CHAPTER I

THE ECONOMIC SITUATION IN 1978-79

Introduction

1.1 The performance of the Indian economy in 1978-79, the first year of the Five Year Plan 1978-83, must be regarded as most encouraging. Growth impulses generated in 1977-78 have been carried forward in the current year and on the whole the economy seems well set on the path of development. Although the rate of growth of gross national product will be much lower than the 7.2 per cent achieved during 1977-78 there are trends which indicate a growing strength of the economy which can be exploited for further growth. Agriculture has shown a marginally better performance over the record achievement in 1977-78 in spite of the devastating floods over large parts of the country and industry seems to have shaken off its earlier stagnation. Investment also has been growing steadily. A remarkable aspect of the performance of the economy in the current year is the relative price stability. Although the money supply rose substantially during this period a restrictive monetary and credit policy and skilful supply management have prevented the emergence of inflationary pressures. Foodgrains stocks are expected to increase to 20 million tonnes by the end of the current agricultural year due to much higher procurement; and supplies of other items like sugar, edible oils and fibres are satisfactory. The so called inability to use foreign exchange reserves for development no longer exists because imports have risen sharply in 1977-78 and the current year mainly because of an increase in the inflow of essential consumer and producer goods following a liberalised import policy. As a consequence the growth in foreign exchange reserves in the first ten months of the year amounts to Rs. 582 crores as compared to Rs. 1,096 crores during the same period last year. The only grey spot in this otherwise bright picture relates to export performance. The rate of growth of exports fell sharply in 1977-78 and actually became negative in the first eight months of the current fiscal year due to various national and international factors.

TABLE 1.1

Selected Economic Indicators

	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79
		(Percentage change over previous year)					
1. Gross National Product at 1970-71 prices	—1.1	5.0	0.8	8.9	1.6	7.2[1]	3.5[2]
2. Agricultural production	—8.0	9.9	—3.2	15.2	—7.0	13.9	2.0[2]
3. Foodgrains production	—8.2	7.8	—5.4	22.0	—9.0	14.8	2.0[2]
4. Industrial production	4.0	2.2	2.6	6.0	9.5	3.9	7.5[3]
5. Electricity generated	5.9	3.3	5.2	12.9	11.8	3.4	12.9[3]
6. Wholesale prices	10.0	20.2	25.2	—1.1	2.1	5.2	—0.6[3]
7. Money supply	16.6	15.5	6.9	11.3	20.3	14.7	12.0[4]
8. Imports (in current prices)	2.4	58.3	52.9	16.5	—3.6	19.6	21.2[5]
9. Exports (in current prices)	22.5	28.0	31.9	21.4	27.2	4.5	—2.3[5]

[1] Quick estimates.
[2] Anticipated.
[3] April-December 1978 over April-December 1977.
[4] As on January 12, 1979 compared with March 31, 1978.
[5] April-November 1978 over April-November 1977.

Gross National Product, Savings and Investment

1.2 Gross national product in the current year is estimated, on the basis of available indicators, to increase by about 3.5 per cent as compared to 7.2 per cent in 1977-78. This is because although the rate of industrial growth is expected to be about 8 per cent, agricultural growth will be nominal as the achievement last year was a record 13.9 per cent. For the four years 1975-76 to 1978-79, the average rate of growth of GNP works out to over 5 per cent, which is substantially higher than the long run trend rate of 3.5 per cent.

1.3 The Central Statistical Organisation's 'Quick estimates' of gross domestic capital formation show that in 1977-78 it was 21.3 per cent of gross domestic product (at market prices). This was slightly lower than the proportion of 21.8 per cent in 1976-77. The decline in capital formation last year was entirely due to a substantial fall in the inventories of food, steel, and fertilizers in the public sector which had contributed to the significant increase in the gross domestic capital formation in 1976-77. Indications are that during the current year the rate of capital formation will be higher than in 1977-78.

1.4 The proportion of gross savings in the gross domestic product in 1977-78 was 22.4 per cent and therefore lower than the proportion of 23.3 per cent in 1976-77. Savings continue to be higher than gross capital formation but the difference between the two has fallen from 1.5 percentage points in 1976-77 to 1.1 percentage points in 1977-78. Savings also are expected to increase during the current year but the discrepancy between savings and capital formation is likely to narrow down further as can be seen from the deceleration of the increase in foreign exchange reserves.

Agriculture

1.5 Rainfall during the *kharif* season in the current year has been satisfactory in all parts of the country. There were, however, devastating floods in certain regions. Nevertheless agricultural production in the *kharif* of 1978-79 is expected to be very good. It is estimated that foodgrains production would be slightly higher than the 77.6 million tonnes achieved in the *kharif* of 1977-78. The prospects for *rabi* output also seem to be reasonably good. Total foodgrains production for the year as a whole is therefore expected to be more than the 125.6 million tonnes achieved last year. Pulses, however, may not show much improvement.

