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In this issue

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A Word from the Acting Director

South Asia bewilders by its sheer size. In 2002, the seven countries that make up the region - Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka - had a combined population of 1.4 billion, accounting for nearly a quarter of world's population. Its size has proven to be a double-edged sword. South Asia is known for its population and poverty, and faces enormous challenges in various aspects of political, social and economic development.

The challenges notwithstanding, South Asia is one of the most dynamic regions in the world. In the 1990s, the region recorded an average annual economic growth of 5.3 percent, second only to East Asia for the same period. India's scientific and technical professionals have been exceptionally successful in the knowledge economy. India is expected to emerge as the third largest economy in the world, behind China and the United States, in the next 30 years. Relations between India and Pakistan are improving, and Bangladesh has made significant achievements in human development in recent years. Civil strife in Sri Lanka has abated, and the country is rapidly rebuilding its economy. Faced with the inexorable force of globalisation, South Asia's economies are opening up, presenting enormous investment opportunities in the region, especially in the infrastructure sector.

Southeast Asia, and Singapore in particular, cannot afford to look away from the resurgence and increasing vibrancy of the South Asian economies. South and Southeast Asia have had strong historical ties. Both regions should now leverage upon those ties, and build new ones, to develop opportunities and capacities for economic growth that will benefit their respective populations.

The Institute of South Asian Studies aims to facilitate the process of mutual learning and understanding between South and Southeast Asian countries. It is an autonomous research institute within the National University of Singapore. It will conduct research on the political, social and economic aspects of South Asia's development from a Southeast Asian perspective. I am pleased to announce that we will be publishing a regular newsletter that will feature the Institute's research activities, events and visitors.

In this inaugural issue, we bring you stories from Bangladesh, India and Pakistan. These include the public lecture by Her Excellency Begum Khaleda Zia, Prime Minister of Bangladesh, and the address by His Excellency P. Chidambaram, India's Finance Minister. Mr Sajjad Ashraf, High Commissioner for Pakistan in Singapore, provides a personal perspective on the improving relations between India and Pakistan. This issue also features articles by our research fellows on the implementation of value added tax in India and the liberalisation of India's telecommunication sector.

Assoc Prof Tan Tai Yong

Bangladesh: Economic Priorities and Challenges

Excerpts from the FIRST ISAS DISTINGUISHED VISITOR LECTURE
by Her Excellency Begum Khaleda Zia
Prime Minister of Bangladesh on 23rd March 2005

I welcome this opportunity to share with you some thoughts regarding the priorities and challenges that face Bangladesh's economy and our evolving development agenda. Obviously, this cannot be divorced from the political environment in Bangladesh today and the governance challenges that go with it. I hope to touch on these issues as well.

Democracy, development and human rights remain the key underpinnings in moving Bangladesh towards a stable, moderate and modern society. We are committed to reach these goals despite formidable constraints. They constitute not only our firm objectives but also remain a yard stick to measure the process of good governance in our country.

At the heart of this transition process for Bangladesh is a veritable war against poverty. For us, economic development hinges around two paramount objectives - accelerating growth and reducing poverty, each contingent on the other.

The incidence of poverty in Bangladesh is still quite high. After China and India, Bangladesh has the third largest number of poor in the world, that is about 63 million people, with one third caught in hard-core or extreme poverty. The market cannot reach deep enough to touch these pockets of poverty. Currently development assistance stands at just one-third of what is needed to meet the Millennium Development Goals (MDGs) targets and a large proportion is earmarked for purposes unrelated to the MDGs. The gap is much more acute in countries with significant concentrations of poor like Bangladesh. According to estimates prepared by a UN study on MDGs needs, Bangladesh will require additional assistance to the tune of 7.5 billion dollars per annum. To put this figure in perspective, the actual net aid disbursement at present is less than one-seventh of Bangladesh' minimum needs.

Bangladesh's fight to reduce poverty depends on the successful implementation of a wider and deeper reform process within the framework of a National Strategy for Economic Growth, Poverty Reduction and Social Development. Our Interim Poverty Reduction Strategy Paper (I-PRSP) was completed in March 2003 after several stages of nation-wide consultations. The government is now about to transform the I-PRSP into a full blown strategy paper after further in-depth consultations with all stake-holders.

Bangladesh's national targets conform closely to the MDGs to country-specific aspirations. These call for eradicating hunger, chronic food insecurity and extreme destitution; reducing by half the number of people below the poverty line; attaining primary education for all boys and girls and eliminating gender disparity in enrollment; reducing by 65 percent infant and under-5 mortality rates; reducing malnourished children under 5 by 50 percent; reducing maternal mortality by 75 percent; ensuring reproductive health services to all; reducing social violence especially against women and children and ensuring comprehensive risk management and environmental sustainability. I am happy that our track record in poverty reduction has been a good one. We are fortified by some remarkable achievements in macro- economic management and human development. Some say Bangladesh has now moved into the UN's middle-income country category. The UN Human Development Report for the first time graduated Bangladesh from the low development category to the medium human development category in 2003.

We have achieved commendable progress on six social and economic development indicators, namely sustained economic growth; reduction of income poverty; maintaining and increasing food security; enhancing disaster management capacity; commendable achievement in human development and promotion of key social sectors and health outcomes. Indeed, Bangladesh's steady progress in comparison with countries at similar income levels as well as its neighbors is nothing short of a miracle. The World Bank has called it a silent revolution.

