financial systems to raise resources efficiently. As domestic reforms progressed, increasing integration with global markets then became another catalyst for further reforms. Entry into the banking, mutual funds and later, the insurance segments has been progressively allowed.

1.2.5.1 Banking Sector Reforms

Practically all financial sector measures have both efficiency and macroeconomic implications. The most important of these measures are:

(a) a cutback in the Statutory Liquidity Ratio (SLR) from 38.5% to 25% , along with moves to make interest rates on government securities market determined(so that there could be a level playing field for private sector borrowers and the government);

(b) adoption of international best practice (Basel) norms relating to capital adequacy, income recognition, asset classification and provisioning and these were sought to be enforced by strengthening of the RBI's regulatory - cum - supervisory role;

(c) gradual abolition of the system of fixing banks' lending and borrowing rates of interest, except for the rate on short-term (savings) deposit; and

(d) abolition of control of capital issues by the government and constitution of the Securities and Exchange Board of India (SEBI) for making the issues easier and rule based, and functioning of stock exchanges transparent.

While adoption of the Basel norms and strengthening of the regulatory and supervisory role of the RBI (as also of the SEBI) were intended to impart stability to or strengthen the shock absorptive capacity of the financial and hence of the macro-economic system, steps like cutbacks in SLR, removal of controls on interest rates, entry of private firms in the financial market, etc were designed to raise allocative efficiency through greater flows of funds to the relatively productive lines of activity in the economy.

In order to upgrade competition, government ownership in public sector banks was reduced and they were allowed to raise capital from the equity market up to 49 per cent of paid-up capital. Greater participation of private ownership in the financial sector was promoted as well as transparent norms were taken up to enable foreign and joint-venture banks and insurance companies to partake Indian finance and insurance markets. Likewise, Foreign Direct Investment (FDI) as well as portfolio investment in the financial sector was permitted.

The interest rates were set free with a handful of exceptions and there were sharp reductions in pre-emption through reserve requirement. Pure inter-bank call money market was introduced with improved payment cum settlement mechanism. These were done to enhance the role of market forces.

1.2.5.2 Debt Market Reforms

Auction system for the sale of GOI medium and long-term securities as well as 'Repurchase Agreement' (Repos) was introduced. Primary Dealers (PD) were allowed to play market makers in the government securities market. 14 day, 91 day, 182 day and 364 day maturities treasury bills were launched. Delivery versus Payment (DvP) settlement system, Market Stabilization Scheme (MSS), Liquidity Adjustment Facility (LAF) and new instruments like Floating Rate bonds, Capital Indexed bonds, Zero Coupon Bonds were introduced for ensuring lucidity in the trading of government securities. For the first time the Foreign Institutional Investors (FIIs) were allowed to invest in government securities subject to certain limits.

1.2.5.3 Foreign Exchange Market

Reformatory measures allowed the exchange rate regime from a single currency fixed-exchange rate system to fixing the value of rupee against a basket of currencies and further to market-determined floating exchange rate regime. Foreign Exchange Regulation Act (FERA), 1973 was replaced by the market friendly Foreign Exchange Management Act (FEMA), 1999. Authorised dealers were permitted to set off trading positions as well as borrow and invest in overseas market. Also, the Banks were permitted to fix interest rates on non-resident deposits subject to the ratifications issued by RBI. Rupee-foreign currency swap markets were encouraged and participants in the foreign exchange market (including exporters, FIIs and the Indians who invest abroad) were allowed to avail forward cover and enter into swap transactions without any limit, but subject to genuine underlying exposure.

These measures and the subsequent ones were attempted to streamline the financial markets so as to provide resources for fresh investments.

1.2.6 Fiscal Reforms

Fiscal sector reforms were perhaps the most critical part of the macroeconomic stabilisation and reforms initiatives taken by the government after the 1991 economic crisis. Since 1991 several efforts have been made through the annual budget process to achieve tax reforms. These have focused on: (i) expanding the tax base by including services (not previously taxed); (ii) reducing rates of direct taxes for individuals and corporations; (iii) abolishing most export subsidies, (iv) lowering import duties; (v) rationalizing sales tax and reducing the cascading effect of central indirect taxes by introducing a Modified Value Added Tax and a nationwide Value Added Tax; (vi) rationalizing both direct and indirect taxes by removing unnecessary exemptions; (vii) providing for tax incentives for infrastructure and export-oriented sectors, including setting up special (Export) Economic Zones; and (viii) simplification of procedures and efforts for improving the efficiency of the tax administration system especially through computerization.

The thrust of the reforms in all areas has been to open India's markets to international competition, remove exchange rate controls, encourage private investment and participation in industry and, in the finance markets, to liberalise access to foreign capital and to ensure that foreign investment is not penalised merely for being foreign. India's heterogeneity and unity in diversity through a stable democratic system must be appreciated. A country like India, with more than one billion people, some 16 officially recognised major languages, and vast ethnic and religious diversities, poses major governance challenges. India has achieved remarkable success in holding the country together.

Through reform, India overcame its worst economic crisis in the remarkably short period of two years. Through prudent macro-economic stabilisation policies including devaluation of the rupee and other structural economic reforms the balance of payments crisis was clearly over by the end of March 1994. Foreign exchange reserves had risen to the more than adequate level of US$15.07 billion and the current account deficit as a percentage of GDP was nearly eliminated. Export growth rate at 20.0

percent in 1993-94 over the previous year was quite encouraging. Macro-economic stability has endured in the fourteen years of economic reforms to 2007.

The trajectory of India's economic policy has been firmly on the neo-liberal track since the early 1990s, with sustained domestic deregulation and a continuous deepening of the integration with the global economy and we find that the economic reforms have led to fiscal consolidation, control of inflation to some extent, increase in foreign exchange reserve and greater foreign investment and technology towards India. This has helped the Indian economy to grow at a faster rate. Presently more than 100 of the 500 fortune companies have a presence in India as compared to 33 in China.

Since the 1991 reforms and the opening of the Indian economy, the economic growth of the country has been spectacular. Economists from the entire world have conducted studies of various aspects of the Indian economy and have envisaged India becoming an economic powerhouse in the next two decades along with China. For over a century, the United States has been the largest economy in the world. However, since the onset of globalisation in the 1990s, there has been a shift in focus from United States and Western Europe to Asia and Far East. The western European countries have seen a decline in global GDP share by 5 per cent followed by United States and Japan with a decline of 1 per cent each. This slack has been made up by the rising share of India and China in the manufacturing, industries and service sectors. It has been forecasted that the share of United states would further decline from 21 per cent to 18 per cent and that of India will rise from 6 per cent to 11 per cent and will become the third pole in the global economy after United States and China by 2025. By then the Indian economy will almost be 60 per cent the size of the US economy. Today, India is the seventh largest country in the world in terms of geographical area, second most populous country in the world and world's 4th largest economy in terms of purchasing power parity. The ambitious economic reforms initiated by the Government during early 1990s aimed at deregulating the country's economy and stimulating foreign investment and has moved India firmly into the front ranks of the rapidly growing Asia Pacific region. Goldman Sachs identified Brazil, Russia, India and China as the set of large emerging market countries projected to grow rapidly over the next thirty years. Within the group, India's potential growth rate was projected to be the fastest –

around 8 per cent per year – faster even than China which is currently, and has been for many years, the fastest growing economy but is expected to slow down in future. According to this study, by 2040 India will become the third largest economy after the USA and China. This projection has been adopted by the US National Intelligence Council's 2020 report "Mapping the Global Future".

Against this background, we now study the Indian economy in greater detail, specifically the different sectors of the economy as well as India's foreign trade and foreign investment in India.

2. THE INDIAN ECONOMY AND ITS MAIN SECTORS

We undertake to study the economy from the fiscal year 1995-96 to the present 2006-07. We start with 1995-96 because it is assumed that by then the reforms would have gotten quite firmly entrenched within the system and started to show results.

From Table: 3.1, we find a buoyant economy with an average growth rate of around 6.5 per cent over the period from 1995-96 to 2006-07, making India one of the fastest growing among developing countries. The average annual growth rate of 6.5 percent achieved by the Indian economy following the economic reforms is encouraging. Currently, after China, India is among the fastest-growing countries in Asia. Perhaps the most striking feature of the Indian economy during the 90s was that unlike most other developing nations which had adopted IMF sponsored structural adjustment programmes, India did not have to undergo a prolonged period of downturn in its GDP: after a dip in the GDP growth rate during 1991-92, there was a smart spurt from 1992-93 onwards. The growth rate of GDP was higher in 1995-2007 than the corresponding average in the 70s and the 80s.

