CHAPTER 1

THE ECONOMIC SITUATION IN 1989-90

The performance of the economy during 1989-90 shows signs of a slow-down in output growth. There has been some deceleration in the industrial growth rate and agricultural production has not increased much beyond the peak level reached in the previous year.

1.2 In 1988-89 the economy recovered very quickly from the setback of the drought of 1987-88. Gross Domestic Product (GDP) in real terms recorded a growth rate of 10.4 per cent aided by a growth of agricultural production by 20.8 per cent and industrial production by 8.8 per cent. The overall inflation rate was contained at 5.7 per cent in terms of Wholesale Price Index (WPI) compared with 10.7 per cent during 1987-88 and 6.5 per cent in terms of Consumer Price Index (CPI) compared with 10.9 per cent during 1987-88.

1.3 During the current year although monsoon rains have been normal, it is unlikely that agricultural production would show a substantial increase over the bumper crop achieved last year. The growth of agricultural production is expected to be 1 per cent or so. Provisional data on the index of industrial production for April—November 1989 shows an industrial growth of 5.2 per cent compared with 9.4 per cent during the corresponding period of the last year. Even after allowing for some improvement in industrial production during the remaining period of the current financial year, it is unlikely that industrial growth rate during the year will exceed 6 per cent. On balance, on the basis of these tentative figures, it is estimated that GDP growth during 1989-90 will be around 4-4.5 per cent, which is below the average growth rate of around 5.9 per cent, achieved during first four years of the Seventh Five Year Plan. Despite this downturn during the current year, on average, the Seventh Plan targets of growth are likely to be achieved.

### Table 1.1

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<td>15.6</td>
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<tr>
<td>Exports at current prices</td>
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<td>5242</td>
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* Provisional

### Notes

1. Growth rates are based on new data set at 1990-91 prices.
2. Growth rates are based on the old index of Industrial Production (Base 1970-71 = 100) up to 1980-81 and on the basis of new index (Base 1980-81 = 100) thereafter.
5. Base 100 is taken at the mid of 1949-50 = 100, prior to 1981-82 and on the basis of new index (1981-82 = 100) thereafter, in point at point basis.
9. As on January 31, 1990. Foreign exchange reserves include gold, SDR, and foreign currency assets and relate to end-period.
1.4 The primary objective of growth must be the alleviation of poverty and for this the impact of growth on employment is crucial. Available evidence suggests that the acceleration of growth in the eighties has not been matched by a corresponding acceleration in employment at least in the organised sector. The policies that determine the direction of investment and public spending and the choice of techniques will have to pay greater regard to this concern.

1.5 The annual rate of inflation in the Wholesale Price Index (WPI) was 7.7 per cent as on February 17, 1990 compared with 5.3 per cent at the corresponding time last year. A measure of price stability is essential for sustaining the momentum of growth and ensuring equitable distribution of the benefits. Inflation especially hurts the poor, since their incomes are not indexed to prices. It also reduces the willingness to save in financial assets, encourages speculation and the generation of black money and distorts investment priorities. The containment of inflation in the current year and the past few years has been largely on supply management with food stocks and imports being used to check the upward pressure on prices of essential commodities. In the past three years stocks of foodgrains have been run down from 22.8 million tonnes in January 1987 to 12.6 million tonnes in January 1990, and imports of cereals, edible oils and sugar have amounted to 2.8 million tonnes, 3.4 million tonnes and 1 million tonnes respectively. The margins available for such supply management are now much lower than they were three years ago. In this situation a tighter control on budgetary deficits and liquidity growth and more rapid increase in output, particularly of wage goods, becomes even more essential.

1.6 Demand management and deficit control are closely linked to the savings rate. The eighties have been characterised by a stagnation in the overall savings rate and a sharp deterioration in public savings. The available evidence suggests that the picture in the current year is more or less the same. Significant improvement in the performance of overall savings, and public savings in particular is necessary for macro-economic stability and for financing the investments required for growth and employment generation.

