2001 Country Reports on Economic Policy and Trade Practices
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INDIA

Key Economic Indicators

(Billions of U.S. dollars unless otherwise indicated)

	1999 1/	2000 1/	2001 2/
Income, Production and Employment:			
Nominal GDP 3/	448.0	478.0	498.0
Real GDP Growth (pct) 4/	6.4	5.2	5.1
GDP by Sector (pct estimated):			
Agriculture	26.6	25.3	25.0
Manufacturing	24.5	26.2	23.8
Services	49.0	48.5	51.2
Government	N/A	N/A	N/A
Per Capita GDP (US$)	452.0	486.0	505.0
Labor Force (millions)	420.0	436.0	448.0
Unemployment Rate (pct)	22.5	22.5	22.5
Money and Prices (annual percentage growth):			
Money Supply Growth (M3)	14.6	16.7	14.5
Consumer Price Inflation 5/	3.4	3.8	6.0
Exchange Rate (Rupee/US$ annual average)			
Official	42.08	45.6	47.8
Parallel	43.3	46.7	48.3
Balance of Payments and Trade:			
Total Exports FOB 6/	36.8	44.4	47.5
Exports to United States 7/	8.5	9.1	8.0
Total Imports CIF 4/	49.8	49.7	52.5
Imports from United States 7/	3.6	2.8	2.0
Trade Balance 6/	-13.0	-5.3	-5.0
Balance with United States 7/	4.9	6.3	6.0
External Public Debt 8/	97.7	98.4	102.5
Central Government Fiscal Deficit/GDP (pct)	5.6	5.2	5.0-5.5
Current Account Deficit/GDP (pct)	1.0	0.5	0.8
Debt Service Payments/GDP (pct)	2.5	2.2	2.1
Gold and Foreign Exchange Reserves	32.5	38.1	45.0
Aid from United States (US$ million)	125.8	125.8	123.0
Aid from All Other Sources 9/	2,990	3,174.2	N/A

1/ 1999 and 2000 data differ from data contained in previous reports inasmuch as previous figures provided by the Government of India were provisional.
2/ Data are for the Indian Fiscal Year (IFY), April 1 to March 31, unless otherwise noted. Figures for 2001 are either Embassy or Center for Monitoring the Indian Economy (CMIE, a private research agency) estimates based on data available in September 2001.
3/ GDP at factor cost.
4/ Percentage changes calculated in local currency.
5/ Wholesale price index is benchmark for inflation.
6/ Merchandise trade.
7/ Source: Directorate General of Commercial Intelligence Service, Department of Commerce, on a fiscal year basis. Figures for 2001 are estimates based on data available through September 2001.
8/ Includes a rupee debt of $4.4 billion (provisional figures as of March 2000) to the former Soviet Union.
9/ Derived using data from USAID and the Indian Finance Ministry's Annual Report.

Sources: Government of India economic survey, Government of India budgets, Reserve Bank of India bulletins, World Bank, IMF, USAID, and private research agencies.

1. General Policy Framework

India has experienced increased rates of growth and macroeconomic stability since economic reform and trade liberalization policies were initiated in 1991. Prior to the September 11 attacks against the United States, the Center for Monitoring the Indian Economy (CMIE) projected GDP growth in Indian Fiscal Year (IFY) 2001-02, April 1 to March 31, to be 5.1 percent, while industrial growth was expected to reach 4.5 percent. In the wake of September 11, some analysts expect that growth will fall short of these targets, falling below the five percent growth achieved in IFY 1997-98 in the wake of the Asian Financial Crisis. For example, the IMF estimates GDP growth as low as 4.5 percent. India's highest rate of growth since 1991 was 1994-1997 when the economy grew at close to seven percent annually. Despite relatively stagnant U.S. trade and investment flows to India, the United States continues to be the largest investor in India and its biggest trading partner.

There are continuing concerns over inadequate infrastructure, especially with respect to roads, ports, power, and drinking water. Infrastructure investment has lagged. In IFY 2000-01, the central government's gross fiscal deficit rose to 5.1 percent of GDP with the consolidated public sector deficit, including states, rising to over 10 percent. Chronic budget deficits are also a problem and the high fiscal deficit/GDP rate continues to be a significant drag on economic growth.

Credit policies announced in April 2001 have focused on softening interest rates to the minimum extent possible while emphasizing the need to guard against emerging inflationary pressures (e.g., the possibility of a higher oil import bill that would affect foreign exchange levels and overall inflation). The average inflation rate, as measured by the Consumer Price Index, is expected to reach about 6 percent during IFY 2001-02, compared to 3.8 percent the previous year. During the first five months of IFY 2001-02, the money supply (M3) rose by an estimated 17 percent, much more than the Reserve Bank of India's (RBI) target of 14.5 percent.

