CHAPTER 1

THE ECONOMIC SITUATION IN 1990-91

1.1 The Indian economy had to face many uncertainties in 1990-91. The effects of the political situation at home, and the persistent fiscal imbalances were accentuated by the Gulf crisis which intensified strains on an already weak balance of payments position. It is a measure of the inherent strength of our economy that it withstood the effects of these shocks rather well. It is also a measure of solid gains registered by our economy during the last forty years since independence. Agricultural output and industrial production continued to grow though their sustainability came under serious doubt. It is estimated that the growth of Gross Domestic Product (GDP) in real terms during 1990-91 will be about 5 per cent. However, due to the combined impact of internal and external factors, consumers have been faced with double digit inflation and the economy is faced with a serious balance of payments crisis. On the domestic front, particular significance is attached to medium-term large and persistent fiscal imbalances which have strained the balance of payments situation and accentuated inflationary pressures in the economy. These factors have been sharply exacerbated by the third oil shock and the related dislocations caused by the crisis and the war in the Gulf during 1990-91.

TABLE 1·1

Selected Economic Indicators

(Percentage Change over Previous year)

Economic Indicators	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90 (P)	1990-91 (P)
Gross National Product(1)	5.6	—4.9	7.3	5.8	2.6	7.9	3.8	4.1	3.6	4.2	10.6	5.2	5.0*
Agricultural Production	3.8	—15.2	15.6	5.6	—3.8	13.7	—1.2	2.5	—3.7	—0.8	21.0	1.7	4.5*
Foodgrains Production	4.4	—16.8	18.1	2.9	—2.9	17.7	—4.5	3.4	—4.7	—2.1	21.0	0.4	3.9*
Industrial Production(2)	7.6	—1.7	4.0	9.3	3.2	6.7	8.6	8.7	9.1	7.3	8.7	8.6	8.4
Electricity generated	12.1	2.0	5.9	10.2	6.7	7.6	11.9	8.6	10.2	7.6	9.5	10.8	7.1
Wholesale Price Index(3)	4.5	21.4	16.7	2.4	7.2	7.2	6.0	4.8	5.1	10.7	5.7	9.1	12.1
Monetary Resources(M3)	21.9	17.7	18.1	12.5	16.1	18.1	18.9	15.9	18.6	15.9	17.8	19.4	15.1(4)
Imports at current prices	13.1	34.2	37.3	8.4	5.0	10.8	8.2	14.7	2.2	10.7	26.9	25.4	21.9
Exports at current prices	5.9	12.1	4.6	16.3	12.8	11.0	20.2	—7.2	14.3	25.9	29.1	36.8	17.5
Foreign Exchange Reserves (Rupees Crores)(5)	5821	5934	5544	4024	4782	5972	7243	7820	8151	7687	7040	6251	11416
Foreign Currency Reserves (Rupees Crores)	5220	5164	4822	3355	4265	5498	6817	7384	7645	7287	6605	5787	4388

*Anticipated, (P) Provisional

1. Growth rates are based on new series at 1980-81 prices.
2. Growth rates are based on old Index of Industrial Production (Base 1970 = 100) upto 1980-81 and on the basis of new Index (Base 1980-81 = 100) thereafter.
3. Rate of inflation is based on old Index of Wholesale Prices (Base 1970-71 = 100) upto 1981-82 and on the basis of new Index (Base 1981-82 = 100) thereafter.
4. Between March 31, 1989 and March 23, 1990 for 1989-90 and between March 31, 1990 and March 22, 1991 for 1990-91.
5. Foreign exchange reserves include gold, SDR and foreign currency assets and relate to end period. Gold has been revalued closer to international market price effective October 17, 1990.

1.2 In 1989-90, the terminal year of the Seventh Plan, Gross Domestic Product (GDP) increased by 5.2 per cent in real terms on top of a record growth of 10.4 per cent in 1988-89. The index of agricultural production increased by a modest 1.7 per cent as was expected following the record growth of 21 percent in the post-drought recovery phase of 1988-89, while the index of industrial production increased by 8.6 per cent, which was about the same as 8.7 per cent in 1988-89.

1.3 The underlying strength of Indian economy is revealed by the fact that many of the targets set for the Seventh Five Year Plan were exceeded, which was partly attributable to the performance of the economy in 1989-90. Thus, the average annual growth rate of GDP worked out to 5.6 per cent, as compared with the Plan target of 5 per cent. In agriculture, the average annual growth rate at 4.1 per cent exceeded the target of 4 per cent, despite a run of poor monsoons in the first three years of the Plan. The overall industrial production increased at an average rate of 8.5 per cent, narrowly missing the plan target of 8.7 per cent per annum. Among the major industrial subsectors, mining and quarrying (weight 11.5 per cent) and electricity generation (weight 11.4 per cent) registered a growth of 5.7 per cent and 9.4 per cent per annum, which fell short of the plan targets of 13 per cent and 12 per cent respectively. This was, however, compensated to some extent by an increase of 8.8 per cent per annum in manufacturing output (weight 77.1 per cent) which had a target of 8 per cent per annum.

1.4 Even though the output and the growth targets of Seventh Plan were exceeded, a signficant imbalance appeared in the pattern of financing of the Plan, with the contribution of resources from public sector savings falling far short of the target. The deterioration in the savings performance of the public sector, which has put the planning process under considerable strain, is an important factor underlying the persistent fiscal imbalances.

1.5 During 1990-91 the country has experienced an excellent monsoon for the third year in succession. Rainfall has been 6 per cent above normal and well distributed across space and over time. Consequently, the production of foodgrains is likely to reach another peak exceeding the target of 176.5 million tonnes and the growth of total agricultural production is expected to be around 4.5 per cent. Provisional data on the index of industrial production show na increase of 8.4 per cent during 1990-91 compared to 8.6 per cent during 1989-90. On the basis of these tentative estimates, real GDP growth in 1990-91 may be expected to be in the range of 5 per cent.