In more specific economic terms, Bangladesh's GDP during the 1990s increased by 60 percent and per capita income exceeded the average for low and middle -income countries. Bangladesh is one of the fastest growing countries in the income group. It is one of only 18 countries in the world whose growth over the past two decades exceeded the industrialized countries' long-term average growth rate of 2 percent.

As living conditions improved during the decade of the 90s, the incidence of poverty fell by about 9 percentage points, a record that exceeded that of most developing countries. The percentage of poor fell from 70 percent in 1971 to less than 50 percent in 2002. In the early 1970s, the country had 75 million people and a substantial food deficit. Since then the population has reached 141 million, but Bangladesh is close to self sufficiency in food. Bangladesh is also ahead of most countries in the region in reducing public food subsidies in urban areas and redirecting most of the public food distribution to poorer groups, mostly in rural areas. It has an extensive food aided safety net.

All this was accompanied by a solid macro-economic performance, which has seen steady growth rates (over 5 percent), rising exports and imports; stable exchange rate; low external debt; comfortable foreign exchange reserves; increasing credit to both agricultural and industrial sectors and a rise in both domestic and foreign investment. Bangladesh's macro economic management measured in terms of fiscal deficit, inflation and debt management compares favorably with their neighbors. Its budgetary policy as shown by the proportion of spending on health and education, defense and capital expenditures also measure favorably in the regional context. Good progress has also been made in improving disaster management capacity and social safety nets.

The progress in the social sectors is even more dramatic. Bangladesh has one of the highest primary school enrolment rates in the developing world, including that of poor children. Moreover, it has achieved gender parity in enrolment at the primary and lower secondary levels. In recent years, enrolment of girls increased dramatically, and Bangladesh is considered to have met the MDG goal of eliminating gender disparity in human resource development. Between 1980 and 2003, infant mortality rate decreased by over 60 percent and it is now 9 percent below the world average. Immunization rates are better than most of the developing world.

Population growth rates have been reduced at an unprecedented speed, falling from 3 percent per year in the 1970s to 1.5 percent in 2000. This is well below India and Pakistan. Total fertility has dropped by 40 percent over the last two decades. Bangladesh is indeed an example of demographic transition at a low income level without resorting to coercive measures.

The empowerment of women has also gathered momentum. The total number of micro-credit borrowers, mostly women, has reached 12 million with a total borrowing of 1.2 billion dollars and a loan repayment rate of about 90 percent. Women's empowerment has been helped by increasing mobility, income generation and decision making in the family and community. Today, in Bangladesh, the percentage of women in the labor force and in school is greater than in any other South Asian country except Sri Lanka.

Past achievements are not enough. As we look to the future, a new evolving agenda is taking shape pushed by domestic as well as external impulses:

- We have to continue to accelerate growth if we are to halve the proportion of poor by 2015.
- New approaches are needed to maintain agricultural and export growth.
- To survive in a post MFA world, Bangladesh has to enhance competitiveness in terms of price, time to market and cost of doing business.
- Increased financial support is needed in areas such as infrastructure, particularly in improving power supply, port facilities and administrative and budgetary systems.
- Growth and social transformation in Bangladesh call for further boosting the investment climate as the driver of the country's future.
- Bangladesh has to go on reducing risks related to law and order; confrontationist politics; social and governance problems; access to justice, corruption and the impact of external shocks and natural disasters.

I would like to conclude by saying that Bangladesh is well aware of its strengths and limitations. Often there is impatience regarding the pace of reform and its substance. Yet Bangladesh is a democracy. No government can willfully ignore the wishes of its people. In Bangladesh, our people may not be economically rich, but they are politically conscious. Accountability cannot therefore be taken lightly. ■

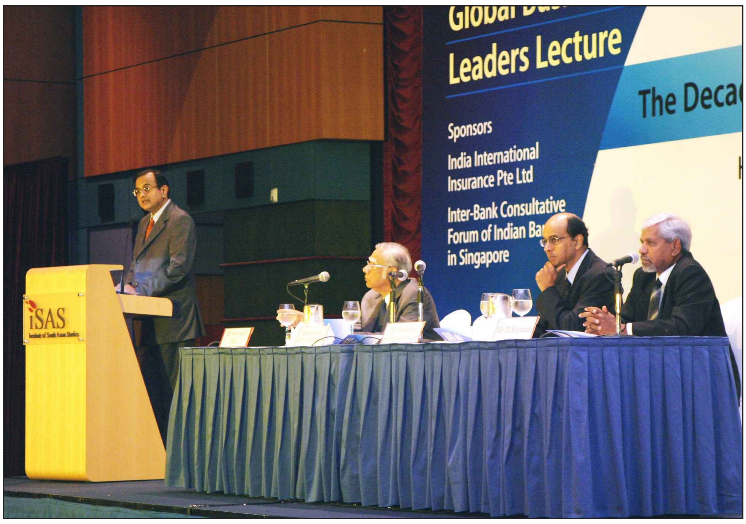
The Decade Ahead for the Indian Economy

Excerpts from the FIRST SICCI-ISAS GLOBAL BUSINESS LEADER LECTURE
by His Excellency Mr. P. Chidambaram
Finance Minister of India on 28 March 2005

In recent years there has been considerable attention paid to India throughout the world. The reasons are not far to seek. India's size, next only to China's and India's commitment to democracy, equal to any other countries in the world has aroused interest in different countries. Some well known indicators of the Indian economy are:

- India's GDP at market prices is nearly $800 billion per year.
- In the latest 4 quarters for which data is available, India earned $133 billion on the current account through earnings from merchandise and invisibles.
- In the latest 4 quarters for which data is available, India received $19 billion in net capital flows.