1.6 Commercial crop production was also very high in 1977-78. While both oilseeds and cotton recorded satisfactory increases, the output of sugarcane was a record one at 18.8 million tonnes (in terms of gur). Sowings indicate that the output of sugarcane will be more or less at the same high level as last year. In the current *kharif* season the production of groundnuts is expected to be appreciably better than the output of 5.3 million tonnes in the last *kharif* season. The total output of the five major oilseeds is expected to rise to 9.5 million tonnes from the level of 8.9 million tonnes reached last year which itself was 14 per cent higher than the production in 1976-77. The production of cotton is expected to reach a figure of 74 lakh bales as compared to 71 lakh bales last year which again was 22 per cent higher than the production in 1976-77.

Industry

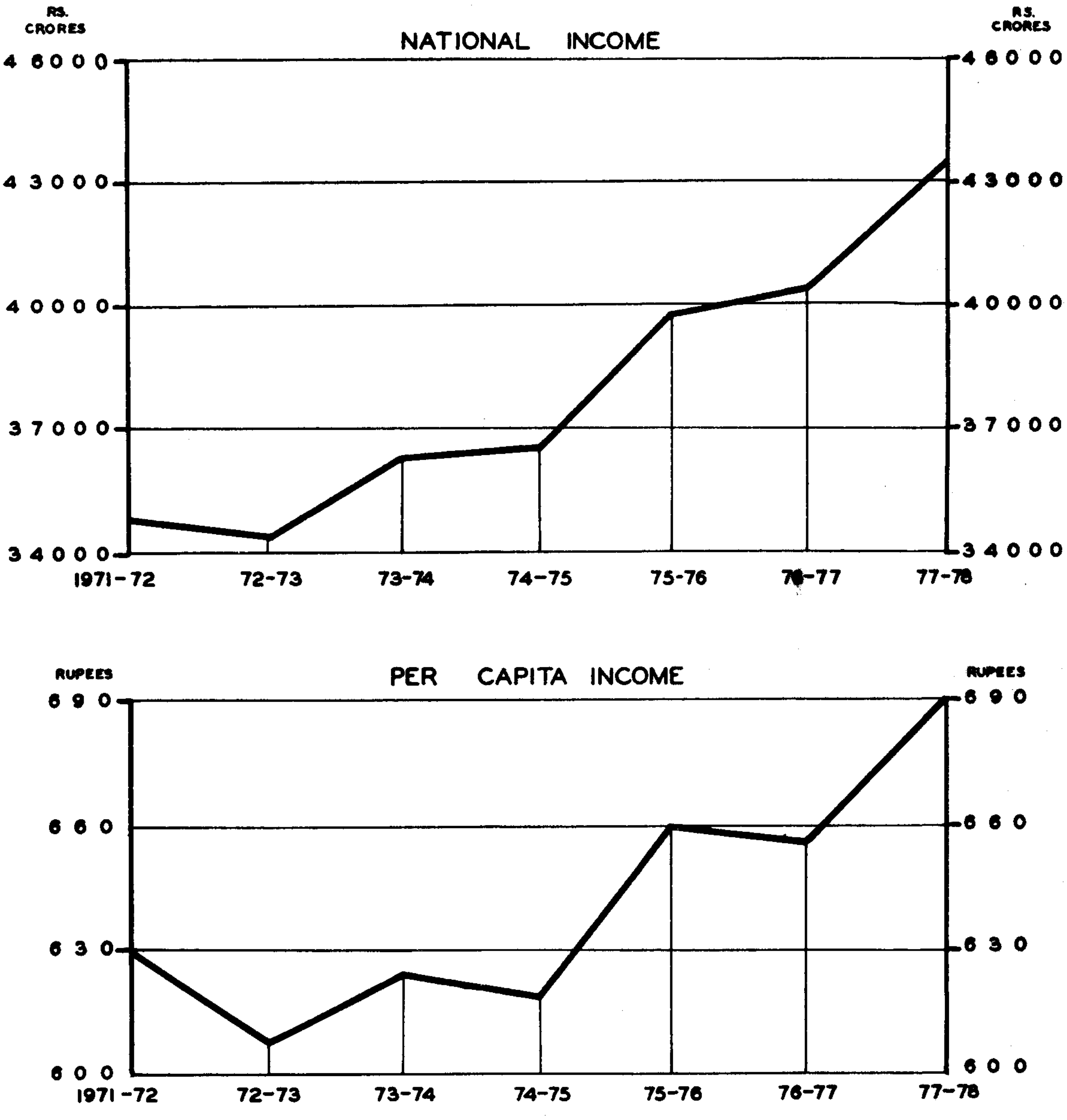
1.7 Industrial production had increased by 3.9 per cent in 1977-78 due to a slow down in basic metal, transport equipment and electricity generation sectors. In the first eight months of the current year, industrial production has shown a remarkable recovery and the rate of growth of industrial production for the whole year is estimated at about 8 per cent. This recovery has taken place in almost all the major groups. In particular electricity generation, food industries and textiles have contributed a great deal to this resurgence. Capacity utilisation has increased substantially throughout the system and even some shortages as in the case of cement have begun to emerge. However two major sectors are causing concern, *viz.*, coal mining and steel. The former was affected severely by floods, but has now almost recovered from their ravages. The latter's production has been adversely affected among other factors by recurring power shortages in the Eastern region. However increased production by mini-steel plants has more than made up the shortfall in the production by integrated steel plants.