1.6 Thus, apart from the deceleration in growth or the actual decline in output of some infrastructure sectors, production performance has been quite satisfactory during 1990-91. Despite this, the price situation has turned out to be difficult. The annual rate of inflation in theWholesale Price Index (WPI), on a point to point basis works out at 12.1 per cent during 1990-91 as against 9.1 per cent during 1989-90. Measured in terms of the Consumer Price Index (CPI), the inflation rate is still higher at 13.6 per cent during 1990-91 as compared with only 6.6 per cent during 1989-90. Inflation hurts everybody, particularly the weaker sections of the population whose incomes are not indexed. This higher rate of inflation is also a cause for concern because the price increase has been large in the case of several essential commodities. Inflation control instruments deployed by the Government have included both physical measures directed at specific commodities as well as deflationary measures in the macro-economic policy stance.

1.7 The physical measures have been centred around effective management of the public distribution system, which has been considerably facilitated by a large domestic stock of foodgrains. Imports of essential commodities have also been undertaken wherever feasible. The procurement of rice during 1990-91 was 13 million tonnes as against 11.1 million tonnes during 1989-90. The procurement of wheat during 1990-91 at 11.1 million tonnes was also higher than that of 9 million tonnes during 1989-90. The stocks of foodgrains stood at 17.3 million tonnes at the end of March, 1991 compared with 11.7 million tonnes at the end of March, 1990.

1.8 Aggregate demand management has been aimed at strict monitoring of government expenditure, limiting the size of the fiscal deficit and reducing the growth of money supply. During 1990-91 the rate of growth of broad money supply (M3) until March 22, 1991 at 15.1 per cent was significantty lower than the money supply growth of 19.4 per cent recorded during the corresponding period of 1989-90. Experience has shown that money supply growth in India is strongly influenced by the behaviour of the budget deficit (the growth of Net Reserve Bank Credit to the Central Government has been the main source of increase in the reserve/base money in recent years) as well the behaviour of foreign exchange reserves. Money supply growth decelerated in 1990-91 despite a sharp deterioration in the fiscal sitation largely because of significant draw down of foreign exchange reserves.

1.9 It is however obvious that a firm control of growth of money supply requires that monetary policy should be closely coordinated with fiscal policy and measures to contain money supply growth have to be backed by associated measures to contain the fiscal deficit. It is with this end in view that the Government introduced a number of measures, in the spheres of both reveneue and expenditure in December, 1990 and a statement was made in Parliament that the fiscal deficit would be limited to 8.3 per cent of GDP in 1990-91 and reduced to about 6.5 per cent of GDP in 1991-92. Unfortunately, the measures adopted turned out to be inadequate and the year 1990-91 ended with a fiscal deficit estimated at 8.4 per cent of GDP. The postponement of regular budget in February 1991 greatly increased the magnitude of efforts now required to achieve the targets set for 1991-92.

1.10 In recent years, there has been a widening gap between the income and the expenditure of the Government which led to mounting fiscal deficits. Imbalances between aggregate demand and domestic output which can be induced, inter alia, by excessive deficit financing generate inflationary pressures and expectations. The fiscal deficits of the Government also spill over into current account deficits on the balanceof payments, which must then be financed either by running down of foreign exchange reserves or through fresh external borrowings, each with their own attendant problems. Consequently, domestic fiscal adjustment is also expected to ease the pressures on the balance of payments which has been sharply accentuated by the third oil shock during 1990-91.

1.11 The impact of the Gulf crisis on the balance of payments situation is very adverse and serious. Largely as a consequence of the increase in the import bill for crude oil and petroleum products, imports in rupee terms have risen by 21.9 per cent as against an increase of 17.5 per cent in the case of exports in 1990-91. Hence, the trade deficit has widened significantly in 1990-91. Combined with the loss of exports to, and remittances from the West Asia, in particular Kuwait and Iraq, there has been a sharp deteioration in the balance of trade. In addition, both the Gulf crisis and domestic political developments affected confidence abroad in the Indian economy. It became more difficult to borrow in the international capital markets. Receipts under non-resident deposits also declerated. All these led to a sharp decline in foreign exchange reserves (excluding gold and SDRs), from a level of about Rs. 5,050 crores at the beginning of August, 1990 to Rs.4388 crores at the end of March, 1991. The decline in reserves would have been still larger if the Government did not resort to borrowing from IMF. The first recourse to the IMF was made during July-September, 1990 when India drew Rs. 1173 crores which constituted 22 per cent of India's Quota and could be drawrn upon without any conditions. This was followed by further recourse to the IMF in January, 1991 when Rs3334 crores were borrowed under the modified Compensatory and Contingency Financing Facility (CCFF) and the first credit tranche under a three month stand-by arrangement. Clearly, the real solution to the problem calls for urgent and effective measures to correct the structural imbalances which had led to the emergence of a chronic balance of payments deficit in the first place.

Gross National Product, Savings and Investment

1.12 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 increase of 5.2 per cent in 1989-90 compared with a growth of 10.6 per cent in 1988-89. Agriculture and allied sectors recorded a growth rate of 2.7 per cent in 1989-90 compared with 15 per cent in 1988-89; industry and construction achieved a growth rate of 6.7 per cent in 1989-90 compared with 8.1 per cent in 1988-89; banking and real estate recorded a growth of 5.8 per cent compared with 8.7 per cent a year ago and transport, storage and communications recorded a growth of 6.7 per cent in 1989-90 compared with 9 per cent in 1988-89, while the growth rate in the public administration, defence and other services remained unchanged at 6.1 per cent during 1988-89 and 1989-90.