1.7 The imbalances between aggregate demand and supply spill over onto the balance of payments and have to be met by running down reserves or increasing debt. Given the limited availability of concessional assistance, growing recourse to foreign borrowing necessarily means an increase in debt service which in turn constrains the room for manoeuvre on the import front. The solution lies in rapid exports growth and, as regards this, trends in the past three years provide good grounds for hope. The visible trade deficit has narrowed significantly in 1989-90 with exports (in rupee terms) rising by 38.3 per cent in the first nine months of the current year as against a growth of 20.7 per cent in imports.

Gross National Product, Savings and Investment

1.8 The Quick Estimates of national income aggregates prepared by the Central Statistical Organisation indicate that Gross National Product at factor cost (constant prices) recorded an impressive growth rate of 10.6 per cent during 1988-89. Agriculture and allied sectors recorded a growth rate of 16.9 per cent in 1988-89 compared with 0.7 per cent in 1987-88; industry and construction achieved a growth rate of 7.7 per cent in 1988-89 compared with 5.6 per cent during 1987-88; banking and real estate recorded a growth of 7.3 per cent compared with 5.8 per cent a year ago and transport, storage and communications recorded a growth rate of 7.6 per cent in 1988-89 compared with 5.1 per cent in 1987-88.
1.9 However, there has been a disquieting trend in the rate of domestic savings which showed little improvement during the Seventh Plan. The ratio of gross domestic saving as percentage to GDP at current market prices improved marginally from 20.4 per cent in 1985-86 to 21 per cent in 1988-89, and the ratio of gross capital formation increased from 22.8 per cent to 23.9 per cent during the same period. While the saving from the public sector has declined continuously from 3.2 per cent of GDP in 1985-86 to 1.6 per cent in 1988-89 and that of the private corporate sector from 2.1 per cent of GDP to 1.8 per cent during the same period, the savings of the household sector recorded an appreciable increase from 15.2 per cent of GDP in 1985-86 to 17.5 per cent in 1988-89. Given this trend of savings and the likely slow-down of the economic growth during the current year, it is unlikely that there would be any marked improvement in the overall savings rate in 1989-90.

Agricultural Production

1.10 The first three years of the Seventh Plan were marked by a succession of unfavourable monsoons culminating in the severe drought during 1987-88. The Index of agricultural production declined by 3.7 per cent in 1986-87 and 1 per cent in 1987-88. There was a record growth of agricultural production by 20.8 per cent during 1988-89. The growth was also widespread over various crops and regions. While foodgrains production recorded an increase of over 21 per cent, production of pulses increased by 25 per cent, oilseeds by more than 41 per cent and cotton by 36 per cent.

1.11 During the current year monsoon has been normal and 29 out of 36 meteorological subdivisions have received excess or normal rainfall. It is expected that agricultural production may rise by about one per cent over the bumper crop achieved last year. Foodgrains production in 1989-90 is likely to cross the record production of 170 million tonnes achieved in 1988-89.

1.12 Rice production in 1989-90 has been targeted at 72.5 million tonnes. With monsoon on time and its coverage being normal, the overall kharif crop production has been reported to be satisfactory. The target for wheat at 54 million tonnes and that of pulses at 14.75 million tonnes are likely to be achieved. Various development programmes of the Government to raise production of rice, wheat and pulses viz. Special Rice Production Programme (SRPP) for the eastern region, Special Foodgrains Production Programme (SFPP) for major foodgrains producing States and the Centrally Sponsored National Pulses Development Project continue to be in operation in 1989-90. With the help of support measures undertaken by the Government and the efforts made by the Technology Mission on Oilsseeds established in May 1986, oilseeds production has gone up significantly in recent years. As a result imports of edible oils during the oil year 1988-89 (November—October) at about 3.7 lakh tonnes were quite modest compared to 18.2 lakh tonnes in 1987-88. A production target of 165 lakh tonnes of oilseeds has been fixed for 1989-90. Production of cotton is anticipated to reach a record level of 95 lakh bales in 1989-90.