The decade I speak about today, ends in 2015, the year by which the Millennium Development Goals (MDGs) are to be attained. We cannot lose sight of the fact that if the MDGs are not attained in India, they will not be attained by the world as a whole.



India is in a way a late starter in the take off process of Asian economies. The enshrining of democratic principles in a newly independent country, and a large country at that, might have involved some initial fixed costs. India having paid those fixed costs, now appears to be ready to reap the dividends. In Indian economic policy, the first and most immediate challenge is fiscal consolidation. Our fiscal responsibility legislation requires us to put current revenues and expenditures in balance by 2008-09. It will result in public savings and open up fiscal space for higher public investment. Such investments are urgently needed for physical and social infrastructure.

According to the "medium fertility and standard mortality" projection of the United Nations, in 2015, we will be 1.21 billion strong. Interestingly enough these projections also show that the proportion of the population between age 15 and age 64 will actually go up from 63.8 percent in 2005 to 67.9 percent in 2015, that is by that year we would have 823 million persons in the working age group. Each new worker is a pair of hands and we are determined to accelerate our achievements in the field of education, basic health and skill information, so that this labor force adds fuel to Indian GDP growth in the decade ahead.

The performance of the Indian economy over the last one year has exceeded expectations. While a substantial proportion of the growth in recent years has been generated in the services sector (and the Indian IT sector has been talked of intensively), the importance of agriculture and industry cannot be understated. The last year has seen a sharp revival in manufacturing growth. Manufacutring growth accelerated every month after May 2004 to reach double digit levels in September and October. With two-thirds of India's population still in villages, agriculture cannot be neglected. Our government is engaged in ensuring greater investment by both private and public, in agriculture by increasing the flow of credit to farmers and by enhancing budgetary outlays for irrigation and rural infrastructure.

India spent many decades with autarkic policies. A central theme of the new economic policy is liberalization and harnessing globalization. India has steadfastly pursued a policy of progressive liberalization on the external front during the last decade and half. Last year i.e. in 2003-04, India's gross trade flows amounted to $225 billion or 35 percent of the GDP. This ratio has been rising by roughly 1 percentage point every year. In some quarters, India is still regarded as a country that does not engage with the world in trade and a country which is closed to capital flows. Many people think that India has stringent restrictions on capital flows. But in reality, the FDI and portfolio investment channels are extremely open, more so than many other emerging markets.

India's engagement with the world has been in the traditional area of trade in goods and services. In recent years, that engagement has broadened to non-traditional areas such as outward foreign investment, increasing participation of Indians in global corporations and the spread of Indian music and movies.

For most Indians, the issue is not globalization. India accepts and willingly embraces the imperative of globalization. We do so in our self interest. The real question is the terms of engagement in globalization. As of today, the terms are weighted in favor of the developed countries. This does not augur well for either globalization or stability.

India's biggest deficiency is the infrastructure deficit. Our roads, our ports, our transport systems, our power and telecommunication sectors and our banks fall far short of the requirements of an economy that has registered over 7.5 percent growth in many years and has the potential to grow at 10 percent. We are focusing on bringing in other players to provide infrastructural services on commercially viable basis. Public-private partnerships are an accepted norm. I have announced the setting up of a Special Purpose Vehicle that would raise long term funds against a sovereign guarantee to meet the back ending funding needs of large infrastructure projects.

Notable successes are already visible in the areas of telecom, roads and ports. India now has more than 90 million lines, and all projections of tele-density have already been exceeded. The financial markets are the new commanding heights of the economy. They evaluate alternative management teams and alternative industries and put labor and capital to use. Like many emerging markets, India is at a point where demographic and economic forces are on the verge of producing a massive increase in the savings that will be intermediated by the financial markets.

In a nutshell, the prospects of higher Indian GDP growth appear bright. The growing labor force and the saving rates coupled with a policy focus on human capital, infrastructure, taxation and financial system suggest that the GDP growth is likely to accelerate significantly in the future. The key aspects of India that you need to appreciate in order to comprehend India's economic success are democracy, demography, globalization, improving infrastructure and the financial sector.

But we are far from done. In my view, the most interesting time series that you can draw for India from 1985 to 1995 to 2005 is that of confidence and optimism. However, let me strike a cautionary note. In today's globalized world, the performance of any economy is closely interlinked with developments in the other parts of the world. While India will continue to persevere with its ongoing economic reforms, success in the next decade will invariably depend to some extent on a congenial international environment.

I want to close on a subject that is close to our hearts in the UPA government: the question of poverty and deprivation. In India we passionately believe that higher growth rates and only high growth rates are the sound foundation of an assault on poverty. A decade of growth of this fashion should make a considerable dent on the headcount of the poor and on possibly eliminating poverty. That miracle of eliminating poverty will be our greatest reward from India' growth. ■

From Guns to Muffled Sounds of Dholak

An India-Pakistan Journey of Hope

Sajjad Ashraf
High Commissioner for Pakistan
Singapore

Gazing into India, on my occasional visits, standing at Pakistani side of Wagah border, the only land crossing permitted along this 2,000 plus Km long border between India and Pakistan, I have inevitably, with moist eyes, remembered my late father. You will naturally wonder why. Bringing me up like a friend he died 34 years back. Sharing his childhood stories was one of his favorite pastimes. And, what nostalgia he used to have of his trips on bicycle and tonga (the horse driven two wheel carriage typical of undivided Punjab) to and from Amritsar. I especially remember the spark in his eyes when he used to recount volleyball matches he played for Lahore against Amritsar. I can still sometimes feel the safety of his hand clasping my little finger walking in the narrow streets of walled city in Lahore, where I was born of Kashmiri parents, and have my earliest memories, pointing out towards doors as we walked past one house after the other reminiscing fondly about his friends who had gone away. In my innocence I often wondered, why did his friends have to go away?