2. Exchange Rate Policy

The exchange rate was unified and the rupee was made fully convertible on the trade account in 1993, and on the current account in the following year. Controls remain on capital account transactions, with the exception of those made by Non-Resident Indians (NRIs) and foreign institutional investors. The gradual removal of these controls is expected as foreign exchange reserves increase and India makes progress in merging its capital markets with international financial markets. In June 1997, the Tarapore Committee on Capital Account Convertibility recommended a three year, 1998-2000, period for complete capital account convertibility of the rupee. The government has defended its position by arguing that India is in no hurry to complete full convertibility, especially given the crisis in East Asian economies and the need to strengthen the banking sector further.

The RBI intervenes in the foreign exchange market to maintain a stable rupee. From April to September 2001, the rupee depreciated substantially (3.5 percent) against the dollar and is, as of October 2001, trading in the range of 47.80 – 48.05 per dollar. In IFY 2000-01 the average exchange rate was rupees 45.61 per dollar. India was shielded from the East Asian currency crisis due to a staged approach to liberalization and its relatively low degree of exposure to global financial markets. In addition, India's short term foreign borrowing is relatively low and Indian banks and financial institutions have very little exposure to the real estate sector.

3. Structural Policies

Pricing Policies: Central and state governments still regulate the prices of many essential products (e.g., food-grains, sugar, basic medicines, energy, fertilizers, and water), while many basic foods are under a dual pricing system. Some output is supplied at fixed prices through government distribution outlets, "fair price shops", with the remainder sold by producers on the free market. Prices in government outlets usually are regulated according to a cost-plus formula. However, wheat, rice, and sugar are supplied to persons living below the poverty line at subsidized rates. Regulation of basic drug prices has been a particular problem for U.S. pharmaceutical firms operating in India, although changes in national drug policy have sharply reduced the number of price-controlled formulations from 142 in 1994 to 72 at present. The Government of India is seeking to reduce the number of drugs under the Drug Price Control Order, but has made little headway in this regard. Agricultural commodity procurement prices have risen substantially during the past nine years, while prices for nitrogenous and phosphatic fertilizers, rural electricity, and irrigation are subsidized. Acute power shortages are forcing several states to adopt market pricing for electricity, although progress in this area has been slow. The federal government has also begun to scrutinize the cost of its subsidies more carefully, especially in the power sector. The Government of India's oil price control mechanism is scheduled to be dismantled in April 2002.

Tax Policies: Public finances remain highly dependent on indirect taxes, particularly import tariffs, which account for about 67 percent of central government revenue. India's direct tax base is small: only 26 million taxpayers out of a possible 250 million households. Marginal corporate rates are high by international standards, although the corporate income tax rate for foreign companies has been lowered from 55 percent to 48 percent. Tax evasion is rampant. The government has stated that future rate cuts will depend on the success of efforts to improve tax compliance. The government worked to simplify India's complex tax code and has announced that a full-fledged Value Added Tax (VAT) will be in place by April 2002. In early 2001, the excise and custom duty structure was rationalized by reducing three tiers of excise duties to one, and five tiers of custom duties to four. In August 2001, the government adopted transfer pricing regulations which will become effective in April 2002. The government provides certain tax incentives, such as a 10-year tax holiday for knowledge-based industries like pharmaceuticals and biotechnology, two sectors which are of interest to US firms.

Regulatory Policies: Indian industry remains highly regulated by a powerful bureaucracy armed with excessive rules and broad discretion. As economic reforms take root at the federal level, the focus of liberalization is gradually shifting to state governments, which, under India's federal system of government, enjoy extensive regulatory powers. The speed and quality of regulatory decisions governing important issues such as zoning, land-use and the environment varies dramatically from one state to another. At the federal level, the abolition of industrial licensing for many sectors, the convertibility of the rupee on trade and current account transactions, and the advent of a regulatory approach more conducive to investment and competition have produced a change in the Indian business climate. Independent regulators have been established in key areas, electricity and insurance, but are still developing their methodologies, policies, and procedures to ensure transparency and independence from the government and the government bodies they oversee. Nevertheless, Indian industry remains highly regulated by a powerful bureaucracy armed with excessive rules and broad discretion. Coalition politics and political opposition have slowed or halted important regulatory reforms in areas like labor and bankruptcy law that would enhance the efficiency and levels of domestic and foreign investment.

