

CHAPTER I

THE ECONOMY IN 1974-75

Introduction

1.1 By all accounts, 1974-75 was a year of unprecedented economic strains in the history of independent India. However, it was also a year of determined action on the part of the Government, demonstrating vividly the basic resilience of our democratic polity in grappling with crisis situations.

1.2 The first half of the year recorded the sharpest rate of increase of prices in the post-war years. Several factors contributed to this outcome. There was the disproportionate expansion of money supply inherited from the two previous years. Inflationary expectations also seem to have received an added impetus in the earlier part of the year because of unsatisfactory production and procurement of foodgrains during the 1974 rabi season. There was also a large increase in prices of various petroleum products as well as fertilisers in the beginning of the year—which was, in turn, an inevitable by-product of steep increase in posted prices of crude oil in January, 1974. The overall international environment of inflation, leading to a sharp increase in prices of a large number of imported products of basic importance to the economy, gave further stimulus to the already strong inflationary impulses operating in the economy. In a situation in which international prices of commodities such as foodgrains were much higher than domestic prices, imports, even when physically available, could not exercise a visible downward pressure

on domestic prices. However, while international factors undoubtedly aggravated the situation, it must be recognised that the inflationary pressures of the last two years are basically rooted in some of the obvious inadequacies of our domestic economic structure, the principal manifestation of which can be found in the continued sluggishness of agricultural production since 1971-72.

1.3 Faced with the gravity of the economic crisis, the Government took vigorous measures designed to moderate the growth of monetary demand and to discourage unduly large accumulation of stocks. The combined result of the tax proposals contained in the regular Annual Budget for 1974-75 as well as the second Finance Act, the increase in postal rates and the enhancement of railway fares and freight twice in the year, was the mobilisation of a record amount of Rs. 690 crores by way of additional financial resources by the Central Government in 1974-75. In a full year, these measures are expected to yield Rs. 935 crores. The States also put in significant efforts at additional resource mobilisation, yielding Rs. 358 crores in 1974-75. On any reckoning, this was an impressive attempt at resource mobilisation. It is, however, unfortunate that a large part of these resources has been absorbed by inescapable commitments of non-developmental, though by no means non-essential, expenditure.

TABLE 1.1

SELECTED ECONOMIC INDICATORS

1	1969-70	1970-71	1971-72	1972-73	1973-74	1974-75
	(Percentage change over previous year)					
	2	3	4	5	6	7
1. National income at constant (1960-61) prices	5.7	4.9	1.4*	-0.9*	3.1**	1.0+
2. Agricultural production	6.7	7.3	-0.4	-7.1*	9.1*	—
3. Food grains production	5.8	9.0	-3.0	-7.7*	6.8*	
4. Industrial production	7.4	3.0	3.3	5.3	0.5	3.8†
5. Electricity generated	14.4	8.4	8.8	4.8	1.6	7.8‡
6. Wholesale prices	3.7	5.5	4.0	9.9	22.6	27.2†
7. Money supply	10.8	11.2	13.1	15.9	15.3	3.1@
8. Imports	-17.1	3.3	11.6	-1.5	56.4	53.8‡
9. Exports	4.1	8.6	4.8	21.9	25.9	36.2‡
10. Freight carried by railways (net tonne kilometres)	2.5	-0.7	4.6	2.5	-10.4	3.7‡

+ Estimated

* Provisional

** Quick estimate

† April-July, 1974 compared to April-July, 1973.

‡ April-December, 1974 compared to April-December, 1973.

@ As on January 31, 1975 compared to March 31, 1974.

‡ April-November, 1974 compared to April-November, 1973.

1.4 The Government made strenuous efforts to maintain the tempo of investment activity in the vital core sectors of the economy. During the course of the year, additional funds were allocated to these sectors to meet the unavoidable increases in project costs. Nevertheless, it cannot be denied that the pace of public sector investment could not be sustained at an adequate level. This was unavoidable in a year in which concern with price stability had, quite justifiably, the first priority in the mind of policy makers. To the extent various measures of resource mobilisation have led to a reduction in the magnitude of deficit financing and slowed down the expansion of money supply, they have helped to create a macro environment conducive to greater economic stability.