Prices

1.8 The price situation during the current year has been characterised by a remarkable degree of stability. The Wholesale Price Index (1970-71 = 100) which stood at 182.9 for March 1978—it was the same for March 1977—has risen to 184.8 in December 1978, an increase of 1 per cent. Food articles on the whole are somewhat cheaper though the prices of pulses have increased by 3.1 per cent. On the other hand, the prices of manufactured products such as basic metals, rubber and rubber products, leather and leather products have advanced appreciably. Floods in September in the North led to a contra-seasonal increase in prices in October. Subsequently however this trend has been reversed but in view of the fact that the rise in the lean season was not very sharp the seasonal decline has also been moderate.

NET NATIONAL PRODUCT

(AT 1970-71 PRICES)



MINISTRY OF FINANCE, ECONOMIC DIVISION.

GMGIPND-PLW-450/5/Finance/78-79-Chart 2

1.9 The stability of the Wholesale Price Index is in contrast with the movements in the Consumer Price Index. The latter has risen from 321 in March 1978 to 340 in November 1978 before declining to 335 in December, showing an increase of 4.4 per cent as against the 1.0 per cent increase in wholesale prices. To a certain extent this divergence arises from differences in the base of the two indices and their coverage.

Monetary Trends

1.10 During 1977-78 money supply increased by 14.7 per cent. The factors primarily responsible for this increase were the sharp rise in foreign exchange assets of the banking system and the expansion of credit by banks to Government and the commercial sector. In the current year till January 12, 1979 the increase in money supply has been of the order of 12.0 per cent as compared to 8.1 per cent in the corresponding period last year. The principal factor responsible for this rapid increase in money supply has been the growth of bank credit to the commercial sector. This increased by Rs. 3347 crores as compared to Rs. 1750 crores in the same period last year. On the other hand, bank credit to Government which was an important expansionary factor affecting money supply last year has shown a smaller increase of Rs. 703 crores in the current year so far as against Rs. 1203 crores last year. Likewise, the increase in foreign exchange assets which had been a major factor contributing to an expansion of money supply in the past three years has not been so prominent. The growth of time deposits, which is an important contractionary factor in money supply expansion has been, however, lower at 19.5 per cent compared to 20.7 per cent last year.

1.11 In order to minimise the impact of these monetary resources on the economy, a restrictive monetary and credit policy has been maintained. Banks were required, after June 1, 1978, to deposit with the Reserve Bank, in terms of rupees, half the amount of deposits accruing in the non-resident deposit accounts. Refinance facilities in respect of food credit were reduced and banks' entitlement to refinance to the extent of 1 per cent of demand and time liabilities was abolished in order to control the expansion of money supply. Banks were asked to restrict the expansion of gross non-food credit for the period December 1978 to March 1979 to 40 per cent of the growth in deposits. The statutory liquidity ratio was raised from 33 per cent of banks' total demand and time liabilities in the form of investments to 34 per cent, with effect from December 1, 1978. However, care was taken to ensure that legitimate requirements of credit, particularly to the priority sectors, were not adversely affected by these measures.

Balance of Payments

1.12 The worsening in the balance of trade noticed last year has continued in the current year. Imports which rose sharply last year have increased further in the current year and are 21 per cent higher in April—November 1978 than the level in the corresponding period in 1977. Exports whose growth had sharply decelerated last year show a slight decline in April—November 1978 as compared to 1977. The growth in imports was due to increased imports of items like edible oils, artificial fibres, iron and steel, fertilizers and higher costs of petroleum and its products. The decline in exports was due to the end of the boom for tea and coffee, restrictions in importing countries on items like cotton textiles and garments, recessionary conditions in the world economy which affected the market for engineering goods and growing domestic demand for certain exportables like steel. Nevertheless the continuing, though decelerating, increase in non-export receipts and higher aid receipts have led to an increase of Rs. 582 crores in India's foreign exchange reserves in April—January 1978-79, after repaying Rs. 212 crores to the International Monetary Fund. This was slightly more than half the growth in the reserves in the same period of 1977-78.

1.13 To conclude: the aim of the policy in the coming year will have to be to improve upon this satisfactory performance of the economy. In agriculture it will be necessary to have more investment, concentrated research effort and better crop planning so that in addition to continuing the production trends in cereals there will be higher production of needed commodities like pulses, oilseeds and cotton. In industry the need is for more investment in sectors like steel, cement, fertilizers and at the same time for improved operational efficiency in a wide range of industries and projects. In infrastructure the need is to improve capacity as well as efficiency in sectors like power and transport to eliminate the current constraints on production. While there has been a great degree of price stability so far, its continuation in the coming months depends greatly upon the success in controlling the growth of money supply. Both monetary policy and fiscal policy have to be on a short leash if the liquidity in the system is not to increase further. Finally all possible steps will have to be taken to increase exports. Since the policy of import liberalisation has had a beneficial effect on the economy it is important that any strain on the balance of payments in the future is reduced through more vigorous export promotion rather than through restrictions on imports.