Since the annual rate of population growth has slowed down significantly to nearly 1.8 percent during the 1990s, per capita income (PCI) has been growing at a healthier real rate of 4.5 percent per annum. The last two years have seen a very high increase in the PCI, at over 7 per cent. India's growing middle class of more than 350 million people, with a reasonably affluent standard of living, provides a huge market for foreign corporations, especially since April 2003, when all quantitative restrictions on imports were lifted.

Table: 3.1 India's GDP and Rate of Inflation

Year	Annual Percentage Change		
	GDP	**Per Capita GDP**	**Inflation**
1995-1996	7.3	5.2	-
1996-1997	8.0	6.1	4.6
1997-1998	4.3	2.9	4.4
1998-1999	6.7	4.4	5.9
1999-2000	6.4	4.2	3.3
2000-2001	4.4	2.5	7.2
2001-2002	5.8	3.9	3.7
2002-2003	3.8	2.1	3.4
2003-2004	8.5	6.7	5.4
2004-2005	7.5	5.8	6.4
2005-2006	9.0	7.3	4.4
2006-2007	9.4	7.5	5.5
Average Annual Growth Rate	**6.5**	**4.5**	-

Source: *Asian Development Outlook, Asian Development Bank; various issues*
Handbook of Statistics on Indian Economy, RBI, India.

While growth rate has picked up in the new millennium, the inflation rate has moderated to still lower levels ensuring price stability. Since 2000–2001, the annual inflation rate as measured by the wholesale price index has averaged below 6 percent, despite the recent oil price shock. The highest annual inflation, on a point-to-point basis, recorded in the new millennium was for 2002–03 (6.5 percent) when the growth rate was adversely affected due to drought conditions in some parts of the country. More recently, the wholesale price inflation after reaching a peak 6.7 percent at end-January 2007, mainly due to food price shocks, has edged downwards to 3.3 percent during the week ended September 29, 2007.

Along with its fairly good growth rate, India has been successful in reducing poverty. The poverty ratio (that is, people below the poverty line as a percentage of the population) as estimated by the Planning Commission at the national level came down from 36 percent in 1993-94 to 19 percent in 2006-07. The poverty ratio during this period declined both in rural areas and in urban areas. There is little doubt that poverty in India has been reduced during the last decade.

Following the conventional classification, an economy is divided into three sectors, that is, agricultural (or primary), manufacturing (or secondary) and service (or tertiary) sectors. The agricultural sector consists of farming, forestry, animal husbandry and fishery. Industry includes mining, quarrying, manufacturing, construction, electricity, water and gas. The manufacturing sector is composed of mining, construction and manufacturing. All other economic activities, except public administration and defense (which is taken separately), which are not covered by the agricultural and manufacturing sectors are broadly defined as services and hence belong to the service sector. They include services provided for the agricultural sector, activities associated with the supply of water, electricity and gas, transport and communications, wholesale and retail trade, finance and insurance, business and personal services, and community and social services.

Not only has the GDP increased but also the direction of growth in the sectors has changed. Earlier the maximum part of the GDP in the economy was generated from the primary sector but now the service industry is devoting the maximum part of the GDP. Along with the rapid expansion of the tertiary sector, the other significant aspect of the structure of growth during the reform period has been the relatively unimpressive-to-dismal performance of the commodity producing sectors, in particular, agriculture and large segments of small-scale manufacturing. Given that the majority of the country's workforce, almost 60 per cent, still depends primarily on agriculture, the depressed performance of this sector is a major problem. In fact, one of the most significant features of contemporary India's macroeconomic scenario is the growing disconnect between the performance of the agricultural and non-agricultural sectors.[1] The services sector remains the growth driver of the economy with a contribution of more than 60 per cent of GDP. India is ranked 18th among the world's leading exporters of services with a share of 1.3 per cent in world exports. The services sector is expected to benefit from the ongoing liberalization of the foreign investment regime into the sector. Software and the Information Technology enabled Services-Business Process Outsourcing (ITeS-BPO) sectors have recorded an exponential growth in recent years.

Share in the GDP from major sectors of the economy and their growth rates can be seen from the following Table.3.2 and Charts: 3.1 (i) and 3.1 (ii).

Table: 3.2 Sectoral Composition of India's GDP

Year	Annual Percentages						
	Agriculture*		Industries		Manufacturing	Services	
	Growth	Share	Growth	Share	Growth	Growth	Share
1995-1996	-0.7	27.3	13.2	21.2	15.5	9.6	51.4
1996-1997	9.9	27.8	8.0	21.2	9.5	6.9	50.9
1997-1998	-2.6	26.0	2.0	20.8	0.1	9.0	53.2
1998-1999	6.3	25.9	3.6	20.2	3.1	8.1	53.9
1999-2000	2.7	25.0	3.5	19.6	3.2	9.3	55.4
2000-2001	-0.2	23.9	6.4	20.0	7.7	5.7	56.1
2001-2002	6.3	24.0	2.4	19.3	2.5	6.8	56.7
2002-2003	-7.2	21.5	6.8	19.9	6.8	7.4	58.7
2003-2004	10.0	21.7	6.0	19.4	6.6	8.9	58.8
2004-2005	0.0	20.2	8.4	19.6	8.7	10.0	60.2
2005-2006	6.0	19.7	8.0	19.4	9.1	10.3	60.9
2006-2007	2.7	18.6	11.0	19.6	12.3	11.0	61.8
Average Annual Growth Rate	**2.6**		**5.6**		**4.7**	**8.4**	

* Agriculture & Allied Activities

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

Chart: 3.1 (i) Sectoral Composition of India's GDP

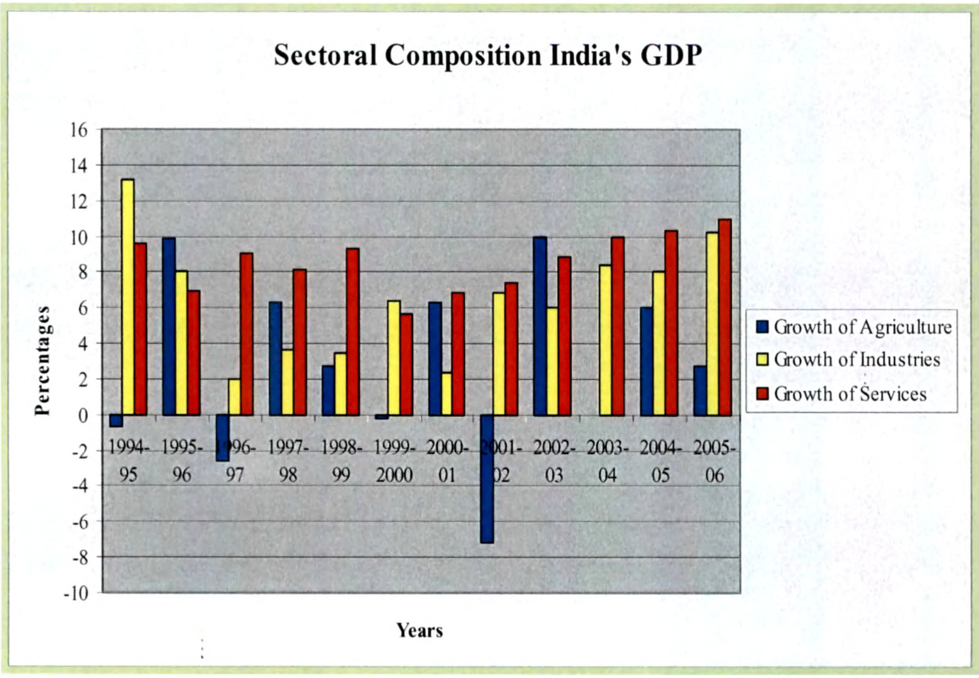
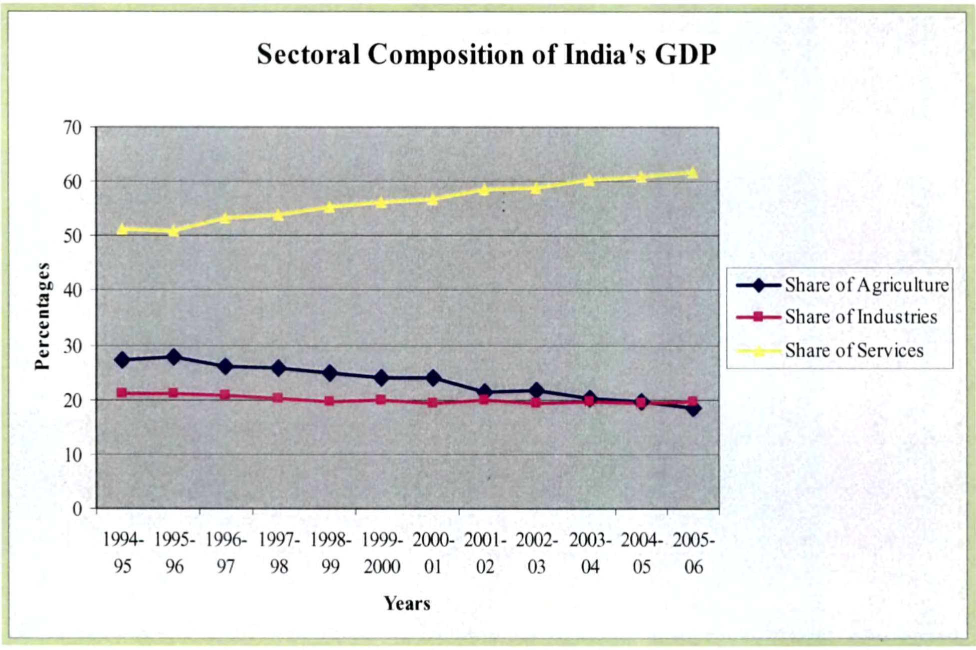


