

CHAPTER 1

THE ECONOMIC SITUATION IN 1986-87

There is strong evidence that the Indian economy is now on a new growth path. In the eighties, the average annual rate of growth has been 5 per cent which is much higher than the historical trend rate of growth. The industrial growth rate is increasing and, despite three successive weak monsoons the food situation remains comfortable. Inflation is under control and, in the current year, the trade deficit has also been reduced significantly. These are substantial achievements, made possible by a sound and responsive macro-economic policy environment.

1.2 Despite a poor monsoon, the growth in Gross National Product in 1986-87 may reach five per cent,

which is close to the Seventh Plan target. The index of industrial production (base 1980-81=100) provides confirmation that industrial growth in recent years has been higher than previously recorded. This index reflects the present composition of industry better than the current index (base 1970=100) and includes more comprehensive information on the small scale sector. The manufacturing sector, in particular, has shown a much healthier growth rate. There have been fewer bottlenecks to industrial growth as the infrastructure sector also performed well for the third year running with the growth in electricity generation, railway movement and coal production being the most impressive.

TABLE 1.1
Selected Economic Indicators
(Percentage change over previous year)

	1977- 78	1978- 79	1979- 80	1980- 81	1981- 82	1982- 83	1983- 84	1984- 85	1985- 86	1986- 87
1. Gross National Product at 1970-71 prices	8.7	5.8	-4.7	7.4	5.4	2.6	8.0	3.7	5.1 [@]	4.5-5.0*
2. Agricultural Production	14.3	3.8	-15.2	15.6	5.7	3.8	13.7	-0.9	1.9	1.0*
3. Foodgrain Production	13.7	4.3	-16.8	18.1	2.9	2.8	17.6	-4.5	3.4	1.0*
4. Industrial Production ¹	4.2	7.6	-1.7	4.0	8.6 (9.3)	3.9 (3.2)	5.4 (6.7)	6.8 (8.6)	6.3 (8.7)	6.4 ¹ (7.8)**
5. Electricity generated (utilities only)	3.4	12.2	2.1	5.9	10.2	6.6	7.6	11.6	8.6	10.3 ²
6. Wholesale prices (on point to point basis)	0.3	4.6	21.4	16.7	2.4	7.3	8.2	7.6	3.8	5.9 ³
7. Monetary resources (M3)	18.4	21.9	17.7	18.1	12.5	16.1	18.1	18.9	15.9	15.7 ⁴
8. Imports (at current prices)	18.7	13.1	34.2	37.3	8.4	5.0	10.8	8.5	15.1 [£]	1.4 ⁵
9. Exports (at current prices)	5.2	5.9	12.1	4.6	16.3	12.8	11.0	21.3	-7.1 [£]	17.3 ⁵
10. Foreign exchange reserves (including gold & SDRs—end of period Rs. crores)	4862	5821	5934	5544	4024	4782	5972	7243	7820	766

[@]Quick estimates.

[£]Over the corresponding partially revised figures of the preceding year.

*Anticipated. See text.

**April—October, 1986 (Estimated)

1. April-October, 1986 over the same period of 1985.
2. April-December, 1986 over the same period of 1985.
3. Between March 29, 1986 and January 24, 1987.
4. Between March 31, 1986 and January 2, 1987.
5. April-November 1986 over the same period of 1985.
6. January 31, 1987

Note : Index of Industrial Production from the year 1983-84 is based on CSO's re-distributed weights. The growth rates based on the revised series of industrial production (base 1980-81) are given in parenthesis.

1.3 Major reforms, which gave a new direction to fiscal policy over the last two years, not only provided a sizeable increase of over 22 per cent in revenues from major Central Government taxes in 1985-86 (Revised Estimates) but a continued high growth of around 17 per cent in 1986-87 (April—December). However, trends in growth of non-Plan expenditure are disturbingly high and the Government has initiated a number of measures to reduce costs and expenditure in order to curb further escalation.