1.13 Despite larger acreage and production of sugarcane, sugar production declined to 87.52 lakh tonnes in the sugar year 1988-89 (October—September) compared with 91.1 lakh tonnes recorded in 1987-88. Considering the estimated size of the sugarcane crop, sugar production during the current year may register a significant increase. Production of tea in 1988-89 increased by 5 per cent but is likely to decline during the current year.
1.14 The increase in agricultural production has been stimulated largely by the increase in the use of key inputs like irrigation and fertilizers. Taking the period 1980-81 to 1988-89 the average growth in agricultural production (in terms of physical output) was 5.4 per cent, that in irrigation (measured in terms of gross irrigated area) was 3.0 per cent and in fertiliser use (measured in terms of NPK) was 8.9 per cent. Given the dependence on weather a year-to-year correlation between input use and agricultural production cannot be expected. However, in 1989-90 a more or less normal monsoon year, agricultural production is expected to grow by a little over 1 per cent as against the 15.6 per cent increase in fertiliser use.

1.15 The Government also continued its policy of providing adequate and timely credit at subsidised rates to the farmers through institutional agencies like co-operatives, commercial banks and Regional Rural Banks to support agricultural and allied activities. The total quantum of agricultural loan increased substantially from Rs. 6,794 crores in 1985-86 to Rs. 11,752 crores in 1988-89 and the target for 1989-90 has been fixed at Rs. 13,294 crores.

1.16 In 1989-90, for more effective implementation of wage employment programmes, a new employment generation programme known as the Jawahar Rojgar Yojna has been introduced and merged with the existing National Rural Employment Programme (NREP) and Rural Landless Employment Guarantee Programme (RLEG). A sum of Rs. 2623 crores (including Rs. 523 crores as States’ share and the subsidised value of foodgrains) has been provided for the scheme during 1989-90 in order to generate Rs7 million mandays of employment.

Industry and Infrastructure

1.17 After a slight deceleration during 1987-88, industrial production recovered quickly during 1988-89 and grew by 8.8 per cent compared with 7.3 per cent during 1987-88. The improvement in the growth rate was shared by all the sub-sectors—manufacturing sub-sector recorded a growth rate of 8.9 per cent, mining and quarrying sub-sector 7.9 per cent and electricity sub-sector 9.6 per cent. The growth was also supported by the recovery in agriculture, improved performance of infrastructure sectors like coal, steel, cement, fertilisers, railways and power generation and an increase in overall demand.

1.18 There has been a slow down of industrial growth during the current year, and data available up to November 1989 indicate a growth rate of only 5.2 per cent compared with 9.4 per cent during the corresponding period of last year. The current down-turn in industrial growth is essentially attributable to the poor performance of the manufacturing sub-sector which accounts for more than three-fourths of the total weight in the Index and recorded a growth rate of only 3.6 per cent during April—November 1989 compared with 10.2 per cent achieved during the corresponding period of last year. The deceleration has been marked in a few key industries like sugar, steel, cement, fertilisers, cotton cloth (mill sector), commercial vehicles and consumer electronics.

1.19 An analysis of industrial growth by use-based classification indicates that during first eight months of the current year there has been a significant deceleration in the growth rates of basic industries (from 10.8 per cent in April—November 1988 to 4.7 per cent in April—November 1989), consumer durables (from 19.2 per cent to 0.8 per cent) and intermediate goods (from 13.2 per cent to 2.2 per cent), while capital goods have maintained more or less the same growth rate around 9 per cent, and consumer non-durables have improved their performance from 2.8 per cent to 5.9 per cent.

1.20 Mining and quarrying and electricity have performed significantly better during this year as compared to that during last year. While mining and quarrying registered a growth rate of 8.4 per cent during April—November 1989 compared with 6.8 per cent during April—November 1988, the electricity sub-sector recorded a growth of 12.1 per cent during April—November 1989 compared with 7.5 per cent during corresponding period of the last year.