1.13 There has been an encouraging trend in the rate of overall domestic savings which showed an improvement during the Seventh Plan period. The ratio of gross domestic savings to GDP, at current market prices, which declined continuously from 21.6 per cent in 1979-80 to 18.2 percent in 1984-85 improved to 21.1 per cent in 1988-89 and further to 21.7 per cent in 1989-90. With this, the average gross domestic savings during the Seventh Plan works out to 20.2 per cent compared with 19.6 per cent achieved during the Sixth Plan. While the savings from thepublic sector declined continuously from 4.5 per cent of GDP in 1981-82 to 1.7 per cent in 1989-90 and that of the private corporate sector fluctuated around 1.5 percent during the Sixth Plan and 2 per cent of GDP during the Seventh Plan, the savings of the household sector recorded an appreciable increase from 13.7 per cent of GDP in 1984-85 to 17.8 per cent in 1989-90. On the other hand, the ratio of aggregate gross domestic investment to GDP improved by 4.5 percentage points from 19.6 per cent in 1984-85 to 24.1 per cent in 1989-90 with an average rate of 22.6 per cent of GDP during the Seventh Plan compared with an average rate of 21.1 per cent of the GDP during the Sixth Plan. The gap between domestic investment and domestic saving had to be financed by an inflow of foreign capital to the extent of 2.4 per cent of GDP during the Seventh Plan compared with 1.4 per cent of GDP during the Sixth Plan. This gap might have increased sharply in 1990-91 because of a deceleration in export growth and inward flow of remittancees.

Agricultural Production

1.14 Indian agriculture has shown some degree of resilience in recent years. Even during the severe drought year of 1987-88 the decline in agricultural production was only 0.8 per cent although foodgrains output declined by 2.1 per cent. Agricultural production increased by 21 per cent in 1988-89 and by 1.7 per cent in 1989-90. The average annual growth in agricultural production during the Seventh Plan works out at 4.1 per cent compared with 6 per cent during the Sixth Plan. However, the wide variations in yields between crops and across regions remain a matter of concern.

1.15 The year 1990-91 experienced the third successive good monsoon as a result of which 32 out of 35 meteorological sub-divisions received excess or normal rainfall. It is expected that agricultural production may rise by more than 4.5 per cent in 1990-91 over the bumper crop achieved during 1989-90. Foodgrains production in 1990-91 is likely to cross the record production of 170.6 million tonnes achieved in 1989-90 and may rise even above the target of 176.5 million tonnes.

1.16 Rice production in 1990-91 was targeted at 73.7 million tonnes. With the monsoon arriving in time and its coverage being normal, the total kharif crop production was reported to be satisfactory and the total rice production during 1990-91 may exceed the target. The target for wheat at 54.5 million tonnes and that for pulses at 15 million tonnes are also 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 continued to be in operation in 1990-91. In the absence of other sources of protein, the intake of pulses for a balanced diet has assumed greater significance. But it is distressing to note that the production of pulses has remained almost static during the past two decades, while the per capita availability of pulses has declined from 70 grams per day in 1956 to about 37 grams per day in 1990.

1.17 With the help of support measures undertaken by the Government and the efforts made by Technology Mission on Oilseeds (established in May, 1986), oilseeds production increased to a record level of 18 million tonnes in 1988-89. But, the production declined to 16.8 million tonnes in 1989-90 due to adverse weather conditions in Saurashtra and some other parts of the country.

A production target of 18 million tonnes of oil-seeds was fixed for 1990-91 (10 million tonnes of kharif oilseeds and 8 million tonnes of rabi oilseeds). The kharif groundnut production was adversely affected by the failure of rains at the time of sowing in the Saurashtra regon. However, the loss in kharif oilseeds is expected to be offset by an increase in the output of rabi oilseeds. The supply of edible oils has generally lagged behind the demand and the gap has to be bridged by imports. The imports of edible oils during the oil year 1989-90 (November-October) aggregated 6.1 lakh tonnes valued at Rs.328 crores as against 18.2 lakh tonnes valued at Rs. 1,061 crores in 1987-88. The foreign exchange crisis of 1990-91, however, led to a significant reduction in imports with inevitable adverse effects on prices.

1.18 Due to larger acreage and production of sugarcane, sugar production increased to a record level of 109.9 lakh tonnes in the sugar year 1989-90 (October-September) compared with 87.4 lakh tonnes in 1988-89. Considering the estimated size of the cane crop, sugar production during 1990-91 may be above 115 lakh tonnes. Production of cotton reached a record level of 114 lakh bales in 1989-90 against the target of 100 lakh bales, bat was adversely affected by excessive rains during 1990-91. Even then the size of the crop in 1990-91 is expected to be about 102 lakh bales. Production of tea is estimated to have increased to 719 million kgs. during 1990-91 compared with 703 million kgs. recorded in 1989-90.

1.19 Consequent upon the expansion of area under irrigation and greater use of HYV seeds, consumption of fertilisers in the country increased from 8.8 million tonnes of nutrients (NPK) in 1987-88 to 11.1 million tonnes in 1988-89 and further to 11.7 million tonnes in 1989-90. In 1990-91, following the third good monsoon in succession, fertiliser consumption is anticipated to increase to 12.7 million tonnes. Given this increase in consumption as also production of fertilisers, the fertiliser retention price and subsidy scheme introduced on November 1, 1977 combined with the fact that there has been virtually no increase in prices of fertiliser for cultivators since July, 1981, has led to a steady increase in the subsidy on fertilisers from Rs.375 crores in 1981-82 to as much as Rs.4,592 crores in 1989-90. The revised estimate for the subsidy on fertilisers during 1990-91 is Rs.4,388 crores as against the budget estimate of Rs.4,000 crores.

1.20 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 loans increased substantially from Rs.6,793 crores in 1985-86 to Rs.13,022 crores in 1989-90 and the target for 1990-91 was fixed at Rs.13,240 crores.

