

CHAPTER 1

THE ECONOMIC SITUATION IN 1979-80

Introduction

1.1 There was a sharp deterioration in the economic situation in the country in 1979-80 as compared with the two previous years. Severe drought gripped large parts of the country and rainfall was erratic in other parts with the result that agricultural production declined by about 10 per cent in sharp contrast to the record harvest in 1978-79. Industrial production declined marginally, again in contrast to the increase of 7.6 per cent in 1978-79. Owing to the poor performance of power, coal and rail transport the infrastructure emerged as a severe bottleneck on production. After two years of reasonable economic growth, 1979-80 witnessed a decline of about 3 per cent in real GNP.

1.2 The year also witnessed the emergence of severe inflationary pressures. Between the end of March 1979 and March 29, 1980, the Wholesale Price Index rose by 19.9 per cent. Aggregate demand had been buoyant for the past two years and the sudden emergence of severe supply constraints triggered inflation. Public expenditure had been rising continuously and the reliance on deficit financing was particularly heavy both in 1978-79 and 1979-80. Also the liquidity in the system on account of large increases in money supply in the previous years produced conditions in which shortages generated inflationary expectations which led to great pressure on prices. These inflationary pressures are by no means eliminated.

TABLE 1.1
Selected Economic Indicators

	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80
	(Percentage change over previous year)						
1. Gross National Product at 1970-71 prices	4.9	1.0	9.7	1.5	8.1	4.2 ¹	-3 ²
2. Agricultural production	9.9	-3.2	15.2	-7.0	14.5	3.4	-10 ³
3. Foodgrains production	7.8	-5.4	22.0	-9.0	15.5	3.9	-10 ²
4. Industrial production	0.8*	3.2*	7.2*	9.5	3.3	7.6	-0.8 ³
5. Electricity generated	3.4	5.2	12.8	11.5	4.4	12.1	2.0
6. Wholesale prices**	20.2	25.2	-1.1	2.1	5.2	No. Ch.	16.7
7. Money supply	15.5	6.9	11.3	20.3	14.7	19.8	10.3 ⁴
8. Imports (in current prices)	58.3	52.9	16.5	-3.6	18.7	13.2	24.6 ⁵
9. Exports (in current prices)	28.0	31.9	21.4	27.2	5.2	5.9	8.2 ⁵
10. Foreign exchange reserves (excluding gold and SDRs)	21.3	5.1	144.3	91.9	57.2	16.0	-1.1

¹ Quick estimates.

² Anticipated.

³ April 1979—February 1980 over the same period in 1978-79.

⁴ As on March 28, 1980 compared with March 31, 1979. This figure understates money supply growth during 1979-80 because of changes in definition (See Chapter 6).

⁵ Provisional.

*Revised.

**Annual average.

1.3 The balance of payments came under severe pressure during 1979-80 because of the sharp increase in crude oil prices and prices of other imports and a large volume of imports necessitated by domestic shortages. The very same domestic constraints also depressed exports. As a result the trade gap widened to Rs. 2233 crores in 1979-80 as compared with Rs. 1088 crores in 1978-79. Foreign exchange reserves (excluding gold and SDRs) declined by Rs. 56 crores during the year whereas they had risen continuously and substantially in previous years. The decline in foreign exchange reserves has continued into 1980-81 with reserves declining further by Rs. 274 crores by May 30, 1980. As a matter of fact, the shadow on the economy of the continuously rising oil prices seems to be growing longer day by day.

1.4 The only two relieving features in this otherwise unsatisfactory picture are the size of the food stocks and the level of foreign exchange reserves. The former amounted to 14 million tonnes at the end of March 1980. This is lower than the figure of 16.2 million tonnes at the end of March 1979, reflecting the running down of stocks because of the poor *kharif* in 1979-80, but they are nevertheless substantial. Foreign exchange reserves declined during 1979-80, even so, they are substantial, amounting to Rs. 4890 crores on May 30, 1980. This provides some cushion while the economy takes medium term adjustment measures.