4. Debt Management Policies

External Debt Structure and Management: The government has slowed the addition of new debt substantially in the past year by maintaining a tight rein on foreign commercial borrowing and defense-related debt, encouraging foreign equity investment rather than debt financing, lowering the ratio of total external debt to GDP from 39.8 percent in IFY 1992-93 to 21.4 percent in IFY 2000-01. India's total external debt reached $100.25 billion in March 2001 due to the accretion of $5.5 billion under the India Millennium Deposits. India has an excellent debt servicing record, and debt service payments were estimated at $4.4 billion in IFY 2000-01. Roughly two-thirds of the country's foreign currency debt is composed of multilateral and bilateral debt, with much of it (approximately 38.5 percent) on highly concessional terms. As a result, India had boosted foreign exchange reserves to $42.5 billion, excluding gold and SDRs. The increase in foreign exchange reserves is attributed to higher growth in revenue from tourism, higher net inflows of FIIs, higher FDI inflows, and a contraction in India's trade deficit.

Relationship with Creditors: Citing its growing foreign exchange reserves and ample food stocks, India chose not to negotiate an extended financing facility with the IMF when its standby arrangement expired in May 1993. In October 1998, Standard and Poor's (S&P) downgraded India's foreign currency rating from BB+ to BB. In October 1999, Moody's upgraded India's foreign currency rating outlook from stable to positive while maintaining an unchanged speculative grade rating of Ba2. In August 2001, S&P downgraded its outlook on both local and foreign currency from stable to negative due to unchecked fiscal deficits and rising domestic indebtedness. Moody's also lowered India's sovereign rating ceiling from positive to stable.

5. Significant Barriers to U.S. Exports

Import Licenses: U.S. exports have benefited from significant reductions in India's import-licensing requirements. Since 1992, the government has eliminated the licensing system for imports of intermediates and capital goods. India's average import tariff fell drastically during the last decade but has been static for several years and is currently 28.3 percent. U.S. exports to India increased from $2 billion in 1991 to $2.8 billion in IFY 2000-01. Historically, India maintained quantitative restrictions (QRs) on imports on balance of payments grounds. The last of these QRs was removed in April 2001 under an agreement with the WTO and the United States.

Some commodity imports must be channeled ("canalized") through public enterprises, although many canalized items are now decontrolled. The main canalized items currently are petroleum products, some pharmaceutical products, and bulk grains (wheat, rice, and maize). Under an April 1999 WTO dispute settlement ruling, India is committed to removing many of its "canalization" requirements, but no progress has been made. Import licenses are still required for pesticides and insecticides, some fruits and vegetables, breeding stock, most pharmaceuticals and chemicals, and products reserved in India for small-scale industry. This licensing requirement serves in many cases as an effective ban on importation.

Services Barriers: Government-owned companies dominate many service industries, but private sector participants are increasingly being allowed to compete in the market. Entry of foreign banks remains highly regulated. Foreign Banks entered the market in 1993, and as of September 2001, 45 foreign banks were operating approximately 200 branches in India. India does not allow foreign nationals to practice law in its courts, but some foreign law firms maintain liaison offices in India. India recently opened the general insurance and the domestic long distance telephony sectors to private and foreign investment. Foreign investors, however, are limited to a 26 percent share of insurance companies and a 49 percent stake in domestic long distance firms.

Standards, Testing, Labeling and Certification: Indian standards generally follow international norms and do not constitute a significant barrier to trade. India's food safety laws are often outdated or more stringent than international norms. Where differences exist, India is seeking to harmonize national standards with international norms. Labeling of genetically modified organisms (GMOs) is not yet an issue in India and imports of GMOs are negligible. In November 2000, the Indian government promulgated new regulations dictating that the import of 131 specified commodities (mainly food preservatives, color, dyes, steel, and cement) will be subject to compliance with specified Indian quality standards, and that exporters/manufacturers will be required to register with, and obtain a certificate from, the Bureau of Indian Standards before exporting such goods to India. The government also subjected all imports of packaged goods intended for retail sale to carry specified declarations prior to clearance through Indian Customs. The declaration shall include: name/address of the importer; generic and common name of the commodity being imported; net quantity; month and year of packaging; and the maximum retail price at which the commodity will be sold to the consumer. Many U.S. companies have pointed out that conformity to the labeling requirements before clearance of goods is "time-consuming" and creates operational problems.