1.5 Measures for additional resource mobilisation were supplemented by more direct attempts at regulation of disposable consumer incomes. Thus the legislation impounding a part of additional dearness allowances and the entire increase arising from revision of wages and salaries, imposition of restrictions on declaration of dividends beyond stipulated limits and compulsory savings for tax payers in higher income brackets, represented a serious effort at moderating the growth of household spending. The increase in interest rates and exercise of greater discipline since the 1974 slack season in the expansion of bank credit to the commercial sector were designed to encourage savings and to provide a disincentive to excessive accumulation of inventories. It is possible that some of these measures produced unintended adverse side effects. However, their overall impact thus far in the current year has been to bring about a visible reduction in the rate of growth of money supply. In a year, which is likely to be characterised by hardly any growth in real national income, a more rapid increase in money supply would have greatly intensified the inflationary pressures.

1.6 As part of a package of anti-inflationary measures, Government also intensified its operations against smugglers, hoarders and black marketeers. The active use of MISA against smugglers and other anti-social elements seems to have immobilised a part of black money, hitherto being used to finance an undue accumulation of inventories. The resulting reduction in the velocity of circulation of money has encouraged disharding of sensitive commodities and, as such has assisted in stabilising the price level.

1.7 The adoption of various measures designed to moderate the growth of monetary expansion does not imply a blind faith in the monetarist approach to problems of economic policy. However, considering the exceptionally large growth of money supply in recent years, one does not have to subscribe to the monetarist prescriptions to conclude that greater financial and monetary discipline must constitute an essential element of any stabilisation policy. At the same time, it is recognised that in a predominantly agrarian economy, food prices form the king-pin of the price structure and that these prices can be stabilised only by ensuring a proper balance between demand and supply. Since in the short run, output could not be

increased significantly, there was no alternative to sizeable imports of foodgrains. Accordingly, Government arranged to import about five million tonnes of foodgrains in 1974-75. Moreover, in order to influence the state of price expectations, in the closing months of 1974, the Government firmly resisted sectional pressures for higher procurement prices, which could not be justified by the objective requirements of increased production or procurement.

1.8 The behaviour of prices since the third week of September, 1974 indicates that the various stabilisation measures have had a favourable impact. The fall in prices in the last quarter of 1974, notwithstanding an unsatisfactory kharif crop, suggests some weakening of inflationary forces. The improved prospects for the forthcoming rabi crop can be expected to have a further moderating influence on prices. Even then, it has to be recognised that there are still sizeable imbalances in the demand and supply of basic wage goods. As such, it will be unwise to assume as of now, that the struggle against inflation has been brought to a successful conclusion.