Chart: 3.1 (ii) Sectoral Composition of India's GDP



2.1 Agriculture

The Indian economy has traditionally been significantly dependent on its agricultural sector. Agriculture has been an engine of growth not only due to the output from this sector but also due to the demand and supply linkages to the non-agricultural sector. The most important input in agricultural production is water, for which the country is largely dependent on rainfall. As a result, deficit rainfalls are the most frequent of shocks faced by the Indian economy. Agricultural growth affects the growth of non-agricultural output through demand and supply linkages. Thus, a rainfall shock affects the growth of both the agricultural and non-agricultural sector. More than 60 per cent of the Indian population depends on agriculture for its livelihood, often at just subsistence level. Indian agriculture is characterized by land fragmentation, lack of irrigation facilities and hence a very high dependency level on the vagaries of the South West monsoon, outdated techniques of cultivation, obsolete equipments, etc. All these, specially the monsoon factor, result into a skewed growth story, sometimes there is an impressive growth and at other times it is extremely low. This, in spite of the country having the distinction of the presence of the highest live stock and the maximum amount of land under irrigation, is extremely worrying. In the recent times, reasons like poor rainfall in some regions and floods in others, lack of investment in agriculture, policies of the Indian government, high subsidies provided by the developed countries to their farming sector, etc. have led to less productivity and low price gain of the product for the Indian farmers. There has been a steady decline in the contribution of the agriculture sector towards the national income. In 1951, the share of agriculture in total output was about 60 per cent and steadily declined over the years to account for 34 per cent in 1985-86, 20 per cent in 2005-09 to less than 19 per cent in 2006-07. There is a growing incidence of suicides among the Indian farmers as they are facing bankruptcy due to crop failure and a simultaneous lack of support system. Since the mid-1990s, however, the growth of the agricultural sector has been low as well as volatile. Volatility in agricultural production has implications not only for overall growth but also for maintaining low and stable inflation. Thus, enhanced growth of the agricultural sector is vital for ensuring food security, poverty alleviation, price stability, overall inclusive growth and sustainability of growth of the overall economy.

The fall in contribution of the agricultural sector to the GDP was not compensated by the industrial sector, especially the manufacturing growth did not see the turn-around which was expected of it, except during the last 3 years. We take a closer look at this sector.

2.2 Manufacturing and Industry

The share of industrial sector in the growth of GDP has remained practically stagnant for the past 12 years from 1995-96 to 2006-07. Yet there has been a steady growth of about 6-7 per cent and in recent years about 8 per cent. This sector clocked a growth of 11.0 per cent in 2006-07, the highest for the period taken for this study. This growth in the industrial sector was backed by a superb performance of the manufacturing sector. The pick-up in manufacturing sector, which began in April 2002, sustained its momentum during 2006-07, and in fact at 12.3 per cent, recorded the highest growth ever for the period 199-96 to 2006-07. Manufacturing activity was broad-based, supported by both investment and consumption demand. Electricity generation also aided the growth of this sector.

A congenial domestic investment climate, improvement in world output, a liberalised foreign direct investment (FDI) regime and surging manufacturing exports supported the buoyant performance of the manufacturing sector in the latter years. Intensified competition has encouraged a process of consolidation and restructuring of the Indian industry in tune with global supply and demand conditions as integration with the global production gathers pace. Also, sustained expansion in domestic as well as export demand, increased capacity utilisation, augmentation of capacities and positive business and consumer confidence underpinned the strength of the manufacturing sector.

The most significant feature of the recent years has been a dramatic increase in the share of the tertiary sector.

2.3 Service Sector

Since the mid-1990s, the share of the tertiary sector in the economy has gone up from about 51 per cent in 1995-96 to nearly 62 percent per in 2006-07. In fact, well over 60 per cent of the incremental growth in GDP since the mid-1990s is accounted for by the rate of growth of the services sector. The magnitude of the entire increase in the share of the tertiary sector in the country's GDP since the early 1990s is almost equal to the decline in the share of the primary sector, and the proportion of the secondary sector has remained roughly the same during this period. In other words, the performance of the commodity producing sectors during the reform period has been relatively poor compared to the services sector.

The service sector has become the dominant contributor to the Indian economy, accounting for 62 per cent of GDP in 2006-07. The success in this sector is regarded as "India's services revolution" (Gordon and Gupta 2004)[2]. The service sector has displayed a consistent growth pattern since 1995 and almost all sub sectors like banking, healthcare, insurance, hospitalility, transport, media and the most important of all telecommunications and information technology have contributed to a vast extent to the growth of the Indian economy in the past years to the present period. This sector has compensated for the decline in the contribution of the agricultural sector.

3. THE EXTERNAL SECTOR

India embarked on the path of globalisation in the early 1990s with the objective of improving overall productivity, competitiveness and efficiency of the economy in order to attain a higher growth profile. Concomitantly, industrial, financial and external sector reforms were initiated with a view to creating an environment conducive for the expansion of trade.

3.1 India's Foreign Trade

As a result of the above measures, growth in trade accelerated in the early part of the 1990s. This momentum, however, could not be sustained in the face of various domestic bottlenecks and exogenous constraints. In the later part of the decade with the crises in East Asia, Russia and some of the Latin American countries followed by the slowdown in the US economy, world trade witnessed a downturn. These external factors along with stagnation in investment rate, sluggish industrial growth and slowdown in manufacturing productivity predicated India's trade during the closing years of the 1990s. But, the new millennium brought with it an upswing in India's external trade. The turn of the century has witnessed rapid growth in the country's merchandise trade as imports and exports have risen at a much rapid rates of 22 and 28 per cent respectively over the five-year period, from 2002-03 to 2006-07. Though India's international trade has grown manifold, yet its share in the global international trade (exports and imports taken together) was just 1.2 per cent in 2006-07 (of course, it has grown from as less as just 0.5 percent, which is another encouraging trend).

During 2006-07, India's exports and imports were 1.0 per cent and 1.4 per cent of world exports and imports, respectively. India was the 28th largest exporter and the 17th largest importer in the world in 2006[3]. This failure to make a mark in the world trade has been primarily due to two factors. Firstly, the short sighted policies and priorities of the Indian government like price controls etc. and secondly, due to the policies of the developed countries of the west chiefly the United States like offering huge subsidies to its farmers, etc. The Foreign Trade Policy 2004-2009 (FTP 04-09) has an ambitious export target - that of doubling the existing share in world trade by 2009 (about 1.5 per cent share).

Table: 3.3 India's Foreign Trade

Year	Annual Percentage Changes						
	Merchandise Exports	Merchandise Imports	Services* Exports	Services* Imports	Total Exports	Total Imports	Total Trade@
1995-1996	28.5	36.4	28.5	46.7	28.5	28.4	33.3
1996-1997	11.7	13.2	6.5	-5.7	10.7	9.3	10.4
1997-1998	9.5	11.0	29.5	26.8	13.1	9.7	13.2
1998-1999	7.4	15.7	55.6	52.4	17.4	6.4	19.6
1999-2000	14.2	20.7	23.8	9.4	16.8	12	17.7
2000-2001	27.6	7.3	9.1	32.2	22.2	10	16.6
2001-2002	2.7	6.2	10.8	-1.1	4.8	-0.3	4.7
2002-2003	22.1	21.2	24.9	26.6	22.8	10.1	22.6
2003-2004	15.0	20.8	23.3	-7.2	17.3	26.9	16.0
2004-2005	27.9	39.5	57.2	62.3	36.5	39	40.1
2005-2006	21.6	31.8	41.1	33.6	28.2	37.9	30.3
2006-2007	25.2	30.6	35.1	32.3	28.9	26.9	30.0
Average Annual Growth Rate (2002-03 to 2006-07)	**21.9**	**27.9**	-	-	-		-

* Commercial Services (Services excluding government services)