And then, during one of my first tonga rides, I recall passing by burnt houses inside the Shah Alam gate in Lahore, I used to ask why? What happened? Why are so many of these houses burnt? "These belonged to the people-the Hindus and Sikhs, who have gone away", was the answer. And yet again, as a little boy of 4 or 5, I often use to wonder why have they gone away? Why burn houses, if people living in them have gone? I also recall some relatives and Muslim families who I was told had migrated from Amritsar to Lahore. Why could they not continue living there, after all it is not too far, was always the childlike question? "They could not because they were driven away in communal riots", was the only answer given-always. The long queues outside the rehabilitation offices in Lahore made me grasp that hundreds and thousands had indeed been driven away from their homes and were now seeking alternate shelters. These were the refugees-victims of "ethnic cleansing" in the sub-continent, much before the term became part of contemporary English language usage.

Then when I entered school, it was common to find people in Lahore who I use to hear, went to Amritsar to watch a movie and came back after a day trip. This, I felt as a child, was a semblance of sanity. On this side, though it was some kind of a novelty for youngsters like me, it was still common to see turbaned Sardars in Lahore's Anarkali bazaar and Mall Road during Baisakhi, Guru Nanak's birthday or other Sikh religious festivals. As a little child I could not understand why people who have some of their holiest religious places in Pakistan could not visit them so easily. Simultaneously, I saw that self-seekers were busy ingeniously creating fissures between ordinary folks both sides of the border. Growing up, it was all like a contagious disease, infecting the atmosphere with its biases and prejudices and preventing the simple people from reverting to their old friendly ways. To my horror and that of millions of others in the sub-continent and around the world, this is what happened.

Joining Forman Christian College, Lahore, commonly called F.C. one of the oldest and amongst the most respected institutions in our part of the world, looking at scores of old photographs, hanging in the corridors, was another lesson in history. My most revered Professor Sinclair-may God bless his soul, who died after teaching at F.C for over 50 years had, chosen to continue teaching at F.C. rather than joining his two sons who remained in India. People have a strange inexplicable bond for the land they are born in, I felt. Yet, again this brought back the question of why and how millions could be uprooted, chased away from their homes or left out of fear for their lives and future of their children.

As I contributed with tremendous zeal and motivation in civil defense work in service of my country, during the 1965 war, I distinctly recall rumbling of artillery guns and Lahore's red skyline night after night till the guns fell silent after 26 days. The next war thrust upon us, out of crises in what was then East Pakistan in 1971, underscored how far the two countries had moved away from each other. Perhaps the relations could not sour any further.

In 1978, I was sent on a mission to Beira, the Mozambique town that became infamous for sanction busting against Ian Smith's white minority regime in what was then Rhodesia. The large number of sub-continentals who were living there spoke either Portuguese or Gujrati only. And here in the remoteness of Africa, I recall with a tremendous sense of melancholy one poor elderly Sardar who, came to see me in my hotel. His sobbing embraces after meeting me is an experience in human contact, which I cannot forget. He disclosed that he only heard that a Punjabi speaking person had come into town and he had come to speak Punjabi with me. He said that, he was the only one in that country who spoke Punjabi. The deeper lesson I learnt is that people who had bitterly fought, killed each other in mobs, marauded villages, bazaars are ready to leave the bitterness behind and move on. My belief in eternal goodness of human spirit awoke that day. The sweets and tea he loaded me with, as a parting gift was a priceless expression of warmth he felt, asking nothing except a few moments of conversation in Punjabi with me. That elderly Sardar taught everyone a lesson. He was ahead of his time.

The two countries, India and Pakistan have gone to wars and have even gone nuclear. With forces in eyeball to eyeball positions till three years back, slightest of miscalculations, they say could have led to a disaster of biblical proportions. Little do these people realize that failure to tackle poverty, illiteracy, absence of healthcare, and provision of basic human services, in the wake of monumental military buildups in the two countries is a folly of Himalayan proportions? Together, India and Pakistan account for potentially the largest reservoir of trained manpower in the world. The two countries, because of their belligerent posturing have already missed so many valuable decades that has left them behind in the realms of growth and development. Countries that looked up to us have galloped far ahead. Yet, the roar and sparring continued between the two sides down till early last year.

Thankfully, the leadership of the two sides took a bold decision, to normalize relations, in January 2004, when former Prime Minister Atal Bihari Vajpayee visited Pakistan for the SAARC summit. I was there and was privileged to meet him. The positive movements since his January 5, 2004 meeting with President Musharraf has been trail blazing. My own belief, that expression of genuine warmth shown by the common folks on either side is not an act of robotics was more than vindicated by what was seen, during the historic cricket series when Indian side visited Pakistan after a hiatus of 15 years soon after. Others visitors from India share similar sentiments about their journeys taken initially with a lot of trepidation, to Pakistan. The fact that the leadership on either side is now able to sense it and build on this innate human goodwill is a remarkable development.