Investment Barriers: Automatic approval of up to 74 percent of FDI is permitted in six sectors including mining, storage, warehousing, and transport. In addition, 100 percent of FDI is automatically approved in a few sectors: electricity generation and transmission, construction/maintenance of roads, venture capital funds, business e-commerce, hotel/tourism, pharmaceuticals, and Mass Rapid Transport Systems. Government approval of foreign infrastructure projects that are not subject to the automatic approval process are frequently held up for lengthy periods of time. The requirement for government approval for equity investments of up to 51 percent in 47 industries, including the bulk of manufacturing activities, has been entirely eliminated, although the government reserves the right to deny requests for increased equity stakes in these sectors.

Most sectors of the Indian economy are now open to foreign investors, except for a few big public sectors such as railways, atomic energy, and hydro-power. In May 2001, the government opened the defense equipment industry to private investors with an FDI limit of 26 percent. The government also raised permissible foreign equity in banking from 20 percent to 49 percent, and in Internet Service Providers (ISP) sector from 49 percent to 74 percent. The United States and India have not negotiated a Bilateral Investment Treaty, although the Overseas Private Investment Corporation (OPIC) may offer coverage. In 1994, India became a member of the Multilateral Investment Guarantee Agency, an agency of the World Bank. India is a member of the WTO. With regard to Trade-Related Investment Measures (TRIMs), the United States is challenging in WTO the local content and trade balancing measures that India applies to foreign joint ventures in the motor vehicle manufacturing sector.

Franchising Practices: The Government of India has stringent rules governing "royalty," which inhibits franchise development. The royalty amount franchisors can charge and repatriate is based on outdated and complicated rules that are often unclear as they are treated differently by various Indian government offices. Bureaucratic hurdles have caused some U.S. franchisors to withdraw from business deals after long struggles.

Government Procurement Practices: Government procurement practices are not transparent and discriminate against foreign suppliers, but are improving as a result of fiscal stringency. Recipients of preferential treatment in government procurement are now concentrated in the small-scale industrial and handicrafts sectors. However, public sector enterprises receive preferential treatment as they may undercut the lowest bid on a government contract by 10 percent. Defense procurement through agents is not permitted. When foreign financing is involved, procurement agencies generally comply with multilateral development bank requirements for international tenders. India is not a signatory of the WTO Government Procurement Agreement.

Customs Procedures: Liberalization of India's trade regime has reduced tariff and nontariff barriers, but it has not eased some of the worst aspects of customs procedures. Documentation requirements are extensive and delays are frequent. India has now introduced a harmonized system of classification of export and import items on a standardized form at a 6-digit level to simplify procedures.

6. Export Subsidies Policies

The government still maintains a web of indirect export subsidies. Export promotion measures include exemptions or concessional tariffs on raw materials and capital inputs and heavy subsidies for exports of wheat and rice. The Special Import License (SIL) requirement was eliminated on April 1, 2001, pursuant to the WTO panel report on balance of payments-based QRs. Concessional income tax provisions traditionally applied to exports (export earnings are tax-exempt), although the Indian government is eliminating this provision over five years in equal stages. Commercial banks provide export financing on concessional terms.

7. Protection of U.S. Intellectual Property

Various statutes for the protection of intellectual property rights exist, especially with respect to copyrights and trademarks, although enforcement is poor and piracy is rife. Copyright enforcement, particularly with the proliferation of the Internet and cable television, is generating increased attention from the Indian judiciary. Still, there have been only four criminal convictions for piracy in India since the new copyright law went into effect in 1995. India failed to meet the January 1, 2000, deadline for the second set of TRIPS obligations requiring further amendments to its Patents Bill. A draft Patents Bill is pending with a joint parliamentary committee. The Indian government has announced its intention to take full advantage of the 2005 transition period allowed for developing countries under TRIPS before implementing full patent protection. India is a member of the Berne Convention for the Protection of Literary and Artistic Works. In August 1998, it became a member of the Paris Convention, and in December 1998 it became a signatory to the Patent Cooperation Treaty. Despite some improvements in its protection of patent rights, the USTR has targeted India as a Priority Foreign Country in the “Special 301" process, and included it in the 2001 “Special 301" Priority Watch List.

In April 1992, the United States suspended duty-free privileges under the Generalized System of Preferences (GSP) for $60 million in trade from India. In June 1992 additional GSP benefits were withdrawn, increasing the total affected trade to approximately $80 million. However, in August 2001 GSP benefits totaling $543 million were restored to India.