1.21 The performance of key infrastructure sectors during April—December of the current financial year presents a mixed picture. While electricity generation, crude petroleum and petroleum products, coal and lignite production,
coastal shipping and telecommunications sectors recorded substantial growth; railway revenue earning traffic indicates only a modest improvement and there has been deceleration in the production of salable steel, cement and phosphatic fertilizers. Within the power sector, there has been better performance by both hydro and thermal generation and average PLF has also improved during the year until now. In the petroleum sector, during April—December 1989 crude petroleum production increased by 6.9 per cent and petroleum products by 9.1 per cent. The import of crude oil in the first nine months of the current year increased by 8.5 per cent and that of petroleum products increased by 4.6 per cent over the imports during the corresponding period of last year.

1.22 The slow down in industrial growth in 1989-90 is due to a variety of reasons. In some industries like steel, sugar or phosphatic fertilizers, the explanation lies in specific supply side factors. In some industries, rapid expansion in recent years has proceeded beyond the growth in demand leading to unutilised capacity. In some others the rate of growth of demand may have decelerated as backlogs of unfulfilled demand came down.

1.23 Nitrogenous fertilizer production recorded marginal increase by only 0.4 per cent during April—December 1989 over the same period of 1988, while phosphatic fertilizer production recorded a substantial decline by 31.7 per cent during the period due to shortage of imported phosphoric acid. Cement production during April—December 1989 was marginally higher by 0.2 per cent over the corresponding period of last year although cement prices remained firm throughout the year after complete decontrol of prices and distribution of cement from March 1989.

Prices and Price Management

1.24 The price situation has remained under pressure from the beginning of the year despite a satisfactory monsoon and a bumper crop achieved for the second year in succession. In terms of new series of WPI*, the rate of inflation during 1989-90 was contained at 5.7 per cent compared with 10.7 per cent during the drought year 1987-88. During the current year the WPI registered an increase of 7 per cent up to February 17, 1990 compared with 5 per cent in the corresponding period of last year. The annual rate of inflation in terms of WPI works out to 7.7 per cent on February 17, 1990 compared with 5.3 per cent at the corresponding time of last year. The increase in prices was particularly marked in the June—September period and the seasonal decline in prices which normally starts in September was delayed this year.

1.25 Data on Consumer Price Index (CPI) for Industrial Workers is available upto January 1990 and the increase in CPI works out to 5.5 per cent during current financial year up to January, which is significantly lower than 7.8 per cent recorded upto January last year.

1.26 The increase in prices during current year has been largely contributed by agro-based items like pulses, tea, oilseeds, sugar, jute and jhalisari, and groundnut oil where production has either remained stagnant or has declined. Among manufactured items textiles, beverages, paper and paper products, leather and leather products, tobacco products and base metals have also shown considerable increase. The increase in prices of metals, machinery and paper products is mainly due to higher import prices and those of textiles and leather products, to some extent, reflect increasing demand.

1.27 In order to contain the inflationary pressure, the RBI tightened selective credit controls and took certain measures to mop up excess liquidity. On the supply side Government maintained supplies of foodgrains and other essential commodities through the Public Distribution System. Additional imports were undertaken, to the extent feasible as in the case of edible oils, pulses, rice and sugar in order to maintain adequate supplies. For some essential commodities, appropriate price bands were determined and suitable market intervention operations were undertaken so that ruling prices remain within price bands.

* A new series of Wholesale Price Index (WPI) with 1982-83 as base year has been released in July 1989 by replacing the old series with 1970-71 as base. The new series has a considerably larger coverage of items, their grades and markets and is also based on a larger number of quotations.

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1.28 Stocks of foodgrains built up in earlier years were used during 1987-88 to meet the pressures arising from the severe drought. However, satisfactory level of procurement during 1988-89 marketing season helped to augment the level of stocks. As of end January 1990, stocks of foodgrains with public agencies stood at 12.60 million tonnes, which was higher by 36.2 per cent over their level in the same period of last year.

1.29 During the current year, administered prices of industrial items except for iron and steel and non-ferrous metals were kept unchanged. However, there have been substantial upward revisions in support/procurement prices of major agricultural commodities mainly to provide remunerative price environment and to augment production and procurement of various agricultural commodities. The Government has recently set up a Committee to examine, inter alia, the existing system and criteria for fixing agricultural prices and to suggest modifications for fixation of remunerative agricultural prices.