1.4 The 1986 monsoon was below average for the third consecutive year. Although the widespread drought conditions of 1982 did not prevail because rainfall was more uniform this year, nevertheless, a decline of about two million tonnes in kharif foodgrain production is expected as a result of insufficient rain. Rabi production, however, is likely to increase and as a consequence overall foodgrain output is anticipated to be about one million tonnes higher than last year. The wholesale price index has shown a moderate inflation rate of about six per cent but consumer prices have registered a higher increase. This is a matter of concern. The price situation would need to be kept under careful surveillance.

1.5 The overall balance of payments situation, remains difficult. Although the trade position improved this year with exports increasing by an impressive 17.3 per cent (April—November) and imports remaining well under control with a growth of only 1.4 per cent (April—November), this should not induce any sense of complacency. The strength of economic policy in the trade sector has been the anticipation of possible problems and the implementation of policies well in advance of the developing situation. Further corrective measures need to be taken now in order to ensure a more comfortable balance of payments scenario over the next few years.

Gross National Product, Savings and Investment

1.6 In 1985-86, the first year of the Seventh Five Year Plan, GNP growth was 5.1 per cent, as against 3.7 per cent in the preceding year. The acceleration in GNP growth in 1985-86 was mainly on account of the recovery in agricultural production which, in terms of gross value added, registered an increase of 1.3 per cent in contrast to a decline of 0.8 per cent in 1984-85. The manufacturing sector, both registered and unregistered, also recorded a higher growth rate in 1985-86. These GNP growth rates are based on the current index of industrial production, which understates the growth in the manufacturing sector, and consequently in the overall GNP (see

Chapter 4—Industrial Performance). If, however, allowance is made for the growth recorded by the new index of industrial production (base 1980-81=100), the GNP growth in 1985-86 would be around 5.5 per cent (instead of 5.1 per cent), and about 4.0 per cent (instead of 3.7 per cent) in 1984-85. On the basis of available indications, the growth of GNP anticipated in the current year is between 4.5 to 5.0 per cent. So far, despite a setback in agricultural output, the Plan target for aggregate economic growth is likely to be achieved, aided by good growth in industrial output.

1.7 The rate of gross domestic capital formation in the economy is estimated to have increased from 23.5 per cent of GDP at current market prices in 1983-84 to 24.4 per cent in 1984-85, and further to 24.6 per cent in 1985-86. The rate of gross domestic savings was 22.8 per cent in 1985-86 as compared with 22.9 per cent in 1984-85. Reliance on the inflow of capital from abroad has increased from 1.5 per cent of GDP in 1984-85 to 1.8 per cent in 1985-86.

1.8 The share of the public sector in GDP has increased from 25 per cent in 1984-85 to 26 per cent in 1985-86. Its performance in terms of gross savings was also somewhat better, with its share recording an increase from 13.1 per cent to 13.5 per cent in these two years. However, there is still a significant gap in relation to the Seventh Plan targets for resource generation in the public sector.

Agricultural Production

1.9 The monsoon in 1986-87 was below average for the third consecutive year and was considerably worse than in 1985-86 (see Chapter 2). An expected increase of about 4 per cent in rabi production, however, will more than compensate for the decline of 2.3 per cent in kharif output, and overall foodgrain production should be over 151 million tonnes, which is higher than last year but still below the peak production achieved in 1983-84.

1.10 In spite of the markedly adverse weather conditions, agricultural production in the eighties has maintained a steady growth path. This is encouraging indication of the substantial degree of resilience which has been attained in the agricultural sector as a result of large scale investment in irrigation. Stocks of foodgrains remained at a high level of 23.6 million tonnes (December 1986) which is a reflection of the longer term growth in foodgrains production and the self-sufficiency achieved in this sector.

1.11 The year 1986-87 also saw the successful implementation of certain major Government policies in agriculture which were aimed at boosting domestic production of sugarcane and oilseeds and reducing imports. After last year's two-year sugar policy, which provided a stable environment to farmers, sugarcane production increased substantially and the value of sugar imports fell sharply in the current year. Government policy on edible oils aimed at providing remunerative prices for edible oilseed to farmers in order to increase domestic production and reduce imports. This was followed by a marked reduction in imports of edible oils. These policies contributed to a substantial saving to the nation in foreign exchange.

