
Study Topics by Prof BR Shenoy

Students of Economics, Commerce, and other Social Sciences, who have to submit essays in their courses, might find the Study Topics useful. For example, they could use the topic as historical source material (acknowledging BRS and the ERC), restate the argument in their own words, update the statistics, and comment on the changes in the current economic situation.

In fact Dr SS Bhandare did something like this on a different level, in his ERC Lecture on Topic 21 Public Sector Waste (see Events on the ERC website).

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STUDY TOPIC - 1

A NOTE OF DISSENT

on

THE MEMORANDUM OF THE PANEL OF ECONOMISTS

I am unable to subscribe wholly to the views of my colleagues on (1) the Size of the Plan, (2) Deficit **Financing as a means of raising real resources for the Plan, and (3) certain Policy and Institutional** Implication of the Plan Frame. I may set out, briefly, my views on these subjects.

I. SIZE OF THE PLAN

The Plan Frame is built on the basis of a 25 to 27 per cent increase in the national income in five years. The targets of production in the several sectors, which correspond to this rise in income, would require an increase in net investment (or savings) from 6.75 per cent of the national income in 1955-56 to 10.95 per cent in 1960-61. This relationship yielded a figure of a total net investment of Rs.5,600 crores in five years; Rs.3,400 crores of this expenditure would be in the public sector and Rs.2,200 cores in the private sector.

The total developmental outlay corresponding to a net investment of Rs.3,400 crores in the public sector would be Rs.4,300 crores. Adding to this an expenditure of Rs.4,500 crores outside the Plan, the total outlay of the Centre and the States would be Rs.8,800 crores in five years. The Plan Frame proceeds to finance this expenditure in the following manner:-

(Crores of Rupees)

- | | |
|--|-------|
| 1 Revenue and other current Receipts at the current rate of 8.5% of the National income | 5,200 |
|--|-------|

| | | |
|---|--------------|---------|
| 2. Railway surplus | 200 | |
| 3. Loans and Small Savings | 1,000 | |
| 4. Foreign assistance | 400 | |
| 5. Additional taxation, compulsory savings, and higher profits from government enterprises | 800 | - 1,000 |
| 6. Deficit Financing | 1,000 | - 1,200 |
| TOTAL :: | 8,800 | |

If we separate from the above the total developmental outlay on the Plan (Rs.4,300 crores) the resources for the public sector of the Plan would be derived probably as under:-

| | | (Crores of Rupees) |
|-----------------|--|--------------------|
| 1. | Loans and Small Savings | 1,000 |
| 2. | Foreign assistance | 400 |
| 3. | Revenue Surplus on the basis of Revenue Receipts at the current rate of 8.5% of the national income | 900 |
| 4. | Additional taxation, compulsory savings, and higher profits from government enterprises | 800 - 1,000 |
| 5. | Deficit financing | 1,000 - 1,200 |
| TOTAL :: | | 4,300 |

My colleagues have stated that the increase in investment required for the Plan Frame is "fairly ambitious" and they "stress that the effort involved in this increase is considerable, and will strain the economy a very great deal (para.7). Earlier, however, they have observed that "given a determined bid to put forth a maximum measure of effort", the national income objective, which this rate of increase in investment would yield, "can be attained" (para.4). This, to my mind, does not adequately indicate the risks which an Investment attempt on this scale may involve (unless foreign assistance becomes available in an incomparably larger measure than envisaged in the Plan Frame). To force a pace of development in excess of the capacity of the available real resources must necessarily involve uncontrolled inflation. In a democratic community where the masses of the people live close to the margin of subsistence, uncontrolled inflation may prove to be explosive' and might undermine the existing order of society. In such a background one cannot subsidise communism better than through inflationary deficit financing. Probably the greatest enemy of the Kuomintang in China was the printing press. Alternatively, if appropriate "physical -measures", familiar to a communist economy, were adopted (in an effort to prevent inflation) we would be writing off, gradually or rapidly, depending upon the exigencies, of the plan, individual liberty and democratic institutions by administrative or legislative action. We should be therefore, forewarned of the dangers of an over-ambitious plan. A wide gap between targets and achievements as has been hitherto the case with the first plan was a third possibility. This depended, however upon the rigour with which we may resist temptations for inflationary finance, and the pressure to encroach upon the liberty of the individual. Such resistance may prove to be difficult under the natural enthusiasm to reach the target, It may entail, moreover, some wastage incidental to a revision (to match the available resources) of a plan in progress which had been based on a larger blue print.

The Plan Frame begins by prescribing the increase in national income which the Plan would set to achieve. Its authors, then, proceed to find the real resources necessary for the corresponding rate of Investment. In making the national budget, it is permissible to determine expenditure first and then, raise equivalent funds, as the Receipts of the State form but a part of the total national income. The budget can grow by drawing on the rest. This procedure cannot be applied to the budget of a Plan, which embraces the entire monetised saving and investment activity of the nation. Here the availability of real resources must be assessed first and the investment plan must match it. In a communist economy the volume of savings may be made to vary within fair limits by restricting allocations to the consumer trades. Within these limits a communist plan can determine expenditure first, and, then, proceed to find the requisite resources. In a democratic society the scope for variation in savings, which is largely the result of individual choices, is comparatively limited.

The availability of real resources must depend on the reliability of the estimates of saving. Under no circumstances can total net investment (excluding external assistance) exceed the total net savings of the community. Revenue surpluses, surpluses of State business undertakings, loans, ploughing back of profits, deficit financing, credit creation, and so on, are but devices of appropriating the savings of the community for purposes of the Plan. There is no device of creating real resources which are not saved.

A paper on "Capital Formation in India" supplied to the Panel of Economists estimates net domestic capital formation in India, in the recent past, as under:-

Net Domestic Capital Formation in India

| | (1) | (2) | (3) |
|---------|--------------------------------------|--------------------|-------------|
| | (Rs. in Crores) | | |
| | Net Domestic Capital formation | National Income | 1 as % of 2 |
| 1948-49 | 446 | 8,580 | 5.2 |
| 1949-50 | 524 | 9,000 | 5.8 |
| 1950-51 | 589 | 9,500 | 6.2 |
| 1951-52 | 672 | 10,000 | 6.7 |
| 1952-53 | 659 | 9,800 | 6.7 |
| 1953-54 | 719 | 10,500 | 6.8 |

STUDY TOPIC - 2

DEFICIT FINANCING AND INDIAN ECONOMIC DEVELOPMENT

I. DEFINITION OF DEFICIT FINANCING

The term deficit financing has been employed to describe dissimilar concepts. In the United States loan financing to the excess of governmental outlays (including capital expenditure) over revenue receipts is generally referred to as deficit financing. In India we would see no deficit financing when the budget gap is covered by loans. We recognise a budget deficit when current revenues, the proceeds of loans from the public, including commercial banks, small savings, and other receipts and funds at the disposal of the government fall short of, in the aggregate the total disbursements of the government (including capital outlays). The financing of the uncovered gap, by drawing down the cash balances of the government or by borrowing from the Reserve Bank, is called deficit financing in India.

It is important, at the outset, to be clear about the content of the term, as the possibilities and consequences of deficit spending in the U.S. sense cannot be applied, without modifications, to deficit spending in the Indian sense. Such spending would be, for instance, non-inflationary when the loans are subscribed from, and, in any case, do not exceed the genuine savings of the public. It would do no more than substitute public expenditure for private expenditure activate idle savings. On the other hand, deficit financing in the Indian sense would tend to be inflationary as soon as its magnitude exceeded the available resources, including the savings of the public held in the form of cash balances. Much discussion in the U.S. on the potentialities of compensatory governmental spending as a corrective to a slump in private investment seems to relate to the U.S., not the Indian concept of the term. In what follows we shall use the term deficit financing in the Indian sense.

Two modifications, however, would be called for. Reserve Bank subscription to government debt, or conversion into new loans of the redeemable debt held by the Bank are, in effect, concealed government borrowing from the Bank. In the absence of these transactions, the budget gap, and the deficit financing (as defined above) would be larger. Such transactions should be, therefore, added to the budget gaps as shown in the budget statistics to arrive at a correct picture of the deficit financing effected. The same applied to commercial bank subscription to government loans, or conversion of redeemable government loans held by them, as commercial banks may match government debt in their portfolios by created money, their assets and liabilities moving up by the amount of the debt.

II. ANALOGY BETWEEN INDUSTRIAL AND UNDER-DEVELOPED ECONOMIES

A distinction must be made between the problems of unemployment in industrial economies, and the problems of under-employment in under-developed economies. A mistaken analogy between the two has been responsible for much confusion of thought and erroneous policy approach in under-developed economies. In the one case it was a problem of re-instating labour, equipment and the materials of production back again into employment, or of absorbing the natural growth in the labour force into employment. In either case real resources (i.e. savings, whether viewed in financial terms or in terms of their physical counterpart namely, labour, equipment and materials of production) existed in a form which will permit speedy expansion of production when propitious circumstances may reappear. The presumption here is that the overall rate of saving and investment were above the demographic rate or the rate essential to maintain production and per capita income undiminished. The problem was one of devising ways and means of activating savings or re-employing the idle resources of production.

The problem of under-developed countries, such as India, was one of growth from economic stagnation. Savings were low and the rate of investment was, probably, no more than the demographic rate so that in a background of a growing population the standard of living could be maintained only with some difficulty. The problem here was increasing the rate of investment so as to accelerate efficiency and output faster than the population growth. It would be incorrect to suppose that such economies offered abundant domestic resources and that development was merely a matter of providing finance. The only thing abundant was unskilled labour, and, probably also, scope for profitable investment.

But Labour alone cannot increase output. Even the simplest form of investment in the construction of contour bunds roads or minor dams required some capital. The 'shramadan' workers, who may offer their labour free, bring their own food with them and sleep in the open, had still to be equipped with some implements, however simple, and engineers, foremen, and group leaders had to be found to plan, organize and supervise their construction. At some stage there may be need for some little masonry, cement, timber or steel. Such equipment and materials had to be "saved" from some other use or consumption industry. It is not possible to conceive of production without some saving, and inadequacy of savings was among the central problems of under-developed economies.

The remedies suggested for unemployment in industrial countries have varied. In the twenties, the emphasis was on central bank policy, the cyclical slump in investment being sought to be corrected by changes in the volume of money and the rate of interest. The Great Depression led to emphasis on open market operations as the prime lever of policy. Deficit spending was first advocated as a remedy by Keynes in 1934. It was conceived as a logical sequel to central bank policy and the two were to operate in unison for inducing investment, the open market operations functioning via a lowering of the rate of interest and government borrowing acting directly on the idle deposits. The deficit spending

would taper and vanish as the multiplied and cumulative effect of spending produced the necessary leverage and economic activity climbed back to normal. The mechanism, also visualised a budget surplus and reversed open market operations as a stabilising factor in a boom.

The effectiveness of this device in re-vitalising investment activity has been doubted. It would be misleading to stress the analogy between unemployment in industrial countries and under-employment in under-developed countries and seek a solution to the problems of the latter in the remedies prescribed for the former. Deficit spending, with or without the concomitant central bank policy, cannot create savings, though, under certain circumstances. It had a part to play in the economic development of under-developed countries. When, however, on top of the long-term problems of economic development there get super-imposed the problems of cyclical unemployment in the organised sector of under-developed economies, the pump-priming and compensatory spending devices may be of the value to correct such unemployment. Otherwise, the two problems were fundamentally distinct and the remedy applicable to the one may not apply to the other.

III. THE THEORY OF DEFICIT FINANCING

The authors of the Bombay Plan argued that, since created money as only "meant increase the productive capacity of the nation", in the longrun, it would be "of a self-liquidating" character. In fact, as a result of the expanded output, at the end of the 15 years period of the plan, "the general level of prices would, in all probability, be lower than at the beginning of the plan". The problem of inflationary finance was, in the main, believed to be problem of keeping prices within limits, pending completion of the projects. Accordingly they saw no danger in providing 34 per cent of a total finance of Rs.10,000 crores in created money.

The planning Commission would prefer to steer clear of inflation and, with that end would restrict the amount of deficit financing to the releases from the sterling balances. But if inflation should develop, they would rely on physical controls for holding in check the cost of living indices, the underlying concept being, probably, that, once the additional production commenced flowing into the market, inflation would be eliminated.

Some have compared deficit financing for development to war financing. The latter resulted in inflation because it did not yield "an increase in production for current consumption", whereas "deficit financing now of a development plan" would "lead to a compensatory Increase in production" in the future, though, during the intervening period, a price rise was inevitable. But, as had been attempted in time of war, the rise in prices could be held in check by a skillful use of controls and allocations. Such deficit financing; coupled with controls, could be usefully brought into service in the early phase of the plan (Prof. D.R. Gadgil).*

Let us assume that there exists a considerable labour force engaged in agriculture which is under-employed and whose contribution to agricultural output is exceptionally small

and that these marginal workers are transferred to the construction of dams, roads or other investments, the requisite finance being provided by budget deficits. Such transfer, by assumption, would not involve any appreciable diminution in agricultural output. The transferred workers would be paid wages at least at the rate of their earnings in agriculture. As agricultural output had not fallen, the income of those left behind on the farms will not diminish. The total income of the community would, therefore, rise by the wages paid to the transferred workers.

There was always a time lag between investment (whether in the construction of wells, roads, or factories), its completion, and the resulting increase in output. Much economic disturbance may occur during the interval. The currently available supply of consumer goods being unchanged, the rise in money incomes would cause a rise in the prices of consumer goods. The time interval was the crux of the problem and the rise in consumer prices, the starting point of the trouble. Wages being paid by the week or the month, prices will rise immediately upon the commencement of the projects. The price rise will be all pervasive and will not remain confined to the immediate place of location of the projects.

The tempo of inflation would depend upon the magnitude of the deficit financing and will continue with the progress of it. The question arises whether, on the completion of the new investment, the initial inflation would get "liquidated" by the "compensatory" increase in output. Even supposing that, after an interval of one or two years, the new investment adds to production annually an amount equivalent to the investment financed by budget deficits, no such cancelling of inflation is tenable. As a financial counterpart to the increased output, there will simultaneously accrue a corresponding increase in the income of those who, directly or indirectly participated in it. This amounts to the same thing as saying that the initial inflation will have been absorbed by the community in higher prices, higher money wages and profits, and higher cash balances. Short of a process of deflation, there would be no reversal to the initial price level.

It follows that any attempt to continue deficit financing beyond this point, would be inflationary like the initial deficit financing and for the same reasons. A part of the increased income will accrue to the state as taxes, a part may be set aside against depreciation, and a part left after provision for increased consumption, may be saved. The depreciation and the savings would be invested through the usual channels. There would be nothing in the current situation to suggest that the continuance of deficit financing after the new investment comes into production would not be inflationary.

Inflationary financing of economic development through budget deficits would be self-defeating. Its dangers would, probably, manifest earlier in under-developed economies than in industrial economies. The average income of the low-income groups in under-developed economies being close to the margin of subsistence, the inequitable incidence of inflationary finance may prove to be socially explosive. It would tend to produce a pattern of income distribution, contrary to the socialistic. From the standpoint of social security, the incidence of further inflation on the real incomes of the constable* in the Police Forces and of the Jawan in the Defence Services should be borne in mind. This

aspect of the matter must not be dismissed lightly under the thought that dearness allowances would take care of the inequity of inflation. Probably the greatest enemy of the Kuomintang in China was the printing press.

These socio-political considerations apart, inflationary finance would impede economic development by creating other demands on the available real resources. It induces a misdirection of savings and investment in non-essential (luxury) trades to meet the inflationary demand for them, and in real estate, in urban building property, in foreign exchanges and in gold, as a result of the efforts of the savers to protect their savings from rising prices. It may discourage current savings, when, as in India, the rate of interest was kept artificially low. In the sphere of external payments, inflation accentuated the payments difficulties especially when the exchange rate was rigid. It produced a pressure for imports of consumer goods or of materials and equipment for the production of consumer goods, and reduced exports.