Fiscal and Monetary Policy

1.30 The Union Budget for 1989-90 had sought to correct the growing imbalances between revenues and expenditures. The actual outcome is however, likely to be much worse than the budget estimates in the Budget for 1989-90. Aggregate resources of the Central Government including internal and extra-budgetary resources of Central Public Enterprises were estimated to increase by 17.2 per cent over that in 1988-89. Aggregate disbursements, on the other hand, were estimated to be higher by 15.6 per cent than that in 1988-89. The Central Government Plan Outlay for 1989-90 was raised by 20 per cent as compared to the 1988-89 level. The budget deficit was programmed at Rs. 7,337 crores amounting to 1.7 per cent of GDP. However, the increase in Net RBI Credit to Central Government has been running well above this level for the greater part of the year, which is a matter of great concern.

1.31 The Budget Deficit as conventionally reported is only a partial measure of the fiscal imbalance that has built up over the eighties. As far as money supply growth is concerned, what matters is the Monetised Deficit i.e. the increase in net RBI credit to the central government. From the broader point of view of macro-economic balance it is useful to look at the Overall Deficit between the revenues of the government and its total expenditure. This deficit measures the government borrowing requirement which has to be met from domestic and external sources. As our 1988-89, the Central Government is concerned the behaviour of these indicators over the past few years has been as follows:

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<td>GDP at market prices (Rs.)</td>
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<tr>
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These large deficits have been met by borrowings, and the debt of the Central Government has necessarily increased and interest payments now account for a substantial part of the budget. Thus the net interest burden (i.e. interest paid less interest recovered) in the Central Budget has gone up from 3.6 per cent of the total expenditure in 1989-90 to 10.1 per cent in 1989-90 (BE).

1.32 The Economic and Functional Classification of the Budget prepared every year reclassifies expenditures into those which directly generate a demand for goods and services by the Government and those that are transfers to other spending organisations and sectors. This classification of the Central Government Budget shows that there has been steady decline in the proportion of expenditure on capital formation from over 40 per cent in mid eighties to 34.7 per cent in 1989-90. On the other hand, transfer payments from the Central Government to the States, Union Territories and other sectors of the economy have increased sharply from 31 per cent in 1980-81 to 40 per cent in 1989-90. Among transfer payments, the highest increase has been on account of interest payments which increased from 10 per cent in 1980-81 to 17.7 per cent in 1989-90. The share of consumption expenditure has fluctuated within the range of 21 to 23 per cent. Defence expenditure accounted for about 70 per cent of Government consumption expenditure.
1.33 The Long Term Fiscal Policy (LTFP) announced by the Government in December 1985 had indicated some broad targets. When the actual outturn is compared with these targets, the broad picture that emerges is as follows:

(a) Performance of Tax Revenues has been more or less on target, although indirect taxes have performed better and direct taxes remained slightly lower than the targets.

(b) Non-Tax Revenues have also performed well.

(c) Non-Plan revenue expenditures exceeded plan targets by significant margins. In particular, Defence, Interest Payments and Food and Fertilizer Subsidies were substantially above the targets.

(d) Both market borrowings and budget deficit exceeded the targets by wide margins.

(e) Contribution of public enterprises fell short of projections by significant amount.

(f) The size of Centre’s Plan and assistance to States and Union Territories were also well above the Seventh Plan targets.

1.34 It would follow from the above observation that the growing imbalances in the fiscal system did not stem from any let-up in Government resource mobilisation rather it was due to the increase in Government expenditure which, in turn, was financed by larger borrowings and the budget deficit.

1.35 Fiscal imbalances have implications for liquidity growth. During the current financial year, up to 26th January, the growth in money supply (M3) has been 14.9 per cent compared with a growth of 14.5 per cent in the corresponding period of the last year. Time Deposits with banks have registered a lower growth of 14.6 per cent in this period as against 17.6 per cent last year. However, currency with the public has grown at a faster rate of 15.6 per cent compared with 9.0 per cent during the corresponding period of 1988-89. Demand Deposits have also grown at a higher rate of 16.3 per cent compared with 9.7 per cent a year ago. There has been a large expansion in the Net RBI Credit to Central Government by 26.2 per cent compared with 16.0 per cent in the corresponding period of 1988-89. Bank credit to commercial sector has recorded a modest growth of 10.9 per cent compared with 11.6 per cent during the corresponding period of last year. Non-food credit has recorded a lower growth of 12.7 per cent compared with 13.9 per cent in the relevant period of last year.

