

CHAPTER 1

THE ECONOMIC SITUATION IN 1987-88

Economic performance and economic management during the current year have been dominated by the impact of the drought. While the initial shock of monsoon failure is experienced in agriculture, the derived effects usually get transmitted to other sectors of the economy within a time span of six to eight months. This year, however, a comprehensive package of policies have been carefully planned and implemented across a wide front in order to contain the adverse effects of the drought.

1.2 Coming at the end of a run of four poor monsoons, the current drought is one of the worst mon-

soon failures on record, with 21 out of 35 rainfall subdivisions receiving deficient or scanty rainfall. However, in contrast to earlier years of severe drought, the extent of economic dislocation has been limited this year. Thanks to large foodstocks, adequate availability of foodgrains has been ensured in different parts of the country. The performance of industry so far has been satisfactory. Critical infrastructure sectors like coal mining, railways and thermal power generation have also done well. The price situation remains difficult. However, the inflation rate is not as high this year as during the drought years of the sixties and seventies.

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 (P) | 1987-88 (P) |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
| 1. Gross National Product at 1980-81 prices ¹ | 8.7 | 5.8 | -4.7 | 7.4 | 5.9 | 2.6 | 7.7 | 3.1 | 4.9 | 4.1 [§] | 1 to 2* |
| 2. Agricultural Production | 14.3 | 3.3 | -15.2 | 15.6 | 5.6 | -3.3 | 13.7 | 1.2 | 4.6 | -5.6 | } -7 to -10* |
| 3. Foodgrain Production | 13.7 | 4.3 | -16.8 | 18.1 | 2.9 | -2.8 | 17.6 | -4.5 | 3.4 | -4.2 | |
| 4. Industrial Production** | 4.2 | 7.6 | -1.7 | 4.0 | 9.3 | 3.2 | 6.7 | 8.6 | 8.7 | 9.1 | 10.2 ¹ |
| 5. Electricity generated (utilities only) | 3.4 | 12.2 | 2.1 | 5.9 | 10.2 | 6.7 | 7.6 | 12.0 | 8.5 | 10.2 | 7.6 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 | 5.3 | 9.8 ³ |
| 7. Monetary Resources (M ₃) | 18.4 | 21.9 | 17.7 | 18.1 | 12.5 | 16.1 | 18.1 | 18.9 | 15.9 | 18.6 | 14.5 ⁴ |
| 8. Imports (at current prices) | 18.7 | 13.1 | 34.2 | 37.3 | 8.4 | 5.0 | 10.8 | 8.2 | 14.7 | 2.2 [£] | 13.5 ⁵ |
| 9. Exports (at current prices) | 5.2 | 5.9 | 12.1 | 4.6 | 16.3 | 12.8 | 11.0 | 20.2 | -7.2 | 15.3 [£] | 24.7 ⁶ |
| 10. Foreign exchange reserves (including gold & SDRs—end of period) (Rs. crores) | 4862 | 5821 | 5934 | 5544 | 4024 | 4782 | 5972 | 7243 | 7820 | 8151 | 6813 ⁶ |

¹@Growth rates upto 1980-81 are at 1970-71 prices, based on old series.

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

(P) Provisional.

[§] Quick Estimates.

* Anticipated. See text.

¹ April—November 1987 over the same period of 1986.

² April—December 1987 over the same period of 1986.

³ Between March 28, 1987 and January 23, 1988.

⁴ Between March 31, 1987 and January 15, 1988.

⁵ April—December, 1987 over the same period of 1986.

⁶ January 31, 1988.

** Growth rates are based on the old index of industrial production (Base 1970=100) upto 1980-81 and on the new index (Base 1980-81=100) thereafter.

1.3 The relative stability which the economy has demonstrated this year is partly attributable to the absence of other shocks, such as those experienced during the droughts of 1965-67, 1972-73 and 1979-80. Also, with the diversification of the economy, the share of agriculture and agro-based industries in national income has come down substantially. The effect of a supply shock in agriculture on the rest of the economy is consequently more subdued than before. Apart from these factors, the performance of the economy is in large measure a reflection of the many timely policy interventions undertaken in order to minimise the impact of the drought.

1.4 The most important of these policy measures has of course been government operations in foodgrains. Large stocks, built up to over 23 million tonnes by June, 1987, made it possible to maintain adequate supplies of foodgrains, especially in the drought affected areas, through the Public Distribution System, the relief programmes and other employment programmes. There have also been a host of other policy measures including relief employment programmes and steps to boost Rabi production. Measures have also been taken for the accelerated completion of irrigation projects, conservation of water resources, livestock protection, fodder production and maintenance of drinking water and power supplies. Imported edible oils and pulses have also been released through the vastly expanded public distribution system. These measures have been supplemented by fiscal and monetary policies to make adequate resources available for drought and flood relief without excessive monetary expansion.