IV. PRICE CONTROLS AND ECONOMIC DEVELOPMENT

The question arises whether these distortions and wastages may be successfully held in abeyance by a skillful use of controls. As our own experience and the post war experience of a number of other countries had shown, tightening of import restrictions was no remedy to the payments pressures caused by inflation. The inflationary purchasing power, when denied of import goods, worked on exports. Exports declined and the payments problem persisted.

Price controls may not be effective, as it is not legitimate to expect that a people in want could be induced or coerced not to spend the money put into their pockets. Inflation was all pervasive. If the flow of money in one sector of the economy was restricted by price controls and rationing—the question of the success of such measures apart—the flow of money in other sectors, where no such restrictions prevailed, will increase and there will result a compensatory rise in prices in these other sectors. The general price-level would thus reflect the inflationary pressures. Controls, if successful, will have affected only relative prices.

It has been argued that if "the supply and distribution of foodgrains, and other essential commodities, such as cloth and gur or sugar, could be so organized as to meet the minimum requirements of the population", the dangers of deficit financing would be correspondingly mitigated. If, as a result of these measures, the impact of the larger money incomes fell on non-essential commodities "which matter less from the point of view of the cost of living" of the masses (Planning Commission Report, P.61), this was a matter of relative indifference from the wider social standpoint as only a minority of the well-to-do were thereby affected.

Actually, however, things may work out differently. Under the stress of reduced profits, the output of the essential commodities, the prices of which were controlled, would decline and scarcities will increase; on the other hand, the output of non-essentials, where

higher profits would prevail, would increase. This would defeat the purpose of controls. The control of the prices of foodgrains and of a few other commodities of popular consumption cannot control the cost of living in general. For this, it was necessary that the bulk or the whole of the consumer goods entering into the index should be subjected to control. These considerations, together with the problems of black markets, which will emerge under ineffective controls, would suggest an extension of controls over the entire consumption sector. But this would raise, in a vast country like India, stupendous administrative problems and would involve a diversion of personnel, greatly needed for implementing development, into administering the complex machinery of controls. Even so, the cause of economic development will not be advanced, as price and exchange controls do not create savings. Price controls and rationing are merely a device of distributing equitably scarce commodities, such equity, however, depending upon controls and rationing being nation-wide.

It is, no doubt, possible, to increase savings and investment by a squeeze, through allocations, of the supply of equipment and materials to the consumption trades. But, under the urge of efficiency and of the necessity to avoid waste, this must soon lead to regimentation of the entire economy, universal controls and allocations. The resulting organization of the economy would be indistinguishable from communism.

Inflation appeared when development was carried out in the face of a serious shortage of resources, and controls were no remedy to the situation. Controls cannot make up for an overall shortage of real resources. Whatever may be the importance of controls in a war-time emergency, it was unsuited for long-term economic development. The problem confronting India was not a problem of a sudden spurt of large investment for a year or two, but a programme of expansion extending over a generation or more. As a practical matter, a people in what cannot be expected meekly to suffer the hardships of rationing and price controls for prolonged or indefinite periods. The essence of the matter was that a people as a whole cannot be compelled to save, by the monetary device, more than what they were willing to do voluntarily. The situation was different under communism. There the approach was physical. as distinguished from the monetary and free-enterprise approach. Resources required for development were acquired by regimentation and the reduced output of consumer goods, which would ensue, was rationed out. Regimentation decided, in advance, how much will be saved, not individual choices. Serious difficulties arise when we attempt to mix these two approaches.

V. NON INFLATIONARY DEFICIT FINANCING

This is not to say that there was no room whatever for deficit financing. In fact, deficit financing in a certain measure, depending upon circumstances. may be essential for economic stability in under-developed, as in industrial countries. In the absence of such financing, there may set in unemployment and a reduction in output. But it would not cause inflation. It would do no more than provide the appropriate money supply to finance a growing output at stable prices. The first essential for successful non-inflationary deficit financing was the absence of inflationary pressures. Deficit financing

in any measure would aggravate economic instability if inflationary pressures already prevailed. Given a stable economic background, there may exist scope for two types of non-inflationary deficit financing. An example of the first was the purchase, by the Government of India against its Cash Balances, of sterling from the Reserve Bank to finance imports of equipment for the public sector of the Plan. The assets and liabilities of the Reserves Bank would decline by the amount of the sterling purchased, and the volume of money in circulation would remain unaffected. If sterling was purchased against ad hoc Treasury Bills (as was done, in another context, in July 1948) the effect would be the same, except that there would be, then, no change in the assets and liabilities of the Bank. Deficit financing (as represented by the drawing down of the Cash Balances) would match the payments deficits (as represented by the drawing down of the sterling resources). It would be non-inflationary.

When payments deficits originate in the private sector, sterling in the reserves will be paid for by equivalent funds with the public. This did not, however, always involve deflation. In the early post-war years such transactions may represent a cancelling out of the forces of latent inflation. Sterling may be acquired against the 'excess wealth' of the community held as reserves for expansion by private industrial firms, or against excess liquidity, both being the legacy of the war. The volume of money in circulation would be unaffected. But the economy would have grown in stability by the wiping out of latent inflation. To engage in deficit financing to the extent of such payments deficits would be clearly inflationary (as this would add to the monetary circulation).

Ordinarily, when investment in the private sector are financed from current savings, the foreign exchange required for such investments should be available either as a result of increased exports or reduced imports made possible by the saving activity. But situation may arise when exchange reserves may have to be drawn upon for the use of the private sector. To the extent of such purchase, there would be room for credit creation by the commercial banks in favour of the industry requiring external finance. In such a situation the necessary money supply (to finance increased output at stable prices) having been already created, it would be inflationary for the state to engage in equivalent deficit financing. Deficit financing would be inflationary, too, when the payments deficits resulted from crop failures, natural calamities or inflationary pressure. It is, thus, not possible to lay down a general rule that deficit financing may be safely resorted to the extent of the payments deficits without fear of inflationary consequences. This depended upon where the deficit originated and the causes of it.

The Planning Commission, "so far as it is possible to visualise now", has placed the "safe upper limit to deficit financing" (The First Five Year Plan, p.61) over the five year period at Rs. 290 crores, the amount of the releases from India's sterling balances. The discussion above would seem to suggest that, if deficit financing must be noninflationary, this figure would have to be adjusted to match that part of the releases which would be utilised for the public sector. For the rest, finance would have to be provided by the Commercial banks in the form of credit created in favour of private enterprise.

Deficit financing and credit creation do not bring into existence real resources which are not there. They are only a device of acquiring the resources which exist in the economy somewhere. The question of deficit financing and the question of credit creation by the banks related, in the present context, to the question of who will gain possession of the foreign exchange reserves. When the latter are used for the public sector, deficit financing would take place, and when used by the private sector, banks would create credit.

The second type of non-inflationary deficit financing is that indicated by the Bernstein Fund Mission Report and relates to the cash balances of the public. Here the purpose is to mobilise, for economic development, real resources (savings) held by the public in the form of cash balances.

As production, employment and income would grow, the community will require a gradual increase in the money supply. This would be at least in proportion to the increase in production plus the amounts that may be required as the self-contained village economies produced more and more for the market and cash transactions took the place of barter. Viewing the phenomenon from the side of the individual, an individual's total real income would be exchanged, a part for consumption, a part for saving, and a part for cash balances. If money supply did not keep pace with this demand, deflation may well result. Precisely because of the shortage of real resources in under-developed economies, it was important to ensure that economic development, for which real resources existed, was not impeded by lack of finance. The finance for acquiring the real resources represented by the cash balances may be provided through deficit financing. But precisely because of these considerations such deficit financing should stop severely short of inflation. As in the case of the use of sterling reserves, part of the real resources represented by the cash balances of the public would be appropriated by the private sector; the necessary finance would be, then, provided by the commercial banks. As individual real incomes increased, the cash balances tended to grow and the scope for credit creation or deficit financing would increase as well.

With the increased investment activity of the state and the relative expansion of the public sector, the volume of deficit financing to match the cash balance resources, invested in state undertakings, would have to grow. But it is difficult to assess the exact amount of the deficit financing permissible under this head. This will depend upon the rate of growth of output and the preference of the public for cash balances. As in the case of credit creation by the banking system, the amount is a matter of judgement. The paramount consideration, however, should be that the total of the bank credit and the deficit financing do not exceed the real resources equivalent to the cash balances. Any excess creation of money would lead to inflation, which would be self-defeating as it would adversely react on the preference of the public for cash balances, besides affecting the availability of real resources from other sources.

While the two categories of non-inflationary deficit financing may be easily defined, there is no formula by which we may determine the safe or the necessary amount of deficit financing that may be undertaken in the near future. This is a matter of judgement,

the appropriate magnitude being arrived at through trial and error. The rate of increase in the Indian national output and the cash balance habits of the community, which together would determine the safe amount of deficit financing, are not themselves statistically precise magnitudes. We do not have a comprehensive production index, and the changes in the liquidity preference of the community are a matter for conjecture. It is possible, however, to indicate the order of magnitudes involved. The Bernstein Fund Mission estimated non-inflationary deficit financing together with credit creation by the banking system as balancing the increase in the cash balance requirements of the public at Rs.33-1/3 crores per year for the last three years of the First Five Year Plan. Assuming constant prices, we may place it at a round figure of Rs.35-40 crores per annum for the next Five Year Plan. Though this is only a conjecture, it reflects safe enough magnitudes for a budget of the Plan. What part of this amount would constitute deficit financing and what part credit creation by the banking system, would depend upon the ratio in which the increase in the cash balance real resources of the public would be divided between the public and the private sectors.

To the amount of the deficit financing under this head must be added the sterling releases acquired for the public sector to arrive at the total figure of the deficit financing that might be safely undertaken. The total amount of the sterling releases during the five-year period has been placed at Rs.100-150 crores by the Plan Frame. Part of this would have to be allocated to the private sector and will be matched by equivalent credit creation by the banking system. If we may assume a division of the cash balances resources and the sterling releases between the public and the private sectors, respectively, in the ratio of 2:1, the order of magnitude of the aggregate deficit financing would be Rs.180-235 crores for the five years, or an annual rate of Rs.35-47 crores.

VI. DEFICIT FINANCING AND THE RECENT FALL IN AGRICULTURAL PRICES

The sharp fall in agricultural prices during the past one year (the agricultural price index declining from 382 in 1953-54 to 301 at the close of February 1955) has raised the question whether the dangers of deficit financing and credit creation are not now merely academic talk. In the view of the Planning Commission, the criterion of the "scope for deficit financing at any particular time" rests in "the trends in the cost of living indices". The theory is that when the "costs of living are high, increased purchasing power injected into the system is apt to lead to increased demand for the basic commodities of consumption and push up costs of living still further" (First Five Year Plan, p.61). By implication, when the cost of living indices take a down-turn, this may be deemed a safe enough signal for deficit financing. If the amount of deficit financing is appropriately adjusted, increased investment and production will have been financed without inflationary consequences and the community will have, besides, the advantages of economic and price stability. Though the cost of living indices do not reflect the sharp fall in agricultural prices, and in some of the larger cities the index is more or less steady,

the over-all trend of the urban cost of living as indicated by the all-India index shows a down-trend from 102 in April 1954 to 97 in December 1954.

The prevailing price situation in India generally was a complex one and there was need for caution against too ready acceptance of the view that a solution may be found in fiscal or monetary measures. The fall in agricultural prices was by no means universal or uniform. It was heaviest in pulses, cereals and gur, among foodgrains, in oilseeds, among industrial raw materials and in blackpepper, among the miscellaneous group. Some agricultural prices, e.g. tea, coffee, raw hides and lac, which were export goods, and raw jute, among import goods, had risen almost as high as some other agricultural prices had fallen. The prices of manufactures were comparatively steady. Relatively to February 1954 the index in the last week of February 1955 recorded an increase of 1.8 per cent. In a background of dissimilar movements of prices even among major commodities, it may not be safe to apply simple monetary remedies. The effect of changes in money supply being all pervasive, there may ensue contrary consequences and the net overall price situation that may result from the monetary measures that may be adopted may not be less complex and difficult than the initial price situation. As an upward price movement might disturb the international price relationships of commodities, this may present new export problems. Our cost structure may also go out of equilibrium with the cost structure of competing countries, if the cost of living index, which was already high, should move higher as a result of currency expansion.

In the case of oilseeds, oil and cotton, the fall in prices is related to the International price trends and an artificial price rise in India might, add to the export difficulties of these commodities, especially under a rigid exchange rate which needed to be adjusted for past inflation. In the case of some other commodities, principally cereals, pulses and gur, the fall in prices may be due to the output exceeding the capacity of the domestic market either because of favourable seasonal factors or as reflecting the various measures of agricultural improvements. In the case of some foodgrains this presented a complicated problem, both immediate and long-term, and a solution may lie in permitting export of the surpluses over home needs. In the case of some commodities, their special situation may call for a policy of temporary price support. Price support policies, however, had to be formulated with great caution as they often led economies down a slippery inclined plane of inflation. The problems confronting individual commodities needed close study.

This is not to say that deficit financing had no part whatever to play towards a solution of the price problem. When agricultural output increases, even as output in the other sectors of the economy may increase, the total real income of the community will increase. If there was no relative over-production, the increased output would be marketed at current prices either in the home or in foreign markets. Part of the increase in real income will be consumed, part will be saved and invested, and a part will be held in the form of larger cash balances than hitherto. The increased output corresponding to the larger cash balances (or the equivalent real resources obtained from the home or foreign markets in exchange for the output) may be matched by deficit financing or by credit creation. This would prevent a general fall in prices and, therefore, a fall in agricultural prices, which may otherwise ensue from an increase in total output. But deficit financing of economic

development was no solution to price problems resulting from individual over-production, export difficulties attributable to quality and domestic costs, or exchange over-valuation. It may aggravate the difficulties confronting these commodities. A price decline in one sector of the economy was no indication that the flow of savings was being accelerated. It provided no excuse for a speeding up of the programmes of economic development. This analysis indicated the importance of economic rationalisation, designed to ensure that the major economic variables were harmoniously related to one another.

VII. DEFICIT FINANCING OF THE RECENT PAST

The question arises whether the deficit financing effected in recent years was inflationary or non-inflationary. The total deficit financing from 15 August 1947 to 31 March 1954 amounted to Rs.681 crores. About Rs.252 crores of this amount represented the purchase of sterling from the Reserve Bank against ad hoc Treasury Bills and did not involve the issue of money in circulation. Excluding this sum and allowance being made for the variations in the public debt holdings of scheduled banks, the net deficit financing of the period averaged about Rs.50 crores per annum.

The following statistics reveal the inflationary impact of this deficit financing.

Deficit Financing, Prices and Money Supply

(Rupees Crores)

| Year | Budget Deficit(-) or Surplus(+) | Government debt with R.B.I. (Increase -, Decrease +) | Deficit Financing | Money Supply | Whole sale Price Index (August 1939=100) |
|---------|--|--|----------------------|-----------------|--|
| 1947-48 | -110.68 | -51.49 | -162.17 | 19.65* | 308.2 |
| 1948-49 | - 81.67 | -65.99 | -147.66 | 18.84 | 376.2 |
| 1949-50 | - 43.80 | -22.52 | -66.32 | 18.65 | 385.4 |
| 1950-51 | +12.44 | -69.89 | -57.45 | 18.34 | 409.7 |
| 1951-52 | +0.91 | +19.10 | +20.01 | 17.73 | 434.6 |
| 1952-53 | - 63.54 | +20.75 | -42.79 | 16.83 | 380.6 |
| 1953-54 | - 48.29 | +58.48 | +10.19 | 17.15 | 397.5 |

* Estimated.