1.21 The Central Budget for 1990-91 introduced a debt relief scheme under which outstanding loans upto Rs.10,000 for the non-wilful defaulters engaged in agriculture and other allied activities were waived by the Government. The debt relief scheme underwent several changes in the course of the financial year 1990-91 since its announcement in the Budget for 1990-91. There changes in the scheme, in effect, increased Governments' financial liability and led to a much greater fiscal burden on the exchequer than originally provided in the Budget. The Interim Budget for 1991-92 presented to the Parliament on March 4, 1991 estimated the burden at Rs. 1500 crores for 1990-91 (RE) compared with the Budget Estimate of Rs. 1000 crores. The Budget had also proposed Rs. 1500 crores under the debt relief scheme to the farmers for the year 1991-92. Given the scale of debt relief scheme, it could affect both the profitability and credibility of the Indian banking system. Unwittingly, it could also affect the farmers' incentive towards prompt repayment of bank debts in the future. The scheme contributed significantly to the deterioration in the fiscal situation in 1990-91. It also puts a constraint on supply of credit for productive purposes and in turn, may affect the rural credit delivery system.

1.22 A Comprehensive Crop Insurance Scheme has been in operation since April, 1985 to provide a measure of financial support to the farmers in the event of crop failure due to natural calamities. Coverage of the Scheme has been continuously expandig since its inception.

1.23 In 1989-90, for a more effective implementation of wage employment programmes, a new employment generation programme known as the Jawahar Rozgar Yojna (JRY) was introduced and merged with the existing National Rural Employment Programme (NREP) and Rural Labour Employment Guarantee Programme (RLEGP). An Employment Guarantee Scheme for the drought prone areas and areas with actue problems of rural unemployment was introduced in the budget for 1990-91.

Industry and Infrastructure

1.24 There was a mild deceleration in the growth of industrial production in 1989-90 mainly on account of a slow down in manufacturing and mining. The index of industrial production increased by 8.6 per cent during the year compared with 8.7 per cent in 1988-89. While growth accelerated in the electricity sector from 9.5 per cent in 1988-89 to 10.8 per cent in 1989-90, the rate of growth of manufacturing declined marginally from 8.7 per cent to 8.6 per cent and that of mining and quarrying declined from 7.9 per cent to 6.3 per cent.

1.25 Among the seventeen major industry groups in the manufacturing sector, growth accelerated in six industry groups viz, beverages and tobacco, paper and paper products, electrical machinery and appliances, metal products, cotton textiles and leather and leather products, during 1989-90. Two industry groups viz., jute products and basic metal and alloy products recorded negative growth, while the remaining eight industry groups recorded some deceleration.

1.26 Taking into account non-too favourable macro economic environment, the growth of industrial production in 1990-91 was encouraging. Despite the Gulf crisis and several restrictions on imports of POL and raw materials, the general index of industrial production recorded a growth of 8.4 per cent in 1990-91 compared with a growth of 8.6 per cent in 1989-90. The manufacturing sector (which accounts for more than three-fourths of the total weight in the index) performed better by recording a growth of 9.2 pet cent in 1990-91 compared with 8.6 per cent in 1989-90. In large measure this was due to the combined impact of various promotional measures undertaken during the Seventh Plan period. However, there was a deceleration in the growth of the mining and quarrying sector from 6.3 per cent to 3.5 per cent and that of electricity sector from 10.8 per cent in 1989-90 to 8.6 per cent in 1990-91.

1.27 An analysis of industrial growth by the use-based classification indicates that during the first eleven months of 1990-91, all the groups except basic industries and consumer non-durables recorded accelerated growth : consumer durables from 1.2 per cent to 13.5 per cent, capital goods from 15.8 to 23.6 per cent and intermediate goods from 2.8 per cent to 6 per cent. Growth of basic industries declined from 5 per cent to 3.9 per cent and that of consumer non-durables from 5.6 per cent to 5.1 per cent.

1.28 The performance of the infrastructure sector during 1990-91 was not encouraging. Electricity generation, production of crude oil and refinery throughput showed evidence either of deceleration or actual decline. However, the railways maintained the same growth rate in terms of the revenue earning goods traffic despite loss of freight traffic due to civil disturbances, shortage of diesel and natural calamities. Production of coal and cargo handled at the major ports showed higher growth rates in 1990-1991 compared with 1989-90. Within the power sector, the performance of both the thermal and nuclear sectors was poor while hydro electricity generation exceeded the targets. The average plant load factor in the thermal sector at 53.8 per cent during 1990-91 was lower compared with 56.5 per cent during 1989-90.

1.29 The production of crude oil declined by 3.1 per cent during 1990-91 mainly due to the agitation in Assam. Even refinery production in terms of crude throughput declined by 0.3 per cent during 1990-91 compared to an increase of 6.9 per cent during 1989-90. The decline in the production of crude oil is a cause for serious concern in the context of the current balance of payments situation. Petroleum products play an important role in the supply of energy to different sectors of the economy. As per the latest information available, non-commercial energy (fuel wood, agricultural and animal waste, wind and solar power) constitutes about 40 per cent of our energy supply while commercial energy constitutes the rest. Within the commercial energy sector hydro-electric power constitutes only 3 per cent, nuclear power supplies only 1 per cent, coal and lignite supplies 56 per cent and oil and natural gas about 40 per cent.

1.30 As regards the end use of petroleum products, the household sector consumes about 20 per cent of petroleum products mainly as a fuel for domestic cooking and lighting. The transport sector consumes about 48 per cent of petroleum products as fuel for vehicles, tractors, airlines, shipping and defence. The industrial sector consumes about 32 per cent of petroleum products as feedstocks or fuel for fertilizers, petrochemicals, agricultural pump-sets, thermal power plants, road construction and a variety of industrial applications.

1.31 India depends on imports of oil to a large extent to meet its domestic consumption of petroleum products, presently estimated at about 54 million tonnes. The cost of POL imports in 1990-91 which was projected at Rs. 6400 crores in April 1990 is now estimated around Rs. 10,800 crores due to the sharp increase in international prices of oil caused by the crisis in the West Asia.

