

ECONOMIC SURVEY : 1965-66

PART I

ASSESSMENT IN BRIEF

In the year 1964-65, the general level of prices had risen by 8·7 per cent and the country's gold and foreign exchange reserves had declined to the very low level of Rs. 250 crores. At the same time, there was a substantial increase of both agricultural output and national income. The initial outlook for the current year was, therefore, not unpromising. There was good reason to expect that with normal weather conditions, agricultural output would increase further. Such an increase would in turn have reduced the pressure on prices and enabled a higher level of industrial production.

2. With low or insufficient foreign exchange reserves on the one hand and a considerable carry over of import commitments, a severe reduction of foreign exchange allocations for fresh imports was inevitable. This constraint was sought to be offset in part by quicker use of available AID funds for licensing non-project imports. Against this background the Central Budget for 1965-66 sought to avoid deficit financing while offering further incentives for exports and higher production within the country.

3. In the event, many of these expectations have been belied during the current year which has been one of great strain all round. Adverse weather conditions have resulted in a substantial fall in agricultural output. There has been a continued pressure on prices and export earnings in certain sectors have suffered. The expansion of industrial capacity has enabled greater industrial production in some sectors, but as against this the shortage of foreign exchange for the import of components and raw materials has restrained production in many other fields. Hostilities with Pakistan and the pause in foreign aid from some countries which followed added to the disturbance of the economy. The effects of all these factors have been felt more in the second half of the year than in the first. Thus, while industrial production was higher than last year by 7·3 per cent in April-September, 1965, the increase in the second half of the year is expected to be hardly 5 per cent.

4. The supply of agricultural products during the coming year 1966-67 will naturally be difficult as in large part it will be governed by the comparatively low output of the current year. While increased imports of foodgrains under PL-480 may be expected to ensure requirements for minimum levels of consumption, the prospects of building a buffer stock are somewhat doubtful. Significant additions to industrial capacity are expected in the coming year; particularly in steel, petroleum refinery, cement and aluminium. This should result in higher production in industries based essentially on indigenous non-agricultural raw materials. The situation, however, is different in industries which depend on imported raw materials and components and on agriculture-based raw materials.

Continued reduction of imports during the current year has left these industries with very low inventories. In some of them, for example automobile tyres and non-ferrous metal using industries, the rate of production has already been reduced in order to make the stocks last longer. Obviously, increased production in these industries would depend on arrangements being made as early as possible for the import of the necessary materials either by securing foreign aid or by augmenting our means of payment by increased exports. In these circumstances the outlook for next year, both economic and budgetary, remains somewhat uncertain. There are, however, some silver linings on the horizon. The drive for increased agricultural production is clearly gathering momentum. Arrangements have already been made for supply of fertilizers and pesticides in considerably larger quantities and for putting them to the maximum use in areas likely to give the best response. With normal weather conditions there is reason to expect a considerably higher level of agricultural production next year. Prospects for increase in the flow of imports of raw materials and components are also becoming brighter. With continued monetary discipline and energetic drive for import substitution, there is room for hope that the upswing in industrial production may be resumed before long. The need to stimulate production and exports by offering the right incentives will, however, remain greater than ever.

PRODUCTION AND SUPPLIES

5. Agricultural production increased by 10.5 per cent in 1964-65 as compared with a rise of 3.7 per cent in 1963-64, a decline of 5 per cent in 1962-63 and a small increase in 1961-62. The production of foodgrains reached the level of 88.4 million tonnes in 1964-65. Market arrivals were, however, lower suggesting that private stocks which had been depleted earlier were re-built to some extent. Imports amounted to about 7 million tonnes. In the current year the kharif crop was seriously affected by adverse weather conditions in many parts of the country, and as a result it is estimated that the production of kharif grains may be nearly 15 per cent lower compared to the previous year. Measures for increasing the area under rabi crops have been taken but the outlook remains uncertain. Altogether the total production of foodgrains in the current year will be considerably less than during the last. Even with somewhat higher imports of foodgrains the total availability will be less than last year.