1.5 The challenges of successful management of the drought have focussed attention on the continuing sensitivity of agricultural production to adverse weather conditions. The tempo of higher growth recorded in the first half of the eighties has been disturbed by recurring monsoon failures during the last four years. With a view to recovering the momentum of agricultural growth, it has been decided that top priority should be given to this sector in the remaining two years of the Plan.

1.6 The growing resilience of the non-agricultural sector to drought and supply shocks in agriculture is shown by recent trends in industrial production. During the first eight months of the current year (April to November 1987) industrial production as a whole registered an increase of 10.2 per cent over the comparable period of 1986. However, an analysis of monthly growth patterns during earlier drought years

suggests that the adverse impact of drought on industrial production usually shows up after a time lag. Even after allowing for some slow down in industrial production during the last few months of the financial year, it is likely that over the whole year industrial growth will exceed 8 per cent. This is in line with the high rates of growth recorded during the preceding three years. Assuming a decline of 7 to 10 per cent in agricultural production and a growth rate of 6 per cent in the services sector, as observed in recent years, it may be expected that GNP growth will be around 1 to 2 per cent this year. This contrasts with an actual decline of 4.7 per cent in GNP during a similar drought year in 1979-80.

1.7 The price situation remains difficult with inflation, on a point to point basis, standing at 9.8 per cent between end March, 1987 and 23rd January, 1988. This is causing considerable hardship. However, the wide array of drought management measures taken by the government has ensured that inflation has not been as rampant this year as in earlier drought years. It is also reasonable to expect that inflationary pressures will subside if there is a normal kharif crop in the next season, since it is the set-back in agriculture which has been the driving force behind inflation this year.

1.8 As noted above, monetary and fiscal policies followed during the year were carefully designed to finance the substantial additional expenditure on drought and flood relief operations without generating undue inflationary pressures on this account. A firm effort has been made to reduce other expenditure and raise additional resources through surcharges on taxes as well as upper class rail fares. This has been accompanied by a policy of restrained monetary expansion.

1.9 The balance of payments situation continued to be under pressure because of the increase in essential imports, necessitated by the drought, which has come on top of a number of adverse medium term factors such as the deceleration in oil production, protectionist tendencies abroad, bunching of repayment obligations and the unfavourable climate for concessional external assistance. Anticipating these developments, the government had undertaken a number of measures in 1985-86 and 1986-87 to accelerate the growth of exports and check the increase in imports. These measures have been quite successful, with exports growing much faster than imports during 1986-87 and again during the first nine months of 1987-88

for which trade data are available. However, with the persistence of the adverse medium term factors cited above, the possibility of a lagged effect of the current drought and uncertainty about the inflow of remittances from Indians working abroad, the balance of payments situation will remain under pressure.

Gross National Product, Savings and Investment

1.10 The Central Statistical Organisation, which is the official agency responsible for estimating the national income of the country, has revised the estimates and issued a new series starting from 1980-81. As compared with the old series, the new series shows a small upward revision of the national income figures and certain variations in inter-year growth rates. According to the new series, GNP growth was 4.9 per cent in 1985-86 and 4.1 per cent in 1986-87. The lower rate of growth in 1986-87 was due to a decline of nearly 2 per cent in gross value added in the group 'agriculture and allied activities'. The group 'manufacturing, construction, electricity, gas and water supply' maintained the growth rate of 8.0 per cent recorded in the preceding year. The 'transport, communication and trade' sector showed some improvement, with the growth rate going up to 6.6 per cent from 6.1 per cent a year ago.

1.11 According to the new series, the rate of domestic savings as a proportion of GDP in 1986-87 works out to 21.7 per cent as against 22.0 per cent in 1985-86. The rate of gross domestic capital formation was 23.4 per cent in 1986-87 as compared to 24.4 per cent in 1985-86. Reliance on the inflow of capital from abroad has declined from 2.4 per cent of GDP in 1985-86 to 1.7 per cent in 1986-87.

Agricultural Production

1.12 The drought this year is one of the worst on record, with as many as 21 out of 35 rainfall sub-divisions receiving deficient or scanty rainfall. Coming at the end of a run of four poor rainfall years, the drought has had a severe adverse impact on crop production, especially in the Kharif belt which is still largely dependent on rainfed agriculture.