Between 1947-48 and 1953-54, the wholesale Price Index rose from 308 in the former year to 435 in 1951-52 and stood at 398 in 1953-54. Part of the rise in the Index may be due to the activation of latent Inflation. But its effect could not have lasted beyond the early part of this period. The amount of the latent inflation in India was, in any case, small. It is significant that, notwithstanding the moderate amount of the deficit financing, prices continued to rise until 1951-52 and were about 29 per cent higher at the end of the

period relatively to the beginning of the period. This experience lends support to our estimate of the safe magnitude of the deficit financing for the next Five Year Plan.

VIII. CONCLUSIONS

The conclusions emerging from this discussion may be briefly indicated:-

The problems of under-employment in under-developed economies differed, in fundamental respects, from the problems of unemployment in industrial economies. Deficit spending in the sense, principally, of loan financing of revenue deficits, may be a remedy in the case of the latter. Deficit financing, in the sense of central bank financing of budget deficits, was only of limited applicability in the case of the former. To stress the analogy between the two economies would be misleading. The problem of the under-developed economies was a problem of a shortage of real resources for which inflationary credit creation was no substitute.

An estimate of the availability of real resources for economic development depended upon the reliability of the estimates of domestic savings and of the flow of foreign savings. Such an estimate was essential as a guide to policy.

The concept of the initial inflationary impact of deficit financing being "liquidated" by a "compensatory" increase in output, resulting on the maturity of the investment was not economically tenable, as the increase in the output would simultaneously create a commensurate increase in money incomes. Short of deflation, there was no question of a reversal of prices to the original level.

A time lag between investment and the resulting increase in output was the crux of the problem.

Price controls and rationing were not a reliable device of preventing a price rise, resulting from inflationary deficit financing. Price controls may aggravate the problem of scarcity through shifting resources from essential trades to non-essential trades. Price controls and rationing did not create savings. Inflationary finance of economic development through deficit budgets was self-defeating. On balance, such finance impeded overall economic development through the distortion and wastages it produced. Net deficit financing since Independence, which averaged about Rs.50 crores per annum, was inflationary in character. The scope for deficit financing was limited by the amounts of the sterling reserves, which may be appropriated for the public sector. Deficit financing to match all other cases of payments deficits would be inflationary. The second type of non-inflationary deficit financing related to the appropriation of the real resources represented by the cash balances of the public. Here also only a part of the resources could be acquired for the public sector by deficit financing. As in the case of the sterling releases, the other part had to be left for the use of the private sector, the necessary finance in the latter case being provided by the commercial banks.

Deficit financing, whether of the first type or of the second, did not create real resources. It was only a device of acquiring real resources which existed in the economy somewhere. The order of magnitude of the non-inflationary deficit financing in the prevailing Indian context was Rs.180-235 crores for the five year, or Rs.35-47 crores per year.

The character of the recent price trends, of which a sharp fall in the prices of some agricultural commodities was a dominant feature, did not indicate deficit financing as a remedy. The cases of individual groups of commodities had to be examined separately. Deficit financing was no solution to export difficulties, to exchange over-valuation, or to relative overproduction.

Economic rationalisation to ensure that the major economic variables were harmoniously related to one another, was an essential preliminary to a plan of economic development.

Summary

The term deficit financing has been used in this paper in the Indian sense of covering overall budget deficits by drawing down the cash balances of the government or by borrowing from the Reserve Bank, and not in the Western sense of loan financing of the deficits. Allowance, however, must be made for the variations in the government debt held by the Reserve Bank and by the commercial banks to arrive at a correct measure of the total net deficit financing effected.

The scope for economic development of under-developed economies through deficit spending is limited. A distinction must be made between the problems of unemployment in industrial economies and the problems of underemployment in underdeveloped economies. A mistaken analogy between the two has been responsible for much confusion of thought and erroneous policy approach in under-developed economies. In the case of industrial economies, it was a question of mobilising savings which lie idle; in the case of under-developed economies, it was a question of scarcity of savings. Deficit financing cannot create real resources. Under certain circumstances, it may help to mobilise such resources. The value of deficit financing lies in preventing deflation or unemployment of real resources. Under-employment in under-developed economies was conceivably a result of investment falling short of the demographic rate. Production was not possible with labour alone. Under-developed economies had a shortage of all the needs of production other than unskilled labour. Unemployment in industrial economies, by contrast, co-existed with unemployment of the complementary real resources of production.

The theory of deficit financing for economic development of under-developed economies seems to be that, when the increased production was ready for the market, the initial inflation would get eliminated. The problem of deficit financing was, thus, believed to be merely a problem of preventing an undue price rise during the intervening period.

But there was always a time lag between investment, its completion, and the resulting increase in output. Much economic disturbance may occur during the interval. As wages would be paid by the week or the month, the rise in the prices of consumer goods will probably take place almost immediately. The time Interval was the crux of the problem and the rise in consumer prices the starting point of the trouble. It would be incorrect to suppose that inflation would be "liquidated" when the "compensatory" increase in the output becomes available on the completion of the investment. The increase in the output will be accompanied by an increase in income, the financial counter-part of increased production. This is the same thing as saying that the initial inflation will have been absorbed by higher wages and prices, and, short of a process of deflation, there would be no reversal to the earlier price level.

Inflationary financing of economic development (through deficit budgets) would be self-defeating. It would affect adversely the availability of real resources for economic development from other sources as a result of misdirection of Investment in non-essential trades and real estate, and misdirection of savings in foreign exchange and in gold hoards. The pattern of distribution of income would tend to be away from the socialistic pattern.

The consequences of inflation cannot be bottled up by price controls. To think so is to expect that a people in want could be induced or coerced not to spend the money put into their pockets. Controls do not create savings. Price controls and rationing are merely a device for an equitable distribution of scarce consumer goods.

This is not to say that no scope exists for deficit financing. In fact, some deficit financing may be essential for economic growth with stability. In under-developed economies the necessity for deficit financing was, underlined by the urgency that the limited supply of real resources had to be put to their best use. But, precisely because of the scarcity of real resources, such deficit financing must stop severely short of inflation, as inflation will affect the overall availability of real resources for economic development.

Non-inflationary deficit financing was of two types. The first was represented by the purchase, by the Government of India, against its cash balances, of sterling from the Reserve Bank for use in the public sector. Here we have a case of payments deficits originating in the public sector being balanced by equivalent budget deficits. When, however, payments deficits originated in the private sector, it would not be legitimate to match them by budget deficits; such payments deficits will have been already matched by equivalent creation of bank credit. To engage in deficit financing equivalent to the payments deficits originating in the private sector would be clearly inflationary. The same applied to payments, deficits resulting from crop failures and inflationary pressures. Contrary to the widely held belief, it was thus not safe to engage in deficit financing to match all situations of payments deficit. Its safety depended on where the deficits originated and how they originated

The second type of non-inflationary deficit financing was that indicated by the Bernstein Fund Mission Report and related to the cash balances of the public. The demand for money increased together with, and at least in proportion to, the increase in output. Such increase in the cash balances represented savings, the equivalent real resources being

present In the economy somewhere These resources may be appropriated, by credit creation or by deficit financing. To the extent they may be acquired for the public sector, there would exist room (or equivalent deficit financing.)

The total non-inflationary deficit financing would be, thus. limited to the sterling reserves and the cash balance resources acquired for the public sector. The order of magnitude may be Rs.180-235 crores for the five-year period. or Rs.35-47 crores per year.

The fall in the prices of agricultural commodities during the past one year presents a difficult price problem. The prevailing price situation is a complex one and there was need for caution against too ready acceptance of the view that a solution may be found in fiscal measures. The price decline is neither universal nor uniform. The prices of some major commodities have moved in opposite directions. The cost of living index has declined only slightly, by comparison. The problems of the commodities affected need individual consideration. Adoption of simple monetary measures would aggravate the problem of export commodities, the world prices of which have fallen. especially in the context of a rigid exchange rate. Monetary measures, the effects of which were all pervasive, were no solution to relative over-production. Some limited scope, however, may exist for deficit financing of the second type examined above.

The question of whether a given amount of deficit financing was inflationary had to be judged by reference to the credit created by the Reserve Bank and by the commercial banks, in relation to the rate of increase in investment and output. The availability data indicated that the net deficit financing of recent years. Though it averaged only about Rs.50 crores per year, had been inflationary. This experience lends support to our estimate of the sale order of magnitude of deficit financing.

STUDY TOPIC - 3

SUPPLEMENTARY NOTE TO THE NOTE BY THE PANEL OF ECONOMISTS*

I am unable wholly to agree with my colleagues on certain major issues, relating to the assessment of the prevailing economic situation and the policy recommendations of the Note of the Panel of Economists dated 24 January 1958. I may state them briefly.

The stresses and strains through which the Indian economy is passing are, in the main, the outcome of our own policies of the recent past. They are not the result of economic growth. The crucial year from this standpoint is 1955-56.

I. Rise in Prices

The rise in prices, which began in 1955-56, is, mainly, an inflationary price rise. It does not reflect economic development. Economic development need not cause a price rise. The Indian economy developed at an annual rate of 3.5 per cent during the First Plan. But there was no price rise during the major part of the plan period. Prices began to rise when investment exceeded savings and was financed by inflation.

The inflationary situation is a serious one. The General Index rose, since May 1955, at an annual rate of 13 per cent, food-grains at an annual rate of 26 per cent and the working class cost of living at an annual rate of 10 per cent. Viewing this phenomenon yearwise, there has been a slowing down in the rate of increase in 1956-57 and since August 1957 there has been a welcome decline in prices.

II. Prices and Payments Deficits

The slowing down and the decline are by no means evidence of a weakening of the underlying inflationary forces. These forces have, in fact, been gathering momentum since 1955-56. Of the three monetary taps, the budget tap and the bank credit tap have been running freely—the flow of money from them moving up each year, though, during the first eight months of 1957-58, bank credit declined by Rs.60 crores as against an increase of Rs. 5 crores during the corresponding part of last year.

But the rate of increase in money supply with the public has slowed down since 1956-57 and with it, prices, first, slowed down and, later, declined. This is no indication that the increase in the flow of money from the taps has not had their usual inflationary effect. The slowing down of money supply and prices is due to the fact that since April 1956

there has come into operation a suction pump—the balance of payments deficits. The expansionary issue of money has been withdrawn from circulation through its conversion into foreign exchange at the Reserve Bank. This amounted to Rs.280 crores in 1956-57 and the annual rate of it, in 1957-58, was Rs.370 crores.

To continue the analogy, the suction pump is operating on a battery and the current in it is fast running out. The surplus reserve to-day are about Rs.220 crores and, at the recent rate of drain, may not last for longer than another six to eight months. This is a serious position of the first magnitude.

Under these conditions, it is a matter of paramount importance that the monetary taps are closed right away. I am unable to agree with my colleagues that, immediately, there is any room whatever for further deficit financing. Inflation cannot be contained by controls. The only sure protection against it is a prevention of it.

III. Size of the Plan

This raises the important question of the magnitude of investment during the remaining three years of the plan. I am unable to agree with my colleagues that during the five year period an investment of Rs.4,800 crores (Rs.4,350 crores at 1952-53 prices) is feasible. The gap in internal and external resources is too large to permit this. In view of the importance of avoiding further deficit financing, year to year adjustment in the plan is necessary and the volume of investment should be rigorously limited to the available resources.

The scarcity of rupee finance and of foreign exchange are but manifestations of the savings gap in the plan. Our troubles are mainly due to our effort to cover the savings gap by inflation. The savings gap in the public sector is much wider than budget statistics may indicate at first sight. The subscriptions to public debt and Small Savings since 1955-56 represent a return to the government of the inflationary funds issued into circulation through budget deficits, the purchase of Government debt by the banking system, and commercial bank credit creation. It did not represent the genuine savings of the community. Investment of these funds is inflationary.

IV. Fall in Savings

Since 1955-56 the savings of the community do not seem to have gone up. This is evidenced by the increasing consumer goods bias of domestic production. Though the imports of consumer goods have been severely restricted, the imports of "Materials Chiefly for (the manufacture of) Consumer Goods" rose from Rs.358 crores in 1955-56 to Rs.1,032 crores in 1956-57 a jump of 2.9 times. We have here a case of, so to speak, rations being carried to this side of the frontier for cooking because of import restrictions. Notwithstanding severe cuts in the imports of consumer goods, increased consumption has been, thus, taking place at the expense of capital formation. This is an inevitable

offshoot of inflation and may be, partly, also the outcome of the increase in the consumer bias of the possible change in income distribution. During the past two years domestic investment has been sustained at a high level, not through an increase in savings, but by drawing on our past savings (the currency reserves) and, partly, foreign aid. The currency reserve content of our investments during these years, as a ratio of current savings, has been quite considerable. The possible decline in the flow of savings merits serious thought.

The need to restrict investments in the public as well as the private sectors to the available genuine savings was never greater than to-day. The question of saving the "core" of the plan is linked up with the availability of rupee finance domestic savings-and foreign aid. Domestic savings being small, the pace of acceleration of economic development would be determined by foreign aid.

V. Foreign Exchange Scarcity

The amount of foreign aid required to fulfil the Plan what is described as the foreign exchange "gap". The plan cannot be fulfilled without covering the savings gap. The amount of the foreign aid, therefore, should be equal to the savings gap-which may be placed at an order of magnitude of Rs.1,700-Rs.2,000 crores (for the public and the private sectors together) for the remaining three years of the Plan.

The prevailing foreign exchange scarcity cannot be remedied by intensified import restrictions. This "remedy" might prove to be worse than the disease, as curtailment of the supplies of raw materials and capital goods must impinge on production, employment and national income. The scarcity cannot be remedied except through control of inflation.

India's payments difficulties are primarily a problem of moving sufficient exports to pay for our import needs. While export promotion measures are important-and much scope exists for such measures-in seeking a solution to this problem, we have to take note of four important factors: (i) the low level of our exports relatively to pre-war, (ii) the large gap between the internal and external prices of gold, (iii) the gap of about the same magnitude, on an average, between landed costs and market prices of import goods for which free internal markets exist, and (iv) the rapid progress of the rest of the world towards de facto convertibility. Exchange control leakages to-day apply to our dollar trade, which is about 18 per cent of our total trade. If a premium should appear on sterling as well in terms of 'rupees in the free foreign exchange markets of the world, these leakages may apply to about 70 per cent of our trade. This would render continuance of exchange control difficult as the official gap in foreign exchange will increase and soon exhaust our reserves.

VI. Controls

I am unable to agree with my colleagues that the savings gap can be covered by controls. The gap being so large, it is not possible to cover it and at the same time leave untouched the basic human economic freedoms, namely, freedom of disposal over one's income between spending and saving and the freedom to pursue freely one's freely chosen occupation. Savings can be increased only through taking over from the pricing system the control over the allocation of resources and over the production and distribution of consumer goods. Planning which involved controls of this character and magnitude is close to, if not identical with, total planning. I believe, planning in India would be consistent with democracy.

It is not, however, necessary to make short work of the heritage of human freedom to overcome the stresses and strains through which we are passing. A reshaping of our policies on the lines I have indicated will, in due course, enable a rate of progress, probably, larger than under the First Plan.

VII. Deferred Payments

The principal problem of the Indian economic situation, being a shortage of savings, any inflow of foreign capital, if the terms on which it is made available are not onerous, should be welcomed. Regarding the reasonableness of the terms, businessmen and industrialists in the private sector should be good enough judges, as they cannot be expected, ordinarily, to engage in transactions which may not be worthwhile from the business and industrial standpoint. As foreign capital would add to output, the increase in output should be able to provide the wherewithal for repayment of interest and capital. It would, therefore, appear that there was no necessity to place undue obstacles on deferred payments agreements by the private sector. If they should add to the burden of payments in the future, the increased output they would bring about should provide the necessary increase in exports and the foreign exchange finance to meet the accumulated payments.