6. The fall in agricultural production has not been confined to foodgrains. The output of cotton is expected to be 5.6 million bales this year compared to 5.7 million bales last year. The maintenance of textile production at a level sufficient to meet demand will, therefore, involve a depletion of the stocks carried over from last year. Jute production has been substantially lower and indigenous supplies have had to be augmented by large imports of raw jute, even when the scarcity of foreign exchange has been unprecedentedly severe. The production of oil-seeds has been lower than the high level reached in 1964-65 and the tobacco crop has also been somewhat less. On the other hand, sugarcane output is expected

to be maintained at the same high level as last year. But this will be achieved not by higher yield per acre but only by a considerable expansion of the acreage under sugarcane.

7. Industrial production increased by 7 per cent in 1964-65 as against 8.5 per cent in 1963-64 and 7.7 per cent in 1962-63. While the rate of increase in April-September, 1965, was 7.3 per cent it is likely to be lower in the second half of the year, so that over the year as a whole the growth rate will be less than in 1964-65. Cotton textile output has remained stagnant partly as a result of lower demand and partly due to shortage of power in some areas. Sugar output has been increasing substantially and may be even greater than last year. The output of jute textiles has been sustained so far by increased imports of raw jute but may show some reduction during the next few months. There have been significant increases in the output of steel, aluminium and cement, mainly as a result of additional capacity coming into production. Coal output has already increased by three million tonnes compared to last year. While production has increased in some other industries not dependent on imported raw materials and in certain sectors for which reasonably adequate imports of components and raw materials could be made available under certain special arrangements, output in a number of other industries has been affected by the shortage of foreign exchange.

8. The availability of hydro-electric power suffered in some regions as a result of the failure of the monsoon. Apart from these dislocations, the power supply position was by and large satisfactory. Indeed, in some areas there were temporary problems of finding markets for additional power generated with new capacity coming into operation. The rail transport situation continued to be satisfactory, though there was some dislocation following the hostilities with Pakistan.

9. National income in real terms had risen by 7.3 per cent in 1964-65 as compared to 4.5 per cent in 1963-64 and 2.2 per cent on an average during the first two years of the Third Plan. In the current year, however, there is likely to be no increase; on the other hand, it may be a little lower than the previous year as a result of the decline in agricultural output.

BALANCE OF PAYMENTS

10. The balance of payments was under considerable pressure during 1964-65. The decline in reserves was as large as Rs. 72 crores in spite of drawals of Rs. 47.6 crores from the International Monetary Fund. The pressure on reserves was the result of a rising debt service burden, repayment to the IMF and larger imports of food and goods for development, but with an expansion of exports insufficient to meet these needs. The utilization of external assistance and the proportion available in non-project form showed improvement; but this did not suffice to prevent the large fall in reserves.

11. While there has been progressive improvement in the terms on which external assistance has been available, the servicing of past debts continued to impose a heavy burden. Debt servicing payments during 1964-65 amounted to Rs. 122 crores as compared with Rs. 100 crores in the previous year. Imports during 1964-65, at Rs. 1363 crores, were higher by Rs. 160 crores than in 1963-64. Food imports were substantially larger, the increased payments for food in foreign exchange amounting to Rs. 29 crores. Imports of machinery and raw materials were also at higher levels, as a result of some liberalisation of import licensing in 1963-64. Exports during 1964-65, at Rs. 803 crores, were only Rs. 1 crore higher than in 1963-64. Because of this, in spite of utilization of Rs. 503 crores of aid (compared to Rs. 408 crores in 1963-64) there was a decline in reserves to the level of Rs. 250 crores. With Rs. 200 crores required to be kept as statutory reserves, the balance available for deployment is hardly sufficient to pay for half a month's imports. Under these conditions new licensing for imports to be paid for in free foreign exchange was suspended for two months from the beginning of May, 1965. Allocations for imports other than fertilizers, food, defence and raw materials for export industries were substantially reduced. In spite of these measures and an improvement in aid utilisation by Rs. 27 crores besides a drawing of Rs. 36 crores from the International Monetary Fund, the reserves declined by Rs. 8.5 crores during April-September, 1965. This was mainly due to the fact that actual imports, being the result of import licensing in previous periods, continued to come in at an even higher level for several months. Thus, total imports in April-September 1965, are estimated at Rs. 717 crores as against Rs. 674 crores in April-September, 1964. Export shipments were actually lower in April-September, 1965, compared to the corresponding period of the previous year but export earnings were a little higher as proceeds from exports made earlier were coming in. The measures taken earlier in the year have, however, resulted in an improvement of the position since October. Reserves have been rising slowly and it is expected that after repayment of Rs. 36 crores, which is due to the International Monetary Fund, the reserves at the end of March will not be lower than what they were at the end of March, 1965.