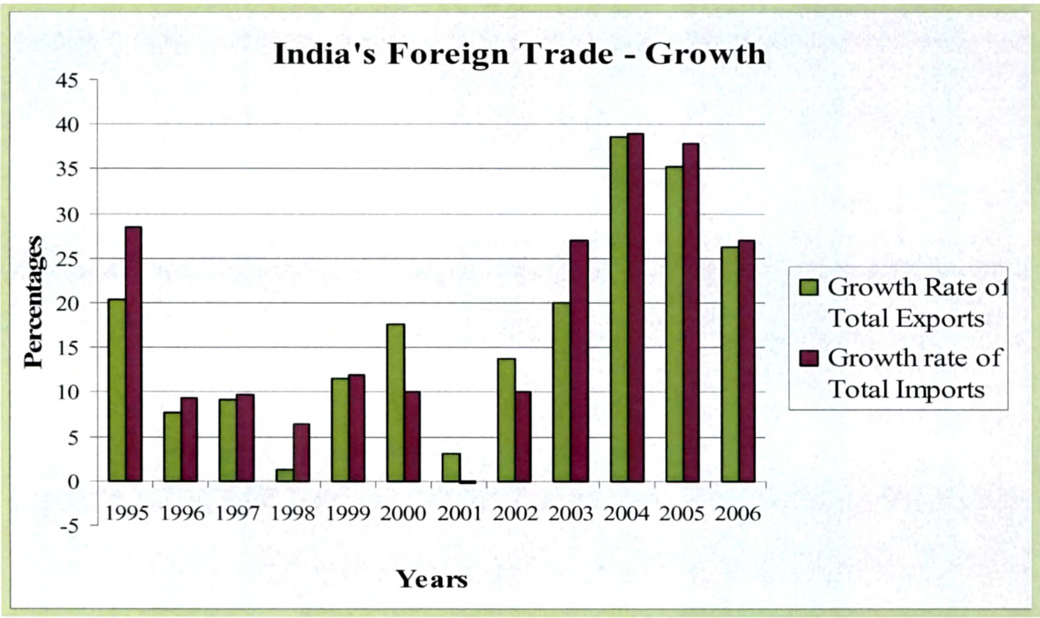
@ Total Trade = Merchandise Trade + Services Trade (Exports and Imports both)

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

During 2006-07, India's merchandise exports recorded a growth of 25.2 per cent to reach Rs. 571.6 crores whereas India's merchandise imports were Rs. 862.3 crores, at a growth rate of 30.6 per cent, a rate lower than the previous fiscal, as seen from Table: 3.3.

Total exports grew at a rate higher than merchandise exports, on the back of high service exports which clocked a growth of 35 per cent, though service exports as well as imports both grew at a slower rate as compared to the previous year. Total trade showed more or less the same growth as the previous fiscal. India's total imports (merchandise plus commercial services) show a higher growth than its total exports, barring a couple of years as seen in Chart: 3.2 below.

Chart: 3.2 India's Foreign Trade – Growth



3.1.1 Sectoral Composition of India's Foreign Trade

Analysing India's foreign trade sector-wise, we observe a sharp increase in both the exports and imports of goods and services since 1995. The sectoral composition of trade is seen in the table below (Table: 3.4) and charts: 3.3 (i) and 3.3 (ii). While merchandise goods have always accounted for a high share in total exports and imports, there seems to be little growth in its share of imports and declining growth in its share of exports. By contrast, we see a rising share of service exports from 1995. This increase occurs until 1999, remaining some what constant for a few years, only to rise once again after 2003. In sum, over a span of 12 years starting in 1995, the share of service sector exports in total exports has grown from 18 percent to 38 percent.

Table: 3.4 Sectoral Composition of India's Foreign Trade

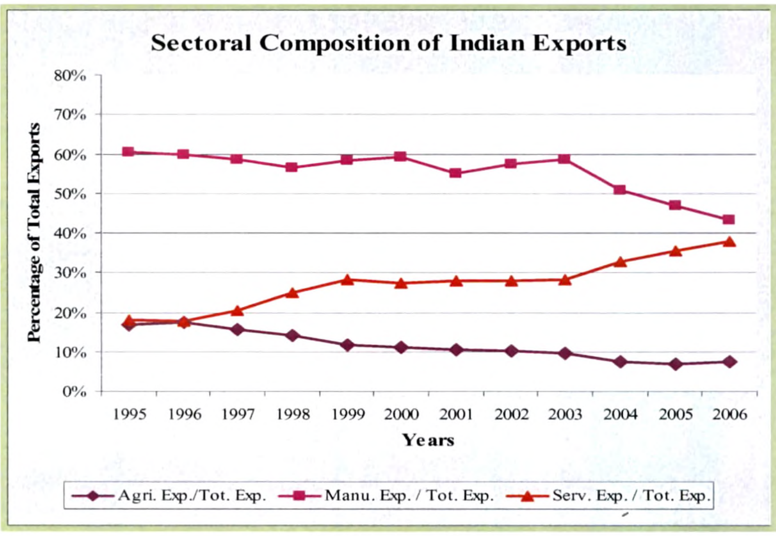
Year	Exports				Imports			
	Total Exports (% growth)	Agri. Exp./ Tot. Exp. (%)	Manuf. Exp./ Tot. Exp. (%)	Serv. Exp./ Tot. Exp. (%)	Total Imports (% growth)	Agri. Imp./ Tot. Imp. (%)	Manuf. Imp./ Tot. Imp. (%)	Serv. Imp./ Tot. Imp. (%)
1995-1996	20.4	16.9	62.1	18.1	28.4	6.7	43.1	22.5
1996-1997	7.7	17.5	59.9	17.8	9.3	6.2	39.0	22.5
1997-1998	9.1	15.6	58.6	20.3	9.7	6.6	38.6	22.9
1998-1999	1.3	14.0	56.6	24.9	6.4	8.1	35.1	24.8
1999-2000	11.6	11.7	58.4	28.2	12.0	7.6	35.6	26.6
2000-2001	17.6	11.0	59.2	27.4	10.0	5.5	31.3	26.8
2001-2002	3.0	10.4	55.0	27.9	-0.3	6.9	33.6	28.2
2002-2003	13.7	10.3	57.4	28.0	10.1	6.6	37.9	26.9
2003-2004	20.0	9.7	58.5	28.1	26.9	6.6	39.1	26.0
2004-2005	38.5	7.6	50.9	32.7	39.0	5.1	37.6	26.8
2005-2006	35.3	7.0	47.0	35.4	37.9	3.9	38.6	26.2
2006-2007	26.2	7.4	43.2	38.0	26.9	3.3	38.3	26.7

Agri. Prod. – Agricultural Products; Manuf. – Manufactures; Serv. – Comm. Services (Services excluding government services)

Source: *International Trade Statistics, WTO; various issues and Statistics Database, WTO.*

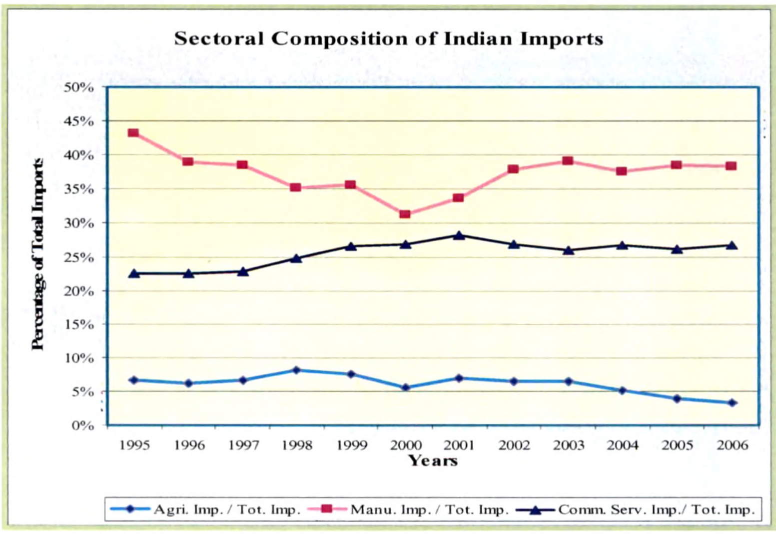
Service sector imports have also increased from about 22 per cent in 1995-96 to about 27 percent of aggregate imports in 2004-05 and then again declined and have remained more or less constant between 26 and 27 per cent of the total imports of goods and services.

Chart: 3.3 (i) Sectoral Composition of India's Exports



Agricultural trade has shown a declining trend with agricultural exports decreasing from around 17 per cent in 1995 to just 7.4 per cent of total exports in 2006 and imports decreasing from 6.7 per cent to just 3.3 per cent of total imports over the same time frame, reflecting the self sufficiency in food production that India has achieved.