Agriculture

1.5 After two years of remarkably good rainfall, a severe drought occurred in the *kharif* season in 1979-80 in the Punjab, Haryana, Rajasthan, U.P., Bihar, West Bengal, Madhya Pradesh and Andhra Pradesh. This led to an estimated decline of about 14 million tonnes in the *kharif* foodgrain output from the record level of 78.7 million tonnes achieved last year. The main set-back was in the output of rice and coarse grains in the drought affected areas. The lack of moisture in the ground and the absence of rains at the time of the *rabi* sowing raised apprehensions that the *rabi* crop may also be affected. Fortunately the area sown in the current *rabi* season has not declined and rains later in the season as also the fact that a large proportion of this area is irrigated have given room for hope that the *rabi* output of foodgrains will only be marginally lower, if at all, than last year. Thus foodgrain output for the year as a whole will be around 116 million tonnes as compared with 131.4 million tonnes in 1978-79. As regards commercial crops the trend has been mixed : while the production of sugarcane, jute and mesta is expected to fall below last year's level, the prospect for oilseeds and pulses is

quite encouraging because of favourable weather in the Western and the Southern regions. On the whole, agricultural production may show a decline of about 10 per cent during the year. The performance in the previous four years had raised hopes that India had embarked upon a path of relatively steady agricultural growth, but this has been belied by the experience of 1979-80 which points to the still substantial influence of weather conditions in determining agricultural performance. Nevertheless, there is evidence that the agrarian economy has gained in basic strength over the years. The economy has not been as adversely affected by what has been a remarkably severe drought as used to be the case in earlier years.

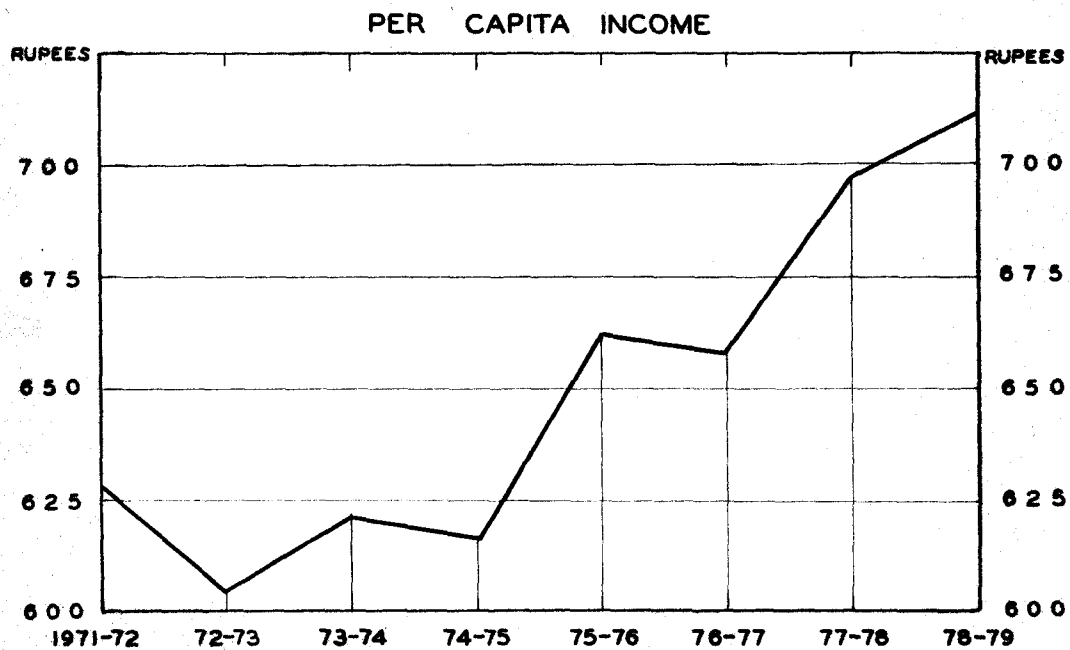
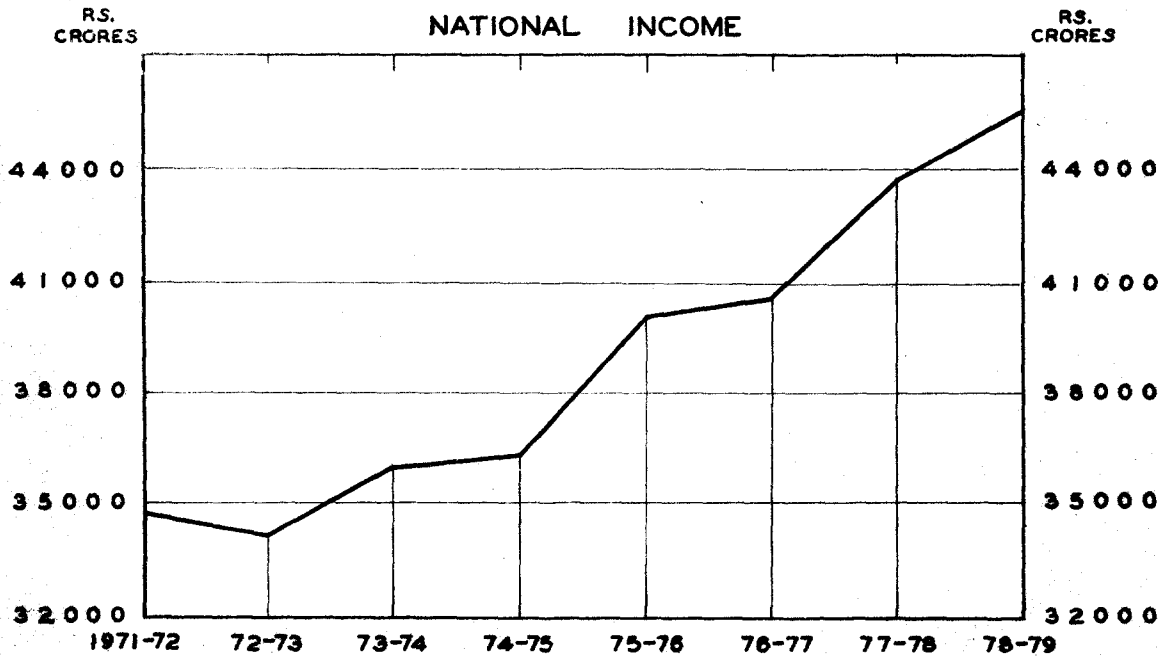
Industrial Production