VIII. Food Policy

The problem of price stabilisation of agricultural produce is a problem of preventing an undue fall in agricultural prices to the detriment of the farmers. The prevailing situation being one of a price-rise, the problem of an undue price decline may arise only in the future. The Foodgrains Stabilisation Organisation proposed by the Ashok Mehta Committee, may not be able to meet the problem of the prevailing price-rise. The rise in prices, being primarily an out-come of inflation, to correct it we have, firstly, to put a stop to inflation and, secondly, import sufficient foodgrains to cover the gap in supplies which has resulted from past inflation. For the application of these correctives it is not necessary to "socialise" the wholesale trade of the country. It is exceedingly doubtful if the proposed monopoly set up would amount to any lesser distribution cost to the economy than the cost of the present machinery of the wholesale trade. We cannot be too sure that

the farmers, in the long run, may expect a better deal from a mammoth monopolistic buyer than from a free market. In a closely integrated modern economy, control of foodgrain prices would necessitate control of the prices of the conjuncturally related consumer and producer goods. The Foodgrains Enquiry Committee has recognised this eventuality. The example of Canada, Italy and Japan in the matter of State intervention of the trade in wheat and rice and of U.S.A. in the matter of price support of agricultural produce are little justification for the colossal undertaking, which socialisation of the wholesale trade in foodgrains would involve in India. In their case, the commodities concerned account for but a small fraction of their national incomes. They can well afford their hobby. In India, by contrast, foodgrains occupy a large sector of the national economy, and we cannot get away with the mishaps that may attend control over the working of the food economy. The venture may prove to be perilous.

STUDY TOPIC - 4

INFLATION, CAUSES, CONSEQUENCES & CURE*

What is the explanation for the current phase of the price rise, which began in May 1955, and for the current worsening of the price situation, which began in April 1962? The official explanation for the current phase of the price rise is that it is the natural and inevitable outcome of economic development. A more dangerous and misleading economic untruth-it has neither logical nor empirical support-was not spoken.

Recent experience of a number of countries, Canada, West Germany, Italy and Japan among them, and, to some extent, our own experience, demonstrates that the official thesis has no empirical support whatsoever. From 1953 to 1959, West German national income rose at an annual rate of over 12 percent. And yet, prices in Germany rose only by about 1 per cent per year during the same period. The Japanese national income rose at an annual rate of 12.3 per cent, probably, a world record for a sustained rise at this high rate. But the Japanese price index showed a rise of only 2 per cent over the whole period. The Italian experience is no less impressive. Though the Italian national income over the six-year period went up by 49 per cent, prices fell, instead of rising, by 1 per cent. Far from economic progress generating inflation, in the post-war world generally, rapidity of development has been in proportion to the achievement of monetary and fiscal stability.

Indian experience, too, seems to indicate the absence of any relationship between inflation and accelerated economic development. During the first four years of the First Plan, Indian national income grew at an annual rate of 3.6 per cent. This was accompanied by a price fall of about 14 per cent. During the five years ending 1959-60, Indian national income rose at a much slower annual pace of 3.0 per cent, but prices went up by about 32 per cent. If the official view had a rational basis, prices should have risen in the earlier years as well and at a rate higher than in the later years.

Economic development, even like the growth of an infant into manhood, is not a disease to cause an inflationary upset. Development must be a weird phenomenon, indeed, if, as it progresses, the fixed and sticky-money-income groups - the masses of the people - must suffer their real incomes to fall continually for the benefit of the upper income groups, traders, businessmen and industrialists, a fraction of the community. And yet this is what would happen, if prices must rise with development.

The fact of the matter is that prices rise not because of development but from the futile attempt to invest non-existent resources. This provides almost the sole explanation for the price rise of 42 per cent, during 1957-1962 period. When plan investments far exceeded

the available resources, the relationship between over investment and inflation is easily seen.

When Plan outlays are balanced by savings, the moneys issued out through such outlays would be flowing into Plan outlays. We have then a simple case of moneys being taken out of the pockets of the savers and put into another set of pockets, the recipients of the plan outlays. These transactions would leave the monetary circulation unaffected.

The same would apply when the investments are financed from past savings, held as currency reserves. When the reserves are drawn upon to pay for the import requirements of public sector enterprises, finance of the transaction would take the form of deficit financing by the Government of India-foreign exchange documents appropriated for the public sector will be replaced by equivalent treasury bills in the assets of the Reserve Bank. No issue of money into circulation will take place. When the reserves are drawn upon for use in the private sector, the transaction would be financed either from hoarded savings -idle cash, bank deposits or an investment asset, say, Government debt - or by credit creation by Commercial banks in favour of the private sector firms, which claim the currency reserves to pay for their import requirements. Here, hoarded savings or created commercial bank money would be exchanged for the foreign exchange asset of the Reserve Bank. The transaction would not add to the monetary circulation.

The same would apply, too, when investments are financed by imported savings (foreign aid). Foreign exchange representing foreign aid would accrue to the Reserve Bank of India, as, in terms of the Foreign Exchange Regulation Act, 1947, on which exchange control is based, all foreign ex-change accruing to Indian national, must be surrendered to the Bank, the latter paying, to the recipients for foreign exchange, the equivalent in Indian money. This applies to all foreign aid, whether for use in the public or the private sector. In the case of aid received by the Government of India, Government deposits held with the Reserve Bank of India will go up. When foreign aid is drawn upon to pay for import requirements, this takes the form of a reduction in the foreign exchange assets of the Reserve Bank and a corresponding reduction of its deposit liabilities - Government deposits with the Bank in the case of aid utilized by the public sector and commercial bank deposits with Bank in the case of aid utilised by the private sector. There will be no additions to the monetary circulation on account of such transactions.

That is to say, however large investments may be, subject to the sole condition that they are matched by equivalent savings-current, past or imported no inflation would result assuming of course, the availability at home of factors of production, complementary to the capital imports represented by foreign aid and drafts on currency reserves.

There is but one major answer to our query regarding the cause of the current phase of the price rise, as also of the worsening of the price situation. Like the debasement of the coinage by Medieval Kings, both are direct outcomes of reckless expenditures by the State. The Medieval Kings ran into financial difficulties through emptying their treasuries on wars, monuments, mausoleums, palaces or forts; we have run into financial difficulties through squandering our scarce resources-over 80 per cent of the national savings and foreign aid-on steel mills, gigantic river valley, irrigation and power projects, heavy

industries and heavy chemicals. Like that of the Medieval Kings, our investment out-lays have exceeded the availability of funds through the normal channels of finance. In other words, we are engaged in the queer attempt to "invest" non-existent resources.

The link between such "investments" and the price rise is easily seen. Investments in excess of available resources take the form of budget deficits. The Medieval Kings filled the gap through the debasement of the coinage; they availed of the monopoly of issuing currency to put less gold or silver in their coin than the face value on them warranted, using the difference to cover their excess expenditures over revenues. We are doing a more sophisticated version of the same thing. We cover our budget deficits through borrowing from the Reserve Bank under Ways and Means Advances, in the first instance, to be followed subsequently by the issue to the Reserve Bank of treasury bills and long-term government loans. As the Reserve Bank produces the necessary funds for the advances through resort to the printing press, we have here a case of budget deficit being covered by printed money.

There is little difference between debasement of the coinage and printing money. In both cases the monetary circulation would increase. Under modern conditions, part of the printed moneys would accrue to commercial banks from the contractors and others who receive them and the banks thereupon add to the finance they provide - through loans, advances, discounts and overdrafts - for investment in the private sector. Overinvestment through created moneys thus spreads from the public sector to the private sector. But over-Investment, as it cannot add to the available physical resources, cannot add to the flow of the national product either. The expansion of money ensuing from over-investment will, therefore, outpace output and a price rise will emerge inevitably. Over-investment from 1954-55 to 1961-62 led to an expansion-of money by 60 per cent, while the national product rose by 27 per cent. Money supply having outpaced out put by 33 per cent, prices rose by about 34 per cent.

If over-investment should drive prices up, how did prices fall by 3.4 per cent in 1961-62, and remain virtually steady in 1957-58? Did we slow down the pace of our investments during these years? The answer to these questions takes us to an important factor in the Indian price situation. In 1961-62, Plan investments in the public sector were stepped up by 7.2 per cent to Rs. 1,148 crores over the level attained in the preceding year; in 1957-58, the budget deficit was at the all time peak figure of Rs.495 crores. If, nevertheless, prices failed to rise during these two years, the credit should go to general-purpose foreign aid and the drafts on currency reserves. But for the operation of this factor, the extent of the price rise might have been vastly higher.

The mechanics of how foreign aid and drafts on currency reserves control or moderate inflation is easily seen. During the period, 1954-55, to 1961-62, budget deficits amounted to over Rs.1,800 crores and scheduled bank credit increased by Rs.869 crores. Yet, money supply rose only by Rs. 1,256 crores, or less than one-half of the sum of the moneys issued into circulation (Rs.2,125 crores) through budget deficits and commercial bank credit creation. The rest of the inflationary funds returned into the Reserve Bank to

purchase foreign exchange sold by the Bank, Rs.619 crores being drawn from the currency reserves and the balance from the general purpose foreign aid. From 1960-61, when our currency reserves approached rock-bottom, inflationary funds have been pumped out of circulation almost wholly by foreign aid.

In 1957-58, though the total expansion of money through budget deficits and credit creation by commercial banks (Rs.62 crores) amounted to Rs.557 crores, sales of foreign exchange by the Reserve Bank from the general-purpose foreign aid and the drafts on currency reserves reduced the actual expansion of money to Rs.72 crores, which represented an increase of 3.1 per cent over the monetary circulation of the preceding year; prices, therefore rose but nominally by less than 1 percent-during the year.

In 1961-62, the decline in prices by 3.6 per cent was, in part a reaction to the steep price rise of 7.4 per cent in the preceding year. This rise reflected inflation only partly it was principally due to a short supply of industrial raw materials and manufactures, the prices of which shot up unduly as a result; with the improvement in the supplies of these commodities in 1961-62, there was a quick reversal in the scarcity price rise. Taking me two years, 1960-61, and 1961-62, together, we get a more consistent picture, though figures of money supply during these two years are not strictly comparable with those of the preceding period. While the budget deficits and commercial bank credit creation during the two years amounted to Rs.441.3 crores, money supply rose only by Rs. 324.4 crores; the rest of the expansionary moneys was withdrawn from circulation, Rs.67.4 crores from the currency reserves and the balance from general-purpose foreign aid. The actual expansion of money represented an increase of 11.9 per cent over the money supply in 1959-60; the increase in the national product having fallen short of the expansion of money, prices rose during the period by 3.5 per cent.

Though all foreign aid, other than P. L. 480, brings foreign exchange, which the Reserve Bank sells against cash, it is important to note in the context of the foregoing discussion that general purpose foreign aid alone, counters inflation. This is so because general-purpose foreign aid, like the drafts from the currency reserves, are salable to any part. It can, therefore, withdraw from the pockets of the people inflationary funds already issued out through budget deficits or commercial bank credit creation. Foreign aid tied to specific projects can be used only for purchasing the import needs of the projects concerned; it will cancel, that is to say, freshly created credit to finance the new projects; it cannot be used to withdraw the inflationary funds already with the public, nor can it remedy the foreign exchange crisis, as it will not provide foreign exchange to cover worsening of the balance of payments position ensuing from the imports for the new projects. This explains the pressures we are exerting on the Aid-India Club for general-purpose aid. With our currency reserves at the rock-bottom, such aid alone can correct both inflation and the foreign exchange crisis.

The foregoing would seem to indicate the principal explanation for the current spurt in commodity prices. The tempo of investment in the public sector has continued, more or less, according to plan. This is to say, over investment and inflation have been progressing apace. But the suction pump drawing inflationary funds out of circulation has

been comparatively inactive. There has been an acute shortage of general purpose foreign aid. The inflationary funds issued out through budget deficits and credit creation having therefore remained in circulation, this led to a reversal of the preceding downtrend in commodity prices.

Prices generally rise by the extent of the increase in money supply over the national product. The apparent violations of this rule are often largely attributable to special circumstances; among them, a reaction to a preceding artificial price rise as after the Korean War and in 1961-62, export restrictions in times of bumper harvests-as during the middle three years of the First Plan, price controls - as during the War period, 1942-43 to 1945-46, changes in the velocity of circulation of money, increases in the cash balances held by the public, when real incomes rise and so on. By ignoring these special factors, it is easy to amuse ourselves over the failure at times of prices to respond to changes in the flow of money incomes. The price of such amusement is delusion. The phenomenon of prices, falling behind money supply-rise after 1952-53, seems to support the view that price controls have vitiated the official price index.

For a solution of the problem, we must tackle it at its roots. The futile, and self damaging effort to "invest" non-existent resources must be abandoned. This would necessitate drastic cuts in the public sector plan outlay. This latter requirement will demand a drastic cut in the civilian expenditures charged to Revenues, for which vast scope exists.

Once inflation has taken - place as a result of the attempt to "invest" non-existent resources prices will rise. The corrective to boiling water-rising prices - is to remove from underneath it the fire or deficit budgeting. Having resorted to deficit budgeting, it is little use getting angry when prices rise or blame, "those who hoard, speculate and profiteer." It is equally wrong to say "raising prices for private profit in this national emergency was a treachery to the country". Despicable though profiteering is, the real act of treachery lies in printing money to meet Governmental outlays and in misdirecting the resources of the nation in spectacular rather than useful channels of investment. It is this policy that has involved the double crime of retarding economic development and of denying the common man the elementary needs of living. We like to shout from the house tops that we are a progressive people, abreast of the thinking of the enlightened part of the world In this nuclear era yet, in the field of economic and monetary policies, we often speak the language of Medieval monarchs.

Even a border war is not enough excuse for financing Governmental outlays through created moneys, especially as, given rigorous discipline, non-inflationary war finance is a feasible proposition. If so, our economic policies - and tomorrow, may be, our policies of war finance - which render inflationary finance inevitable, and the people responsible for these policies must own up the blame for the rising prices; for the untold miseries which this is currently inflicting on tens of millions of families whose money incomes are fixed or are sticky; and for the growing opulence of the trading and industrial classes in the midst of the growing indigence of the masses of the people.

We are, instead, seeking to make the traders a scape-goat. Monopolies and semi-monopolies apart, contrary to popular belief and the emphatic assertions of

administrators, traders have no more control on prices than the thermometer has on temperature. As the rest of the community, traders are but creatures of prices which are determined for all by the forces of supply and demand over which individual traders have no control. The abnormal profits accruing to them under rising prices are a consequence, not a cause, of inflation. Inflation cannot be controlled by tampering with its consequences; nor by replacing the normal channels of trade by the admittedly more expensive and less efficient machinery of state trading and cooperatives. Inflation continuing, sales in the open market or through fair price shops cannot hold back prices in general; with the prospects of rising prices, the (official) stocks released on the market are apt to be added to hoards. To force traders, through police action, to sell at below replacement prices might drive stocks into black markets, where consumers would have to pay higher than open market competitive prices.

It is a sad commentary on the economic and monetary enlightenment of the Indian people that vested interests should be able to sell to us queer notions that legislative and administrative measures can restrain rising prices caused by inflation or that rising prices are part of the package of economic growth.

We have squandered away our currency reserves, which stood at Rs.1,769 crores in April 1946. We have piled up an external debt of which there is little hope of repayment; and an internal debt which has increased tremendously, the repayment of which involves a great deal of further inflation. We have undermined the currency standard by inflating the money supply which has led to price rise.