Chart: 3.3 (ii) Sectoral Composition of India's Imports



Since this thesis deals with transportation, maritime transport to be exact, we take into consideration here only merchandise trade as trade in services does not involve movement of goods across borders the way merchandise trade does.

3.1.2 India's Merchandise Trade

The structure of India's imports has undergone a change since the opening up of the Indian economy. With the move away from 'import substitution' and towards promotion of trade based on dynamic advantage, the policy distinction between essential imports and otherwise has gradually subsided.

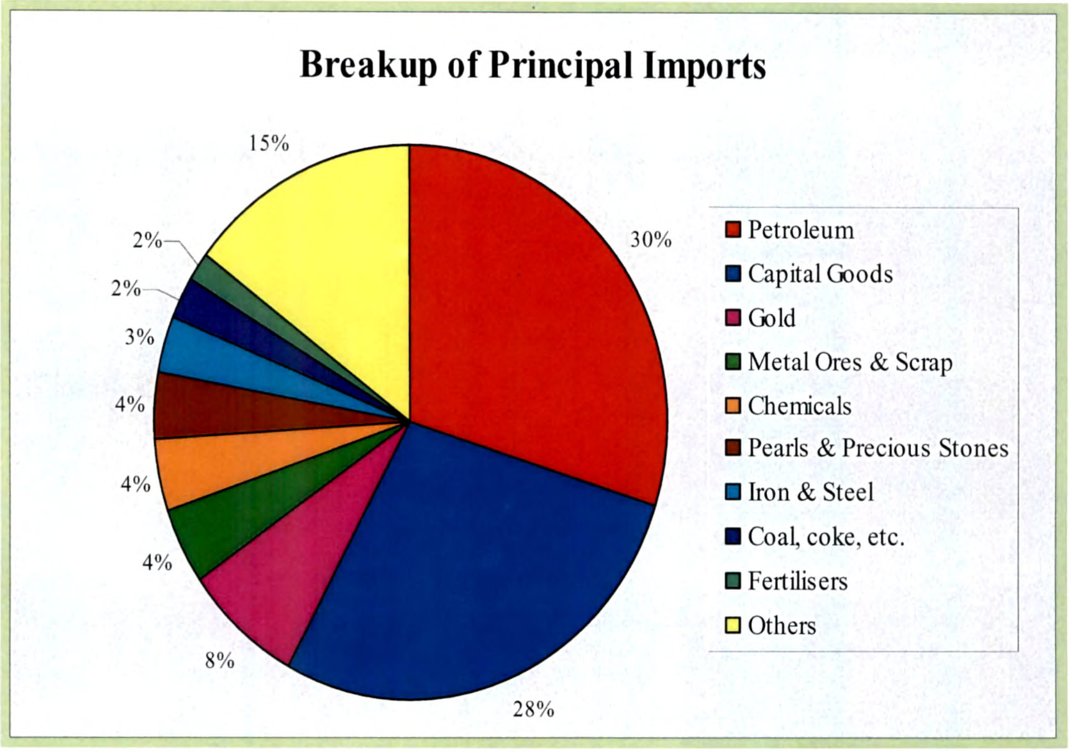
Table: 3.5 Principal Merchandise Imports, 2006-07

Products	Percentage Share
Petroleum, Crude & Products	30
Capital Goods	28
Gold	8
Metal Ores and Scraps	4
Chemicals	4
Pearls and Precious Stones	4
Iron and Steel	3
Coal, Coke, etc.	2
Fertilisers	2
Others	15

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

Commodity-wise analysis (Table:3.5 and Chart:3.4) reveals that while petroleum still continues to have a dominant presence in India's imports, capital goods and other intermediary products for export purposes have emerged as key items of imports in the current year. Within the petroleum imports, there has been a shift from import of petroleum products towards crude imports following a large scale increase of refinery capacity over time. Furthermore, India has transformed itself from a net importer of finished petroleum products to net exporter of the same from 2001-02, products mostly comprising of Naphtha, Petrol, Aviation Turbine Fuel (ATF) and Diesel[4].

Chart: 3.4 Breakup of Principal Merchandise Imports, 2006-07



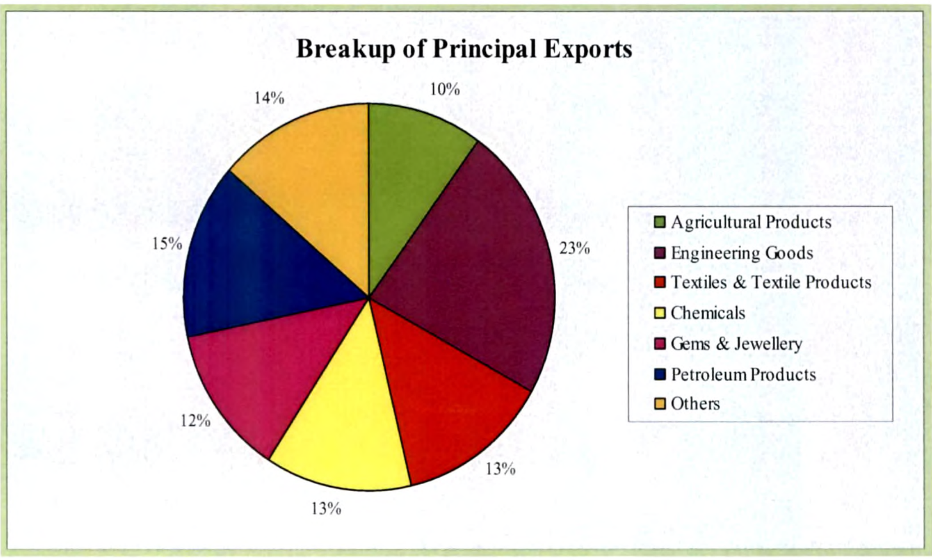
As seen from Table: 3.6 and Chart: 3.5, India's merchandise exports are predominated by the manufacturing sector which accounted for more than two-third of its total exports during 2006-07. There has, however, been considerable re-orientation of relative importance of products within the manufacturing sector. The main drivers within the manufactured product groups were chemicals and allied products, engineering goods, ready-made garments, textile yarn, fabrics, made-ups, and gems and jewellery. The importance of primary products in the export basket has witnessed a steady decline over the years to stand at just 10 per cent of the merchandise exports whereas exports of petroleum products have shown a dramatic rise, with them accounting for 15 per cent of the total exports in 2006-07; thus reflecting the increasing refining capacities within the country. Export growth in 2006-07 was driven mainly by petroleum products with 63 per cent growth and engineering goods with nearly 34 per cent growth. The perceptible increase in the share of petroleum products in total exports reflected not only the rise in POL prices but also India's enhanced refining capacity. The rising share of engineering goods reflected India's revival of heavy manufactures.

Table: 3.6 Principal Merchandise Exports, 2006-07

Products	Percentage Share	Percentage Growth
Agricultural Products	**10**	**24**
Manufactured Goods	**68**	**17**
of which		
(i) Engineering Goods	23	34
(ii) Textiles & Textile Products	13	06
(iii) Chemicals	13	19
(iv) Gems & Jewellery	12	03
Petroleum Products	**15**	**63**
Others	**14**	**-**

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

Chart: 3.5 Breakup of Principal Merchandise Exports, 2006-07



As seen from the above table and chart, India's exports of engineering goods have shown a phenomenal growth in an environment of increasing openness of the economy and supportive policy framework. Since the early 1990s, exports of engineering goods have increased from US $ 1.2 billion in 1987-88 to US $ 29.0 billion in 2006-07[5]. As seen from Table: 3.7, in the recent five years (2002-03 to 2006-07), exports of engineering goods recorded an annual average growth of 33.2 per cent. As a result, their share in India's total exports has increased sharply and they now contribute more than one-fifth of India's total exports. Since 2004-05, engineering goods have emerged as the largest item of manufacturing exports, surpassing the exports of textiles and gems and jewellery[6]. According to the Engineering Export Promotion Council (EEPC), almost 40 per cent of engineering goods exports is contributed by small and medium enterprises.

Table: 3.7 Exports of Engineering Goods

Year	Annual Percentage Change	
	Growth	Share in Total Exports
2002-2003	29.8	17.1
2003-2004	37.3	19.4
2004-2005	39.8	20.8
2005-2006	25.2	21.1
2006-2007	33.9	23.0
Annual Average Growth	**33.2**	-

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

The shock of falling world trade affects almost all countries. Of course, the impact is stronger on countries that are more open and globalised. The Indian economy is no exception and since it has become more and more open in the last decade and a half, it is now more prone to such shocks. As a result, India exports are significantly dependent on the trends in world imports.