1.6 The set-back in agriculture in 1979-80 occurred simultaneously with a set-back in industry. The index of industrial production shows a small decline of 0.8 per cent in the first eleven months of 1979-80. Production in major industries like steel, cement, non-ferrous metals, cotton textiles etc., for which information is available for the full year show significant declines during the year. Saleable steel production declined by 8.4 per cent in 1979-80. Cement production declined by 9.1 per cent ; cotton cloth by 5.7 per cent ; sugar by 26.2 per cent ; and vanaspati by 7.7 per cent. Coal production has increased by only 0.9 per cent in 1979-80. The growth rate in power generation has been only 2.0 per cent compared with 12.1 per cent in 1978-79. It appears, therefore, that on the basis of trends so far industrial production will decline marginally over the year as a whole.

1.7 Failures in infrastructure have been one of the principal causes of the poor performance of industry. Power shortages developed because the sharp increase in demand from agriculture combined with the normal increase in demand from the rest of the economy had to be met by only a small increase in generation. Severe power cuts have had to be imposed in most parts of the country. What is worse there are intermittent interruptions in power supply which makes production planning difficult. Although large additions to generating capacity have been made in recent years, mainly in thermal generation, the proportion of capacity utilised has been going down in the recent past because of technical and managerial factors and poor industrial relations. Stagnancy in coal production and failure on the part of the railways to move coal have been the other important causes of insufficient thermal generation and the drought has naturally reduced generation of hydro electricity.

NET NATIONAL PRODUCT

(AT 1970-71 PRICES)



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1.8 The production of coal (including lignite) increased rapidly after nationalisation until it reached the level of 105 million tonnes in 1976-77, but thereafter it has stagnated in spite of substantial investment each year. Shortage of power, poor industrial relations and problems of law and order in the Bengal and Bihar coal producing regions are the main factors responsible for this situation. Similarly the freight carried by railways has declined continuously from the peak level reached in 1976-77. Total revenue earning traffic on the railways in 1979-80 declined by 3.3 per cent compared with the previous year. This reflects persistent operational problems experienced by the railways, problems regarding industrial relations and also of course the lack of growth in industrial production. The acute congestion in India's ports is yet another manifestation of the failure of the infrastructure and as in other cases arises from a mixture of causes.