The historical baggage is beginning to be laid off. People in one country are discovering the other. Thousands now move across once hostile borders each month when even hundreds was news. Events previously unthinkable are taking place. The agreement on Srinagar-Muzaffarabad bus service becoming possible after India dropped its insistence on the use of passports is a historic "victory of sanity." Now other road and rail routes are up for discussion. The current cricket series between the two, promises to drive these contacts further leaving it difficult for doomsayers to cast their evil spell at this burgeoning movement of human spirit.

Much before others did, Pakistan understood the benefits of mutual economic interdependence and offered the transit of gas from Qatar, Iran or Turkmenistan into India. Pakistan was always convinced, "that this will create mutual linkages and interdependencies, which can form the basis of closer overall relations between countries in the region." After years of dithering on this important initiative now, that the Indian cabinet has reportedly authorized the concerned Minister to open discussions with Pakistan on the gas supplies through Pakistan, it should lead to greater mutual economic dependence. As India lowers its tariff regime, to which a World Bank report also pointed out last year, and with South Asian Free Trade Area (SAFTA) taking effect on January 1, 2006, trade should pick up further between the two sides. The Joint Study Group on economic cooperation, which recently met in New Delhi, will, I am confident, propose acceptable measures for boosting economic relations between our two countries. Naturally, the positive momentum in confidence building measures has generally helped investment activity in the sub-continent. Both countries have seemingly recognized the pivotal role of economics in their bilateral relations. It is a moment of hope.

Seizing this moment, "Pakistan has demonstrated, that it is prepared to take chances for peace," said Pakistan Prime Minister Shaukat Aziz to an international conclave held in New Delhi late February 2005. In search for an alternate future based on peace and cooperation, he said "it is reasonable to expect that India would shoulder responsibility proportionate to its size." The confidence building measures will sustain and in fact accelerate if there is a positive movement towards the settlement of the core dispute on Jammu and Kashmir, solution to which must be found according to the "aspirations of the Kashmiri people." [Emphasis added]

Given the complexity of the issues and mutual suspicions the task ahead is not easy. The road is long and full of potholes. Patience and positive tenacity are the two key words. Globalization and interdependence demands that all states draw strength from their neighbors. This becomes the basis of positive interdependence and shared prosperity with the neighboring regions and beyond. As South Asia resurges based on India-Pakistan cooperation I am confident relations between South Asia and South East Asia will grow to the mutual benefit of the two regions.

With all these monumental changes taking place my mind goes back to my late father's youthful days when ordinary folks enjoyed their festivals together, traveled back and forth, shared their joys and competed on the sports fields, in arts, culture, sciences, economics and host of other useful pursuits rather than on the battle fields. The ensuing fight together against ignorance, poverty and injustice will surely help catapult the two people to their full potential. After all when siblings grow they need their separate spaces to live in harmony.

With guns silenced I can now hear the muffled sound of dholak (drum-so much of a symbol of celebrations and happiness in our part of the world) from a distance. As I look up the horizon I can see my father and his friends meeting again in embrace ... nothing perhaps, will give him more comfort in the heavens. ■

VAT in India:
Opportunities and Problems

Dr. S. Narayan
Visiting Senior Research Fellow, ISAS

On 1 April, 2005, 21 states in India commenced implementation of the Value Added Tax (VAT) for state specific taxes. An Empowered Committee of State Finance Ministers had labored for several years to bring this about, and even at the end, several states did not participate, citing worries over possible revenue losses. As structured, the uniform VAT system would replace the state sales taxes. The existing sales tax systems varied from state to state, with a multiplicity of rates, and a variance between single point and multi point taxations. VAT is a tax on the value added at each stage of the production and distribution process. The VAT is being implemented in more than a hundred countries, and is considered to be a measure that would promote transparency, neutrality and uniformity to the tax burden.

The new VAT system is expected to allow traders to make self assessment of tax liability replacing the need for a special assessment at the end of each year. The VAT to be paid by a registered dealer would be on the value addition of goods sold by him and would be calculated by deducting the tax credit from the tax collected by the dealer during the payment period.

Input tax credit is available to both traders and manufacturers for the purchase of inputs and supplies meant for sale. There is a negative list of capital goods that is not eligible for input tax credit.

Small dealers, with gross annual turnover not exceeding 500,000 rupees (this could vary between states), will not be liable for VAT. Dealers with annual turnover not exceeding 5000,000 rupees, would also have the option to adopt a composition scheme at a small percentage of the gross turnover. It is mandatory for all traders with gross turnover of more than 500,000 rupees, to register, though states would have the flexibility to fix this limit. Liquor, petrol, diesel and motor spirits are to be outside the VAT mechanism, and would continue to be taxed under the state sales tax act. Under the new structure, 46 items have been identified for exemption from tax and a special 1 percent tax is to be applied to a few items, including precious stones and metals. Initially, 550 items have been identified that would attract a tax rate of 4 percent; all other items would have a VAT rate of 12.5 percent.

For Central excise duties, collected on manufactured goods, a Central VAT (CENVAT) system has been in existence for nearly a decade. With over 90 percent of all manufactured goods attracting 16% excise, this system has been effective in reducing the cascading of taxation and transparency in tax accounting. The state-level VAT is expected to achieve the similar results in respect of state taxes. Eventually, the move is towards the integration of state and central tax structures into a single value added tax.

The new system would be a better administered system and would encourage tax payers to keep proper records of their sales and purchases. The VAT also facilitates correct valuation, as all stages of production and distribution are subject to tax. Under the VAT system, there are no exemptions and tax would be levied at each stage of manufacture of the product.