1.36 During the year the RBI made some changes in policy, focussing essentially on refinancing terms for bank credits, to restrain the growth in money supply. As of end September, 1989 aggregate monetary resources (M3) were growing at an annual rate of 18.2 per cent. After the changes made by RBI in October 1989, the rate has moderated and as of end January the rate of growth of monetary resources was 17.7 per cent over the corresponding period last year.

1.37 Some changes were also made during the year in the interest rates on agricultural credit, export finance and term deposits of 46-90 days. The major change was in the short-term money market where the ceiling on interest rate on the inter-bank participation and call money rates was removed and a decision was announced to permit issue of Certificates of Deposit and Commercial Paper at market determined rates.

The External Sector

1.38 As has been the case during the first four years of the Seventh Plan, India’s balance of payments situation has remained under considerable pressure during 1989-90 despite a buoyant trend in exports and a slow-down in the growth of imports. Exports in rupee terms increased by 14.3 per cent in 1986-87, 26.4 per cent in 1987-88 and 23.9 per cent in 1988-89. On the other hand, imports recorded an increase of 22.2 per cent in 1986-87, 11.5 per cent in 1987-88 and 25.9 per cent in 1988-89. Provisional data available so far indicate that during the first three quarters of the current year exports recorded an increase of 38.3 per cent over the corresponding period of last year. Imports have registered a relatively slow growth at 20.7 per cent in terms of rupees. Consequently, the trade deficit at Rs. 5518 crores during April—December, 1989 declined by 16.4 per cent over the same period of last year. In
dollar terms the trade deficit for the first nine months is lower by $1.3 billion compared to last year. Net invisibles, on the other hand, are unlikely to show any improvement because of uncertain trends in the net private transfers, relatively slow growth of tourist traffic and a steady increase in interest payments on past borrowings. Limited information on some items of capital account also confirms the strain on current balance of payments situation.

1.39 The crux of the balance of payments problem during the Seventh Plan lies in continuing high trade deficits and a declining role of invisibles in financing the deficits. Net invisibles as a percentage to GDP have declined from an average of 2.1 per cent during the Sixth Plan to 1.2 per cent during the first three years of the Seventh Plan, while trade deficit as a percentage to GDP declined marginally from an average of 3.4 per cent to 3.2 per cent during the same period. Consequently, the current account deficit as a percentage to GDP has increased from an average of 1.3 per cent in the Sixth Plan to 2.1 per cent during first three years of the Seventh Plan.

1.40 Deterioration in our balance of payments position during the Seventh Plan period is due to several unfavourable factors such as deceleration in the growth of domestic oil production, bunching of repayment obligations to the IMF and other sources, limited availability of concessional assistance and a rise in debt service payments on external debt. The continuing strain on our balance of payments is reflected in steep depletion of our foreign exchange reserves which stood at Rs. 5531 crores at the end of January 1990. Despite the absolute increase in aid commitments, the share of external assistance in India's total external debt has declined over the years. Furthermore, the grant element in external assistance has also declined making the availability of these resources more costly over time.

1.41 The Government has been attaching high priority to an improvement of the balance of payments situation. This is sought to be achieved through acceleration of exports growth, efficient import substitution, prudent allocation of foreign exchange to various sectors, liberalisations of trade and industrial regime and improvements in infrastructural facilities for exports. The reforms in the foreign trade sector have been aimed at providing industries with greater liberty as regards supply of raw materials and machinery, replacement of non-tariff barriers by a tariff structure and provision of various fiscal and monetary concessions for the exports sector. The trends in the value of exports and imports in recent months are encouraging. However, the export performance in terms of both quality and volume needs to be improved even further and imports of bulk items need to be reduced to offset the effect of less favourable terms of trade.