1.9. The performance of some important sectors of the economy in 1974-75 is summarised in the following paragraphs.

National Income, Savings and Investment

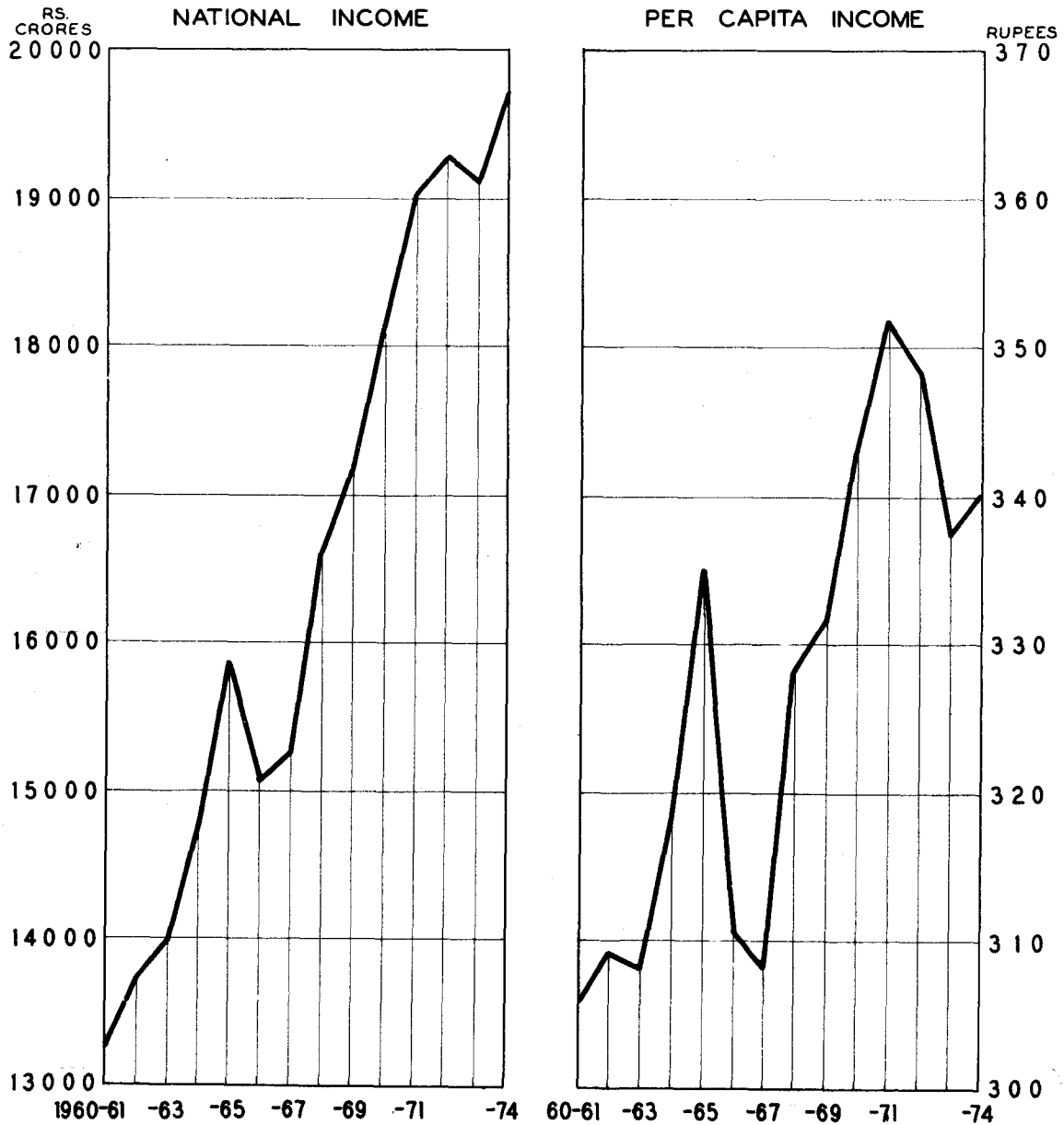
1.10 Official estimates of national income in 1973-74 indicate that the growth rate was only 3.1 per cent. The overall rate of growth of the economy during the Fourth Plan averaged about 3 per cent per annum. This is a disappointing performance for an economy in which population is increasing at an average annual rate of 2.2 per cent. Since effective solutions for the basic problems of poverty and underdevelopment can be found only through rapid economic growth, our objective must be to gear the economy to a higher growth rhythm than it has been used to in the past. Unfortunately, no visible progress is likely to have been made in this direction in 1974-75 since the economy, on current expectations, is not likely to record a rate of growth of more than one per cent.

1.11 Official estimates of saving and investment for 1973-74 are still not available. However, it appears that the steep rise in the price level has adversely affected the rate of saving in the economy. Due to lack of data on savings in the form of physical asset formation in the household sector, a broad idea of the saving of this sector has necessarily to be based on data on net financial assets of this sector. The Reserve Bank has estimated that household saving in the form of financial assets at current prices increased by only Rs. 329 crores in 1973-74. Computed in real terms, the increase would be negligible. While in terms of current prices, the saving of the public sector consisting of Central and State Governments (including local authorities) and their undertakings was perhaps a shade better than in the previous year, here again, in real terms, there appears to have been a decline on account of the price rise. In respect of the private non-financial corporate sector also, it is estimated that its saving in 1973-74 was stagnant at the 1972-73 level. In sum, therefore,

NET NATIONAL PRODUCT [NATIONAL INCOME]

(AT 1960-61 PRICES)

REVISED SERIES



MINISTRY OF FINANCE, ECONOMIC DIVISION.

the aggregate domestic saving in 1973-74 seems to have declined in real terms.