The pattern of distribution of the national income has become more anti-socialistic than ever. The middle-classes among the fixed income groups have slipped down the inclined plane of economic wellbeing; the working classes in the industrial sector have not benefited from the vastly expanded industrial and business activity. The economic condition -employment, money wages, indebtedness - of agricultural labour has deteriorated materially as revealed by two official surveys. The drop in the level of living of the masses of the people, is reflected in the downward fluctuation of the national average per capita consumption of food and cloth. There has emerged too a pronounced shift of income from the rural to the urban sectors of the economy. We have hamstrung the economy with statist policies, controls, restrictions, licenses, quotas and concessions, which, on the one hand, have retarded economic growth through blocking the springs of production and obstructing the flow of output and, on the other, have undermined the moral standards of the nation through the graft and corruption, which they have given rise to. On top of it all, we have erected a highly vulnerable and unstable industrial structure, in deliberate defiance of the law of the comparative costs; the output of our industries - because of poor quality and high costs - is general unsalable abroad; much of it is salable only in the highly protected and inflation-fed domestic market.

The only beneficiaries of these perverse developments are businessmen, industrialists, the corrupt functionaries of the State - the civil servants and the politicians - and the body of touts, contact men and other intermediaries which have sprung up as part of the distributive machinery of the instrument of statist economic controls.

If we interpret economic development to mean a rise in per capita income, our policies of the decade 1955-1965 have retarded such development and weakened the national economy. It has undermined social stability and has caused moral decay. A reform here and a reform there, cannot possibly retrieve the economy from the chaos which we have created. Neither economic nor social salvation is possible without a basic policy reorientation, steering clear of statism and inflation.

STUDY TOPIC - 5

CONTROLS - A REMEDY WORSE THAN THE DISEASE OF INFLATION*

A distinction must be made between price controls and allocation controls. The prime function of the former is to distribute equitably, at fair prices, the scarce supplies of commodities. They do not create or release investment resources. Price controls would not cause to grow two blades of grass where only one grew before.

Controls over resources allocations (often referred to as physical controls) would ill go with planning in a democracy, though it is an essential feature of total planning of the communist type. In a democratic set up, the distribution of resources was determined by the machinery of the market through the device of price changes. The amounts and the ratios in which real resources were employed in production were subject to variation. They depended upon diverse and changing technological, economic and price considerations. It was quite impossible to take into account these complex factors and arrange anything like a satisfactory allocation of resources, while the regulation of the economy was still governed by the market mechanism. Allocation controls however, fit in quite naturally when the market and the price mechanisms, as regulators of production and distribution, are scrapped and are replaced by a Supreme Economic Council of Planners. Allocation controls constitute the alphabet of communist planning. They are a nuisance under democratic planning.

If prices must be prevented from rising, price and allocation controls are not a method of achieving it. Fair price shops can only touch the fringe of the problem. The official price index may respond to price controls. So long as inflation continued, (free) market prices may not. And it is the latter that matters. If market prices must be restrained, the programme of investment under the plan must be revised downward so as to prevent further deficit financing. Alternatively, foreign aid must be stepped up to match the gap in real resources.

The price rise is a monetary phenomenon. It cannot be tackled by non-monetary measures, while the monetary taps are allowed to run freely.

PLANNING IN INDIA

Effects of Price Control

The crucial test of planning lies in the arbitrary control, by the Government, over the disposal of investment resources, comprising domestic savings and foreign aid. The more usual experience is that planning leads to over-investment and, therefore, to deficit financing and price inflation. In fact, Indian planners, in common with their counterparts elsewhere, wish to maintain that price inflation is an essential outcome of the upward "pull of demand", which attends planning, and that it is "the very condition of economic advance": and planners seek to "hold the price line by price interventionist measures, principally, arbitrary determination of the prices of select groups of commodities, by executive fiat, disregarding free market prices. Inflation has been so common a feature of planning that the presence of price control measures may be deemed to be the second attribute of the prevalence of planning.

We shall examine here the economic and social effects of the price control part of planning. So long as inflationary financing continued, it is deceptive to think that any price control measures may keep prices from rising. In time of rising prices, no doubt, windfall gains generally accrue to traders, businessmen and industrialists. But it would not be correct to infer from this that rising prices may be "due" to these windfalls; and argue that, if profits are cut down to "normal" through price fixation, distribution controls, or sales through co-operatives and fair price shops, the consumer may get substantial relief.

First, profits whether windfalls or normal profits, are determined by the level of prices. It is not as if prices are high because profits are high; it is the other way about. Profits are high because prices are high. Profits or losses are not part of the costs of a production. Profits (or losses) emerge from the level and trend of prices; and individual traders (or cooperative societies) have no control over prices, any more than the rest of the community. It is market forces alone that determined prices.

Secondly, if in the context of price inflation, Government should attempt to fix prices, there will emerge the phenomenon of dual pricing of the commodities concerned one price at ration shops and another price in the rest of the market, i.e., an official price and a black-market price.

Dual pricing introduces a species of untruth in the field of price economics. The rationed price is, frequently, unduly below the price which would emerge under free market conditions. The black market price, to, may diverge from the free market price. It may be unduly high, as it may include the costs of the black-market set up, including corrupt payments to officials and to the guardians of law. The net outcome of this arrangement is that, looking to the community of consumers and to society as a whole, the aggregate cost of the price-controlled commodity, may be appreciably higher than in the absence of price control. This would be so because, to the normal costs of its production and distribution, would now have to be added the costs incurred on the black-market machinery.

Price interventionist measures do not eliminate windfalls. They add to the windfalls, the co-sharers of the larger profit margins being—in place of traders alone, as before the coming of price control—traders and the corrupt among the politicians, officials and the police. In other words, price interventionism does not reduce prices and costs. They may increase both, the higher burdens being borne by the general body of consumers and by tax payers. In addition, they may lower the moral standards of traders, businessmen, producers and consumers. When price controls apply to articles of mass consumption, like foodgrains, the windfalls and the corrupt payments would produce anti-social income shifts from the masses into the pockets of a minority of vastly better-to-do people. Almost the only entry on the credit side of the accounts may be that a section of consumers may get part or whole of their needs at controlled prices.

As part of the scheme of price control, some States in past have banned the exports of certain commodities from the States, e.g., rice from all States, wheat from the Punjab, gram from Rajasthan and groundnut oil from Gujarat. The theory and strategy behind the ban is that the people of the State concerned should have prior claim on the essential commodities produced within the State; that, in the absence of the ban, the richer consuming centers may corner the surpluses, the "sons" of the soil being deprived of them, or be compelled to pay fantastic prices. We may examine the economics of this measure by reference to the ban on the exports of rice.

To the extent that the ban may be effective, it will depress the prices of rice within the surplus States, in relation to prices in deficit states.

Though the price repression of rice, doubtless, benefits the consumers within the producing areas, it inflicts gross injustice on rice farmers. While their costs of production and the prices of their own consumption needs would move up with inflation, relentlessly, they would be getting for their rice harshly low prices, as a result of the ban. Price repression causes shifts of incomes from rice farmers to rice consumers, in an outside the producing areas; and to black-market dealers, who intervene between farmers and the free market for rice.

The ban is indefensible economically or on grounds of social justice. The removal of the ban would, doubtless, drive up the open market prices in producing areas, as it would lower the prices in deficit areas. To the extent that prices may fall in deficit areas, the net hoarding demand in these areas may decline. Hoarding is not a function of the ban on exports; it is entirely a function of the general expectation of a rise in prices. If we wish to cure hoarding, the remedy lies, not in banning exports, but in putting a stop to inflation. The ban, by driving up prices, might, in fact, add to the hoarding demand.

This is not to deny that marginal farmers in particular, frequently, sell their output much too early in the season, rather than wait for higher prices, and, thus, deny themselves a better income on their produce. But this unfortunate phenomenon has nothing to do with the presence or absence of the export ban. Such sales are in the nature of distress sales, the result of debt obligations, wedding expenditures or similar needs, which cannot wait, and perhaps also consumption requirements, which have been deferred too long already. The problem, in these cases, is one of poverty and the export ban would add to their

difficulties as, on account of the ban, they would now get even less for their rice than ordinarily.

To argue that the removal of the ban would involve hardships on local consumers is to ignore the basic injustice of the measure on rice farmers; that it is really a case of these consumers foregoing the unmerited income-transfer benefits, accruing to them from the artificial price repression. The removal of the ban removes injustice and restores justice.

If, for political reasons, urban populations, must be provided with rice at controlled prices, the cost of this subsidy is properly borne by State Budgets, or by the Central Budget, not by any particular groups of people. The State and the Centre should purchase rice, at competitive market prices, for sale at subsidised prices to their urban pressure groups. Where is the logic, equity or justice in penalising rice farmers for what is not fault, or responsibility, of theirs?

The economic effects of dual pricing are no less upsetting. To the extent that price control measures may succeed in repressing prices in the surplus producing areas to below their competitive levels, investment in rice farming might be retarded. When price repression applies only to rice, and other outputs are not subject to price restraints, the latter may receive preferential investment attention of farmers. The output of groundnut, sugarcane, jute and other commodities may go up at the expense of rice. If land under rice is unsuited for other outputs, capital and other resources of production may be shifted away from rice farming. Retarded production might render chronic the market shortages, which had induced price control.

Thus, price interventionism produces a four-fold damage. First, it shifts incomes from the producers of the price controlled commodities to a group of favored consumers, who may receive these commodities at controlled prices; and to black-market dealers in these commodities. Secondly, they add to the social costs of supplying the commodities, the higher costs being borne by the general body of consumers and by tax payers; and the benefit of these higher cost accrues to traders, businessmen, industrialists and corrupt functionaries of the State. Thirdly, when price controls apply to article of common consumption, like foodgrains, they give rise to anti-social income shifts, from the masses into the pockets of a vastly better-to-do minority, and lower the moral standards of the nation. Finally, price interventionism might retard the production of the commodities concerned and their supply position may become basically worse.

Even as the remedy to boiling water is to remove the fire from underneath, the only sure remedy to rising prices is to put a stop to deficit financing. Price control amulets will not work. It is delusion to suppose that inflation is unavoidable if we must have economic growth. Economic growth is not a disease to produce an inflationary upset. It is a healthful and invigorating process, even as the growth of an infant into manhood. There is no empirical evidence either in support of this fallacy. One may look in vain for such evidence in International Financial Statistics, which contains relevant data on over 100 countries.

PART II
INDIAN PLANNING

STUDY TOPIC - 6

PLANNED PROGRESS OR PLANNED CHAOS ?

Basically the broad structure of the policy measures adopted in 1950s has remained operative since. The changes in these measures have not affected the basic policy structure. This structure is founded on the belief, outlined in the Second Plan (1956-61) document (page 22), that there was an innate conflict between "private profit" and "social gain"; that the State alone was capable of "speaking for and acting on behalf of the community" as a whole in all "decisions regarding production, distribution, consumption and investment"; in fact, in "all significant socio-economic, relationships"; and that, therefore, economic and social progress was not possible except "within the framework of a comprehensive plan, formulated and implemented by the State. The model for the comprehensive plan was the Russian plan.

Logical Soundness

The doctrine that, when a sovereign consumer controls and regulates the economy, through hiring the services of entrepreneurs to subserve his needs, and that when the entrepreneurs, so hired, work in freedom, the three vital developmental factors, namely, (a) the national product and per capita income, (b) the expansion of employment, and (c) the reduction of income inequalities, must necessarily move in the same direction, is denied off-hand, without examining its logical soundness and the empirical evidence in its support. It is denied too - again without examining logic and facts - that in such a set-up of consumer sovereignty and entrepreneurial freedom, the profit rate must keep declining and the wage rate must keep rising, the two thus moving in the socially desirable, not in the anti-social, direction.

The objectives of these policy measures, which were structured and interpreted in the Five Year Plans, were fourfold: (i) abolition of poverty; (ii) industrialisation; (iii) liquidation of unemployment; and (iv) reduction of income inequalities. Industrialisation appeared in this list of prime objectives because it was believed that the expansion of industries was an index of development. The historical fact that the U.S.A., the economic superpower of today, rose to its eminence on a sound agricultural base and that until 1914 it was still a dominantly agricultural country and was at the same time in the world's top bracket per capita income, was disregarded.

Although we adopted the prevailing policy system in 1951-52, it took some time to organise its administrative base and instruments of operation, and for the policy measures

to take root, so that their economic impact appeared on the surface only around 1960-61, which we may call the watershed year. We shall narrate the achievements of these policy measures strictly on the basis of official statistics although, I hope without boring the readers with statistics.

Per Capita Real Income

The impact of these policy measures on the poverty and income-inequalities fronts may be seen from the trends, first, in the per capita real incomes, secondly, in the consumption of certain articles of food and, thirdly, in the per capita incomes of the agricultural and the non-agricultural populations, in 1950s, the per capita income showed - in line with the more common universal experience - a virtually unbroken uptrend. With the coming of the policies of planning, the style of the income trend changed, as from about the watershed year (1960-61)*. In place of a steady rise, the per capita income fluctuated around a shifting norm, spurting up with weather-caused good harvests, and tending downward thereafter, waiting for another good monsoon to push it up again. Thus, the dependence of incomes on the weather increased. The net result is that the per capita real income (N.N.P. at 1960-61 prices) in 1974-75, Rs. 341, was only nominally higher than that a decade ago, Rs. 335, in 1964-65.

During the decade ended 1960-61, the per capita income rose at an annual rate of 1.9 per cent (compound). During the subsequent 14 years, the period that witnessed Plan acceleration, the rate of growth, based on terminal data, dropped to less than one half, to 0.8 per cent.

The per capita income being a national average of a hotchpotch of all economic transactions - production, consumption, saving, investment, transfers and the rest - of all individuals, groups and institutions, it may not indicate, clearly enough, the trend in the economic well-being of the masses. As the bulk of the masses live on either side of the bread line, this trend may show up much better in the consumption of certain articles of food and of the other basic needs of life. The consumption of pulses, which is almost the only source of protein for the masses indicates the correct position in simple terms. It is unnecessary to burden this paper with the consumption trends of other articles, all of which, however, tell the same story.

Animal protein, as a regular article of diet, being, as a beyond the reach of most of the poor, pulses must provide virtually all their protein needs. We find that the consumption of this article of food tended upward in 1950s, reaching a peak of 2.43 ounces. per capita, a day, in 1961 the watershed year. Thereafter, with the acceleration of socialist planning, the consumption of pulses tended downward and was at a near-low of 1.47 ounces in 1975, a fall of 40 per cent. Apparently, growing poverty compelled the masses to economise on the protein part of their diet*.

Social Injustice

The downtrend in the protein intake of the masses is conclusive enough evidence of their declining real incomes. In a context of virtually stagnant per capita real income, the inference of simple arithmetic is that the real incomes of the upper-income groups have moved up, this is a case of social injustice, the result, as we shall presently see, of the earnings of the masses being shifted into the pockets of the upper-income groups. These perverse income shifts have been feeding, in particular, the affluence of the elite, the old and the new.

Growing social injustice is evidenced, too, by a comparison of the trends in the per capita incomes of the agricultural and the non-agricultural populations. In 1960-61, the watershed year, the per capita income of the agricultural population, which accounts for about 72 per cent of the total population, was Rs. 219 and that of the rest of the population Rs. 531, at 1960-61 price. With the progress of planning, the former tended downward and was Rs. 189 in 1974-75, a fall of about 14 per cent; and the per capita income of the non-agricultural population tended upward, rising by 40 per cent, to Rs. 745. Individuals and groups in the agricultural sector have, no doubt, benefited from socialist measures. But these individual and group gains have been more than negated by the income deterioration of the rest of the rural population; so that viewing this sector as a whole, it has suffered. The whole of the benefit of the development activity under the prevailing policy system has, on balance, deemed to the urban sector.