Further, the dealer is allowed to assess himself and allowed to calculate and pay tax. The manual assessment system and exemption/concessional rate systems are done away with. This reduces interface with the tax authorities and consequent harassment. The invoice credit system would also help in ensuring better tax compliance by generating a trail of invoices that supports effective audit and enforcement strategies.

There have been some concerns voiced over the introduction of the VAT, particularly from the trader community. First, the book keeping would be more complex, as tax invoicing is necessary for each input and for sales. Small and medium traders, who are not well versed in accounting, would face some difficulties. Further, refunds for tax credit have to be obtained post-fact from the state administration, and traders anticipate delays and harassment in securing these refunds. It is important that states come up with system-based, automatic solutions for this, to avoid face to face interactions between the tax authorities and the traders.

Third, an important issue, the Central Sales Tax (CST), has not been addressed. This is a 4 percent tax levied by the state where goods are produced, for all merchandise that is moved out of that state to another. Effectively, it is an export of taxation, for the purchaser in another state bears the tax of the producing state. This distorts the pricing structure, and is to the disadvantage of the poorer states, with little manufacturing output. The Empowered Committee was not able to address this at this stage, as CST revenues are close to 150 billion rupees a year and the states do not want to forego this revenue. Removal of the CST would have to be tied in with a mechanism for compensating these losses in revenues through grants from the central government. The Finance Minister has now promised that he would have the CST removed within two years. This is important to remove distortions in the taxation structure.

As a consequence, the present system is most beneficial to those manufacturing firms that have input sources within the same state.

As all goods movement outside are subject to CST, for which no VAT credit is available, a manufacturer who sources inputs from several states and whose markets are spread out across several states would have little advantage out of the VAT. Typically, a manufacturer with multi state production facilities would gain. Changes in the supply chain are inevitable for major manufacturers.

Manufacturers would try to source inputs from the same state wherein they have production facilities, to maximize input credits and reduce costs. There may also be some consideration to diversifying production facilities closer to markets. However, if there is expectation that the aberrations due to the CST would be removed soon, the shakeout will be marginal.

It is important for the central government to monitor implementation problems closely. The Empowered Committee would be meeting on April 16 to review the situation. The meeting assumes significance, as it would be for the first time that State finance ministers would come together to review the situation after the introduction of VAT in 20 states. Tamil Nadu, Uttar Pradesh, Uttaranchal and the five BJP-ruled States of Rajasthan, Gujarat, Madhya Pradesh, Chhattisgarh and Jharkhand are yet to implement the VAT. There is an effort to persuade these states to fall in line. There is an apprehension that lack of uniformity in implementation might result in some products attracting different rates in different states, thus leading to trade diversion.

Other countries that have implemented the VAT have also had to go through a process of learning and adjustment. The most recent federal structure to implement the VAT was Australia, where it took over a year for the process to settle down. There is, however, unanimity in the view that the VAT is an efficient, equitable and transparent system. The next step in India would be to merge all state and central taxes into a single Goods and Services Tax. ■

Raising FDI Limits in India's Telecom Sector

Dr. Jayan Jose Thomas
Visiting Research Fellow, ISAS

India's Union Cabinet on 2 February 2005 decided to raise the foreign direct investment (FDI) limit in the country's telecommunication sector to 74 per cent, up from the current limit of 49 percent. The increased foreign investment holding limit at 74 percent will be applicable for services such as fixed line basic services, cellular or mobile services, national and international long distance telephony, and global mobile personal communication services. The 74 percent foreign investment can be made directly, or indirectly in an operating company or through a holding company. The remaining 26 percent equity will be held by Indian citizens or an Indian company. If the Indian company is one in which there is some foreign investment, the proportionate foreign investment component of the Indian company will also be counted towards the overall ceiling of 74 percent.

There has been widespread opposition to the proposal to raise the investment ceiling in telecom, particularly from the left political parties. Critics argue that opening up the telecom sector - a sector of key strategic importance - to foreign players will put the nation's security in jeopardy. A few steps have been taken in the new Cabinet decision to address some of the concerns on security. The telecom companies will have to ensure that the majority of directors on the board, including the chairman, the managing director and chief executive officer, as well as the chief technical officer and the chief finance officer will be resident Indian citizens. More over, the department of telecommunications (licensor) will notify, from time to time, any other key positions that may be required to be held by Indian citizens.

The Cabinet decision also stipulates that at least one resident Indian promoter subscribes a minimum of 10 percent equity of the licensee company. The telecom companies will not be allowed to transfer sensitive information relating to subscribers and accounts to destinations outside India. Mobile and landline traffic from one subscriber to another within the country will not be hauled to any place outside India. The company will not transfer any accounting information relating to subscriber, user information and details of the company's infrastructure to any person or place outside India except under special circumstances.

India's telecommunication sector has been expanding rapidly since the 1990s. The number of direct exchange telephone lines (DELs) (including cellular phones) increased in the country from 5 million in 1990-91 to 45 million in 2001-02 and to 90 million in December 2004. Telephone density, or the number of telephone lines per 1000 population, increased from 10.8 in 1994-95 to 50 in March 2003. There is vast potential for the future growth of telecommunication sector in India. India's telephone density today is significantly below the levels in most Asian countries (for instance, telephone density in South Korea in 1999 was 438). The Indian Government targets to expand the number of DELs in the country to 250 million (200 million mobile connections and 50 million fixed landline connections) by December 2007. This requires an investment to the tune of 1,600 billion rupees (or US$36 billion). As the government feels that it is difficult to raise such a huge investment domestically, it is encouraging foreign investors to participate in the expansion of India's telecom infrastructure.

