Review of the General Economic Environment and the Investment Climate

General Economic Environment and the Investment Climate

The fundamental objective of the economic reforms undertaken by the government since 1991-92 was to bring rapid and sustained improvement in the quality of life of the people of India. Central to this goal was the rapid increase in incomes and productive employment. Such growth in turn required productive investment in farms, in industry, in infrastructure and people.

It was with this set of objectives that the government had undertaken economic reforms since 1991-92. Critical elements of the reform package include -

a reversal in the trend of growing fiscal imbalances by reducing fiscal deficits reforms in industrial policy by removal of extensive bureaucratic controls over choices which should ideally be left to entrepreneurial decision making reforms in trade and exchange rate policy reforms in foreign investment policy which recognise that foreign investment has an important role in supplementing internal efforts for development tax reforms to simplify the tax structure and to bring about improvement in tax collections financial sector reforms to increase the efficiency of the financial system and securities markets so that larger savings could be channelled for productive uses reforms in the public sector to increase productivity and profit of public sector enterprises and their economic structuring through disinvestment.

These reforms have been continued by the government over the past five years, and their effect has become evident in the statistics for output, investment and growth. There was a jump in economic growth to 7.2% in 1994-95 (in terms of real GDP at factor cost) and 7.1% in 1995-96. Economic growth in 1996-97 is estimated by the Central Statistical Office (CSO) to be around 6.8% (GDP at factor cost). More important for the future is the fact that the average growth during the last three years is 7%, probably placing India among the top ten performers in the world during this period.

Total gross domestic saving reached a new peak of 25.6% of GDP in 1995-96, exceeding its previous peak of 24.9% of GDP in 1994-95. The rise in domestic saving in 1995-96 was primarily due to a rise in private saving to 23.7% of GDP. Within the private sector the composition of household saving has also changed, with saving in the form of physical assets rising sharply from 7.7% of GDP in 1994-95 to 10.7% in 1995-96 and saving in the form of financial assets declining from 11.5% to 8.8% of GDP. The flow of saving into the organised/ financial system declined from 17.2% of GDP in 1994-95 to 14.9% in 1995-96. Estimates of savings and investment in 1996-97 are not yet available.

According to the Economic Survey of the government for the year 1996-97, the economy so far has presented a mixed picture in other dimensions as well. Although overall economic growth remains high at 6.8%, and agriculture has rebounded, the growth of manufacturing has slowed and the performance of key infrastructure sectors, especially power and crude oil is weak. The annual rate of inflation has risen back to average long term levels and export growth has decelerated markedly in recent months. Despite the slowdown in exports, a combination of sluggish imports and reasonably buoyant inflows of invisible and capital flows have led to build-up of foreign currency assets to over US$22.4 billion. Table 1 below gives the key macroeconomic indicators for the Indian economy.

Table 1 : Key Indicators of the Indian Economy

Indicator	**1993-94**	**1994-95**	**1995-96**	**1996-97**
	% Change over previous year			
Gross Domestic Product (at 1980-81 prices)	6.0	7.2	7.1	6.8
Agricultural Production	3.8	4.9	-0.4	3.0A
Industrial Production	6.0	9.4	11.6	9.8P
Wholesale Prices (point to point)	10.8	10.4	5.0	7.3
Broad Money	18.4	22.3	13.7	15.6
Imports (US$ million)	6.5	22.9	28.7	6.0
Exports (US$ million)	20.0	18.4	21.4	4.0
Rs. Thousand crore (at 1980-81 prices)	*Absolute Values*			
Gross Domestic Product	238.9	256.1	274.2	292.9
Imports (US$ million)	23,306	28,654	36,370	38,548
Exports (US$ million)	22,238	26,330	31,831	33,106

Foreign Currency Assets (US$ million)	15,068	20,809	17,044	22,367
At factor cost. A - Anticipated, P - Provisional.Source: RBI.				

In 1995-96 and the early part of 1996-97, valuations and trading in the secondary markets and the issuance of securities in the primary market and by mutual funds was affected by tight monetary conditions. The attractive interest rates offered by banks and NBFCs for deposits relative to equity returns led to a relative preference for these forms of investment. While equity markets performed poorly, several issuers, especially financial institutions took advantage of interest rate liberalisation and the high level of investment to make large public issues of debt. Debt securities were also issued by several issuers through the private placement route. In the latter part of 1996-97, monetary conditions eased, and interest rates began to decline. This resulted in increased interest in the equity markets, and the launching of new schemes by mutual funds.