1.12 Given the high level of foodstocks, the Government was able to expand a number of schemes which offer food for work and direct subsidized food to the unemployed and low income groups. In addition to providing foodgrains at highly concessional rates to Tribal Development Project Areas and Nutritional Programmes, the allocation of wheat and rice was much higher for the National Rural Employment Programme (NREP) and the Rural Labour Employment Guarantee Programme (RLEGP).

Infrastructure

1.13 The current year will be the third consecutive high growth year in the infrastructure sector, recording an increase of around 9-10 per cent. The high growth rate over the last three years, particularly in key sectors such as electricity, coal and rail traffic, would tend to ease the bottlenecks in the economy and enhance the growth process in other industries. The improved response of this sector is significant as the Government has accorded particular importance to better management and performance in infrastructure industries in view of their crucial role in the economy.

1.14 Foremost among the infrastructure sectors showing impressive performance is the power sector which grew by 10.3 per cent in April—December, 1986 compared to the same period of 1985. This sharp increase comes on top of two previous relatively high growth years: 8.6 per cent in 1985-86 and 11.6 per cent in 1984-85. Perhaps the most important indicators of better performance in this sector are: (i) the record levels of PLF (Plant Load

Factor) achieved over the last two years, with the PLF in 1986-87 (April—December) being the highest for comparable periods over the last seven years; and (ii) the high growth rates achieved in generation from the thermal power plants—the annual growth rate in thermal power generation has been between 13 and 15 per cent over the last three years.

1.15 The performance of the railways has also been strong with a growth in revenue earning goods traffic of 6.6 per cent in April—December 1986 over the same period last year. This is particularly creditable as it follows a high 9.4 per cent growth in 1985-86. An important aspect of this year's growth has been the excellent performance of the railways in transportation of two key commodities; movement in foodgrains increased by 19.7 per cent and iron ore for exports increased by 13.6 per cent during April—December 1986, compared to the same period of 1985. Another core industry showing an improvement this year is the Coal sector. The growth in coal production in 1986-87 (April—December)—at 8.7 per cent—has been the highest in the last five years.

Industrial Performance

1.16 Preliminary results of the comprehensive exercise to revise the index of industrial production from a base year of 1970 to 1980-81, indicate that the actual industrial growth rate over the last two years may be significantly higher than recorded by the existing index (see Table). The revised index of industrial production (IIP Base 1980-81=100) shows a growth rate for the years 1984-85 and 1985-86 of around 8 to 9 per cent per year. Although full details are not yet available for all industries for the current year tentative information based on a large proportion of the industries in the index suggests a growth of around 7-8 per cent in April—October in the current financial year.

TABLE 1.2

Index of Industrial Production
(Average Annual Growth rates)

Year	Revised Series (1980-81 =100)	Existing Series (1970 =100)
1981-82, 1982-83 & 1983-84	6.4	6.3
1984-85 & 1985-86	8.7	6.5

1.17 This tends to corroborate the Annual Survey of Industries (ASI) figures which have always suggested that the 1970-based index tends to under-estimate industrial growth, particularly in the latter years. The ASI which has a much wider coverage in the manufacturing sector of industry than the IIP and does not suffer from the 'base' problems associated with an index, has consistently tended to show a higher growth than the IIP : for the period 1974-75 to 1982-83 the compound annual growth rate according to the ASI was 8.0 per cent, while according to the IIP it was only 4.4 per cent.

1.18 Of the three main components of overall industrial performance, the manufacturing sector has shown the most significant acceleration. The main increase in the growth rate of the manufacturing sector has occurred during the last two years, while in the mining sector the index (1980-81) shows a higher growth rate for most of the eighties, averaging a compound annual growth rate of 11.0 per cent (compared to 10.1 per cent according to the current index). The differential growth rates of the manufacturing sector in the two indices arise from the higher growth rates recorded by several new industries that emerged in the seventies, after the current index was constructed. Another important source of growth better captured by the 1980-81 index is production from small scale industries which has been a dynamic sector of economy and a major employment generator.