Prosperity of the Upper Class

The limitless prosperity which this policy system has brought to the upper crust of society is visible to the naked eye in the change in the style and affluence of their living, in the proliferation of the four and five-star hotels, which are filled to capacity, in the growth of luxury travel facilities, in the overcrowding of the noted holiday resorts, in the multiplication of lavish residences with rich furnishings and in the display of wealth at marriages and other social functions. It is evident, too, in the steep rise in the statistics of the production and supply of luxury goods, most of which are well beyond the access of the masses.

Although statistics of unemployment are not regularly collected, the available estimates show that each Plan passed on to the next more unemployed than it received from the preceding one. Despite mounting Investments, the increase in employment opportunities fell short of the natural additions to the labour force. Unemployment in 1951 was placed at 3.3 million, it multiplied 5.7 times to 18.7 million in 1971, according to the estimate of the Unemployment (Bhagavati) commission. The progress of the prevailing policy measures involved the progress of unemployment*.

Alone among Plan objectives industrialisation has made outstanding progress. Industrial production multiplied 4 times in about two-and-a-half decades, its index rising from 29.7 in 1951 to 118.8 in 1975 (1970-100) an annual rise of 12.5 per cent (simple). Viewed superficially, this is a remarkable achievement. Leaving aside the most spectacular case of Japan (38 per cent), it fell short only of the record of Italy (16.9 per cent), and is faster

than the industrial expansion of Belgium (4.8 per cent), Canada (9.7 per cent), France (9.6 per cent), West Germany (11.2 per cent), Norway (7.5 per cent), Sweden (7.8 per cent), Switzerland (5.6 per cent), U.K. (3.10 per cent), and U.S.A. (5.6 per cent). Much of the evidence of the progress that India has made during the past two decades or more is drawn from the data of Indian industrial development -supersonic planes, civilian use of nuclear energy, output of steel and electricity, machines for producing machines, shipyards turning out ocean liners, the vast numbers of the technologists and the exports of know-how to underdeveloped countries.

Industrial production, however, has not noticeably influenced the curve of per capita real income, as it accounted for but 6 per cent of N.D.P. in 1950-51, the pre-Plan year, and was still only 14.3 per cent in 1974-75. Agriculture and allied activities, which contribute, even currently, 50.5 per cent to N.D.P., remain the major influence on the trend of per capita income.

Poor Achievement

The poor achievement of socialist planning was not due to any deficiencies in investment or effort. The annual average investment (at 1960-61 prices) in the Second Plan (1956-61) was 82 per cent higher than in the first (Rs. 825 crores), was several times as high in the Third (1961-66), and is placed at nearly 4 times as high in 1973-74 (Rs. 3,260 crores). The rise in investment was 5.7 times as fast as that of population. Total investment from 1951-52 to 1973-74, at 1961-62 prices, amounted to Rs. 44,342 crores. An average of about 38 per cent, if not more, of this investment represented foreign aid.

Nor was Plan effort lacking. Planning had the full support of the Government, which commanded an overwhelming majority in Parliament, the Prime Minister has been the chairman of the Planning Commission, the Finance Minister a member, its Deputy Chairman has the rank of a Cabinet Minister, and Plan projects command the advice of high-ranking talent in the country and also that of hand-picked foreign experts. The execution of the Plan is in the hands of administrators, technicians, economists and other experts who are among the ablest and the most highly paid Government personnel in the country.

This raises the question, where have all this investment, foreign aid and dedicated effort gone? If, as Professor Colin Clark says, investment at four times the rate of increase in population should ordinarily ensure absorption into employment of the natural increase in the labour force, Plan investments having risen 5.7 times the population growth, why should unemployment continually increase? The explanation lies, almost wholly, in resource wastages and resources misdirections, which have generally attended the prevailing policy measures. The debit incidence of these two factors has negated much of the investment effort so that the impact of this effort on N.D.P. has been far less than its magnitude.

Resource Wastages

The major heads of resource wastages and resource misdirections are, briefly, as under:

(a) Perhaps the largest and the worst case of resource wastages is corruption - the "kick-backs" of American terminology - as applied, primarily, to public-sector investments, although corruption may obtain in private-sector investments too. While the parties concerned alone can be aware of the correct position, if the kick-backs are placed, as I have done in my earlier writings, at 20 per cent to 40 per cent of the amounts invested, this proportion of public-sector investments is a case of transformation of national savings, through kick-backs, into private incomes. Thus, in 1973-74, when Plan investments were at Rs. 3.260 crores, the amounts actually going into Plan projects would be less by whatever may be the amounts of the corrupt payments, although the account books would not show any change in the investments. To this must be added the kick-backs in the private sector.

(b) Unutilised production capacities are another large case of resource wastages. Some unutilised capacity, like some unemployment, is perhaps unavoidable even under the best of conditions. But the undue magnitude of this phenomenon led the Reserve Bank to conduct sample surveys of under-utilisation in both the public and private sectors.

The published data of the working of 20 selected public-sector undertakings, for the three years ended 1968-69, showed that 35 per cent to 55 per cent of the production capacities remained unutilised. As 60 per cent to 66 per cent of the total Plan resources are drawn into the public sector, this would make resource wastages off an order of 21 per cent to 36 per cent of the aggregate Plan investments, the public and private sectors being viewed together. Although these percentages of idle capacity (35 per cent to 55 per cent) may not hold true of the public sector as a whole as they apply to the major undertakings, the resource wastages in idle plant and equipment, during the three years concerned, should be substantial.

The position has considerably improved since 1968-69. The data for 1974-75 show that idle capacity during the year, in 60 public sector undertakings, was 31 per cent of installed capacity. This reduces resource wastages under this head to 20.5 per cent of the total Plan investments. To this must be added the idle capacity in the private sector.

(c) A third head of resource wastages is the over-staffing and laxities in management and in expenditures. In the public sector, both may be due to the absence of the discipline of the profit motive and political influence. In the private sector, over-staffing and laxities in expenditure may be devices of absorbing, in the form of costs, the windfalls from licenses, permits and quotas, and from sheltered markets, which, otherwise, might, in large part, get lost in taxation.

Resource Misdirections

A major head of resource misdirection is pressurised import substitution. Almost as a rule, production costs of manufactures in India contrast with the cost of corresponding manufactures abroad. Data collected some time back showed, to take a striking illustration, that a home-made irrigation oil engine of 5 H.P. may cost Rs. 3150, as against the (c.i.f.) cost of Rs. 1,900 for a French engine and an incredible Rs. 315 for a

Japanese one (made of aluminium); and the overall average of these contrasts for imports as a whole were placed, at the official exchange rate, at an order of 75 per cent to 100 per cent of the c.i.f. (landed) costs of the imports, and at a lesser order at the free market exchange rates. Latterly, these contrasts have been amended as the result of a faster rise in prices and costs abroad than in India. But the cost differences are almost universal and still remain substantial.

To fabricate at home substitutes to import goods, the costs in resources are, therefore, considerably larger than the costs - to the Indian economy - of the import goods kept out. This would correspondingly reduce the pace of expansion of the national product for a given volume of investment resources.

Debit Impact

The debit impact of import substitution on N.D.P. is much more than the higher costs of the domestic substitutes. This becomes apparent when we take note of the second and the subsequent innings of production, i.e., when the homemade oil engines and other substitutes to import goods are put to productive uses. As the number of oil engines turned out is smaller and their quality poorer, their output would be less than the output of the French and Japanese oil engines foregone. The same applies to other cases of import substitution. The flow of output at a lower level would last during the life-time of the home-made producer goods. This indicates that, if industrialisation is left to be determined by the doctrine of comparative costs, Indian N.D.F. may be, for the same investment effort, larger than that we have under pressurised import substitution.

The socialist policy package includes the belief, which has persisted in under-developed countries generally, that the magic of economic growth and of economic well-being lies in (i) expansion of the public sector, and (ii) industrialisation. Empirical and logical evidence to the contrary is ignored. It is also ignored that it may be perilous for a country to neglect agriculture, when 72 per cent of its total population derive their income from agriculture and allied activities.

This policy bias has led to resource misdirection on a massive scale. The heavy emphasis on the expansion of the public sector has led 60 per cent to 66 per cent of the total investment resources being acquired by public-sector undertakings, although, in recent years, they accounted for but 5.1 per cent to 8.4 per cent of N.D.P. The rest of the economy is left to manage with the balance of 34 per cent of the total resources. As industry, however, receives priority and preferential attention, agriculture and allied activities, which currently account for 50.5 per cent of N.D.P. have been the worst sufferer.

Capital Starvation of Agriculture

These resource misdirections - away from agriculture, mostly into the public sector and partly into industrialisation - and resource wastages have involved the capital starvation of agriculture. This is evident in the sharp deceleration of the total investments in agriculture during the period 1961-75, when socialist planning accelerated, in relation to

the total agricultural investments during the period 1950-61. This deceleration has been of such an order that the evidence of it is prominently visible in agricultural production per capita and also in other agricultural statistics, as witness: (I) notwithstanding the Agriculture Ministry's interest and effort in agricultural development, only about 23.4 per cent of the net area shown has been irrigated, as of 1972-73; (ii) the H.Y.V. programme has been extended to only about 30.4 per cent of the area under the crops subjected to this programme, as of 1974-75; and (iii) for much of the rest of agriculture, cultivation is more or less primitive and the yields depend heavily on the state of the monsoons.

The crowning evidence of the capital starvation of agriculture may be seen in the fact that the annual average expansion of agricultural production, during the 14 years ended A.Y. 1974-75, 1.66 per cent (compound), lagged behind the expansion of population; so that, the domestic product from agriculture and allied activities, per head of the rural population, fell during the period, from Rs. 192 in 1960-61 to Rs. 172 in 1974-75 (at 1960-61 prices).

That the capital starvation of agriculture is functionally linked up with the implementation of the prevailing policy measures is evidenced by the trend in per capita agricultural production before and after 1961, the watershed year. We find that the agricultural output per capita of the rural population, taking terminal data, increased at an annual rate of about 1 per cent (compound) during 1951-61. This output declined at an annual rate of 0.7 per cent (compound) during the period 1961-75, when socialist planning was accelerated.

When during the 14 years ended 1974-75 agricultural production rose at an annual rate of 1.66 per cent (compound) and the per capita output of the agricultural population declined, industrial production went up, by contrast, at an annual rate of 5.5 percent (compound) and the per capita output of the non-agricultural population went up, too.

Effect of the Shift

This is the effect of the shift of resources at the expense of agriculture into industries. The perverse - i.e., the anti-production and hence the anti-employment and anti-income (N.D.P.) - character of these resource transfers is evidenced by the following data:

(a) The expansion of industrial production is not the outcome of the forces initiated by a sovereign consumer through hiring the services of entrepreneurs and a price-directed market mechanism. This expansion is pressurised through the issue of production licenses- which is done in terms of the Industrial Policy Resolution-through controls over capital issues and over the grant of credit facilities, and through subsidies and incentives on the exports of industrial output. Consequently, this output, infrequent if not rare exceptions apart, falls considerably short of the international cost-quality tests; and its fabrication at home involves heavy resource wastages. This has rendered virtually the whole range of Indian manufactures uncompetitive in the world markets; and has necessitated more or less heavy subsidies and incentives to enable the exports of manufactured goods to move.

(b) By contrast, agricultural exports, crude as well as processed, which account (or 35 per cent to 40 per cent of total exports, satisfy the international cost-quality standards and have been able to move without subsidies, and even under the handicap of an unrealistic exchange rate.

(c) As already indicated, vast scope exists for the expansion of agricultural production through the application of modern methods of cultivation and processing. Under the New Agricultural Strategy, the yields of wheat and rice on demonstration farms and in crop competitions, have, for instance, multiplied no less than seven to twelve times the national average yields. Being technology-based such expansions of production may reduce costs and improve the quality of the output. This should enable Indian agricultural output to extend its hold in the world markets.

(d) The rupee prices of rice have been, even at the official exchange rate, considerably below international prices. Since 1973, mainly as a result of the spurt in the latter, the contrast between the two prices has grown. No exports of rice, however, took place as, along with other foodgrains, rice exports remain banned. But rice is reported to be smuggled out, through Goa and elsewhere, despite the risk; involved. This demonstrates that rice exports may yield attractive comparative cost advantages, i.e., enhance the national product for the same quantum of investment resources.

(e) In the case of wheat, Indian prices remained higher than world prices until 1972. In 1973, and after, mainly as a result of the rise in world prices, Indian prices have turned lower than world prices. But, because of the ban on exports, there have been no exports of wheat. If exports are permitted, wheat too, would enhance the national product through the benefits of the doctrine of comparative costs.

These factors indicate that resource shifts have been taking place, not from the less productive to the more productive sectors as should be the case in a developing economy, but from a sector (agriculture) where the comparative cost advantages are clear, into a sector (manufacturing industries), where the comparative cost disadvantage are no less clear or into the public sector, where resource wastages have been heavy. Although the quantification of these perverse resource movements is not, from the very nature of things, practicable when we add up the possible orders of their magnitude we have an adequate enough explanation for the failure of the phenomenal Plan investments and Plan effort to produce any impressive impact on Indian poverty, especially during the past one-and-half decades or so.

Unmerited Income Transfers

In view of the need to restrict the length of the article, it is not possible to go into the details of the factors responsible for the growing social injustice, reviewed above. If we define social injustice as a case of "I earn and you spend", the growing social injustice is the consequence of the unearned and unmerited transfers of the earnings of the masses into the pockets of a privileged minority through, first, the various policy instruments of planning and other socialist measures, and, secondly, through inflation.

The socialist policy instruments-licenses, permits, quotas, the inordinate extension of the public sector, and restrictions on the internal movements of goods, e.g., food zones-create monopolies of various degrees and cause unmerited income transfers through the lesser or larger monopoly windfalls, or through corrupt payments, both of which accrue to people in the upper-income brackets, at the expense of the masses.

Among the worst of these instruments is the physical restrictions on imports through the system of import licensing. This has created vast gaps, varying with commodities, between the c.i.f. costs and the market prices. The gaps between these costs and prices accrue partly to the government, by way of import duties and partly to the recipients of the import licences, by way of windfall profits, or as sales proceeds of the licenses. When to these sums are added the monopoly gains from the remaining instruments of planning and other socialist measures, the amounts of the income transfers may add up to a substantial part of the annual increase in N.D.P. The share of the poor from these increases would, therefore, be small. The socialist developmental activity, in effect, is thus a meaningful activity much more to the affluent classes and the upper-income groups than to the rest of the population. For the latter, the income gains are small, nil or, as in the case of the agricultural population, viewed as a whole, even negative. In a context of flagging per capita income, the incidence of this on the masses, who are already poor, has been harsh. This explains the strange phenomenon, reviewed above, of the per capita income of the rural population moving downward and per capita income of the urban population moving upward.

Outline of a policy Alternative

It is clear from the foregoing review that, if the prevailing policy measure continued, it is most unreasonable to expect, under ordinary circumstances- i.e., apart from a major catastrophe like a world war, from which we keep out - the following : (a) a continued increase in per capita real income; (b) a continued uptrend in the incomes and well being of the masses; (c) a rapid enough expansion of employment to absorb the natural additions to the labour force (d) an expansion of employment faster than (c) which the prevailing unemployment situation really calls for - in order to absorb not only the natural additions to the labour force but also some of the backlog of unemployment, which logically follows from (c); and (e) an assurance that wages and other incomes would but measure the contributions of the individuals concerned to the stream of the national product, so that, at the upper-bracket income levels, "I expend more than what I earn" and cases of "I earn and you spend- are eliminated at all income levels'. While below the upper-bracket income levels, doles to the distressed by the State or by private parties may be only exceptions.