3.1.3 Trade Openness

Higher trade openness is generally associated with export-oriented economies. Trade openness, conventionally measured as the sum of exports and imports of goods as a ratio of GDP, brings out clearly the growing trade liberalisation over time. While the available empirical evidence as to whether exports cause economic growth or vice versa still remains inconclusive, most recent studies suggest that trade liberalisation contributes to growth and that trade openness is an important factor behind higher productivity and per capita income. At the same time, protected industries appear to have slower growth than others, reflecting the fact that growth in productivity is as much because of acquisition of sophisticated technology as it is due to learning by doing. Open trade and liberal capital account policies allow a country to exploit comparative advantage in production, promote lowest cost product import with embedded advanced technology, and to deploy larger variety of intermediate and capital goods to enhance the productivity of its own resources. It may be difficult, however, to segregate the effect of trade openness on growth from other institutional mechanisms or policy reforms. India's linkages with the global economy are getting stronger, underpinned by the growing openness of the economy.

The Indian economy has become much more open during the reference period 1995-96 to 2006-07, with (a) merchandise trade - GDP ratios recording spectacular increases from 19.2 per cent to 34.8 per cent; and (b) a rise in the country's share of exports in world trade from below 0.5 per cent to 1.2 per cent in 2006-07[7].

Table: 3.8 Analysis of India's External Sector

Year	Merch. Exports/GDP (%)	Merch. Imports/GDP (%)
1995-1996	8.9	10.3
1996-1997	8.9	12.8
1997-1998	8.7	12.5
1998-1999	8.2	11.4
1999-2000	8.3	12.3
2000-2001	9.9	12.6
2001-2002	9.4	11.8
2002-2003	10.6	12.7
2003-2004	11.0	13.3
2004-2005	12.2	17.1
2005-2006	13.1	19.5
2006-2007	14.0	20.9

Source: *Annual Report, RBI, India; various issues.*

Analysing the above further in table: 3.8, we find that, as a proportion of GDP, on balance of payments (BoP) basis, exports rose from a level of 8.9 per cent in 1995-96 to reach a level of 14.0 per cent of GDP in 2006-07 while imports in 2006-07, as a proportion of GDP, on BoP basis, were placed at 20.9 per cent of GDP as compared to 10.3 per cent in 1995-96.

Thus, the last few years have seen India integrate into the world economy as never before. An important indicator of gains from economic reforms, reflecting the attractiveness of India as an investment destination and, in turn, leading to an increase in the industrial activity in the country, is shown by the increasing inflows of both FDI and portfolio investments into India.

3.1.4 Foreign Investment Inflows

Major changes in foreign investment policy were introduced in 1991 as a part of the economic reforms programme. The foreign investment regime now operates on the "negative list" approach such that except specific restrictions spelled out in the foreign direct investment (FDI) policy and subject to sectoral rules and regulations; up to 100 percent foreign investment is permitted under the automatic route. Foreign investment is now freely allowed in all sectors including the services sector, subject to specified sectoral ceilings. Since 2000, all industries, except a small list, have been brought under the purview of the automatic route. Exceptions include retail trade where no foreign investment is allowed (except single-brand product retailing where foreign investment up to 51 percent is allowed) and insurance, defense, and publishing of newspapers and periodicals dealing with current affairs, where foreign investment is limited to 26 percent. Under the automatic route, prior approval is not required; only the reporting stipulations have to be met for monitoring purposes.

India follows the internationally accepted definition of FDI. According to the IMF definition, FDI is the category of international investment that reflects the objective of obtaining a lasting interest by a resident entity in one economy in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise, and a significant degree of influence by the investor on the management of the enterprise. In line with international best practices, FDI includes both equity capital, reinvested earnings (retained earnings of FDI companies) and 'other direct capital' (inter-corporate debt transactions between related entities). The policy towards FDI inflows is reviewed regularly by the government and FDI limits in several sectors, including banking, petroleum and natural gas have been revised to create an enabling environment for FDI inflows along with infusion of new technologies and management practices.

One of the major forces changing the face and structure of international capital markets since 1990s has been the flow of cross border portfolio investments - especially by FIIs, from developed countries to the developing countries. According to the IMF definition, portfolio investment refers to cross-border transactions and positions involving debt or equity securities, other than those included in direct investment or reserve assets. Portfolio investors provide institutional character to the capital markets, together with highly intensive research and diversified investments. FII investments inject global liquidity into the markets, raise the price-earning ratio and thereby reduce the cost of capital. Foreign Institutional Investors (FIIs) are allowed to invest relatively freely in India's capital market with forward cover available on all investments. Prior to 1992, only non-resident Indians (NRIs) and overseas corporate bodies (OCBs) were allowed to undertake portfolio investment in India. In line with the recommendations of the High Level Committee on Balance of Payments (Chairman: C. Rangarajan), FIIs were allowed to invest in the Indian debt and equity market. In India, FIIs cover overseas pension funds, mutual funds, investment trusts, asset management companies, nominee companies, banks, institutional portfolio managers, university funds, endowments, foundations, charitable trusts, charitable societies, trustees or power of attorney holders incorporated or established outside India proposing to make proprietary investments or investments on behalf of a broad-based fund (*i.e.*, fund having more than 20 investors with no single investor holding more than 10 per cent of the shares or units of the fund). Ceilings on FII investments have been progressively relaxed and at present, aggregate investment by FIIs in a company are allowed within the sectoral cap prescribed for FDI. Apart from equity, FIIs registered under the 100 per cent debt route can invest in both Government and corporate debt instruments.

In India, foreign capital inflows are broadly categorised into non-debt and debt creating inflows. The former includes FDI and portfolio investments while the latter includes all the debt creating instruments like external commercial borrowings (ECBs), external assistance, NRI deposits, etc.

As can be seen from Table: 3.9 below, over the years, the total capital inflows into the country have demonstrated volatile swings, both up as well as down, with the year 2006-07 showing the highest upswing. This was a reflection of growing investor interest in India's growth prospects as well as global liquidity conditions. During 2006-07, capital flows (net) were US $ 44.9 billion led by external commercial borrowings and foreign direct investment flows.

Table: 3.9 Foreign Capital Inflows

Year	Total Capital Inflows (% growth)	FDI/Total Capital Inflows (%)	FDI/GDP (%)	Portfolio Investment/ Total Capital Inflows (%)	External Commercial Borrowings/ Total Capital Inflows (%)
2000-01	-	45.6	0.9	31.2	48.6
2001-02	-3.3	71.6	1.3	23.6	-18.6
2002-03	26.8	46.5	1.0	9.0	-15.7
2003-04	54.4	25.8	0.7	67.9	-17.5
2004-05	67.4	21.4	0.9	33.2	19.4
2005-06	-16.5	32.7	1.0	53.4	12.7
2006-07	92.1	43.3	2.1	15.5	36.5

Note : Data on FDI have been revised since 2000-01 with expanded coverage to approach international best practices. FDI data since 2000-01 include, besides equity capital, 'reinvested earnings' (retained earnings of FDI companies) and 'other direct capital' (inter corporate debt transactions between related entities). FDI data for previous years would not be comparable with those figures and so have not been included here.

Source: *Annual Report, RBI, India; various issues.*

We analyse the capital inflows in a greater detail now. Expansion in domestic activity, positive investment climate, progressive liberalisation of the FDI policy regime, and simplification of procedures have led to an increase in FDI flows in recent years, with the sharpest increase being recorded in 2006-07. Foreign direct investment (FDI) to India increased sharply from US $ 7.7 billion during 2005-06 to US $ 19.5 billion during 2006-07[8] (an increase of 153 per cent). The rising pace of mergers and acquisitions in sectors such as financial services, manufacturing, banking services, information technology and construction also boosted FDI inflows, which currently accounts for 43.3 per cent of total capital inflows into the country. According to Annual Report, 2006-07 (RBI), sector-wise, manufacturing industries and services, particularly finance and business services, remained the major beneficiary of FDI inflows. The services sector attracted the maximum FDI inflows (US $ 6.1 billion in 2006-07 as compared with US $ 1.4 billion in 2005-06). FDI inflows into the construction sector and 'financing, real estate, and business services' increased substantially during 2006-07. Though the share of FDI inflows taken as percentage of GDP has increased recently, from 0.9 per cent in 2000-1 to 2.1 per cent in 2006-07, it is still quite low when compared to other developing/emerging market economies. The FDI inflows into India, if compared with China, Brazil, Mexico, Poland and Bulgaria is substantially low[9]. Thus, there is still a lot of scope for India to attract more FDI. FDI flows into India during 2006-07 were significantly higher than portfolio flows, which stood at just 15.5 per cent of total capital inflows.