Expectedly, the Cabinet decision is largely welcomed by the Indian industry. Mobile operating companies in India such as Bharti Tele-Ventures, Hutchison Essar, Idea Cellular/Tata Teleservices, BPL, Spice Telecom and Reliance Infocomm will be able to attract substantial foreign investment flows for funding their expansion plans and acquire the flexibility to create new telecom infrastructure. In companies such as Bharti Tele-Ventures and Hutchison Essar, foreign investment has already reached the levels of 67-69 percent of their equity; the new Cabinet decision will regularize the foreign holdings in these companies.

The Cabinet decision has brought cheer to a consortium of Singapore Technologies Telemedia Ltd and TM International. The consortium at present holds 48 per cent equity stake in India's Idea Cellular. The remaining equity is held by two large Indian business houses, the Birla Group and Tata Group. As the limit on foreign investment is raised, the consortium said that it would evaluate the option to purchase additional shares in Idea Cellular.

It may be noted that although the FDI cap in telecom is enhanced, it will not automatically lead to a surge in foreign investment. Several regulatory bottlenecks and long-pending litigation remain to be sorted out before investment flows fast in the telecom sector. They include spectrum allocation issues in the mobile telephony sector; the access deficit charge regime, which makes entry into fixed line and long-distance services unattractive; and the unified licensing policy, which raises entry barriers for new operators. It is possible that the exit of some of the foreign operators in 2003 and 2004, during a period when the mobile telephony market was exploding, is due to the unresolved regulatory issues in the country. While 32 global companies bid for mobile licenses and 16 for fixed line licenses through joint ventures in India in 1994-95, only three remain in the country today.

Another issue of concern is regarding the expansion of telephone network to rural areas. Telephone density in India's rural areas, particularly in the rural areas of less-developed States like Bihar, is appallingly low (in 2003, telephone density in rural Bihar was 4.8). Experience from the 1990s (when the private sector was first allowed entry into basic and value added telecom services in India) shows that the private sector telecom operators have not been committed to the spread of rural telephony; they have been targeting the thin strata of upper-income consumers. It is yet to be seen whether the raise in FDI investment limits will lead to any progress in expanding the rural telecom network in India.

The Cabinet order on 2 February 2005 lowered the access deficit charges (ADCs). These are the charges which private sector telecom operators have to pay to the public sector telecom companies - Bharat Sanchar Nigam Limited and Mahanagar Telephone Nigam Limited - for gaining access to the latter's network in areas where the public sector is the only fixed line provider. There has been demand from the private sector to reduce and even completely eliminate ADCs. The strategy of the government has been to provide telephone rentals/local calls at subsidized rates so that larger number of people can be brought in to the telecom network. While public sector companies provide basic access to the telecom network at subsidized rates, the aim of ADCs is to make private sector companies share the burden of the subsidy. While private sector telecom operators will greatly welcome the decision to lower ADCs, there are fears that this move will weaken the public sector telecom companies, and, ultimately, undermine the goal of increasing teledensity in India's rural areas.

The unified licensing regime in India's telecom sector has raised many serious concerns among private-sector telecom operators. One of the decisions by the government as part of the unified licensing regime was to give full mobility to wireless in local loop (WLL) mobile phones. This decision was taken with consumer interests in mind; however, it generated protests from private-sector cellular (mobile phone) operators. Licensing conditions have been much less favourable to cellular operators than to WLL operators. License fee has been higher for cellular operators. For calls originating from cellular networks and terminating in the basic service network, cellular operators have to make a payment to the basic service operator (this charge is the ADC); no such payment is involved in the case of calls originating from WLL mobile phones. It is pointed out that these provisions of the unified licensing regime have been specifically helpful to one private sector telecom unit, leading to the monopolistic growth of this company.

The concerns of Code Division Multiple Access (CDMA)-based operators (which include operators of WLL mobile phones) are regarding spectrum allocation. Unlike Global System for Mobile Communications (GSM) operators, CDMA operators are not allowed to use the 1900 MHz band. Given the crunch in spectrum availability, CDMA operators are finding it difficult to roll out high speed wireless Internet services. At the same time, GSM operators contend that allocating the 1900 MHz band to CDMA operators will create interference with their network.

The Telecom Regulatory Authority of India (TRAI) in January 2005 has made a set of fresh recommendations on the unified licensing policy. The recommendations include the introduction of a unified licensing regime for all telecom services, and the reduction of license fee from the present rate of 15 percent of adjusted gross revenue (AGR) to 6 per cent of AGR. TRAI also recommends that niche operators may be permitted to offer all types of telecom services in rural areas without payment of any entry fee. The full implementation of TRAI's recommendations will enhance the attractiveness of India's telecom sector for investment. It is also expected that the recommendation on niche operators in rural areas will lead to the creation of over 3000 micro entrepreneurs. ■

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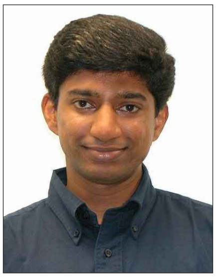
ISAS Research Staff

Dr. S. Narayan
Visiting Senior Research Fellow

Dr S. Narayan has nearly four decades of public service in development administration in the state and central governments, starting in 1965. His last appointment was the Economic Adviser to the Prime Minister (2003-2004). Prior to his appointment as Adviser, he was the Finance and Economic Affairs Secretary, and Secretary in the Departments of Revenue, Petroleum, Industrial Development and Coal since 1997.

