CHAPTER 1

ECONOMIC SITUATION IN 1985-86

The year 1985-86 has seen a successful start to the Seventh Five Year Plan. A number of major policy initiatives were taken to boost economic growth, reinforce anti-poverty programmes, revitalise industry and provide a new direction to fiscal policy. These policy decisions were taken against a background of reassuring economic indicators which show a distinct improvement in the growth of Gross National Product (GNP), buoyancy in revenues and a decline in the rate of inflation.

1.2 Despite drought in several regions, a recovery in agricultural production is expected and with the growth in the manufacturing sector showing a substantial increase over last year, the GNP is exepected to grow by 4.5 to 5.0 per cent. The economy was able to finance a substantial rise in Plan expenditure and at the same time maintain a reasonable control over prices. In the first ten months of the financial year, the increase in wholesale prices has been the lowest for the last seven years. The inflation rate for the entire year is likely to be lower than in the previous year. However, consumer prices, which increased at a slower rate than wholesale prices in 1984-85, grew at a somewhat faster rate this year. These divergent trends were mainly a result of the price behaviour of certain items in the food group which have a higher weight in the Consumer Price Index (CPI) than in the Wholesale Price Index (WPI).

TABLE 1.1

Selected Economic Indicators

(Percentage change over previous year)

	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86
1	2	3	4	5	6	7	8	9	10	11	12
1. Gross National Product at 1970-71 prices	9.9	0.6	8.7	5.8	—4.7	7.5	5.3	2.6	7.7	3.7@	4.5—5.0*
2. Agricultural production	15.2	—7.0	14.3	3.8	—15.2	15.6	5.6	—3.8	13.7	—0.9	3.0*
3. Foodgrains production	21.2	—8.2	13.7	4.3	—16.8	18.1	2.9	—3.8	17.6	—4.0	2.6*
4. Industrial production	7.2	9.6	3.3	7.6	—1.4	4.0	8.6	3.9	5.4	5.8	6.6[1]
5. Electricity generated (utilities only)	12.9	11.5	3.4	12.2	2.1	5.9	10.1	6.6	7.6	11.9	8.2[2]
6. Wholesale prices (on point to point basis)	—6.5	12.0	0.3	4.6	21.4	16.7	2.4	7.3	8.2	7.6	3.1[3]
7. Monetary resources (M3)	15.0	23.6	18.4	21.9	17.7	18.1	12.5	16.1	18.1	18.9	13.3[4]
8. Imports (at current prices)	16.5	—3.6	18.7	13.1	34.2	37.3	8.4	5.0	10.2	8.4 £	24.5[5]
9. Exports (at current prices)	21.3	27.4	5.2	5.9	12.1	4.6	16.3	12.8	12.1	17.0£	—0.7[5]
10. Foreign exchange reserves (including gold & SDRs—end of period) Rs. crores	1885	3242	5224	5822	5930	5542	4022	4782	5972	7243	6919[6]

@Quick estimates.
£Over the corresponding partially revised figures of the preceding year.
*Anticipated.
[1]. April—November, 1985 over the same period in 1984.
[2]. April—December, 1985 over the same period in 1984.
[3]. Between March 30, 1985 and January 25, 1986.
[4]. Between March 31, 1985 and January 3, 1986.
[5]. April—September, 1985 over the same period in 1984.
[6]. As on January 31, 1986.

1.3 A notable achievement of the year was the sharp increase in tax revenues and particularly heartening was the spurt in direct tax collections. A policy of setting more reasonable tax rates, coupled with strict enforcement, resulted in a reversal of the disturbing trend of a declining ratio of direct taxes to Gross Domestic Product (GDP). In spite of these increases in tax receipts, the net revenue position of the Government is likely to deteriorate because of a rise in non-Plan revenue expenditure.

1.4 An area of concern during the course of the year was the deterioration in the trade deficit on account of a sharp rise in imports and a relatively slow growth in exports. The increase in imports was, to a large extent, due to a rise in purchases of bulk commodities, particularly petroleum, oil and lubricants (POL), fertilisers and sugar. A series of measures to curtail imports by boosting domestic production were taken during the year. In particular, major price and market incentives were provided for increasing sugarcane and oilseed output. Although inflows on invisibles and the capital account somewhat compensated for the trade gap, nevertheless a slight drop in the level of foreign exchange reserves is expected by the end of the year.

Gross National Product, Saving and Investment

1.5 As a consequence of a decline in agricultural production, the GNP growth in 1984-85 decelerated to 3.7 per cent. In the current year, however, the prospects are more promising and the Seventh Plan's target growth rate for the economy may be achieved in its first year. Certain agricultural crops, particularly foodgrains, are likely to show a definite improvement over the levels attained in the preceding year. The growth rate in the industrial sector will be about 6.5 to 7.0 per cent despite a planned deceleration in the output of coal in the mining sector. In the remaining sectors of the economy, the robust growth rate consistently recorded in the past few years, is expected to be maintained in the current year.