FISCAL AND MONETARY DEVELOPMENTS

12. The Central and State Budgets for 1965-66 made a provision for a further increase in outlays although the increase was smaller than in the previous year. The bulk of the increase of Rs. 459 crores was for development purposes. While the Central Budget showed a small overall surplus, State Budgets showed large deficits amounting in all to Rs. 71 crores. By July, 1965, it became clear that the initial expectation that Government outlays would be financed by resources raised in a non-inflationary manner was not likely to be realised. This was due to additional commitments for securing the defences of the country, increased dearness allowances and an anticipated shortfall in receipts as a result of import restrictions and the slow growth of production. A supplementary budget was, therefore, presented in August 1965, for raising additional resources of about Rs. 100 crores during the current fiscal year. In spite of this it is likely that there will be an overall deficit in the Central Budget.

13. The budgetary position of State Governments has remained weak although several State Governments took measures of additional taxation. In the course of the year the reliance of the States on Reserve Bank increased substantially. The ways and means advances of the Reserve Bank to the State Governments have gone up substantially and several State Governments have run up large over-drafts with the Reserve Bank.

14. A large deficit on State Governments account is, therefore, likely to emerge even after allowing for a transfer of resources from the Central Government to the States which was not visualised at the start of the year.

15. The budgetary deficits accounted in large part for a substantial expansion in the supply of money. The rate of increase during the current year may well be about 9 per cent, i.e., the same as last year. The money market was, however, tight throughout the earlier part of the year. Interest rates moved upward in spite of the expansion of money supply at a rate higher than the rate of growth of output. The banking system had to finance larger stocks of foodgrains, sugar and cotton textiles. The requirements on this account were considerably larger than the reductions that may have taken place in the inventories of imported raw materials. Because of the sluggishness of the capital market, industry had resort to the banks for the financing of purchases of fixed assets, instead of the normal way of raising funds on a long-term basis. The growth of commercial bank deposits was slower than last year and the rate of increase of funds available with the banking system was therefore lower, while some transactions hitherto financed by the unorganised market may have required bank financing as a result of measures taken to prevent tax evasion through hundi etc. During the current busy season, deposit growth has picked up though credit expansion has been slower than usual. Agricultural production declined and there may have been a further reduction in stocks of imported raw materials. The underlying monetary situation is, however, such that the continued availability of short-term credit for genuine purposes can only be secured through policy designed to match savings and investment and to balance public revenues and expenditures.

PRICES

16. Wholesale prices which had risen by 8.7 per cent in 1964-65, following on an increase of 9 per cent in 1963-64 rose further during the year though at a slower rate. During the first nine months of 1965-66 the rise in prices was 11.4 per cent as compared with a rise of 16 per cent in the corresponding period of 1964-65.

17. The rise in prices this year has been largely due to higher prices of food articles. Foodgrains prices rose in spite of the good crop last year probably due to expectations of a poor kharif crop this year. It may be noted that there are wide disparities in prices of foodgrains as between surplus and deficit areas as a result of controls on movements. Among other food articles, there was a

sharp increase in the prices of edible oils. While a steep rise occurred in raw jute prices, cotton prices remained relatively stable.

18. Prices of manufactures also rose during the year. In part these price increases were intended to provide incentives to additional production. They, however, also reflected increases in costs as a result of higher food prices; in many instances, cost of living allowances to industrial workers are related to prices of foodgrains, and many industries have had to pay higher prices of agricultural raw materials.

ECONOMIC POLICY—PERSPECTIVE AND IMMEDIATE TASK

19. The period of transition from one plan period to another naturally provides an opportunity for an assessment of policies and performance in the perspective of the long-term aims that the country has set before itself. At the same time, difficulties accumulate and sharp disturbances arise from time to time as happened during the current year. These call for immediate remedial action. Often, the response to sudden or sharp difficulties in the short run has got to be in terms of restraint and restrictions which may interrupt or inhibit the pursuit of long-term objectives for a while. Thus, when foreign exchange reserves are low and declining, there may be no escape from restricting the imports of even essential goods. Rationing and restraint on even basic consumption are inevitable when crops fail badly. And fiscal and credit policy may have to curtail investment when price increases threaten to get out of hand. But even while providing a corrective to sudden or sharp difficulties as they arise from time to time, care has to be taken to ensure that the process of expansion is resumed as soon and as vigorously as possible. Thus a response to shortage or inflation or balance of payments difficulties even in the short run has to be more in terms of efforts to increase production, saving and exports than in terms of rationing or reduction in investment or imports. Economic policy had to face this dilemma throughout 1965-66.