1.13 The official estimate of total foodgrain production which had declined to just over 144 million tonnes in 1986-87, as compared to 151 million tonnes in 1985-86, is not yet available for the current year. However, it is expected that production will decline by 7 to 10 per cent from the previous year's level. Apart from Kharif cereals, other crops affected by the drought include pulses, oilseeds, cotton and to some extent sugarcane.

1.14 Despite the sharp decline in agricultural production it has been possible to maintain the increased

releases of foodgrains through the Public Distribution System, employment programmes, relief programmes and other channels because of the large stock of over 23 million tonnes which had been built up by June, 1987. This programme of maintaining adequate releases of foodgrains has formed the backbone of government strategy in combating the drought and it has provided the support necessary for a whole range of other measures.

1.15 In order to boost agricultural growth, special emphasis will have to be given to the extension of area under assured irrigation, greater use of ground water resources in rainfed areas with untapped growth potential, particularly in the eastern region, optimal water use in dry land agriculture and a better balance between crops as well as regions in agricultural growth. To attain the desired cropping pattern adjustments, a special technology mission on oilseeds has been set up with a view to achieving self-reliance in edible oils. The Mission has shown some promising initial results. To ensure better regional balance in agricultural growth, special agricultural development strategies are to be drawn up for each distinct agro-climatic region, specially suited to the requirements and specificities of each region. The Planning Commission has now constituted a high level group to prepare an action plan for fulfilling agricultural targets along these lines.

Industry and Infrastructure

1.16 Despite the adverse consequences of the drought, the performance of industry has been highly satisfactory during the first eight months of the current year for which data are now available (April-November 1987). The industrial sector as a whole achieved a growth rate of 10.2 per cent. This is significantly higher than the growth rates of 8.5 per cent to 9 per cent attained during the corresponding period of the previous three years, which were themselves much higher than the growth rates attained in the first half of this decade and earlier. The growth rate for the manufacturing sector proper, which accounts for over 77 per cent of total industrial production, has been even more impressive, showing an overall growth rate of over 11 per cent in the current year.

1.17 It is important to note that while there are large variations in growth performance across industries, the growth is not confined to a narrow base but is fairly widely dispersed in the manufacturing sector. Industries accounting for over two-thirds of the total weight of the manufacturing sector have shown positive rates of growth during this period, while the weight of industries registering a growth rate of over 10

per cent adds up to about 21 per cent of the total weight of the sector.

1.18 The high growth performance of industry during the first half of the current year does not allow for any complacency. An analysis of industrial growth behaviour during earlier drought years indicates that the impact of drought on industry appears with a lag of six to eight months. Nevertheless, even after allowing for this factor, it is reasonable to expect that industrial growth for the year as a whole will exceed 8 per cent, which is actually higher than the long term trend rate prior to 1984-85.

1.19 High industrial growth has been facilitated by the robust performance of the infrastructure sectors during 1987-88 (April—December). Coal production increased by 10.2 per cent, while railway revenue earning goods traffic went up by 5.4 per cent. Power generation increased by 7.6 per cent despite the sharp fall in hydel generation on account of the drought. This has been made possible by an increase of 15.7 per cent in thermal (including nuclear) power generation. The impressive increase in thermal generation is attributable to the achievement of a higher plant load factor of 55 per cent as well as the streaming in of additional generating capacity.

Prices

1.20 Prices came under pressure right from the beginning of this year as a consequence of the poor weather and shortage of some essential agro-based commodities experienced during 1986-87. The inflationary consequences of bad weather in one financial year usually reach their peak towards the end of the relevant agricultural season, which falls in the next financial year. These pressures were further aggravated around July, 1987, when it became apparent that the country was going to experience another drought. Up to the third week of January, 1988 the Wholesale Price Index (WPI) had registered an increase of 9.8 per cent, on a point to point basis, since the end of March, 1987. The Consumer Price Index (CPI), which is a more appropriate measure of price increases being faced by consumers, showed an increase of 9.6 per cent up to December, 1987, the last month for which data is available so far.

1.21 A major part of the inflation which has occurred in the current year is accounted for by the rise in prices of seasonal items of agricultural origin, which have a weight of about 52 per cent in the WPI. Agricultural prices had risen by over 14 per cent up to the middle of January, 1988. Even in the case of manufactured products, the increase in prices is largely on account of agro-based items. The individual items

which have shown the maximum increase in prices this year include edible oils and oilseeds, condiments and spices, cotton, pulses, gur, khandsari and cereals. It is, therefore, quite clear that the driving force behind inflation this year is the shortfall in agricultural production.