1.12 As regards investment, some idea of the capital formation in the public sector in 1973-74 can be formed on the basis of economic classification of the Central Budget. These data show that, although in money terms there was a marginal increase in capital formation, in real terms there was a significant decline. It is not possible to give even an approximate estimate of capital formation in the household sector for lack of adequate data. In regard to the private non-financial corporate sector, however, an overall view about the trend of investment based on the flow of funds to this sector for investment purposes through financial intermediaries, capital issues and its own investible funds generated through retained profits and depreciation provision can be formed. Based on these data, the Reserve Bank has estimated that the gross capital formation of the corporate sector increased by less than 9 per cent in 1973-74 compared to an increase of 13.5 per cent in the preceding year.

1.13 In aggregate terms, both domestic saving and investment as a proportion of national income seem to have declined in 1973-74 as compared to 1972-73. While domestic saving was about 10 per cent of national income, investment may have been around 11 per cent of national income. There is unlikely to have been any improvement in 1974-75. This is an indication of the task that lies ahead in our quest for a more dynamic economy.

Agriculture

1.14 There is considerable evidence to suggest that India's agriculture seems to have lost the momentum for growth it exhibited in the late sixties. The index of agricultural production reached a record level of 131.6 in 1973-74. However, it was only marginally higher than the previous peak level of 131.4 reached in 1970-71. The fact that the population of the country has since increased by nearly 7 per cent underscores the imbalance between availability and requirements as a result of the sluggishness of agricultural output.

1.15 In large measure, adverse weather conditions have been responsible for this unsatisfactory state of affairs. However, it would be a mistake to regard the continued sluggishness of agricultural output as being due wholly to the operation of such random factors as weather conditions. For example, the decline in the output of wheat after 1971-72 is partly attributable to the appearance of a new rust disease affecting Kalyan Sona. Because of more favourable weather conditions, the output of wheat during the coming rabi season may well stage a recovery. Nevertheless, the maintenance of a healthy upward trend in the output of wheat is crucially linked to the availability of new rust resistant varieties of seed. As regards rice, despite a three and a half times increase in the area under high yielding varieties in the Fourth Plan period, there has been no visible acceleration of the rate of growth of productivity in the traditional rice growing States. Although output in 1973-74 reached the re-

cord level of 43.7 million tonnes, it was only marginally higher than the previous peak level of 43.1 million tonnes reached in 1971-72. The output of rice in the 1974 kharif season is estimated to have declined by nearly 1.7 million tonnes from the level of 40.7 million tonnes reached in the kharif season of 1973. Susceptibility of new varieties to pests and diseases, particularly under conditions of lack of effective control on water supply, continues to pose a major problem. Among coarse grains, with the exception of bajra, the new high yielding varieties have yet to establish their popularity. As for pulses, there are at present no effective high yielding varieties. Production in the Fourth Plan period averaged 10.9 million tonnes, which was only slightly above the average for the First Plan (10.7 million tonnes). Among commercial crops, the new varieties seem to have made a visible impact only in the case of cotton. Even in this case, output after 1971-72 has failed to reach the peak level of 6.6 million bales attained in 1971-72. Output declined to 5.4 million bales in 1972-73 but recovered to 5.8 million bales in 1973-74. In 1974-75, the output is likely to be about 6.0 million bales. There are indications that while the output of sugarcane in 1974-75 may be about the same as in 1973-74, there is likely to be a decline in the production of both oilseeds and raw jute.

1.16 On current reckoning, the Index of Agricultural Production in 1974-75 is unlikely to record any significant increase. The output of foodgrains may be about the same as the level of 103.6 million tonnes reached in 1973-74. The sub-group index of commercial crops may record a decline.

Industrial Production

1.17 Industrial output in the first seven months of 1974 increased by 2.3 per cent. Judging by the available production data for subsequent months, the rate of growth of industrial production in 1974 may be about 2.5 per cent as compared to 0.7 per cent in 1973. However, for the fiscal year 1974-75, the increase in industrial production may be of the order of 3.5 per cent as compared to 0.5 per cent in 1973-74.