External Commercial Borrowings (ECBs) provide an additional source of funds for corporates to finance the expansion of existing capacity as well as new investment, taking cognisance of interest rate differentials between domestic and international markets and the associated market risks. Loans raised by resident entities from international capital markets with maturity of more than three years are classified as ECBs. ECBs include commercial bank loans, buyers' credit, suppliers' credit, securitised instruments such as Floating Rate Notes and Fixed Rate Bonds and, commercial borrowings from the private sector window of multilateral financial institutions such as International Financial Corporation (IFC) and Asian Development Bank (ADB). An important objective of ECB policy in India has been to provide flexibility in borrowings by Indian corporates, while maintaining prudent limits for total external borrowings. In the 1990s the policy on ECBs was made transparent and procedures streamlined to enable borrowers to improved access to international financial markets. One of the guiding principles for ECB policy has been to encourage infrastructure financing since such facilities are crucial for the overall growth of the economy. The policy stance on ECB is regularly reviewed and revised by the Government in consultation with the Reserve Bank taking into account factors such as current macro economic situation, borrowing requirements of the corporate sector, domestic liquidity conditions and external debt parameters. ECB can be raised through two routes, *viz.*, (i) Automatic Route and (ii) Approval Route. Under the present guidelines, corporates in India can avail ECB up to US $ 500 million during a financial year under the Automatic Route, with minimum average maturity period of 5 years; in addition, US $ 250 million with average maturity of more than 10 years is permitted under the Automatic Route. ECBs above these limits come under the Approval Route. As seen from Table: 3.9, over the years, ECBs as a percentage of total capital inflows have registered a great instability, with even negative results in a few years. Though, gross disbursements under ECBs rose from US $ 14.5 billion during 2005-06 to US $ 20.6 billion during 2006-07[10], thus contributing highly to the capital inflows at 36.5 per cent of the total inflows into the country. This reflected sustained domestic investment demand as well as import demand in the face of a hardening of domestic interest rates. Greater risk appetite of global investors for emerging market bonds also facilitated higher ECB drawings.

India's economy has successfully moved into a higher trajectory of growth and displayed strong dynamism in selected sectors as seen in the above paragraphs. This encouraging performance brightens the prospects for stepping up India's growth rate and improving the competitive edge in the years to come through further appropriate economic reforms.

Kelkar (2004)[11] has noted that Indian economy has been much less volatile in the last 20 years compared with the period before. In a recent influential paper, Rodrik and Subramaniam (2004)[12] have gone further and suggested that India will do even better over the next two decades and most likely outperform China. The two authors' optimism about the future course of the Indian economy is shared by other leading economists and organizations, including notably Goldman-Sachs. There are two major reasons for these very positive assessments of the Indian economy. The first is that

India is thought to have a high level of institutional development, much higher than that of China's. India's advantage lies in achieving functioning democracy and other associated institutions at various levels. This is in accordance with the current theories of development economics which suggest that institutions are the most important 'deep' determinants of economic development. The second reason for optimism about the Indian economy is that Indian labour force is expected to grow over the next several decades at a faster rate than that of China and other competitor countries. In a growth accounting framework, which is the basic analytical tool used by Rodrik and Subramaniam for their projections, a faster growth of labour input should lead to a faster output growth.

The process of economic policy reforms and liberalisation by the centre in different segments of the economy relaxed the constraints and regulation of economic activities. Concomitantly, the states also got more freedom and flexibility with which to pursue their respective goals of economic and social growth and welfare. Gujarat was no exception. It responded very well to the reforms sweeping the country and was in fact, one of the first states to simultaneously undertake a serious exercise in economic reforms by setting up the state finance commission in 1992. The "Agenda for Reform" given to the government by the commission was not only accepted by the government of Gujarat, but was also endorsed by all the political parties in the state.

Several changes have taken place in the policy framework as well as industrial environment in Gujarat, especially after 1991. Stability in policy formulation and execution has helped Gujarat generate confidence among investors. The economic policy reforms and liberalisation at the national level had considerable impact on the Gujarat economy.

4. GUJARAT – INDIA'S PREMIER STATE

Gujarat is a land of entrepreneurs. Gujaratis are spread not only nation-wide but also world-wide for the sake of business. The people of Gujarat are globally recognized as highly entrepreneurial and industrious. The risk taking ability, along with the mature level of commercial knowledge, has made the State the fountainhead of a new enterprise. The 1991 liberalisation process initiated and continued by the Government of India which enhanced industrial and trading activities in the country also translated into a massive spurt of industrialisation in Gujarat and helped make it one of the foremost industrial states, currently ranking second amongst the most industrially developed states in the country and enjoying a high growth of GSDP. Gujarat continues to occupy a distinctive position in the Indian economy. With 5 percent of the country's population and 6 percent of the country's geographical area, Gujarat contributes to about 13 percent of industrial production in India. The State has witnessed an annual average growth of 7.5 per cent in the last seven years (GDP is estimated at Rs.169 crores) and an average industrial growth of 15 percent for the same period. Accounting for over 12.5 percent of the industrial production of India, Gujarat has demonstrated leadership in many areas of manufacturing and infrastructure sectors.

The labour force in Gujarat is reasonably skilled in areas such as diamonds, chemicals, petrochemicals and pharmaceutical sectors. The cost of labour is also competitive in Gujarat, which along with the impressive infrastructure adds to the overall productivity of the State. Gujarat is one of the most urbanized states in the country with nearly 40 per cent of population residing in urban areas[13]. This has had a positive influence on the growth of industry in the State.

4.1 Economic Profile of Gujarat

Growing at an annual average of 7.5 per cent per annum at constant 1999-2000 prices during the period 1999-2000 to 2005-06, Gujarat's Gross State Domestic Product (GSDP) was Rs. 169 millions in 2005-06, as seen from Table: 3.10. Its sectoral composition has been as follows: The share of agriculture has been between 14 and 18 per cent, with the current year recording nearly 16 per cent share; industry has always shown a healthy share of around 33 to 36 per cent, with the current year marking a share of nearly 35 per cent; the manufacturing sector in the GSDP of Gujarat has been contributing between 27 and 31 per cent to the GSDP and in the current year stands at around 29 per cent. Lastly, the services sector, keeping in trend with the overall national scenario, has shown itself as the highest contributor to the GSDP – its share ranging between 48 to 51 per cent. Of the services sector, it was the trade, hotels and restaurants sub-sector which had a larger share in the contribution towards the GSDP.

Table: 3.10 Composition of Gujarat's GSDP and its Contribution at National Level

Year	GSDP (% Growth)	% Share in GSDP				% Share at National Level				
		Agri.	Ind.	Mfg.	Serv.	GSDP	Agri.	Ind.	Mfg.	Serv.
1999-2000	-	16.1	36.0	30.8	47.9	6.1	4.0	11.3	12.8	5.3
2000-2001	-4.9	14.6	34.6	29.4	50.8	5.6	3.4	9.7	10.8	5.1
2001-2002	8.4	17.6	33.2	27.1	49.2	5.7	4.2	9.9	10.5	5.0
2002-2003	8.1	13.7	35.8	29.0	50.5	6.0	3.8	10.8	11.4	5.1
2003-2004	14.8	17.5	33.5	28.3	49.0	6.3	5.1	10.9	12.0	5.3
2004-2005	7.4	13.6	36.0	30.2	50.5	6.3	4.2	11.6	12.6	5.3
2005-2006	12.2	15.6	34.7	29.4	49.8	6.5	5.2	11.6	12.6	5.3
Avg. Annual Growth	**7.5**									

Agri. – Agriculture & Allied Activities; Ind. – Industry; Mfg. – Manufacturing; Serv. - Services

Source: *www.mospi.nic.in (State Domestic Price Series at the new 1999-2000 prices are available only from 1999-2000 to 2005-06, as on 18th December, 2007).*

Table: 3.11 Comparisons of the State and National Sectoral Growth Rates

Year	GDP	GSDP	Sector-wise Growth (National GDP)				Sector-wise Growth (GSDP)				Per Capita GDP	Per Capita GSDP
			Agri.	Ind.	Mfg.	Serv.	Agri.	Ind.	Mfg.	Serv.		
1999-2000	-	-	-	-	-	-	-	-	-	-	17847	22395
2000-2001	4.4	-4.9	-0.2	6.4	7.7	5.7	-14.0	-8.4	-9.0	0.8	18300	20827
2001-2002	5.8	8.4	6.3	2.4	2.5	6.8	30.9	3.8	0.0	5.1	19007	22060
2002-2003	3.8	8.1	-7.2	6.8	6.8	7.4	-15.6	16.7	15.4	10.9	19410	23522
2003-2004	8.5	14.8	10.0	6.0	6.6	8.9	46.4	7.3	12.0	11.4	20714	26556
2004-2005	7.5	7.4	0.0	8.4	8.7	10.0	-16.9	15.3	14.7	10.6	21923	28064
2005-2006	9.0	12.2	6.0	8.0	9.1	10.3	29.1	8.2	9.1	10.6	23528	31012
Avg. Annual Growth Rate	**6.2**	**7.5**	**2.3**	**5.9**	**6.4**	**8.0**	**6.9**	**6.8**	**6.7**	**6.2**	**-**	**-**

Agri. – Agriculture & Allied Activities; Ind. – Industry; Mfg. – Manufacturing; Serv. - Services

Source: *www.mospi.nic.in*

As seen from table: 3.10, at the national level, in the current year, the Gross State Domestic Product (GSDP) accounts for 6.5 per cent of the Gross Domestic Product (GDP). The contribution of the different sectors at the national level are: Gujarat's agriculture output has contributed 5.2 per cent to the national agricultural produce, industry and manufacturing sectors have contributed substantially at 11.6 and 12.6 per cent respectively to the national industrial and manufacturing production and the services sector has contributed just around 5 per cent at the national level. The high contribution of the manufacturing sector at the national level shows the dynamism of this sector in the state.