Dr Narayan was a visiting fellow at several academic institutions including the National Academy at Mussoorie. He contributes regularly to newspapers, including the Financial Express, Hindustan Times and Economic Times, on issues relating to public policy, governance, public finance, trade and energy.

Dr Narayan obtained his PhD from the Indian Institute of Technology in New Delhi. He has an MPhil (Development Economics) from Cambridge University and Master of Business Management (Finance) from the University of Adelaide. He graduated with an MSc (Physics) from the University of Madras (Madras Christian College).



Dr. Jayan Jose Thomas
Visiting Research Fellow

Dr Jayan Jose Thomas completed his Ph.D. in development studies from the Indira Gandhi Institute of Development Research, Mumbai, and a Bachelor's degree in industrial engineering from Kerala University.

Dr Thomas has wide research interests in development economics, political economy and the economy of South Asia. His papers have appeared in reputed journals including World Development and Indian Journal of Labour Economics, and also in edited volumes published by Oxford University Press and Palgrave Macmillan Ltd.

Dr Thomas was awarded the 'Young Labour Economist Award' of the Indian Society of Labour Economics in 2003. He teaches a course on 'Knowledge Economies' at the National University of Singapore.

Ms. Aparna Shivpuri Singh
Research Assistant

Aparna Shivpuri completed her Master’s degree in International Studies from the National University of Singapore (NUS) in July 2003 and her Bachelor’s degree in Economics from Rajasthan University in July 2002.

Prior to joining the Institute, Ms. Shivpuri worked as a Research Associate with Centre for International Trade, Economics and Environment, India (CUTS) from August 2003 to December 2004. During this period, she worked on various trade and development issues such as Agriculture, Trade in Services, Regional Trade Agreements and the Millennium Development Goals (MDGs). She also coordinated a project on Trade Facilitation and presented a paper on MDGs and India at the Commonwealth Civil Society Meeting, London in July 2004.

Ms Shivpuri was among the top three students of her graduating class and also the faculty representative (Graduate Student's Society) of the Faculty of Arts and Social Science faculty at NUS.

ISAS: Recent Events

ISAS Official Launch: Guest-of-Honour: Senior Minister Goh Chok Tong, 27 January 2005.

Inaugural Conference on South Asia, "Engaging South Asia: Challenges and Opportunities", 28 January 2005.

Seminar by Professor Nirvikar Singh, University of California, Santa Cruz, on "Understanding Regional Inequality in India", 7 March 2005.

Public Lecture by Dr. S. Narayan, Former Adviser to the Prime Minister of India, on "India Budget 2005", 11 March 2005.

Seminar by Professor Anthony D'Costa, University of Washington, on "Globalization, Development and the Mobility of Technical Talent: India and Japan in Comparative Perspectives", 17 March 2005.

Seminar by Professor Sumit Majumdar, University of Texas at Dallas, "On Corporate Governance and Globalization: The Structure of Ownership and the Balance of Trade in the Indian Corporation", 4 April 2005.

Breakfast-cum-Dialogue Session with Mr. Ratan Tata, Chairman of the Tata Group, on "Internationalisation of Indian Businesses", 6 April 2005.

ISAS-Institute of Southeast Asian Studies Public Lecture by Mr. Arun Shourie, 23rd Lee Kuan Yew Exchange Fellow, on "India's Current Economic Strategies: Impact and Opportunities for Singapore and Southeast Asia", 7 April 2005.

Public Lecture Mr. N. Ram, Editor-in-Chief of the Hindu, on "India 's News Media: Roles and Outlook", 19 April 2005.

Seminar on "Preliminary Findings on Cold Chain Management: Singapore-India Initiative", 28 April 2005.

Seminar by Professor Imran Ali, Lahore University of Management Studies, on "Rolling Back Capitalism: Strategic Business Responses in Pakistan", 28 April 2005.

Cold Chain Management Singapore-India Initiative

ISAS is undertaking a six-month study on cold chain management in India jointly with the Federation of Indian Chambers of Commerce and Industry (FICCI). The study will examine the key challenges in cold chain management in India and initiatives taken by the Indian government and the private sector. It will also highlight the emerging opportunities and identify possible business and investment areas in the sector.

Preliminary findings on the project were released on 28 April 2005 at a seminar attended by close to 50 industry players. Mrs. Padmaparna Dasgupta, Director of the Confederation of Indian Food Trade and Industry (the food wing of FICCI), highlighted the key growth areas in India whilst Prof. Viswanadham, the Deputy Executive Director of The Logistics Institute - Asia Pacific, identified specific areas of opportunities in the sector for Singapore companies.

The final report, which will be ready in July 2005, will be published. ISAS will also share the findings of the report in a seminar.

Seminar by Dr. Vishvanath Pai Panadiker, President, Academy of International Education, and Chairman, Panadiker Family Companies, India, on "India's Political Economy in Retrospect and Prospect", 6 May 2005.

Second ISAS Distinguished Visitor Lecture by HE Shaukat Aziz, Prime Minister of Pakistan, on “Promoting an Environment for Security and Cooperation in Asia”, 11 May 2005.

Seminar by Dr. Shireen Mazari, Director General, Institute of Strategic Studies, Pakistan, on “Pakistan’s Nuclear Doctrine and Approach to Arm’s Control”, 31 May 2005.