1.32 Some developments at home, like agitations in Assam, have accentuated our difficulties in oil supplies. The shortfall in domestic production of crude oil during 1990-91 is estimated at 2.4 million tonnes. Any bottleneck in the supply of oil could have a substantial effect on industrial output, costs of production and transport facilities. Although there is some scope for inter-fuel substitution and conservation of petroleum, the possibilities in this regard are limited in the short run. The area where the need for conservation and efficiency in use is the most urgent is the oil sector. There is an urgent need to check the growth in demand for petroleum products through a package of price and non-price measures.

Human Resources

1.33 The development and utilisation of human resources play a vital role in improving the quality of life, reducing poverty and ensuring social justice. Economic development is a complex phenomenon which calls not only for higher growth of GDP but also for an improvement in living conditions whether health, education, employment shelter, food or nutrition. Growth in GDP, therefore, has to be sustained by complementary measures of human capital formation and social welfare. This is also necessary so as to arrive at a more complete assessment of economic progress.

1.34 Economic growth with social justice has always been the basic objective of planning in India. There has been a special emphasis on anti-poverty programmes, particularly in the Sixth and the Seventh Plan. Development efforts, particularly in the areas of health, education and provision of basic amenities such as housing and water supply, supplemented by special programmes for disadvantaged and vulnerable groups like women and children, economically and socially backward classes and the handicapped, have led to a significant reduction in the proportion of population below the poverty line. The poverty ratio, as estimated by the Planning Commission on the basis of quinquennial Consumer Expenditure Surveys conducted by the National Sample Survey Organisation, declined from 54.1 per cent in 1972-73 to 33.4 per cent in 1987-88 in the rural sector and from 41.2 per cent to 20.1 per cent in the urban sector resulting in an overall decline from 51.5 per cent to 29.9 per cent during the same period.

1.35 During the past four decades, considerable progress has been made in the social sectors although actual achievements have lagged behind expectations in many spheres. In the sphere of education, gross enrolment of students in the primary schools increased from 43.1 per cent in 1950-51 to 99.6 per cent in 1989-90 and the overall literacy rate which was a mere 18.3 per cent in 1951 improved to 52.1 per cent in 1991. However, universal elementary education still remains an elusive goal as drop-out rates and sex disparity ratios continue to be significant. In the field of higher education, the number of universities has increased from 25 in 1950 to 172 in 1990 and the number of colleges from about 700 to 7000 over the same period. But a proliferation in the number of educational institutes has not been accompanied by a commensurate improvement in standards and infrasturctural facilities. In many streams, formal education is devoid of works-needs of the society and vocationalisation of education is limited, thus causing unemployment among the educated.

1.36 There has been significant progress in the sphere of health. The expectation of life at birth has increased from 32 years in 1950-51 to 59 years today. The death rate showed a remarkable decline from 27 per thousand of population in 1951 to 10.2 per thousand in 1989 as a consequence of the control of communicable diseases accompanied by the provision of safe drinking water and better sanitation facilities. The birth rates, however, have not declined *pari passu* with death rates so that rate of population growth remains high. The infant mortality rate has also declined considerably from 162 per thousand live birth in 1951 to 129 in 1971 and further to 91 by 1989. There has been considerable expansion of the health infrastructure in both rural and urban areas. Despite impressive quantitative growth, the quality of services and the conditions in the primary health centres are poor and need immediate attention. A major lacuna in the health and family welfare services has been the very limited integration with other health related services like supply of drinking water, housing facilities, sanitation and so on.

1.37 In other sectors such as housing, water-supply, sanitation, urban transport and family welfare, both the quantity and the quality of services are inadequate as judged by the needs of society. The vastness of India and the large size of its population impose special demands on the social infrastructure. As the majority of people lack the ability to pay for the services, Government has to play a greater role in providing social services at subsidised rates, at least to the weaker sections of the community. However, efficiency and quality should not be sacrificed for the sake of expansion. Environmental considerations, regional development, participation by private and voluntary organisations in the development of social sectors also need special attention.

Prices and Price Management

1.38 The price situation remained under pressure throughout the year 1990-91 despite a satisfactory monsoon and a bumper crop for the third year in succession. The annual rate of inflation in terms of the Wholesale Price Index (WPI) at 12.1 per cent in 1990-91 was higher than the rate of inflation at 9.1 per cent in 1989-90. The increase in the Consumer Price Index (CPI) for Industrial Workers was much higher at 13.6 per cent during 1990-91 compared with 6.6 per cent during 1989-90. The major concern about inflation during 1990-91 was that it seemed to be concentrated in essential commodities such as foodgrains, vegetables, pulses and edible oils. The WPI for food articles increased by 18.9 per cent during 1990-91 compared with a rise of only 2.1 per cent during 1989-90. However, the prices of manufactured products remained somewhat subdued and the rate of inflation for the manufactured products during 1990-91 was 8.9 per cent compared with 11.1 per cent during 1989-90.

1.39 The build up of inflationary pressures in recent years is due to (a) fiscal imbalances resulting in a higher increase in money supply, liquidity overhang and thus effective demand, (b) supply and demand imbalances in sensitive commodities mainly due to shortfall in domestic production and inability of the Government to import desired quantities because of persistent pressure on the balance of payments and (c) the consequent inflationary expectations.

1.40 Apart from the underlying inflationary pressures arising from macro-economic imbalances the substantial increase in the prices of essential commodities during 1990-91 may be attributed to the following specific factors :

(a) The increase in prices of cereals, particularly rice and wheat, was attributable to the substantial increase in procurement prices and the consequent rise in issue prices which set the trend for open market prices.

(b) The continued increase in the prices of pulses was caused by the persistent excess demand against the situation of near stagnation in domestic production in the last two decades.

(c) The sharp increase in prices of edible oils was mainly due to shortfalls in the domestic production for two successive years and the inability of Government to import larger quantities on account of the foreign exchange constraint.

(d) There was no obvious specific explanation for the increase in prices of other food articles, particularly fruits and vegetables. It is possible that the increase in transportation cost attributable to the increase in prices of petroleum products in March and October 1990 may have been an important factor. Disruption in transport during August-October 1990 on account of the law and order situation might have accentuated the problem.