1.6 Estimates of gross domestic savings and gross domestic capital formation for 1984-85 show that both these macro-economic variables remained unchanged as a proportion of Gross Domestic Product (GDP) at market prices at 22.1 per cent and 23.4 per cent respectively. The implicit rate of inflow of capital from abroad also remained unchanged at 1.3 per cent of GDP.

1.7 While the share of the public sector in gross domestic savings declined from 16.9 per cent in 1983-84 to 14.4 per cent in 1984-85, its share in GDP increased from 23.6 per cent to 25.4 per cent during the same period. The share of the public sector in the total gross domestic capital formation also increased from 46.7 per cent in 1983-84 to 51.3 per cent in 1984-85. Perhaps the single most important effort in raising resources for the Seventh Plan must aim at improving the savings generated from the public sector.

Agricultural Production

1.8 The erratic and inadequate rainfall during the monsoon season has been somewhat compensated for by the excellent pre-sowing and early rabi season rains. Consequently, while kharif output is not likely to increase, rabi production is expected to show a sharp rise. This is likely to result in an overall growth in agricultural production of about three per cent in 1985-86 with the current estimates suggesting that foodgrain output may touch 150 million tonnes.

1.9 Food stocks reached record levels in June, 1985 (29.17 million tonnes) and with a good rabi harvest, stocks are likely to remain at high levels next year, further emphasising the self-sufficiency achieved in cereals. Nevertheless, excessive food stocks are a financial burden and reflect both a problem of distribution and, perhaps as important, a supply problem. On the supply side of agricultural commodities the rising stocks of wheat and rice can be viewed as a reflection of the shortfall in other crops (oilseeds, sugar, pulses, etc.) as the area sown under these crops is diverted to cereals. This area diversion, which alters the cropping pattern across the country, is mainly a consequence of the expansion in irrigated area, the uneven pace of growth of new technology, and changes in relative prices. The distribution problem, on the other hand, is alleviated by an improvement in effective demand. A major attempt was made this year to improve distribution by supplying wheat at a heavily subsidised price to the poorest sections as well as to improve effective demand by providing employment through an enhancement of the Rural Labour Employment Guarantee Programme (RLEGP) and the National Rural Employment Programme (NREP).

1.10 As a result of adverse weather conditions agricultural production in 1984-85 was 0.9 per cent below the remarkable peak achieved in the previous year. Output of foodgrain also declined mainly on account of a fall in the kharif crop which dropped from 89.23 million tonnes in 1983-84 to 84.72 million tonnes in 1984-85. Rabi output was more resilient against the poor natural conditions and declined by 2.6 per cent. In spite of this decline in output, it was encouraging to note an increase of 6.4 per cent in the use of fertilisers in 1984-85 over 1983-84 levels, and this may have mitigated the impact of the poor monsoon to some extent.

1.11 In the case of oilseeds, it is imperative to extricate the edible oil economy from the current situation of high imports which depress domestic prices and cause farmers to switch over to other more remunerative crops. This adversely affects the output of oilseeds and leads to a further demand for imports. As a first step towards giving an incentive for edible oilseed production, the supply of imported oils at concessional price for vanaspati production was reduced from 60 per cent to 30 per cent during the oilseed harvest season. The resultant greater demand for domestic oilseeds would thereby provide farmers with more remunerative harvest prices. Moreover, following the encouraging growth in the output of rape and mustard seed, use of domestic rape seed/mustard oil in the production of vanspati has been permitted to the extent of 40 per cent of the total raw oil consumption. This should help to generate greater domestic demand and stabilise prices.

Infrastructure

1.12 The growth rate in most of the key infrastructural sectors was higher in 1985-86 than in the previous year and substantially higher than the average annual growth rate recorded in the Sixth Five Year Plan. Important exceptions which fared less impressively are hydel power generation and crude oil production. The improvement in thermal (including nuclear) power generation has been spectacular, with a growth rate of 15.5 per cent (April—December, 1985 over the same period in 1984) following an impressive increase of 14.2 per cent in 1984-85. The Plant Load Factor (PLF) increased from an average of 50.1 per cent in 1984-85 to 50.8 per cent in 1985-86 (April—December). Nevertheless, despite two consecutive years of substantial improvement in power generation, a considerable gap between demand and supply still exists. The relatively low PLF, high transmission losses and a failure to bring about an integrated operation of the regional grids, continue to be the disturbing features of the power sector.

1.13 Railway movement has shown an exceptionally high growth rate this year with revenue earning goods traffic increasing by 9.1 per cent (April—December, 1985 over the same period in 1984) which is more than twice the annual average growth rate in the Sixth Plan. As a consequence, despatches of coal increased by 10.4 per cent (April—December, 1985) compared with a rise of only 3.7 per cent in 1984-85 and an average annual growth rate of 6.3 per cent in the Sixth Plan.