20. A rapid increase in agricultural production has been recognised to be imperative. Imports of fertilizers were increased substantially in spite of the difficult foreign exchange situation, and measures were taken to increase output to the extent possible from indigenous fertilizer plants. From a longer-run point of view, measures are being taken to speed up the establishment of additional capacity for the manufacture of fertilizers. Other industrial inputs, such as pesticides and tractors, are also of importance for agriculture. Attempts were made to augment supplies in the short-run through larger imports of these products and of raw materials for their manufacture, while encouraging expansion of these sectors of industry. Industrial materials can, however, be effectively used only as part of a scientific package of inputs which must include effective organisation. Attention has, therefore, been given to the multiplication and distribution of improved varieties of seeds, speeding up of the implementation of irrigation projects, and provision of guidance to farmers regarding the best methods of using these resources. Intensive attention has been paid to selected areas

holding out the best promise of quick returns in terms of increased production. In order that it may be worthwhile for farmers to use modern inputs, remunerative prices have been offered; procurement prices in 1965-66 for rice have in general been about 5 to 10 per cent higher than those for 1964-65.

21. While arrangements were made for increased imports of foodgrains, it was clear that supplies would not suffice to meet demands in full. Measures were, therefore, taken to protect to the extent possible the more vulnerable sections of the population. The policy objective has been to enforce statutory rationing in cities with a population of 100,000 or more. So far statutory rationing has been introduced in Calcutta, Madras, Coimbatore and Delhi. In order to secure supplies to meet the requirements of deficit areas, the procurement of foodgrains was intensified. Restrictions were maintained on movement of foodgrains to facilitate procurement.

22. In the industrial field, efforts were made to minimise the impact on production of the shortage of foreign exchange for imports of components and raw materials. Technical possibilities of import substitution were identified and implemented in a number of industries. In certain cases, incentives through higher prices were provided for the establishment of additional capacity. The distribution and prices of cement were decontrolled; cement producers are to meet essential Government requirements at a fixed price while selling the remainder of output at higher prices.

23. The Budget for 1965-66 included a number of provisions designed to stimulate production, investment and savings. The excise duties were lowered on certain products whose output could be expanded in response to higher demand. The lists of priority industries entitled to concessional treatment for direct tax purposes were enlarged and rationalised. Schemes for the grant of tax credit certificates on increase in corporate income and on additional production in certain industries subject to excise duties were announced in order to secure larger output, not only through the establishment of additional capacity but, more important, from the efficient use of existing capacity.

24. After the Budget for 1965-66 was presented, it became apparent, however, that revenues would be lower than anticipated because of the sluggishness of the economy, and that expenditure in certain directions would be higher. In order to avoid substantial deficit financing in the context of poor agricultural output and rising prices, a Supplementary Budget was presented in August 1965, which provided for substantial additional revenue from import and excise duties. In keeping with the long-term objective of giving an impetus to import substitution the need for additional revenue was met by raising and rationalising the structure of import duties.

25. It was expected that with the start of the year, the expansion in the supply of money will be more or less in line with the growth of output, on the basis of higher agricultural production and a balanced budget. These expectations were falsified as a result of the adverse weather conditions in agriculture and the deterioration in the

budgetary position. The expansion in money supply over the year has been substantial though output has not risen. Efforts were made to keep monetary expansion in check through appropriate policy measures. In the event, the extent of credit contraction during the slack season was less than anticipated; the policy for the following busy season was, therefore, devised so as to ensure an adequate flow of credit to the priority sectors of exports, defence production and holding of food stocks by approved agencies while restricting severely the expansion of credit to other sectors. While considerable stringency prevailed in the money market, there was, nevertheless, a substantial expansion in the money supply over the year as noted earlier; basically, this was because investments (including in the public sector) which would appropriately have been financed through long-term savings have had in part to be financed by the banking system.