1.19 A number of industrial policy initiatives were taken during the year which were in continuation of the basic trend over the last few years of simplifying procedures and removing bottlenecks to capacity expansion and technology upgradation. The basic thrust of industrial policy has been growth oriented in order to boost production and generate employment with particular focus on small scale industry and the manufacturing sector. Schemes of broad-banding and capacity re-endorsement were introduced to increase output and improve capacity utilisation. Several other policy measures were taken to encourage investment and expansion of existing units to levels that ensure economies of scale.

Prices

1.20 Based on present trends, it is likely that 1986-87 will end with an inflation rate of around 6.5 per cent according to the Wholesale Price Index (WPI). This is considerably below the average annual price increase of about 8 per cent over the last decade and suggests that the overall price situation in the economy

is within control. However, the rise in the Consumer Price Index (CPI) (for industrial workers) of 7.8 per cent between March and December, 1986 was once again higher than for the WPI. The higher increase in the CPI is due to the different weighting patterns, time-lags in transmittal of changes from wholesale to retail levels, and higher increase in prices of certain items not included in the WPI, such as housing and personal services. The downward pressure on CPI which begins only after November each year also occurred this year with a drop of 4 points in December and it is to be hoped that the CPI will come closer in alignment with the WPI by the end of 1986-87.

1.21 Prices of food articles in 1986-87 have been far more stable than in 1985-86, increasing at an underlying rate of about four per cent compared to around 6.5 per cent last year. On the other hand, prices of agricultural commercial crops have increased sharply. In the previous year there was over-production and excess supply conditions existed in a number of fibre and commercial crops, causing their prices to fall sharply : jute prices fell 72 per cent; raw cotton fell 16 per cent; tea fell 11 per cent; condiments and spices fell 16 per cent and oilseeds fell by 1 per cent. The production of many of these commercial crops have stabilized at lower levels this year and their prices have risen to more normal levels.

1.22 The impact of these sharp changes in the supply and prices of this group of items was to cut about 3 per cent off the inflation rate last year, and to add an extra 2 per cent to the current inflation rate as the prices of these crops increased from the extremely low levels reached last year. If this unusual volatility in prices of this group of commercial crops is averaged over the last two years, the inflation rate for both the years centres around 4—5 per cent per year which is a more accurate reflection of the underlying inflation rate in 1985-86 and 1986-87, the first two years of the Seventh Plan.

1.23 The sharp increase in prices of edible oils and oilseeds this year contributed to the rise in the price indices. The current year's price increase, however, should be seen in the context of the falling prices of these items over the last two years. Considered over a three-year period, the average rise in prices of oilseeds was about 5 per cent per year. The Government's policy is to boost domestic production of edible oils and reduce imports in order to save foreign exchange. Consequently, the falling price trends of oilseeds and edible oils over the last two years needed

to be reversed if farmers are to receive remunerative prices for growing oilseeds. The rise in prices this year counteracts this declining trend and attempts at redressing the balance between the farmer and the consumer.

Fiscal and Monetary Policy

1.24 The year 1986-87 witnessed far-reaching reforms in fiscal policy which carried forward the process initiated in the previous year. Steps were taken to implement most of the key proposals in the Long Term Fiscal Policy (LTFP). The principal objectives guiding the reforms have been to simplify the tax structure, establish a regime of reasonable tax rates combined with better administration and enforcement to improve compliance and raise revenues, foster a stable and predictable tax policy environment, usher in a more open approach to budget making and make the tax structure more conducive to growth and equity.

1.25 The Centre's revenues from major taxes, which increased by over 22 per cent in 1985-86 (RE), showed a further increase of around 17 per cent in April—December 1986, according to provisional data. Of particular interest is the buoyancy in direct tax collections, which increased by about 23 per cent in 1985-86 (RE). Income and Corporation taxes (excluding from the oil sector) are estimated to have increased by a further 26 per cent in April—December 1986. The rapid increase in tax revenues after 1984-85 tends to confirm the soundness of the Government's approach.