1.9 Poor industrial relations have affected activity not only in the infrastructure but over a wide spectrum of industries. Strikes and lockouts have led to an excessively large loss of mandays. Even where these have not taken place, go slows and work to rule etc., have affected production. The loss of morale and discontent among supervisory cadres has contributed to many managerial problems that have emerged.

Gross National Product

1.10 The overall impact of these adverse developments has been to lower Gross National Product by about 3 per cent. This will bring down the average rate of growth achieved over the past three years to 3.2 per cent which is slightly below the long term trend growth rate. Furthermore, it is likely that the rates of investment and saving in the economy which had been growing in recent years will show a decline. Shortages in materials such as steel and cement, delays in decision making, and of course the likely impact of lower agricultural production all point to a decline in investment. At the same time, the current account deficit in the balance of payments has widened considerably indicating that domestic savings were well below even the reduced level of real investment in 1979-80.

Price Trends

1.11 The emergence of severe supply constraints in the economy was bound to produce a sharp upsurge in prices. In fact, after two years of near complete price stability, prices began to rise sharply from the last month of 1978-79. The price rise gained momentum during the first six months of 1979-80 and the increases in the early months were extremely sharp; in July it

was 4.6 per cent and in August it was 3.2 per cent. The monthly rate of inflation slackened thereafter. Nevertheless, between the end of March 1979 and March 29, 1980, the Wholesale Price Index (1970-71 = 100) rose from 191.0 to 229.1. Thus on a point to point basis, prices rose by 19.9 per cent during 1979-80. However, comparing the average level of prices in 1979-80 with the average level in 1978-79 the increase is 16.7 per cent. The Consumer Price Index rose from 332 in March 1979 to 373 in March 1980 i.e., by 12.3 per cent. The average level of this index in 1979-80 was only 8.5 per cent above the average level in the previous year. Because of the difference in coverage and the time lag in the adjustment of retail prices to changes in wholesale prices, the Consumer Price Index showed a lower rate of inflation.

1.12 Although the price rise has been wide-spread, the sharpness of the rise is because of a few commodities such as gur, sugar, oilseeds, edible oils, coal, petroleum and natural gas and iron, steel and ferro-alloys. Thus gur prices at the end of March 1980 were 89 per cent higher than the low level prevailing at the end of March 1979. Sugar prices rose by 36 per cent in the same period. Oilseed prices rose by 30 per cent and groundnut oil prices by 34 per cent. Rice prices also rose by 21 per cent partly because of the preference for varieties affected by the drought in principal rice growing areas. The price index for crude oil and natural gas increased by 98 per cent reflecting higher import prices. Among administered commodities, the price of coal rose by 55 per cent and iron, steel and ferro alloys by 19 per cent. This indicates that the price spiral has been partly because of internal supply factors, long delayed upward revisions in administered prices and inflation imported from abroad. Policy vacillations in sugar not only led to a frittering away of large carryover stocks of sugar in the economy but also led to a decline in the area under sugarcane in 1979-80 by giving wrong signals to growers.

Monetary Situation

1.13 High rates of monetary expansion, which typically contribute to buoyant aggregate demand, have played an important role in the inflationary process. Increase in money supply during the three years 1976-77 to 1978-79 gives an annual average of 18.3 per cent. The rate of expansion of money supply in 1979-80 (after adjusting for definitional change in the apportionment of savings bank deposits by a few banks) is about 3 per cent lower than 18.7 per cent recorded in 1978-79, but even this is quite high in a year in which output declined. The strict monetary and credit control which the Reserve

Bank has been operating enabled it to ensure that the increase in bank credit to the commercial sector (inclusive of Participation Certificates) in 1979-80 was at a rate less than in 1978-79 i.e., 17.4 per cent against 20.0 per cent. Reserve Bank credit to the Government, however, has risen at a much higher rate i.e., 28.3 per cent as against 16.0 per cent in 1978-79. The steady increase in Government expenditures every year from 1976-77 onwards led to a heavy reliance on deficit finance in 1978-79 and again in 1979-80, with the expected impact on money supply. In 1979-80, in particular, the Central budget deficit in the revised estimates amounted to Rs. 2700 crores which was substantially larger than Rs. 1382 crores originally anticipated in the budget. The expansionary impact of the larger deficit on reserve money and also money supply was mitigated by the fact that the movements of net foreign exchange assets of the banking system showed only a marginal increase in 1979-80 compared with their behaviour in previous years when net foreign exchange assets increased very substantially. The large volume of liquidity in the system created conditions in which the emergence of severe domestic supply constraints together with buoyant demand conditions led to a sharp increase in prices.