Expectation (a) above is, under the prevailing policy measures, most unreasonable because the expansion of much of the investment would, as we have seen, get negated through resource wastages and resource misdirections, which necessarily attend these policy measures. Expectation (b) is most unreasonable because, in a set-up which permits public sector appropriations of 60 per cent to 66 per cent of the national resources and which, beside grants, priority allocations to industries, the capital starvation of

agriculture-the remaining sector-is unavoidable and the per capita production of 72 per cent of the population, which subsists on agriculture-must remain stagnant, if it does not decline, as has been the case hitherto. Expectation (c) is most unreasonable because the expansion of employment is a function of the expansion of production, not necessarily that of investment. When investment is negated by wastages and misdirections, production, and hence employment cannot increase commensurately with investment so that expansion of unemployment becomes a most reasonable prospect. When the expansion of employment falls short of the natural additions to the labour force, the question of liquidating a part of the backlog of unemployment, (b) above, does not arise. Expectation (e) too, is most unreasonable because under the prevailing policy measures, the incomes of the masses must necessarily be less than their earnings, (i) by the amounts of the perverse income transfers effected through the various instruments of planning and other socialist policy measures, and (ii) by the impact of inflation - which inevitably attends these policies - on their money incomes.

If those expectations, which are but the integral parts of attributes of developing economies, are most unreasonable, it logically follows that, if what we are looking for is, really economic development - in the sense of growing mass well being - with continued social justice, the policy measures we have pursued hitherto must be jettisoned, lock, stock and barrel. These policy measures can bring continued prosperity and affluence only to traders, business men, industrialists, Their trusted executives, who receive more than the recorded emoluments; to the corrupt among the politicians and administrators; and to those who cater to the manifold needs of this economic-political power elite. The lot of the rest of the population must inevitably include social injustice - for them it would be always "I earn and you spend" - even though, as in the case of industrial workers, their real incomes may have gone up relatively to 1950s. For the salaried classes, in particular - the new poor" of Mr. C.D. Deshmukh's definition - these policy measures have yielded little more than wilted well-being.

Social Justice

If we must have economic development with social justice, there is no escape from U-turns on all major policy fronts. Given these U-turns, but never otherwise, the locked-up potential of growth — of the great capabilities of which dirigistes, to quote Professor Ludwig Erhard, the architect of the German economic miracle, can have no knowledge whatever — in a nation of the 600 million people, would gel released; and even as Japan dwarfed the economic miracle of Germany, we can dwarf the economic miracle of Japan. This is so because of the immense untapped scope for growth which obtains in the Indian economy and which is colossal in comparison with Germany and Japan.

In place of dependence on food imports, these policy U-turns will enable us to feed the hungry part of the world; in place of chronic reliance on foreign aid, we could, as Germany and Japan have been doing, extend aid to other countries; and in place of persisting balance-of-payments difficulties, the rupee could rank-with the German mark, the Swiss frank and the Japanese yen - among the leading hard currencies of the world. Economics being the heart of politics, this transformation on the economic front would

help to transform our rather poor image in the world today; and it is a transformed image alone that can bring us our rightful place as a leader of the world community.

It is exceedingly odd to witness a people with our great heritage and numerical importance being treated as a satellite entity, instead of our commanding the world's regard as a front-rank power. We can never achieve this rank under the prevailing policies, for the simple reason that these policies, while they last, are destined to tie us down to more or less helpless position of subsidised relationships on all major economic fronts, internationally. World eminence and diplomatic strength cannot be built up by a people who, however vociferous they may be, are always to be found in the receiving ranks.

Poverty is not insolvency. Nor is economic growth a disease. Given correct policies, a poor people can hold their head high under a banner of full solvency, and also march forward along the road to lasting, and self sustaining, progress with confidence and speed. Even as the growth of an infant into manhood is a story of a continued increase in vitality, vigour and strength, so is economic growth the narrative of a continued expansion of per capita income and mass well being. Both are eminently healthful processes not cases of perpetual surgical attention and bandages. Continued insolvency and persistently erratic achievements can result from wrong policies and mismanagement alone. India cannot possibly move into a position of solvency and rise from strength to strength unless we abandon the policy system which has let us down, and adopt alternatives which have proved their merit, both logically and empirically.

The Vital Need

To bring about this revolutionary economic transformation, the vital need, first and foremost, is to restore the sovereignty of the consumer, in respect of the control and regulation of the economy. This control has to be implemented through the instrumentality of consumer-directives to entrepreneurs, and to a price-regulated market mechanism.

From this U-turn on the plane of ideas, must necessarily ensue the following U-turns, or major reforms, on the plane of policy action:

(i) The termination of the system of organised chaos, miscalled planning, and the allocation of resources among the various channels and units of investment through a consumer regulated price-market machinery:

(ii) the reduction of the activities of the State and of the public sector to those, the benefits of which the consumer cannot command through private entrepreneurs, because of the latter's inability or unwillingness to undertake these activities:

(iii) the U-turn (ii) above may involve de-nationalisation of some categories of public-sector undertaking;

(iv) elimination of all monopolies; whether in the public or the private sector, and the determination of all incomes through the market mechanism;

(v) an adjustment of the money flows to the expansion of the national product, the Budget being appropriately balanced or attuned to achieve this;

(vi) the scaling down of taxation and governmental outlays to match the reduced activities of the State;

(vii) the recognition that trade is the spearhead of all development and a drastic reduction in or removal of all barriers to internal and external trade, which logically follows from this recognition and

(viii) the adoption of a fully floating rupee.

It may not be possible to achieve all these U-turns in one leap, though Professor Erhard to quote his own word, had scrapped virtually all control measures in "one swoop". The package of reforms could be adopted in a phased programme. The continued bumper dividends which are destined to come our way as we progress along the road, may be trusted to accelerate the pace of the adoption of the U-turns.

STUDY TOPIC – 7

PLANNING IN INDIA - A CRITIQUE *

In assessing the achievements and consequences of planning in India, we shall consider the more obvious issues which arise. First, why did we embark on planning? Second, how do plan achievements look in relation to plan objectives? Third, if the audit of performance reveals that planning as a technique has failed to deliver the goods, what is the alternative policy action which may be better calculated to achieve our objectives? In view of the recent border difficulties with China and the armed conflict with Pakistan, it may be of interest to examine, finally, the impact of the policies of planning on India's defence potential.

I. Definition of Economic Development

In a communist society, planning is inseparable from their concept of social and political life. With us it is different. We have selected the technique of planning, from among alternatives for achieving stated objectives. These objectives were four fold: (I) abolition of poverty, (2) liquidation of unemployment, (3) reduction of income inequalities and (4) industrialisation. Through due accent on the third objective - reduction of income inequalities - we seek to establish, simultaneously with economic progress, a socialist pattern of society. The principal characteristics of this socialist pattern are stated to be absence of concentrations of wealth, income and economic power, and prevention of the stifling of talent for want of opportunities.

The central theme of these objectives, which are, clearly, unexceptionable, is economic progress, if we define economic progress as a continued rise in the standard of living of the masses of the people. We may, therefore, say that the aim of planning in India is economic progress.

Certain clarifications follow from this definition. First, if the standard of living of the masses did not rise and that of the salaried middle classes was continually eroded, while the opulence of a thin layer of the upper-income groups accelerated, we do not have economic progress. Such a state of affairs is economic development of the affluent classes. Secondly, spectacular progress in nuclear science, the science of rocketry and space science, and the stock - piling of missiles and other nuclear weapons, in the context of shortages of food, clothing, house-room and the like, is not economic progress either. These developments may add enormously to the striking power of the nation and should be termed military development. Thirdly, striking progress in heavy engineering and

heavy chemicals, mammoth river-valley projects, the building up of idle production capacities and indiscriminate industrialisation, when the masses of the people are ill-clad and under-fed, do not constitute economic development. We may call this, appropriately, show-window economic activity or, at best, sectoral development.

Before proceeding further, we may briefly comment on the term "planning". This term implies order and, hence may be presumed to make for progress. The experience of the working of the policies of planning, however, has been different. These policies have, frequently, produced chaos and disorder, detracting from overall economic and social progress, if they may have also striking achievements to show in certain sectors favored by the planners. A more neutral term to describe the policy measures miscalled planning may be the European word "Planification" spelt "Planification" in Spanish and "planificazione" in Italian.

II Planification & Anti- Social Income Shifts

Taking first the objective of the abolition of poverty ordinarily, progress here may be broadly gauged by the expansion of the national product. During the ten years ending 1965-66, Indian national income rose at an annual rate of 3.8 per cent, and population at an annual rate of 2.5 per cent. This yields an annual rise of about 1.35 per cent in per capita income.

Can we infer from these statistics that the Indian economy is making progress, albeit at a snail's pace? Has the standard of living of the masses of the people been going up, though slowly, i.e., are we experiencing economic development in the sense of our definition of the term?

To answer these questions, we must, so to speak, go behind national income statistics. Simultaneously with the expansion of the national product, income shifts have been taking place from the masses of the people, to the upper-income groups on a distressingly large scale. Though this takes us to a subject which does not make welcome discussion in public, its exclusion may detract from a full appraisal of the basic forces which have been operating in the Indian economy and a comprehension of which is essential for a proper assessment of the achievements of planification.

These income shifts have resulted from three factors:(1)Inflation, which has eroded the incomes of the fixed and sticky money income groups, who comprise the masses, wage earners and salaried people, and has added correspondingly to the incomes of a fraction of the community, traders, businessmen and industrialists; (2) Controls, in particular, import controls, which have transferred incomes as monopoly gains, or illicit earnings, through the corrupt practices to which controls give rise, from the general body of consumers to the privileged upper-income groups who include entrepreneurs, intermediaries, and the corrupt functionaries of the state; and (3) the phenomenal expansion of the public sector, which has added enormously to the illicit gains of contractors and other participants in this expansion.

The largest bulk of these income transfers has ensued from the system of import licensing. Import licences are generally documents of enormous value, which accrue to the recipients of the licences and to which they have neither an economic nor moral title. These values emerge from the restrictions on imports, and from currency over-valuation, the latter being an outcome of inflation. Devaluation led to sharp drops in the values of import licences. But, with the continuance of inflation thereafter, there has been a recovery in these values.

Before devaluation in June 1966, the premiums on these licences varied from 500 to 700 per cent in respect to 10 per cent of the licences and were below 200 per cent in respect to the rest. Assuming an average premium of 75 per cent on all private sector licences, the income shifts on account of import licences on private sector imports - which averaged Rs.625 crores annually during 1961-62 to 1964-65 may be of an annual order of Rs.470 crores.

III. Planification and the Conditions of the masses.

If to this sum is added the amounts of the income transfers from inflation, from controls and from the undue expansions of public sector activity, we may say that the largest part of the annual expansions of national income have accrued to a thin upper crust of the privileged sections of the people, leaving the condition of the masses unchanged or worse than before. With the rich becoming richer and the poor remaining poor, or becoming poorer income contrasts between the rich and the poor have become sharper. Corroborative evidence of this strikes the eye all around us, in the growth of luxury living, the flaunting of riches by a minority, the battered condition of the salaried middle classes, and the growing misery of the masses, especially in the rural areas in the Gangetic belt.

The trends in the consumption of food and cloth by the masses confirm the picture of the semi-stagnation of their economic condition. Per capita "availability" of cotton cloth, already sub-standard, fluctuated downward. It was 14.70 meters in 1956 and 14.58 meters in 1965. Per capita "availability" of foodgrains (cereals and pulses) per day, which tells a similar story, fell from 16.4 ozs in 1961 to 15.4 ozs in 1963 and was 15.8 ozs. in 1964. With record imports of 7,45 million tonnes, the per capita availability rose to 16.6 ozs. in 1965. Army rations are 19 ozs. and jail rations 16 ozs. The consumption of food before world war II was higher. A Reserve Bank study shows that during the seven years ending 1937-38, when foodgrains imports had aggregated to but 9.5 million tonnes, per capita availability of cereals averaged 14.20 ozs per day. The corresponding figure for the seven years ending 1964-65, when food grains imports were as high as 34.4 million tonnes, was 13.9 ozs. per day. Thus, for all the developmental effort of three plans, the masses of the Indian people are more hungry today than before the war.

Evidence of the perverse income shifts and of the growth in social injustice is writ large in the changes which have taken place during the past 11/2 decades in the pattern of production. Since 1955-56, when the policies of planification gathered momentum, and as at 1965-66, the registration of cars, jeeps and taxis has more than doubled to 216 per cent, or by 10.5 per cent per year; during the decade ending 1965-66, the registrations of

motor cars alone rose by 78 per cent, or by 7.8 per cent per year. The output of other goods entering into the consumption of the upper-income groups, which are mostly curios to the masses, generally rose steeply - electric lamps to 4.9 times, electric fans to 6.4 times, radios to 9.5 times, sewing machines to 10.0 times and rayon yarns to 34 times. On the other hand, the output of consumer goods used by the masses and the middle classes rose by much smaller multiples, from 1.4 times (matches) to 2.0 times (soap); the output of cotton cloth, which is in universal use, rose 1.8 times. In the context of a population increases of 2.5 per cent, per year, these figures, clearly, are evidence of the damage done by policies of planification to mass well-being.

Social injustice is reflected, too, in the price structure. The output of consumer goods in common use being unduly restricted by the transfer of resources for the production of luxury and semi-luxury goods, and/or non-consumer goods, prices of food articles rose, during the past 6 1/2 years, by 48 per cent, of cereals by 53 per cent and of textiles by 23 percent. The prices of luxuries and semi luxuries generally, on the other hand, remained comparatively steady until recently, rising only latterly and by much lesser percentages. Apparently, the masses of the people have had a raw deal on every major front - on the income front, on the production front, and on the prices front.

Applying our definition of economic progress, this is not a picture of progress at all. The masses of the people remaining poor, under-fed and ill-clad as ever, it may take a lot of arguing to try to maintain that we are forging ahead.

IV. Unemployment

We cannot argue that the growing social injustice and the disappointing results in the attack on mass poverty, have ensued from any slackening of investment activity or niggardliness of foreign aid. Total investment in the second plan (Rs.7,900 crores) was more than double that in the first (Rs.3,760 crores). The third plan (Rs.12,400 crores) is over three times as large as the first, and the fourth (Rs.23,750 crores) may be about six times large. Foreign aid has mounted steeply, from an annual average of Rs.40 crores in the first plan to Rs. 720 crores in 1964-65.

If aid is valued at the Indian market prices of the import goods acquired against aid funds, the amount of the aid in 1964-65 may be Rs. 1,025 crores. This represented about 5 per cent of Indian national income: nearly two - thirds of national savings, assuming savings to be at 8 per cent of national income: and was equal in value to about three -fourths of India's foreign exchange receipts from exports. Budget support from foreign aid in 1964-65 amounted to 45 per cent of the capital outlay and one fourth of total budget disbursements. At no time of the post-war reconstruction phase did any of the Marshall aid countries receive aid in so massive a proportion, except for a year or so in the case of one or two countries.

Despite, this colossal investment activity, the net gain in the field of employment seems to be negative, in the sense that the additional employment resulting from planification has fallen short of the natural increases in labour force. The second plan passed on to the third Plan vastly more unemployed (conjectured to be 9 million) than it inherited from the

first plan (conjectured to be 5.3 million). The Fourth Plan estimate is that it will receive from the Third Plan a backlog of 9 to 10 million unemployed. It is estimated that, by the end of the Fourth Plan, the number of unemployed may be 13-14 million.

V. Expansion of industries, A pyrrhic victory.

In contrast with this disappointing record in respect of the three objectives of planning considered above - abolition of poverty, reduction of income inequalities and liquidation of unemployment - we have achieved striking progress in industrialisation, the fourth objective. With 1954-55 as the base year and as at 1965-66, industrial production rose by 117 per cent, or by 11 per cent per year. This achievement, however, is not a matter to be enthused over, since it is the result of a forced diversion of resources away from agriculture and other more lucrative sectors. Behind these mounting statistics of industrial expansion lies the untold story of the loss of the additions to the national income which would have ensued if the forced diversion of resources had not taken place. Moreover, much of the industrial output may not survive, if we should remove the artificial props and protection which import restrictions and exchange control provide to Indian industries; and stray exceptions here and there apart, the quality and cost of our industrial production are such that they have little chance of getting a foothold in world markets. During the past about a decade, India's industrial exports have lost almost as much ground as they have gained,' though, to "earn" foreign exchange, some of this output is sold abroad even at below cost. The statistical achievements in respect to the fourth objective of planification are thus a species of pyrrhic victory.