1.18 In the earlier part of the year, factors such as shortages of power, fuel and transport facilities hampered industrial production. More recently, there has been a notable improvement in the generation of power and in the production and transport of coal. However, on account of none too encouraging prospects for increased availability of agricultural raw materials, the overall outlook for industrial production continues to be uncertain. In the meanwhile, if unsettled conditions in industrial countries affect the demand for our exports, this could be a further complicating factor.

1.19 It is a matter of considerable satisfaction that many public sector undertakings continue to record higher levels of production. Output in a number of core sector industries has shown encouraging trends. According to advance information which is necessarily of a provisional nature, industries such as electricity generation, steel and coal recorded a significant increase in output during the period April to December, 1974 as compared to the corresponding period

of 1973. The output of electricity went up by 6.0 per cent, of saleable steel from principal producers by 10.4 per cent and of coal by 8.5 per cent. The output of nitrogenous fertilisers went up by 8.0 per cent though that of phosphatic fertilisers went down by 7.1 per cent. On the debit side, industries like cement and aluminium recorded a fall in output by 3.5 per cent and by 17.0 per cent respectively. Among consumer goods, the production of vanaspati declined by 29.3 per cent. While the output of cotton yarn remained stagnant, that of mill made cotton cloth went up by 3.9 per cent. The output of commercial vehicles declined by 6.7 per cent while that of cars and jeeps went down by 23.7 per cent and 19.7 per cent respectively. The output of scooters went up by 15.0 per cent. Vehicular diesel engines recorded an impressive growth of 45.2 per cent.

1.20 Although the capital market and, in particular, the new issues market, has been depressed since the ordinance imposing restrictions on dividends was issued in July, 1974, the data relating to approvals by the Capital Goods Committee, and demand for funds from the term financing institutions do not indicate any visible slackening of industrial investment in 1974-75. However, since investment behaviour is often subject to unpredictable moods of pessimism and optimism, the situation needs to be carefully watched so as to facilitate a flexible response to the emerging situation.

Prices

1.21 The Wholesale Price Index reached its highest peak in the week ending September 21, 1974. The index at that point was 32 per cent higher than during the corresponding week of 1973. In the following three months, prices declined by about 5 per cent. As a result, the index at the end of December, 1974 was 18.8 per cent higher than at the end of December, 1973. This is to be contrasted with an increase of 26 per cent in the index between December, 1972 and December, 1973. Despite the welcome relief of recent months, the average value of the Wholesale Price Index in 1974 went up by 27.3 per cent as compared to the average increase of 19.2 per cent in 1973. This is an indication not only of the continuing strength of the inflationary forces in the economy but also of severe distortions that inflation has introduced in our economic structure.

1.22 It has to be noted that nearly one-half of the rise in the Wholesale Price Index both in 1973 and 1974 was due to a steep increase in the prices of food articles. The improved prospects for the forthcoming rabi crop, the fact that Government have arranged to import sizeable quantities of foodgrains to maintain an orderly flow of foodgrains through the public distribution system and a reduction in the rate of growth of money supply can be expected to have some stabilising effect on prices. Moreover, the impact of the sharp increase in the prices of petroleum products would by now appear to have been largely absorbed in the price structure. Taking all these factors into account, one can expect that in the coming months, the rate of growth of prices will slow down as compared to the corresponding period of the last

year. However, given the existing precarious balance between demand and supply of basic wage goods and the known instability of agricultural output, it cannot be readily assumed that, without additional efforts, we can look forward to a regime of reasonable price stability.

Fiscal and Monetary Policies

1.23 Available data indicate that despite various efforts by the Central Government to mobilise additional resources and curb less essential expenditure, the budgetary deficit in 1974-75 will turn out to be much higher than the figure of Rs. 126 crores mentioned in the budget estimates. This is due to higher expenditure than was originally budgeted for on items such as food and fertiliser subsidy, payment of dearness allowance to the Government employees, certain commitments to the States on account of drought relief and budgetary support for a number of public sector enterprises for meeting their cash losses. Nevertheless, it is a matter of some satisfaction that during the current year so far, deficit financing at the Centre, as measured by the net increase in the Reserve Bank credit to the Central Government, has been running at a rate lower than that of the last year. The improvement is much more marked if one takes into account both the Centre and the States. The net increase in the Reserve Bank credit to Government (Centre and States combined) works out to Rs. 540 crores during the current fiscal year upto January 31, 1975 as compared to Rs. 807 crores during the corresponding period of 1973-74.