Balance of Payments

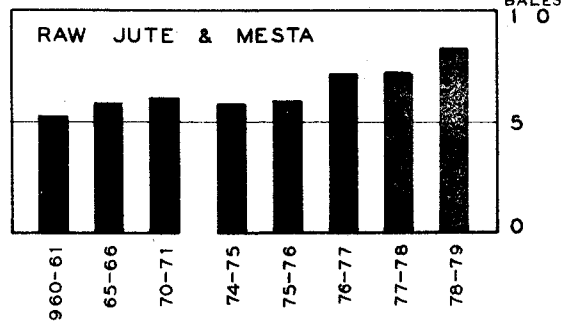
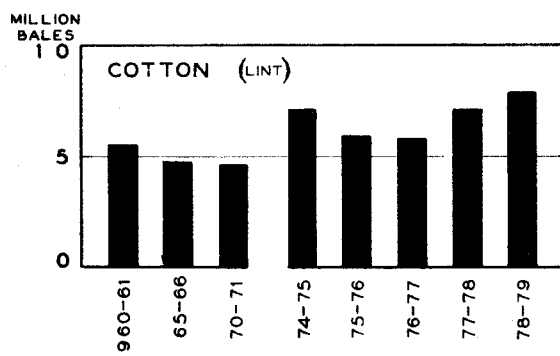
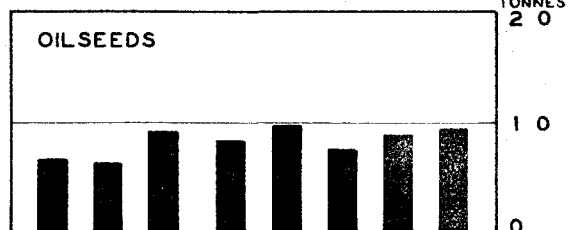
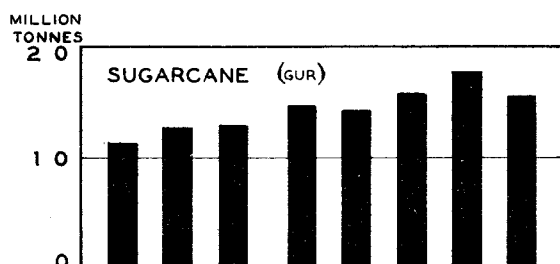
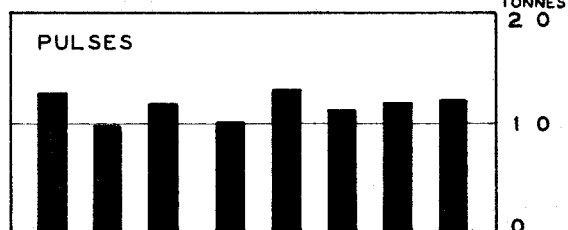
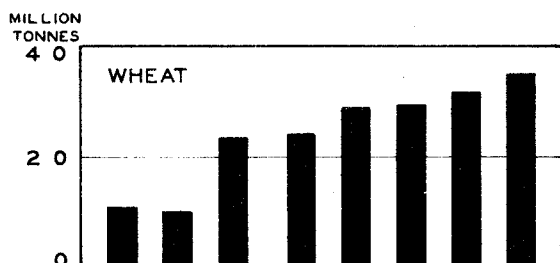
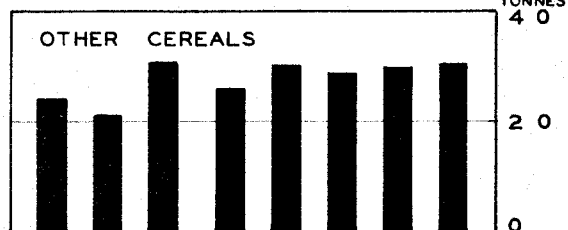
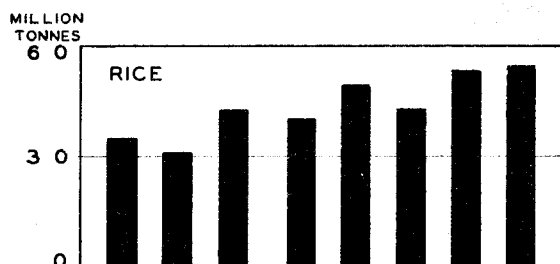
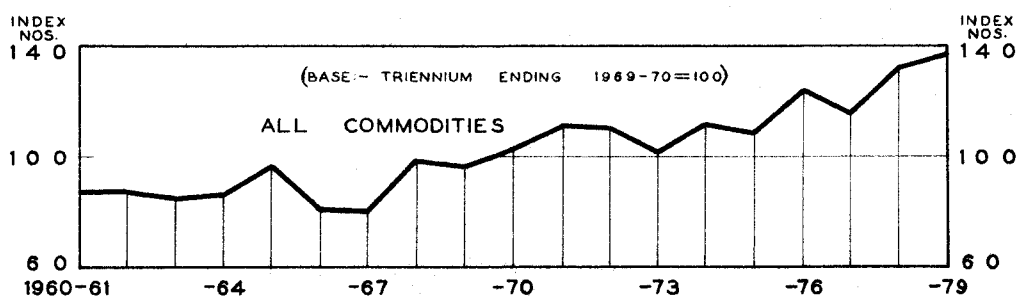
1.14 There have been important adverse changes in the external situation facing the country. There has been a sharp increase in oil prices and world trading conditions have deteriorated. The balance of payments in 1979-80 reflects these developments only partially. However, their continuation will have serious implications for the balance of payments in the current year and beyond. In the last few years, the country has been somewhat complacent about exports because of the high growth rates achieved in 1974-75, 1975-76 and 1976-77 and also about imports because of our success in minimising food imports. The situation changed substantially in 1978-79 as exports increased by only 5.9 per cent while imports increased by 13.2 per cent resulting in a trade deficit amounting to Rs. 1088 crores. However, the deterioration in the trade deficit was offset by net invisibles receipts and foreign exchange reserves increased by Rs. 720 crores.