1.26 Despite the enviable record in raising revenues, the Government's resource position continued to be under heavy pressure because of the rapid increase in expenditure commitments, especially on non-Plan account. In 1985-86 (Revised Estimates) defence, interest payments and major subsidies, accounted for 67 per cent of the Centre's total non-Plan expenditures. In 1986-87 (Budget Estimates) the proportion rose to 70 per cent. The problem of growing claims on the Government's resources was compounded during the year by the measures taken to implement the Pay Commission's recommendations.

1.27 The pressures on the Government's fiscal position found reflection in monetary developments. In 1985-86 the growth in overall liquidity in the economy (M3) had been contained at 15.9 per cent as compared with an annual average increase of 18.5 per cent in the preceding two years. The growth of M3 in

the current year has been faster, with an increase of 15.7 per cent in the first nine months (upto January 2, 1987), as compared to a rise of 13.3 per cent in the same period of 1985-86. Of particular concern is the marked increase of Rs. 5,048 crores (upto January 2, 1987) in net RBI credit to the Government, as compared to a rise of Rs. 3,186 crores in the same period last year.

1.28 The current year also saw the implementation of some of the major recommendations of the Committee to Review the Working of the Monetary System, including the introduction of monetary targeting, on an experimental basis, the decision to modify the presentation of information relating to the Government's budgetary deficit, the introduction of new 182 days Treasury Bills with flexible rates determined on the basis of monthly auctions and increased yields on long-term Government securities together with reduction of the maximum maturity period.

1.29 Highlights of the fiscal policy initiatives undertaken during the year include an overhaul of the excise tax structure through the introduction of modified value added tax (MODVAT); the launching of a simpler and more growth-oriented scheme of excise duty concessions for small scale units; the implementation of revised classifications and nomenclatures for the excise and customs tariffs; simplification and rationalization of taxation provisions relating to gifts and capital gains; introduction of the new Investment Deposit Account Scheme with a view to replace the existing scheme of Investment Allowance; simplification of depreciation provisions under the Income Tax Act, the enhancement of income tax concessions to exporters; a revamping of the Duty Drawback Scheme for exports; the publication of a Discussion Paper on "Simplification and Rationalisation of Direct Tax Laws" to elicit public opinion on the matter, the establishment of the new Customs and Excise Revenues Appellate Tribunal; systematic steps to curb tax evasion including, for example, the empowering of Government with a pre-emptive right to purchase properties above a certain value, the introduction of a series of new financial instruments to help mobilize resources for the public sector and measures to improve control over expenditures.

Balance of Payments

1.30 In anticipation of the emerging pressure on the balance of payments, the Government undertook a series of corrective measures, during the course of

1985-86 and 1986-87 to boost the growth of exports and curb the increase in imports. A wide range of export enhancing initiatives were launched during this period. On the import side, the focus was on measures to encourage indigenous production of key bulk import items such as sugar, edible oils and fertilizers. These measures, together with the sharp fall in international prices of crude oil contributed to the healthy increase of 17.3 per cent in exports, in rupee terms, in April—November, 1986 over April—November, 1985 and the curbing of import expansion to only 1.4 per cent over the same period. Excluding crude oil, exports increased by 19.6 per cent. As a result, the trade deficit in April—November, 1986 showed a decline of 18.3 per cent or Rs. 1,001 crores as compared to the value attained in April—November, 1985.

1.31 These recent trends in the country's external trade account are clearly welcome, but they should not induce any complacency. The balance of payments

continued to be under pressure from the bunching of repayment obligations on past borrowings from the IMF and other sources, protectionist tendencies in international trade, the deceleration in indigenous oil production and the unfavourable climate for concessional assistance. The adverse factors exerting strain on the balance of payments can be expected to persist throughout the rest of the decade and into the 1990s. Full balance of payments data are not available beyond 1984-85, but the available information suggests significant balance of payments pressure in the current year despite the improvements on trade account. Overall foreign exchange reserves, movements in which reflect the net result of all transactions in the external sector of the economy, recorded a decline of Rs. 160 crores by the end of January, 1987 as compared to increases of Rs. 1271 crores and Rs. 577 crores in 1984-85 and 1985-86 respectively. However, the overall foreign exchange reserves position continues to be comfortable with holdings equivalent to over four months' import requirements.