1.22 As a part of its policy to contain inflation, the Government has attempted to keep a check on the size of the budgetary deficit, despite the large unforeseen increase in drought and flood relief expenditure. The additional expenditure has been largely met by additional resource mobilisation and a cut back in other expenditure. This has been buttressed by a policy of restrained monetary expansion. The cautious monetary and fiscal policies being pursued by the Government and the Reserve Bank of India have been necessary in order to avoid any aggravation of the price situation. However, since the basic inflationary pressures have arisen because of a supply shock in the real sector, the main burden of macro-management has, accordingly, fallen on effective supply management.

1.23 The maintenance of adequate supplies of foodgrains, primarily through the Public Distribution System and relief and other employment programmes, has been the backbone of supply management policy. This has been possible because of the huge stock of over 23 million tonnes of foodgrains which had been built up by June, 1987. The enhanced releases of rice and wheat have been backed up by similar large releases of imported edible oils and pulses, both in the Public Distribution System and in the open market. The Public Distribution System has been substantially expanded with the addition of about 5600 new FPS outlets, of which around 3000 new fair price shops and a large number of mobile PDS outlets are located in drought affected States. The drive against hoarding has been stepped up and a monitoring system has been put in place in order to maintain a close watch on the prices and availability of essential commodities throughout the country.

Fiscal and Monetary Policy

1.24 During the current year fiscal policy has been aimed at maintaining the pace of investment despite the serious problems thrown up by the drought. On the basis of reports submitted by the Central teams which visited the drought affected States, it was estimated that the additional expenditure on drought and flood relief during the year would substantially exceed the provision made for this purpose in the budget. To meet a part of the additional expenditure, the Government announced surcharges on personal income tax, corporate income tax, wealth tax

and customs duties, as well as surcharges on upper class railway fares. These surcharges were expected to yield additional revenue of about Rs. 500 crores. Administrative efforts to improve revenue collection were also stepped up. At the same time the Government also initiated economies in expenditure which were expected to yield a saving of about Rs. 650 crores. Furthermore, to help finance the substantial additional imports of essential items such as edible oils and pulses necessitated by the drought, Government took a number of initiatives for additional mobilisation and accelerated disbursement of external assistance.

1.25 Leaving aside the impact of the drought on the Centre's budgetary position, its other effects on the money-output-prices situation have included a sharp reduction in food credit with the draw down of food stocks and a reduction in output growth leading to the emergence of inflationary pressures. In these circumstances the monetary authorities have pursued a policy of restricting money supply (M_3) growth to a level lower than in the previous year while meeting the genuine credit requirements of trade and industry. Thus the Statutory Liquidity Ratio (SLR) was increased from 37 per cent to 37.5 per cent on April 25, 1987 and further to 38 per cent with effect from January 2, 1988. The Cash Reserve Ratio (CRR) was also raised from 9.5 per cent to 10 per cent with effect from October 24, 1987. Selective credit controls, which had been relaxed earlier in the year, were re-imposed and tightened between July and October, 1987 for a number of drought affected commodities such as oilseeds, vegetable oils, cotton, kapas, paddy/rice and other foodgrains (excluding wheat). At the same time banks were advised to extend liberal credit facilities to drought affected farmers. Higher export refinance limits were also made available during the year. As a consequence of all these measures the leading monetary indicators have been growing at satisfactory rates.

Balance of Payments

1.26 The balance of payments situation came under further pressure during the year on account of additional imports of essential commodities such as edible oils, pulses, etc. necessitated by the shortfall in domestic production. These short term pressures have come on top of a number of adverse medium term factors such as the expected deceleration in indigenous oil production, protectionist tendencies abroad, the bunching of repayment obligations to the IMF and other sources and an unfavourable climate for concessional external assistance.

1.27 In anticipation of some of these medium term developments, the Government had taken a number of measures during 1985-86 and 1986-87 to accelerate the growth of exports and check the increase in imports. Further steps have also been taken during the current year. These measures have met with considerable success. Exports increased by 15.3 per cent in 1986-87 and again by 24.7 per cent during the first nine months of the current year as compared to the corresponding period of 1986-87. In contrast imports grew by 2.2 per cent during 1986-87 and 13.5 per cent during April-December, 1987 as compared to April-December, 1986. The increase in imports in the current year is largely on account of the increase in import prices of crude oil and petroleum products apart from additional imports necessitated by the drought. With exports growing faster than imports the trade deficit declined in 1986-87 and in the first nine months of the current year.

1.28 However, trade performance during the first nine months may not have fully reflected the adverse impact of the drought, which could surface during the last quarter of the current year. The balance of payments situation will therefore need to be monitored closely.