1.14 Although the 4.3 per cent growth in crude oil production (April—December, 1985) was lower than in 1984 (11.4 per cent), the refinery throughput increased by a substantial 21.9 per cent during April—December, 1985. A disturbing aspect in the POL sector, however, is the rapid rise in consumption demand in 1985-86 which placed the balance of payments position under pressure. The current rate of growth in petroleum consumption is not sustainable over a period of time.

Industrial Policy and Performance

1.15 It has become increasingly apparent over the last few years that industrial growth is hampered by unnecessary procedural delays in clearing projects and by controls that have become counterproductive. Moreover, uneconomic scales of production coupled with an excessively sheltered industrial environment have fostered monopolistic profits, high costs and products of poor quality. In a series of important policy measures during the current year, the process of reform initiated earlier was given greater impetus. The aim of these policies is to modernise industry, upgrade technology, replace monopoly markets by competitive ones and thereby generate a higher overall growth rate and employment in the industrial sector.

1.16 The main thrust of the industrial policy has been the removal of unnecessary licensing procedures to encourage investment and a push towards expanding capacity levels to achieve economies of scale. The restructuring of industrial policy to stimulate greater productivity and efficiency, which began some years ago, was hastened with the delicensing of 25 priority industries and the 'broadbanding' of 28 other important industries. Restrictions on the expansion of capacity were lifted and the assets limit for coverage under the MRTP Act was revised. With the removal of all these restrictions in the short span of one year, a major opportunity has been provided for growth in investment and output in a wide variety of industries. While the impact of these measures will take some time to take effect, there are already several indications of a fresh impetus on the industrial front, particularly in terms of the sharp rise in the number of applications to start new projects and the remarkable buoyancy of the stock market.

1.17 Industrial production continued to rise in 1985-86 at approximately the same rate as it did in 1984-85 of around six to seven per cent. However, the overall industrial production index obscures the differential growth rates in the major sub-sectors. In an attempt to reduce enormous pit-head stocks of coal which had reached a peak of 29.2 million tonnes at the end of 1984-85, production of coal was stabilised. Consequently, mining and quarrying, which has a weight of 9.69 per cent in the index of industrial production, recorded a growth rate of only 2.9 per cent during April—November, 1985 over the same period in the previous year. The largest sector, manufacturing, with a weight of 81.08 per cent, recorded a higher growth rate of 6.8 per cent during the same period. Electricity generation, with a weight of 9.23 per cent, increased at the fastest rate of 8.4 per cent.

1.18 Major policy initiatives were also taken for specific industries (such as textiles, electronics and sugar) and policies for several other industries (such as drugs and pharmaceuticals) are in the process of being reformulated. With all these major policy changes in the industrial sector, obstacles to a substantial acceleration in industrial growth have been removed. A great deal, of course, depends on the effective implementation of these policies and only if the policies result in quicker processing and decision making will there be a discernible impact on the industrial environment. The Government is monitoring the results of these policy measures very closely.

Price Behaviour

1.19 The Wholesale Price Index (WPI) increased by 3.1 per cent between end-March, 1985 and January 25, 1986, the lowest increase for this period for the last seven years. During January and February, 1986 certain administered prices were raised. However, even after taking these into account the rate of inflation in 1985-86 is likely to be lower than in 1984-85. This slow down in the inflation rate has been achieved as a result of effective supply management policies and by maintaining a tight control on the growth in money supply.

1.20 While prices of manufactured items have remained fairly stable in 1985-86, agricultural prices have been volatile with the prices of some items rising and of others falling as a result of a glut in the market (in particular, jute, cotton, tea and coconut). The agricultural commodities for which prices increased were mainly wheat, vegetables and sugar. Prices of a large number of food items, however, either remained stable or somewhat declined. Domestic edible oils are important items of the food basket whose prices remained stable over the year. While the rise in the price of wheat has occurred after a substantial decline in its price last year, vegetable prices have recorded a continuous increase. Wheat prices increased partly as a result of a hike in procurement price and partly as a consequence of an estimated low level of stocks with private trade as the Government carried the bulk of the stocks. Moreover, wheat prices tend to rise seasonally till December and decline in March following the harvest which this year is expected to be good. Sugar prices increased as a result of a fall in sugarcane output, as area under cane decreased sharply over the last few years. The recent two-year Sugar Policy aims at encouraging sugarcane production through a sharp increase in the statutory minimum price of cane (raised from Rs. 14 in 1984-85 season to Rs. 16.5 per quintal for 1985-86) and reducing uncertainty by announcing the statutory minimum price one year in advance (Rs. 17 for 1986-87).