India's patent protection is weak and has especially adverse effects on US pharmaceutical and chemical firms. Estimated annual losses to the pharmaceutical industry due to piracy are about $500 million. India's Patent Act prohibits patents for any invention intended for use or capable of being used as a food, medicine, or drug or relating to substances prepared or produced by chemical processes. Many U.S.-invented drugs are widely reproduced since product patent protection is not available. Processes for making drugs may be patented, but the patent term is limited to the shorter of five years from the grant of patent or seven years from the filing date of the patent application. Product patents in other areas are granted for 14 years from the date of filing.

Trademark protection is considered good and was raised to international standards with the passage in December 1999 of a new Trademark Bill that codifies existing court decisions on the use and protection of foreign trademarks, including service marks. Enforcement of trademark owner rights has been indifferent in the past, but is steadily improving as the courts and police respond to domestic concerns about the high cost of piracy to Indian rights' holders.

India continues to have high piracy rates for all types of copyrighted works. Strong criminal penalties are available on paper, and the classification of copyright infringements as "cognizable offenses" theoretically expands police search and seizure authority. Still, severely backlogged Indian courts, coupled with the excessive requirements of Indian criminal procedure, have led to infrequent and lax enforcement. The recently passed Information Technology Act provides a legal framework for the prevention of piracy and protection of intellectual property rights, to include penalties for the unauthorized copying of computer software.

The proliferation of unregulated cable television operators has led to pervasive cable piracy. A strong anti-piracy effort in the business applications software field, where India ranks third in the world with $5 billion in sales in 1999, has produced a drop in the business software piracy rate from 78 percent in 1995 to 61 percent in 1999. According to a recent industry report, trade losses due to the piracy of U.S. motion pictures, sound recordings and musical compositions, computer programs, and books totaled $310 million in 1999.

8. Worker Rights

a. *The Right of Association:* India's constitution gives workers the right of association. Workers may form and join trade unions of their choice and work actions are protected by law. Unions represent roughly 2 percent of the total workforce, and about 25 percent of industrial and service workers in the organized sector.

b. *The Right to Organize and Bargain Collectively:* Indian law recognizes the right to organize and bargain collectively. Procedural mechanisms exist to adjudicate labor disputes that cannot be resolved through collective bargaining. State and local authorities occasionally use their power to declare strikes "illegal" and force adjudication.

c. *Prohibition of Forced or Compulsory Labor:* Forced labor is prohibited by the constitution; a 1976 law specifically prohibits the formerly common practice of "bonded labor." Despite implementation of the 1976 law, bonded labor continues in many rural areas. Efforts to eradicate the practice are complicated by extreme poverty and jurisdictional disputes between the central and state governments; legislation is a central government function, while enforcement is the responsibility of the states.

d. *Minimum Age for Employment of Children*: Poor social and economic conditions and lack of compulsory education make child labor a major problem in India. The government's 1991 census estimated that 11.3 million Indian children from ages 5 to 15 are working. Non governmental organizations estimate that there may be more than 55 million child laborers. A 1986 law bans employment of children under age 14 in hazardous occupations and strictly regulates child employment in other fields. Nevertheless, hundreds of thousands of children are employed in the glass, pottery, carpet and fireworks industries, among others. Resource constraints and the sheer magnitude of the problem limit states' ability to enforce child labor legislation. The U.S. Department of Labor has initiated cooperative programs with the Indian government to address child labor. The Government of India recently announced its intention to introduce legislation to provide compulsory education to all children between the ages of 6 and 14. The legislation is likely to be introduced in the Winter Session of Parliament beginning November 2001.

e. *Acceptable Conditions of Work:* India has a maximum eight-hour workday and 48-hour workweek. This maximum is generally observed by employers in the formal sector. Occupational safety and health measures vary widely from state to state and among industries, as does the minimum wage.

f. *Rights in Sectors with U.S. Investment:* U.S. investment exists largely in manufacturing and service sectors where organized labor is predominant and working conditions are well above the average for India. U.S. investors generally offer better than prevailing wages, benefits, and work conditions. Intense government and press scrutiny of all foreign activities ensures that any violation of acceptable standards under the five worker rights criteria mentioned above would receive immediate attention.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 2000

(Millions of U.S. Dollars)

Category	Amount

Petroleum		-430
Total Manufacturing		790
Food & Kindred Products	239	
Chemicals & Allied Products	92	
Primary & Fabricated Metals	(D)	
Industrial Machinery and Equipment	358	
Electric & Electronic Equipment	157	
Transportation Equipment	-161	
Other Manufacturing	(D)	
Wholesale Trade		124
Banking		291
Finance/Insurance/Real Estate		179
Services		68
Other Industries		236
TOTAL ALL INDUSTRIES		1,258

(D) Suppressed to avoid disclosing data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.