26. Measures were also taken to strengthen the balance of payments. In order to encourage exports, a scheme of tax credits against export earnings was announced in the Budget for 1965-66. In recent years, certain categories of invisible receipts have flowed increasingly through illegal channels; and under the National Defence Remittance Scheme inducements were offered for a limited period to remit these funds legally. A temporary scheme was also announced under which gold could be lent to Government on the basis of repayment in gold after a period of years. The rationalisation and enhancement of import duties in the supplementary budget were designed to provide a stimulus to import substitution.

27. Policy measures must continue to be applied to improve the rate of growth, and to strengthen the balance of payments while securing price stability. A major task is to secure the maximum output in the short-run from investments already made. This is, in part, a matter of identifying specific impediments to higher production, for example by completing distribution channels where irrigation facilities already exist. In part, there is need for incentive prices in priority sectors in which unduly low price levels have held back production. The creation of a framework in which the running enterprises, whether in agriculture or industry, can respond flexibly to changing situations to secure larger production can also make an important contribution. The concentration of control at strategic points, while permitting flexibility in subsidiary decision-taking, can result in the better use of resources available; for example, the de-control of categories of steel in plentiful supply has provided greater flexibility to the engineering industries.

28. The greater flexibility in the use of imported components and raw materials is related partly to the level of supplies that is available. In recent years, an increasing proportion of assistance has been available in non-project form, and a further move in this direction will be of value. Higher prices for imported materials, such as those resulting from the revised import tariff, also facilitate a greater degree of flexibility in import licensing, while reducing in part the windfall profits made by those who are allocated foreign exchange for the import of finished goods or of raw materials. Such excess profits

can legitimately be diverted to financing the investments needed for growth.

29. A sizeable expansion of export earnings is imperative if development is to proceed at a rate commensurate with our requirements. While increased levels of external assistance are desirable and can be put to effective use in stimulating the growth of the Indian economy, reliance must primarily be placed on export earnings to finance the growing needs of imported materials and equipment. The relatively low rate of growth of export earnings in the recent past is a matter of serious concern. There is need to create a frame-work which provides a strong and stable stimulus not only to short-run export promotion but also to the building up of productive capacity to meet foreign demands and long-term investments in marketing abroad. Such a frame-work must be sufficiently comprehensive to enable advantage to be taken of new opportunities abroad and new possibilities of production in the country as and when they arise. Further, it is not only with regard to commodity imports and exports that export promotion and import substitution are desirable. Sustained effort in these directions is needed also in fields such as shipping, banking and tourism.

30. In the context of the growing requirements of development, the need for augmenting domestic savings is greater than ever. The need for strengthening the budgetary position is all the greater since the substantial budgetary support which the imports of foodgrains under PL-480 has provided in recent years cannot be considered as an integral part of long-term fiscal policy. In part, there is need and scope for mobilizing resources by additional measures of taxation. But given the substantial measures of additional taxation already imposed, the extent to which domestic savings can be mobilised for development would depend henceforth increasingly on the rate at which output can be expanded. While it may be necessary and desirable to extend the tax system to cover more fully those who benefit from development, to mop up incomes which serve no functional purposes and even to raise the rates of taxation, reliance will need to be placed primarily on increasing the yields of taxes at current rates and the surpluses of public sector undertakings through greater and more efficient production. In this sense, the quick expansion of output and the mobilization of resources for development are only different aspects of the same problem.

31. The adequate mobilization of internal resources is the only means of avoiding excessive expansion of the money supply and inflationary pressure in the economy. While adjustments in relative prices are often desirable in order to provide a stimulus to production, they become ineffective if they are neutralised by corresponding increases in prices generally. A further requirement for stability is that, when relative prices are changed for policy reasons, there is restraint in adjustment of incomes to compensate for higher costs. If agricultural prices must be relatively higher than they were some years ago in order to stimulate agricultural output, it is not feasible to adjust non-agricultural incomes to compensate in full for higher agricultural prices. There is thus need to view proposals for changes

in prices and incomes in individual sectors in the context of an overall price and income policy providing for a reasonable degree of overall price stability.

32. In short, increased use of fiscal and monetary measures, promotion of competition on the basis of price and quality to the maximum extent possible, a greater degree of mobilization of resources for investment and the expansion of public investment and savings, and selective application of controls at points at which they can be applied effectively in the pursuit of specific social objectives, are all essential ingredients of a policy designed to promote rapid economic growth while furthering the social objective of reducing inequalities of income and wealth.

AGRICULTURAL PRODUCTION