(e) The Gulf surcharge of 25 per cent on domestic prices of petroleum products imposed with effect from 15th October, 1990 had an overall impact of 1.5 per cent on the WPI.

(f) The increase in transportation costs and transport bottlenecks created by the oil crisis combined with law and order problems may account for the fact that the seasonal decline in prices of essential commodities which begins from mid-September every year was not observed during 1990-91.

(g) It has also been our experience that international oil shocks, inevitably associated with increases in world prices and domestic prices of petroleum products, generally lead to higher rate of inflation compared with the trend rate of inflation. There were two previous oil shocks in 1973 and 1979 and the consequent average rate of inflation was significantly higher than that in preceding or succeeding years as evident from table below :

TABLE 1.2

Average annual rate of increase in WPI

Period	(In Percentage)
1971-72 & 1972-73	7.6
1973-74 & 1974-75	20.0
1975-76 to 1978-79	2.0
1979-80 & 1980-81	19.0
1981-82 to 1989-90	6.5
1990-91	12.1

1.41 In order to contain the inflationary pressures Government took a number of steps. The RBI tightened selective credit controls and took certain measures to mop-up excess liquidity. The Statutory Liquidity Ratio (SLR) was increased from 38 to 38.5 per cent on all deposits of commercial banks. On the supply side, Government maintained the supply of foodgrains and other essential commodities through the public distribution system. Import of edible oils and pulses, to the extent feasible, were used to supplement domestic supplies of these essential commodities.

1.42 The uptrend in prices manifest in the recent years still persists in 1991-92. The annual rate of inflation on a point to point basis on June 29, 1991 was 10.2 per cent compared with 9.4 per cent on the corresponding date last year. However, the cummulative increase in the prices in terms of WPI during the first 13 weeks of the financial year 1991-92 at 2.4 per cent was significantly lower than the increase of 4.1 per cent during the corresponding period last year.

Fiscal and Monetary Policy

1.43 Macro-economic imbalances characterised by high fiscal deficits and a growing revenue deficit have continued to remain a major source of concern for the Government during the past few years. These concerns have been compounded by the impact of the Gulf crisis during 1990-91. Aggregate resources of the Central Government including internal and extra budgetary resources of Central Public Enterprises were estimated to increase by 15.0 per cent in 1990-91. Aggregate disbursements, on the other hand, were estimated to increase by 9.4 per cent in 1990-91, thereby indicating some reduction in the relative size of the gap between income and expenditure of the Central Government. This also applies to the combined Budget Estimates (BE) of the Centre, States and Union Territories for 1990-91, which estimated a deficit of Rs. 8,999 crores compared with the Revised Estimates (RE) of Rs. 12,149 crores in 1989-90. Aggregate receipts were estimated to increase by 13.4 per cent while aggregate expenditure was expected to increase by 10.4 per cent.

1.44 The Annual Plan for 1990-91 provided for a total outlay of Rs. 64,717 crores for the Centre, States and Union Territories implying an increase of 12.4 per cent over that in the terminal year of the Seventh Plan. The allocation for the Central Plan was Rs. 39,329 crores.

1.45 The Budget for 1990-91 laid stress on containment of the budget deficit through strict monitoring of Government expenditure and revenues. The Budget provided for a deficit of Rs. 7,206 crores amounting to about 1.4 per cent of GDP as against the deficit of Rs. 10,592 crores amounting to 2.4 per cent of GDP in 1989-90. A commitment was also made in the Budget to make a periodic review of the actual developments in the budgetary situation and to keep Parliament and the people informed. The review for the period April-July 1990, presented to the Parliament, revealed a budget deficit of Rs. 9,926 crores at the end of July, 1990 compared with a deficit of Rs. 11,390 crores at the end of July 1989. However, the analysis anticipated the difficulties in keeping the deficit at the estimated level because of the impact of the Gulf crisis on the fiscal situation. The OCC surplus budgeted at Rs. 1400 crores, would not be realised, and the cost of repatriation of Indian citizens from Kuwait would have to be met. The second review made for the period April-November 1990 and presented to Parliament on January 11, 1991 indicated a deficit of Rs. 13,000 crores at the end of November 1990 compared with a deficit of Rs. 13,082 crores at the end of November 1989. The trend in the budget deficit represented a disquietening picture of shortfalls in revenue while expenditure continued to be incurred as budgetted. The same trends continued until the end of the year, and the Interim Budget for 1991-92 presented on March 4, 1991 estimated the year end budget deficit at Rs. 10,772 crores (RE). The increase in deficits is due to additional loans to the States, higher interest payments, inadequate provision for the rural debt relief, higher burden on account of fertiliser and food subsidies and shortfalls in revenues.

1.46 The Budget deficit, as conventionally reported, is only a partial measure of the fiscal imbalance. It is the difference betwtween all receipts and expenditure (both current and capital) of the Government and does not indicate the Government's draft on domestic savings or its dependence on borrowed funds. A more complete measure, used in most countries, is the gross fiscal deficit which is the difference between Government expenditure and net lending on the one hand and current revenue and grants on the other. As far as money supply is concerned, what matters is the monetised deficit, that is Government borrowings against the issue of treasury bills or dated securities picked up by the Reserve Bank of India which result in the creation of reserve money in the economy. While the budget deficit is the sum total of net addition to the treasury bills issued by the Government and draw-down from its cash balance held with the Reserve Bank of India, the monetised deficit is the sum total of the net increase in the holdings of treasury bills by the Reserve Bank of India and its contribution to the market borrowings of the Government. The large deficits of recent years have been met by borrowings which, in turn, have contributed to the burgeoning stock of Central Government debt and the consequent interest payments as also repayment obligations.