1.24 As a result of a more selective credit policy, the rate of growth of bank credit to commercial sector during the current year so far has been significantly less than last year. Thus between March 31, 1974 and January 31, 1975 the increase of Rs. 959 crores in bank credit to commercial sector was considerably lower than the increase of Rs. 1,287 crores last year.

1.25 As a combined result of smaller expansion in bank credit both to Government and to the commercial sector, and a decline in foreign exchange assets of the banking system, there has been a visible reduction in the rate of growth of money supply in the current year. The expansion in money supply amounted to Rs. 337 crores between March 31, 1974 and January 31, 1975 as against Rs. 960 crores witnessed during the corresponding period of 1973-74. There has been sizeable contraction in the currency component of money supply during the current year so far (till January 31, 1975) in contrast to an increase of Rs. 565 crores in the corresponding period of 1973-74.

Balance of Payments

1.26 The steep increase in the prices of imported fuel, food and fertilisers has given rise to renewed pressures on our balance of payments, even though this pressure has so far been contained within manageable limits as a result of significant increase in the value of our exports as well as large borrowing from the IMF.

1.27 According to the customs data, exports during 1973-74 increased by about 26 per cent as compared to 1972-73. On the other hand, the value of total imports recorded a still sharper increase of nearly 56 per cent. As a result, the balance of trade showed a deficit of Rs. 437.7 crores in 1973-74 as compared to a surplus of Rs. 100.3 crores in 1972-73. During the first eight months of 1974-75, the trend towards a faster expansion of imports than that of exports has continued. While exports moved up by 36 per cent, the rise in the value of imports was of the order of 54 per cent, resulting in an adverse trade balance of Rs. 425 crores.

1.28 In February, 1974, India drew Rs. 62.6 crores under the compensatory financing facility of the IMF. In the current year, India has so far drawn Rs. 488 crores from the IMF. The IMF borrowings have to be repaid in the coming 3 to 7 years. This implies that unless India's imports decline in the coming years or exports display a much greater buoyancy than was the case in the past, we shall be faced with a balance of payments problem of unusual severity. In this context, the highest priority needs to be attached to reducing our dependence on imported foodgrains as well as imported oil and fertilisers. In any viable planning for our balance of payments, we must also take note of the continuing weakness of India's export promotion efforts. The recent increase in the value of exports is mostly a consequence of fortuitous circumstances connected with world inflation and the international commodity boom. In volume terms, India's exports in 1973-74 grew no faster than 3.6 per cent and the average annual rate of growth of

export volume in the Fourth Plan period was no higher than 4.2 per cent. With the expected decline in international commodity prices to their more normal levels, India's export earnings may receive a visible setback unless we can revitalise our promotional efforts.

The Year in Retrospect

1.29 1974-75 happened to be the first year of the Fifth Plan. Unfortunately, judging by such criteria as the rate of growth of national income and rate of saving and investment, the economy's performance during this year has been out of line with the expectations underlying the draft Fifth Plan document. This was perhaps inevitable in a year in which the economy experienced not only a considerable shortfall in agricultural output in the kharif season but also received severe external shocks. In view of the acute inflationary pressures, the foremost concern of economic policy was to impart a measure of stability to the economy. Since no viable development strategy could be implemented in the background of steeply rising prices, it was inevitable that longer term goals had to give precedence to the short-term task of economic stabilisation. It would still be premature to assume that the economy was on the threshold of a new era of price stability. Nevertheless, the continuing concern with problems of stability has to be matched by selective stimuli at strategic points, designed to raise the rate of saving and investment in the economy. Unless the economy grows, even price stability in a poor country such as ours will elude us. This is a measure of the challenge that policy planners will have to face in 1975-76.