From the Table: 3.11, on comparing the GSDP with the GDP, we find that, barring a few exceptions, GSDP has grown at a rate higher than the GDP and has averaged at 7.5 per cent as compared to 6.3 per cent of the GDP for the corresponding time period. In the seven year period 1999-2000 to 2005-06, at constant 1999-2000 prices, agriculture has shown an extremely high growth in Gujarat at nearly 7 per cent as compared to the national level of just 2.3 per cent. The industries and manufacturing in Gujarat have also been growing at a substantially higher growth rates, both at an average of 6.9 per cent and 6.8 per cent as compared to the national figures of 5.9 and 6.4 per cent respectively. The figures of the key growth parameters of Gujarat underline the importance of the state in the Indian economy. It is only in the service sector that the state is lagging behind in its growth as compared to the national growth. This sector grew at an average growth of around 6 per cent at the state level as compared to 8 per cent at the national level.

As seen in tables above, Gujarat is a powerhouse of industrial growth and is the strong-arm of the nation's industrial and trade performance. It has witnessed impressive industrial development since its formation as a state in 1960 and has a strong, well diversified and high value added industrial base. The industrial sector at present comprises of over 1200 large industries and over 3,12,000 micro, small and medium industries. As per the results of the Annual Survey of Industry (ASI), 2004-05 carried out by the Central Statistical Organization (CSO), under Ministry of Statistics and Programme Implementation, Government of India, Gujarat accounts for 17.2 per cent of fixed capital investment, 15.6 per cent of value of production and 13.7 per cent of value added in industrial sector in India. Gujarat has achieved the distinction of being the top most industrially developed state in India in respect of investment in industrial sector and second among states in respect of value of production and value addition in industrial sector in India[14].

Over the years, Gujarat has diversified its industrial base. The state was known for textiles industry. Today, refined petroleum products has emerged as the largest industrial group followed by chemicals including dyes and pharmaceutical products, agro and food processing, engineering industries, basic metal industry, textiles and apparels and other industries in descending order in terms of value of output in all industry in Gujarat. The industries in Gujarat produce a variety of products. However, the important products which have substantial contribution in India include: Soda Ash having 94 per cent share, Salt (80 per cent), Polyester Filament Yarn (75 per cent), Refined Petroleum products (55 per cent), Drugs and Pharmaceuticals (45 per cent), Phosphate Fertilizers (36 per cent), caustic soda (35 per cent), Textile Fabrics (34 per cent), Sponge iron (33 per cent), cement (10 per cent) and so on. Gujarat is also having largest share in diamond cutting & polishing and accounts for 80 per cent of the processed diamonds and 90 per cent of diamond exports from India. The State's exports stand at 14 per cent of India's total exports, exhibiting a strong global orientation of the industrial structure[15].

Gujarat is looking at moving forward to become the 'Petrocapital' of India. Gujarat accounts for 54 percent of India's onshore crude and 39 percent of onshore Natural Gas Production. It has about 46 percent of India's installed refining capacity and 60 percent of India's total crude oil import facility. The Government has announced MoUs (Memorandum of Understanding) worth US $4.5 billion and investments worth US $ 5.7 in Gujarat[16].

Gujarat has a well established gas grid of 550 kms and it plans to expand the same to 2,200 kms with investment worth USD 500 million. Investments have been proposed to build new LNG terminals in addition to the existing terminals in Dahej and Hazira, are underway.

The State offers immense opportunities across the energy value chain. Progressive and investor friendly industrial policies, including rationalization of tax regime, power reforms and SEZ development coupled with the logistical proximity to the Middle

East gas resources are among the significant growth enablers for the sector. Gujarat has well established distribution gas network and the LNG terminals at Hazira and Dahej have led to a strong local consumer base. Presence of cooperatives such as IIFCO, KRIBHCO, power companies like NTPC and GEB and industrial majors such as Reliance have led to a vibrant energy sector in Gujarat. The Jamnagar refinery is the largest in India in terms of refining capacity and also is considered as the biggest grassroots refinery in the world. Gujarat has oil & gas reserves located at Ankleshwar, Mehsana, Tapti High, Hazira, Bharuch, Gandhar, Dahej, Jambusar, Palej, Kalol and isolated gas fields around Ahmadabad. In addition to this, it has discovered oil reserves in Dholka and Khambat.

The prominence of Gujarat is by the virtue of having nearly 1,600 kms long coastline and being the nearest maritime outlet to the Middle East, Africa and Europe. Gujarat features the Gulf of Khambat and the Gulf of Kutch, and both offer logistical advantage for reaching the northern and western hinterland. This helps to capitalize on the strong manufacturing and trading base. Gujarat also houses India's only chemical port terminal, which has a capacity of 3 million metric tonnes.

As economies advance and diversify internally, trade helps to bring economies of scale, better market access and well integrated supply chain for various economic agents of any nation. Historically **trade** is, driven by traditional comparative advantage, provided as key growth accelerator for economic expansion and national differentiation. Singapore is a good example of a nation State to have fully leveraged its geography and made trade as the basis of its growth and development. **Infrastructure** has been considered as a key enabler that provides not just multiplier benefits for any expansion process, but is also considered critical for the sustainability of any growth process. Investing in a well-planned and properly financed public infrastructure helps to bring vitality and direct growth to the benefit of the whole community. China's investment in infrastructure is one such example of economic growth. The Government of India has targeted 10 per cent GDP yearly growth rate which would be unattainable without simultaneous growth in international trade which in turn needs to be facilitated by modern and efficient infrastructure.[17]

About 95 per cent of India's foreign trade by volume and about 77 per cent by value pass through India's seaports. Therefore, any attempt to make a significant increase in the volume of foreign trade would necessarily challenge the adequacy and capacity of Indian ports to handle the projected traffic. Ports not only play a crucial role in facilitating international trade but also act as fulcrums of economic activity in their surroundings and hinterland. The country's coastline of 7,517 kms spread over 13 States/ UTs (Union Territories) is studded with 12 major ports and 187 non-major ports. Of the non-major ports, around 60 are handling traffic. The total traffic carried by both the major and minor ports during 2006-07 was estimated at over 649 million tonnes. Despite having adequate capacity and modern handling facilities, average turnaround time is 3.5 days as compared with 10 hours in Hong Kong, which undermines the competitiveness of Indian ports. Congestion is due primarily to the slow evacuation of cargo rather than a lack of handling capacity, since ports are not adequately linked to the hinterland. An efficient multimodal system, which uses the most efficient mode of transport from origin to destination, is a prerequisite for the smooth functioning of any port. It involves coordinating rail and road networks to ensure good connectivity between port and hinterland. Indian infrastructure for logistics is poor compared to world class.

The consistently salutary performance of the country's foreign trade, both exports and imports, over the last four years, despite infrastructure impediments, has been a puzzle. Yet, to carry on with a 'business-as-usual' attitude, without addressing ground-level glitches, would not only slow the country's growth momentum but also stall its ambition to be a global trade major in the foreseeable future. The country's foreign trade is expected to grow every year at a rate of over 20 per cent. Encouraged by the robust export/import growth, the Prime Minister had set a target of achieving a trade figure of US $500 billion by 2010. This places on the infrastructure sector significant challenges because in order to sustain such a rapid growth, the provision of a seamless, cost effective, fully integrated multimodal transport system seems to be the only feasible possibility. These challenges are not only limited to massive investment but also include the acquisition of knowledge necessary to manage and operate such systems. As globalisation and the emergence of global supply chains define a greater role for India in the world economy, there will distinctly be more movement of goods. This calls for an exemplary transport system to achieve high levels of efficiency and service. With improvements in infrastructure that would promote future trade, India can consolidate its position in global trade.

Endnotes

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