1.47 Another disturbing development is the steady decline of the share of capital formation in Central Government expenditure. The Economic and Functional Classification of the Budget, which 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, shows that there has been a steady decline in the proportion of expenditure on capital formation from over 40 per cent in the mid-1980s to 32.7 per cent in 1990-91 (BE). On the other hand, transfer payments from the Central Goverment to the States, Union Territories and other sectors of the economy have increased sharply from 30.7 per cent in 1980-81 to 42.7 per cent in 1990-91 (BE). Among transfer payments, the highest increase has been on account of interest payments; the proportion of expenditure on interest payments increased from 10 per cent in 1980-81 to 18.9 per cent in 1990-91 (BE). The share of consumption expenditure has fluctuated in the range of 21 to 24 per cent during the 1980's.

1.48 The Seventh Plan had projected targets for selected fiscal indicators for the terminal year 1989-90 compared with those in the base year 1984-85. These targets were annualised in the Long Term Fiscal Policy (LTFP) announced by the Government in December 1985. A comparison of actual performance with these targets shows the following :—

(a) Performance of tax revenues has been better than the targets in all the years of Plan except the terminal year. Within tax revenues, however, the performance of direct taxes lagged behind the targets.

(b) Non-tax revenues have also performed better exceeding the targets in all the years.

(c) Non-Plan revenue expenditure, particularly, defence, interest payments and subsidies on food and fertilizer remained substantially above the targets.

(d) In financing the plan, the shares of domestic borrowing and the budget deficit far exceeded the targets.

(e) The contribution of Public Enterprises fell short of the targets by significant margins.

(f) Central Plan assistance to the States and Union Territories taken together remained well above the targets in all the years of the Plan.

1.49 It would follow from the above observations that the growing imbalance in the fiscal system stems partly from a shortfall in overall resource mobilisation but largely from excessive growth of Government expenditure, which had to be financed by larger than planned borrowings and deficits.

1.50 Unanticipated deficits, financed through excessive seignorage, obviously lead to undue monetary expansion. But the large and originally unplanned draw-down of external reserves in 1990-91 led to some slow down in the money supply growth as is evident from the following table :

TABLE 1.3

Growth of Selected Monetary Variables

(In per cent)

Variable	1989-90 (March 31 to March 23)	1990-91 (March 31 to March 22)
1. M3 (Aggregate Monetary resources)	19.4	15.1
2. Currency with the Public .	21.5	15.2
3. Demand Deposits with banks	23.3	11.2
4. Time Deposits with banks .	17.9	15.0
5. Net Bank Credit to the Govt.	20.9	18.0
6. Net RBI credit to the Central Govt.	24.6	20.1
7. Bank credit to the Commercial Sector	16.4	12.0

1.51 During 1990-91, the RBI made some changes in credit policy, essentially aimed at regulating the growth in money supply and credit in such a manner so as to meet the genuine credit needs fully and, at the same time, to moderate the liquidity growth in the system. The statutory liquidity ratio was increased from 38 to 38.5 per cent on net demand and time liabilities of the the scheduled commercial banks. Appropriate use has also been made of selective credit controls in respect of bank advances against stocks of price-sensitive essential commodities in the light of price-output trends in the market. The interest rates on bank advances were rationalised by replacing purpose and area specific rates by rates linked to the size of loans, except for concessional credits to exports and certain priority sectors.

1.52 During 1991-92 until May 31, 1991 the growth of money supply has shown some acceleration as indicated in the table below :—

TABLE 1 4

Growth in Money Supply & Selected Monetary Variables

(In per cent)

Variables	March end to June 1, 1990	March end to May 31, 1991
1. M3	3.5	3.9
2. Currency with public . .	7.3	8.5
3. Demand deposits . . .	2.2	3.8
4. Time Deposits . . .	2.4	2.8
5. Net Bank credit to Govt. .	7.4	7.7
6. Net RBI credit to Central Govt.	8.7	9.0
7. Bank credit to Commercial sector	1.6	2.1

The External Sector

1.53 India's balance of payments situation remained under considerable pressure throughout the Seventh Plan period, despite a buoyant trend in exports. Exports in rupee terms increased by 25.9 per cent in 1987-88, 29.1 per cent in 1988-89 and 36.8 per cent in 1989-90. On the other hand, imports recorded an increase of 10.7 per cent in 1987-88, 26.9 per cent in 1988-89 and 25.4 per cent in 1989-90. The Gulf crisis imposed an additional burden during 1990-91 in the form of a higher POL import bill, a decline in exports, and also a possible decline in the inflows of remittances from the West Asia. In terms of rupees, exports registered a growth of 17.5 per cent in 1990-91, while imports recorded a relatively higher growth at 21.9 per cent. Consequently, the trade deficit increased by 38 per cent from Rs. 7,735 crores during 1989-90 to Rs. 10,644 crores during 1990-91. Net invisibles are also estimated to have declined during the year due to a likely fall in the net private transfers on account of the Gulf crisis, a relatively slow growth of tourist traffic and a steady increase in interest payments on past borrowings. In the capital account, net aid disbursements in 1990-91 were higher than that during the previous years. Available information on other items of capital account also confirms the severe strain on the balance of payments.

1.54 The crux of the balance of payments problem during the recent years has been the large and persistent trade deficit and the declining capacity of invisibles to finance this deficit. Net invisibles as a percentage to GDP declined from an average of 2.2 per cent during the Sixth Plan to 1 per cent during the Seventh Plan, while the trade deficit as a percentage of GDP declined only marginally from an average of 3.4 per cent to 3.2 per cent over the same period. Consequently, the current account deficit which needs to be financed through capital receipts, increased from an average of 1.3 per cent of GDP in the Sixth Plan to 2.2 per cent of GDP during the Seventh Plan.