1.15 The position worsened in 1979-80. The near doubling of crude oil prices in 1979, and the even sharper increase in prices of petroleum products, added very substantially to the import bill while the adverse impact of oil price increases on the economies which trade with us depressed export demand. Domestic production constraints also contributed to the rapid expansion of imports and compounded the difficulties for exports caused by external factors. In 1979-80, exports rose by 8.2 per cent and imports by 24.6 per cent over the previous year. The result is that the trade deficit for the year was Rs. 2233 crores compared with Rs. 1088 crores for the previous year.

1.16 In recent years, India's balance of payments benefited considerably from a substantial growth of invisibles receipts on account of transport and tourism, investment income and remittances from Indians abroad. The last in particular has grown spectacularly because of the emigration of Indian workers to the Gulf countries. It was because of these factors that India's foreign exchange reserves increased by Rs. 881 crores, Rs. 1371 crores, Rs. 1637 crores and Rs. 720 crores in 1975-76, 1976-77, 1977-78 and 1978-79 respectively. The growth in workers' remittances seems to have slackened considerably because of the slowing down of activity in many Gulf countries and, therefore, these receipts were not able to neutralise the trade deficit in 1979-80 to the same extent as before. This is reflected in the decline in foreign exchange reserves (excluding gold and SDRs) of Rs. 56 crores during that year. The declining trend has continued into the current year and reserves declined by Rs. 274 crores upto May 30, 1980 in the current year.

1.17 In summary, it would appear that in 1979-80 the economy faced difficulties in almost every sector, partly on account of internal factors and partly on account of external factors. Many of these difficulties will continue with varying degrees of severity in the current year because the factors that have given rise to them cannot be rectified overnight. Determined corrective action is called for aimed not only at the short term but also the medium term.

AGRICULTURAL PRODUCTION



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