1.21 The impact of a rise in prices of agricultural commodities, particularly food items, is much greater in the Consumer Price Index (CPI) where these items are given a higher weight. Consequently, CPI has risen faster than WPI, recording an increase of 7.5 per cent between March and November, 1985. Much of this increase can be attributed to the usual sharp seasonal increase in CPI that occurs between April and October and a downward seasonal pressure on CPI for the remaining months of 1985-86 would normally be expected.

1.22 Fluctuations in the prices of agricultural commodities are caused by volatility in agricultural output. Conversely, price fluctuations themselves lead to increased uncertainty and tend to increase the volatility of agricultural supply. A long term price policy in agriculture is an important determinant of assured and consistent output growth and forms a critical input for improved demand and supply management in this sector.

Monetary and Fiscal Policy

1.23 The year 1985-86 has been characterised by major short and long term policy initiatives on the fiscal front and a remarkable degree of control over monetary variables. In the 1985-86 Budget, the structure of direct taxes was rationalised, the rates of personal income tax were reduced for all income levels, and the basic corporate tax rate was lowered by five percentage points to 50 per cent. The aim of these and other provisions in the budget was to increase revenues by combining reasonable rates with improved compliance. Contrary to the fears expressed that these measures would lead to a decline in government tax receipts, the Centre's direct tax revenue collections in the first ten months of 1985-86 were 24 per cent above collections during the same period in 1984-85.

1.24 A significant development during the year was the announcement of the Long Term Fiscal Policy (LTFP) which aimed at providing a detailed fiscal perspective to the financing of the Seventh Five Year Plan. Moreover, by spelling out the Government's fiscal objectives over the next five years, the LTFP aims at providing a stable economic environment under which uncertainties are reduced and the foundations for economic growth ensured. The LTFP will add a degree of coherence to annual budgets.

1.25 In order to provide stability in the economic environment and to further pursue the policy towards direct taxes in the budget—of raising more revenues through more strict enforcement—it was announced in the LTFP that the rates of personal income tax and the wealth tax will remain unchanged for five years. The LTFP also clearly specifies the intention to raise the Centre's direct taxes as a percentage of GDP from 1.5 per cent in 1985-86 (B.E.) to 2.1 per cent by 1989-90. Fresh incentives for savings are also proposed in the LTFP and a major innovation revamping the old investment allowance is specified. On indirect taxes, the intention to gradually move towards a Modified Value Added Tax is announced and significant measures for rationalisation and simplification proposed.

1.26 A distinct decline in the rate of growth of money supply (M3) is the most significant development in the monetary sector; between April, 1985 and January 3, 1986, M3 increased by 13.3 per cent compared with 14.5 per cent during the same period in 1984-85. Deceleration in reserve money has been an important reason behind this improvement in the control over M3 growth. Management of the credit situation has also been very successful with the Government relying more on borrowings from commercial banks rather than the RBI and yet not resulting in any "crowding out" of bank credit to the commercial sector. Non-food credit, in fact, rose by Rs. 4,629 crores in 1985-86 (April—January, 3) in comparison with Rs. 3,886 crores in the same period in 1984-85.

Balance of Payments

1.27 A disturbing element in the economy is the deterioration in the balance of trade position. The trade data base is one of the weakest information sources on the Indian economy with long time lags and large revisions to provisional figures. Provisional data show that for the first six months of 1985-86 imports increased by 24.5 per cent and the rate of growth of exports was sluggish. Total exports showed a marginal decline of 0.7 per cent but this occurred mainly because of a tapering off of crude oil exports in 1985-86 following an increase in domestic refining. Exports, net of crude oil exports, were higher by 7.6 per cent.

1.28 Most of the increase in imports has been on account of bulk commodities, such as oil, fertilisers and sugar. The first half of the financial year saw a bunching of imports of these bulk items and advance information for the third quarter of the year shows that the spurt in the imports of these commodities has slowed down appreciably. For the year as a whole the overall growth in imports should be substantially lower than initial trends suggested. Moreover, as recent policy initiatives for increasing domestic production of sugar and edible oils take effect, import growth in the coming year should decline further. Overall foreign exchange reserves have shown a decline of Rs. 324 crores between end-March, 1985 and end-January, 1986.

1.29 Capital inflows to deposit accounts from non-resident Indians have been buoyant in 1985-86. The interest rates on these deposit accounts (the Foreign Currency Non-Resident Account and the Non-Resident (External) Rupee Account) are above the domestic interest rates and have begun to attract funds at an increasing rate. During the first nine months of 1985-86 accretions to these accounts amounted to Rs. 1,172 crores compared with Rs. 634 crores during the same period in the previous year. Nevertheless, the overall balance of payments suggests a rising external debt position and even though the level of India's external debt is low in comparison with most other developing countries, it still needs to be closely monitored.