1.55 During 1990-91 our import bill on oil at Rs. 10,820 crores was 72 per cent higher than that of Rs. 6,273 crores during 1989-90. There was loss in exports to West Asia, particularly Kuwait and Iraq. There was also a shortfall in the remittances from West Asia because of the crisis and the war in the Gulf. Thus, the balance of payments situation was under great strain throughout the year. Thus despite sizeable borrowings from the IMF in July-September 1990 and January 1991, the level of foreign exchange reserves (excluding Gold and SDR) which was about Rs. 5,050 crores at the beginning of August 1990 dropped to Rs. 4,388 crores by the end of March 1991, and further to Rs. 2,386 crores by the end of June 1991.

1.56 To meet the balance of payments problems caused by the Gulf crisis the Government initiated a number of steps. First, measures were taken to reduce the rate of growth of domestic consumption of petroleum products for containing imports of POL. Second, a set of measures were taken to cut Government expenditure, particularly its import and foreign exchange component. Third, restrictions were put on the imports of components, spares and raw materials, particularly in electronics and automobiles. Thirtyfour items of capital goods and thirteen items of raw materials were shifted from OGL list to the licencing category, and the residual category of imports under OGL comprising unlisted items in the import policy was shifted to the limited permissible list. Fourth, measures were initiated to generate additional exports. Fifth, efforts were made to accelerate the utilisation of the authorised but undisbursed external assistance. Sixth, the possibilities of obtaining credits from oil-exporting countries and further deposits from non-resident Indians were also explored. Finally, efforts were made to obtain additional finance from bilateral donors and multilateral institutions.

1.57 To meet the balance of payments difficulties India used its reserve tranche at the IMF during July-September 1990 and obtained SDR 487.26 million (Rs. 1173 crores). India along with other oil importing developing countries had pressed the IMF to modify the Compensatory and Contingency Financing Facility by including oil import element in it. This modification was approved by the IMF Board in mid-November 1990. The IMF Board also approved on 18th January, 1991 the use of financial resources by the Government of India, totalling SDR 1268.83 million, equivalent of about US $ 1786 million or Rs. 3153 crores. Of this, SDR 716.9 million, the equivalent of about US $ 1,009 million or Rs. 1,781 crores, was provided under the modified CCFF. The remaining SDR 552.93 million, equivalent of US $ 777 million or Rs. 1372 crores were made available under first credit tranche under a three-month stand-by arrangement. Thus, the entire amount of SDR 1268.83 million (about Rs. 3153 crores) was made available to India for immediate drawal and has been received.

1.58 The drawal from the IMF provided immediate relief, but the balance of payments continued to be under severe strain. During March-July 1991 the Reserve Bank of India announced various measures to further moderate import growth and protect foreign exchange reserves. These included a raising of the cash margins/ deposit requirements for imports other than capital goods, import of capital goods only through lines of credit available with financial institutions, restructuring of interest rates on post-shipment export credits to facilitate the realisation of export earnings, imposing an incremental CRR at the rate of 10 per cent over the existing CRR of 15 per cent and the imposition of an interest surcharge on bank credits for imports.

1.59 In order to improve the international competitiveness of our exports and restrain demand for imports, the Reserve Bank of India adjusted downwards the value of rupee by 8.7 to 9.7 per cent in relation to four major currencies (Pound Sterling, US Dollar, Deutsche Mark and Japanese Yen) on July 1, 1991 and further by 10 to 11 per cent in relation to five major currencies (Sterling, Dollar, DM, Yen and French Franc) resulting in overall appreciation of these currencies in relation to rupee by 21 to 23.1 per cent. In a bid to curb imports and reduce aggregate demand in the economy the RBI also announced a package of monetary measures on July 3, 1991 by raising the bank rate from 10 per cent to 11 per cent alongwith an increase in the scheduled commercial banks' deposit rates, lending rates and the RBI refinance rates from July 4, 1991. The Government also announced major structural reforms in the area of trade policy on July 4, 1991. These include a uniform REP rate (to be called EXIM Scrip and to be freely tradeable) of 30 per cent of the FOB value of exports, abolition of all supplementary licences except in the case of the Small Scale Sectors and for producers of life-saving drugs/equipment, suspension of Cash Compensatory Support (CCS), abolition of additional licences granted to export houses and increase of REP rate for advance licence exports from 10 per cent of net foreign exchange (NFE) to 20 per cent of NFE. Under the new policy, REP would be the principal instrument for export-related imports, and the items now listed in the Limited Permissible List (Appendix 3A and 3B), OGL items imported by PMP Units (Appendix 6), all capital goods (Appendix 4), machinery and spares (Appendix 9) and unlisted OGL will henceforth be imported only through the REP route.

1.60 The management of the difficult balance of payments situation during the short-term has been a crucial task for the Government. The difficulties for the external sector of the economy are likely to persist for some time. In order to manage the blance of payments situation, it would be essential to step up the growth in the volume and value of exports, to economise as much as possible on POL imports, to continue with prudence in the sphere of non-oil imports and to exercise restraint in canalised imports. Special attention would need to be paid to an acceleration in the utilisation of committed but undisbursed external assistance. It is expected that the planned fiscal adjustment would also help to ease the pressures on the balance of payments.

Outlook

1.61 The Indian economy is passing through a very difficult stage due to continued pressures on balance of payments, large budget deficits and double digit inflation. These problems have persisted over the past few years. The situation had been aggravated by the Gulf crisis as well as the uncertain domestic political situation during 1990-91. Due to the shortage of foreign exchange, Government had to impose certain restrictions on imports of capital goods, raw materials and components to the industry. There were also constraints on transport and other infrastructural facilities due to a shortage of petroleum products during 1990-91.

1.62 The current economic situation is indeed very difficult. Effective measures are needed to correct fiscal imbalances and to contain the balance of payments deficit within manageable limits. The short term correctives have to be viewed in a medium term setting. Credible structural reforms designed to improve the efficiency and productivity of resource use are an inescapable necessity, if the unavoidable fiscal adjustment is not to lead to stagflation but becomes an occasion to impart a new element of dynamism to the growth process. One should not underestimate the enormity of the task. But the people of India have shown more than once in the past that faced with a crisis their response can fully match the requirements of the situation.