Apart from the questionable success on the industrial front, not only are the results of planification at variance with the objectives with which we embarked on these policies in 1951-52; the economy today is in a state of near prostration, and is harassed by several formidable economic crises. We have a food crisis; a crisis of inflation with living - costs spiraling upward endlessly; a persisting foreign exchange crisis with our balance of payments position showing little hope of viability in the visible future; a capital market crisis with under-writers being, frequently, called upon to play of role-of to quote an apt phrase of Mr. G.L. Mehta -undertakers of the capital issues under-written by them; and; on top of it all, a dangerous distortion in the pattern of income distribution - the area of affluence growing at one end, the area of indigence and starvation galloping faster at the other end, and the one-time prosperous salaried middle classes, the bulwork of social and political stability, working with ruefulness or rancour, under mounting family budget pressures. The easy irritabilities of students, teachers, factory workers, bank employees, lower grades of civil servants and even the better paid technicians and engineers, which have been causing much public concern, are but manifestations of the destabilising social effects of these developments. If the economic pressures from underneath these irritabilities are not removed soon enough, there is a real danger of their getting transformed into political instabilities.

These multiple economic crisis ensue from our own policy misdeeds. They were not thrust on us by China or Pakistan. They have their roots, directly or indirectly, in policies of planning though some may like to throw part at least of the blame on the human and

bovine population pressures, rain gods, race qualities of the Indian people and, latterly, the slowing down of foreign aid. The logical link between the foodgrains crisis and planification is easy to see.

VI. Planification and the Food Crises.

Following a major crop failure in 1951, India's food economy had progressively recovered and we had almost achieved self-sufficiency in food by 1955, when the imports of foodgrains had tapered to 60,000 metric tonnes. The food position progressively deteriorated thereafter, and food imports skyrocketed with imperceptible rapidity. The deficit had jumped to 5.13 million tonnes in 1960, it shot up further to 7.45 million tonnes in 1965, was about 9.72 million tonnes in 1966, and we are officially warned, that, in the current year, the deficit may be double this figure.

Among the most unfortunate features of Planification has been the drafting into the public sector of incredibly large proportions of investments resources. Though public sector undertakings account for less than 5 per cent of the Indian national product and the contribution of the private sector is 88 per cent, over 70 per cent of the total investment resources has been forcibly drawn, year after year, into the public sector, the rest of the economy having had to "make do" with the remaining 30 per cent. In such a context, disaster must strike, sooner or latter, as, with the best will in the world, the private sector, being starved of capital, would be then unable to make its due contribution to the national product.

Seeing that during the decade ending 1964.65, capital formation in the industrial sector multiplied 2.7* times and industrial production, too, more than doubled, clearly the industrial sector, - this applies, too, to the tertiary sector-has been able to claim well beyond its due share of investment resources, though the aggregate resources allotted to the private sector have been a niggardly part of the total. The worst sufferer of this arrangement has been the rural sector, especially agriculture. Evidence of capital starvation of agriculture is writ large in the findings of the Rural Debt and Investment survey, 1961-62 when considered together with the Rural Credit Survey, 1954, both conducted by the Reserve Bank of India.

VII. Decay of Capital Formation in Agriculture

These surveys highlight the deterioration, which is in progress, of the capital base of the agricultural sector during the decade, 1951-52 to 1961-62. While total investment in the economy rose nearly 3 times from Rs.750 crores in 1951-52 to Rs.2,000 crores in 1961-62, gross capital formation in farm business declined by nearly one half by the end of the decade, from Rs.300 crores to Rs.187 crores.

As agricultural population in meanwhile went up by 22 per cent, gross expenditure on capital in farm-business, should have gone up at least by an equal per percentage, even under stagnant economic conditions. The sharp decline in the pace of capital formation demonstrates de facto capital consumption in agriculture, which provides livelihood to 70 per cent of the population. We have corroborative evidence of the capital starvation of

agriculture in the fantastically high interest rates on farm loans, which range from 25 to 50 per cent or more on secured loans.

This capital decay and the consequent deterioration in the productive efficiency of agriculture, is reflected in the near stagnation of agricultural production since 1960-61. The index of agricultural production declined from 142.2 in 1960-61 to 134.0 in 1965-66 (1949-50 =100), the improvement in 1964-65 due to good weather conditions being more than negated by the much sharper fall (about 15 per cent) in production in 1965-66. As the new policy of pressurised diversion of resources into industry gathered momentum after 1955-56, apparently, it took about five years for the resulting damage to show up in agricultural output. Poor monsoons may explain poor harvests in individual years, but are no answer to continued stagnation of production.

Eight out of every ten acres of arable land being under food and 70 per cent of agricultural activity being related to food production, retarded agricultural output has necessarily involved retarded food production. Our food statistics being unreliable, this retardation does not, however, show up in the statistics, of food production. If these statistics were correct, we should have no food crisis today, as, following 1955, both net production of food and population have gone up at an annual rate of 2.5 per cent; The damage to food production from the neglect of agriculture is more correctly recorded in the statistics of food imports. As imported food is all eaten up, little or no part of it remaining for long as buffer stocks, galloping imports of food are a dependable measure of the food deficits that have developed since 1955.

Clearly, therefore, food shortages and reliance on massive food imports to keep the wolf of famine away, are not a passing phenomenon. The food crisis will remain with us so long as the prevailing policies of planning continued, though we may have short-lived relief, now and again, when nature may decide to be bountiful. The deterioration in the capital base of agriculture has been, however, such that even under these conditions of bountifulness, heavy imports would have to continue, though at below peak levels.

None doubts that, if agriculture received due investment attention, we could easily make good our food shortages, which have been of the order of 6 per cent or less of the domestic output. Per acre production of food grains in India is among the lowest in the world. It is higher only than the average for African countries. In 1961-62, the Indian per acre yield of wheat was little better than one-half of the U.S. yield; and of rice about two-fifths. For both cereals, the Indian yields were less than one-third of the Japanese averages. Even simple innovations are known to bring ample returns. Better seeds alone have added to the output of rice 7 to 15 per cent; transplanting, in place of broadcasting, 20 to 50 per cent; and pest and diseases control 10 per cent. Better ploughing, more fertilizers and better irrigation should lift up the yields much higher. In all cases, the ampler returns may appear in the first crop year.

It does not, however, follow that we may soon see the end of the food crisis with any so-called "agricultural bias" to Planification, if by this is meant mammoth projects in the rural sector in place of more such projects in urban sectors, though this is the direction in which policy makers have been moving. This would only shift the geographical location

of resources misdirection, extravagance and wastages. Nor would increased imports, or manufacture at home, of fertilizers help to solve the food crisis, if we still continued Planification. While some of the fertilizers may find their way into increased food production, the chances are that, under pressures of relative prices the largest bulk of them may get drawn into the so called "commercial crops".

The only lasting answer to the food crisis is to organise a reversal of the flow of resources away from the so-called "basic industries" and from the programmes of indiscriminate industrialisation, into capital formation in the 70 million Indian farms. This cannot be achieved without a complete abandonment of Planification; of the 70:30 ratio of resource allocation between the public and private sectors; and we turn over a new leaf of more sensible policy measures. As food imports feed one in every eight of the population and mass starvation may result from a stoppage or drastic scaling down of food imports, any delay in the adoption of this reform may be disastrous.

VIII. Planification, Inflation and Foreign Exchange Crisis

The functional link between the crisis of inflation and Planification is via the union Budget. Unrestrained expansion of government expenditures and public sector investments have led to the Budget outlays exceeding the sum of Revenues, domestic savings placed at the disposal of the Government and foreign aid. We have been covering the resulting deficits by printing money.

It is significant that the current phase of inflation in India began in 1955-56, when Planification gathered momentum. The budget deficit of the year more than doubled to Rs.225 crores, money supply went up by Rs. 203 crore (10.3 per cent) and prices rose by 10.7 per cent. During the past decade, 1955-56 to 1965-66, large budget deficits having persisted, year after year, money supply rose by Rs. 2310 crore and prices by 75%. During the nine months ending December 1966, money supply went up by a further Rs.195 crores and prices by 21 per cent. There is little hope of inflationary deficit financing being eliminated unless we drastically revise our policy thinking.

It is easy to demonstrate that the foreign exchange crisis, which has survived all attempts to solve it, is a direct outcome of deficit budgets. Ordinarily, individual money incomes are the monetary counterpart of our respective contributions to the national product. When we expend these money incomes, or invest savings from them, we claim from the stream of the national product our choice of an assortment of goods, the result of other people's efforts. What we produce other take; what other produce, we take. So long as all money incomes represent the sweat of our brows, being the equivalent of individual outputs, aggregate money demand will be balanced by aggregate output.

When budget deficits appear and moneys are created to cover them, the government acquires from the stream of the national product output equivalent to the created moneys,, without adding anything at all to the stream. As the consumption and investment activity of the people would continue as before, the goods appropriated through deficit financing

would not be balanced by any reduction in consumption or investment. Deficit financing would therefore feed on goods set apart for export as it can impinge no where else, to begin with. Inevitably, public sector projects may require import goods as well. This may cause imports to increase. Lesser exports would reduce the available supplies of foreign exchange; and larger imports would add to the demand for foreign exchange and foreign exchange difficulties would increase as deficit financing persisted, the gap between the demand for, and the supply of, foreign exchange becoming wider by the amounts of deficit financing.

In the early stages of inflation, the foreign exchange gap, caused by deficit financing, was covered by, primarily, drafts on currency reserves and partly also from foreign aid. With the commencement of inflationary finance beginning with April 1956, the currency reserves ran out rapidly the total loss amounting to Rs. 645 crores in the decade which followed. When currency reserves fell towards rock bottom, around 1960-61. We had to rely more on foreign aid than on currency reserves. From now on, the stringency on the foreign exchange markets rested on the rate of flow of aid. The freeze on aid with the Indo-Pakistan war in September 1965 and the uncertainty of aid, since then, have deepened crisis conditions in the foreign exchange market.

IX. Planification and Decay of the Capital Market

The link between Planification and the crisis on the capital market is via the mounting revenue collections and the appropriation of the lion's share of domestic savings and foreign aid into public sector projects. Share values reflect the yields on them current and prospective; the latter depend on the volume of output and its acceleration; output is a function of thoughtful and effective investment; and investment varies with the availability of savings. The flow of national savings therefore, is the ultimate root determinant of share prices and stock market activity.

When private sector savings steadily rose from Rs.670 crores in 1945-55 to Rs. 1335 crore in 1960-61. the share prices index kept rising too, though subject to a certain time lag. It galloped from 48.5 in 1954-55 to 100 in 1961-62, a climb of somewhat more than 100 per cent in 8 years. With the sharp drop of Rs.115 crores in private sector savings in 1961-62 and their downward fluctuation thereafter, equity prices slipped downward, reaching an all-time low of 71.5 in December 1965 (1961-62 =100), a drop of 28.5 per cent. With the failure of savings to recover, the stock market has failed to register any significant recovery. The uptrend in equity prices since last December may be mainly speculative, resting, principally, on hopes that election results may induce policies away from interventionism.

The repressed flow of private sector savings is related to the steep rises in revenue collections and in public consumption. Revenues shift incomes from the pockets of the people into government treasuries. Virtually the whole of Revenue receipts are burnt up in public consumption, the amounts saved through Revenue surpluses for capital formation in the public sector being, since 1960-61, a meagre 3.8 per cent of the revenues. In the hands of the public, the same incomes might have added to savings vastly more, perhaps about 25 per cent, as the marginal rate of saving of the more

significant groups of the tax paying public may contrast with the rates of saving of the rest of the community.

On this basis, every increase of Rs.100 crores in Revenue collections may deprive the private sector of Rs. 25 crores of savings, while it may add Rs. 3.8 crores to public sector capital formation; and the net result may be a decline in national savings by about Rs. 21 crores. The converse may also hold true. With every staling down of Revenues by Rs.100 crores, private savings may go up by Rs. 25 crores, public sector savings may fall by Rs.3.8 crores, and national savings may show a net increase of about Rs. 21 crores. It follows that a revival of the capital market depends on a reversal of the steep rise in taxation, an integral part of Planification.

X. Need for Basic Policy Shifts.

We have seen that the growing social injustice is closely related to Planification. The widening gap between the rich and the poor and the squeeze on the middle classes ensued from the income shifts from the rest of the community into the pockets of a minority, the beneficiaries of Planification, namely, businessmen, industrialists, traders and the corrupt functionaries of the state, the instruments of these perverse income shifts being inflation, import licences, exchange controls, price controls, controls over the movement and allocation of goods, quotas and other restrictions, and the phenomenal expansion of the public sector. We have seen, too, that perhaps the bulk of annual increases in national income accrue, in effect, to the favoured sectors of the community, leaving the masses of the people as poor as before, or poorer. We have noted, too, that the disappointing achievement on the employment front is linked up with the pressurised shift of investment resources away from agriculture and consumer goods industries into the so-called "infra-structure" industries and industries, brought into existence under policies of import substitution. It has been estimated that Rs.1 crore worth of additional resources invested in agriculture may add to the national product about Rs.57 to Rs. 69 lakhs of output; about Rs.36 lakhs, if invested in cotton textiles; and about Rs.19 lakhs, if invested in iron and steel. Our policy preference for iron and steel and other "infrastructure" industries, and for import substitution, to the neglect of agriculture and of cotton textiles, has involved producing less in place of producing more for the same quantum of resources. This in large part explains the slow pace of growth of the Indian national product during the past Ph decades, despite a more than three-fold increase in investment.

Employment being a function of the expansion of the national product, not necessarily of the expansion of the volume of investment, the retardation of the national product has retarded, too, expansion of employment. It has been estimated that an investment of Rs. 1 crore would provide employment, at current wage rates, for 500 persons in large scale industries producing investment goods; for 1,150 persons in large scale industries producing consumers goods; and 4,000 persons in agriculture and the small and household industries. There is little hope of relief from the pressures of unemployment without basic policy shifts.

The foregoing socio-economic audit demonstrates the urgent need to discard the policies of economic interventionism, miscalled "Planning" of the past 1½ decades. The guide

line for selecting alternative policy measures should be the basic proposition that all economic and social well-being are necessarily linked up with the income curve. The aim of all policies, therefore, must be the maximisation of the national product. There is no better way of achieving this than to ensure that every unit of the factors of production is put to its most effective use. This calls for mobilising, for public good, the local knowledge of the people of competence regarding the possibilities of investment, in alternative channels, of investment resources, in places where these resources are available or located.

Nearly one-half of Indian national income flows from agriculture and 70 per cent of the population draws its living from it. Peasant farming dominates agriculture, the number of farm families being 67 million and the average holding per family, 5.5 acres. Tens of millions of independent production units exist in the rest of the economy, too. Cotton textiles, the oldest and largest Industry, which accounts for one-third of industrial production, comprise 2.0 million handlooms, scattered round the country, 80,000 to 90,000 powerlooms, and 478 large-scale mills.

Maximisation of the national product in such a context, demands full freedom over the disposal of investment resources to entrepreneurs and to the owners of these resources. Centralised control of resource allocation and of production would be both unpracticable and damaging. Freedom and flexibility in these matters are vital, in particular, because of the continually changing demand for end products, the changing factors prices and technological improvements; for best production results, these changes necessitate adjustments in the flow or shift, of resources among the several sectors and producing plants.

If we may quote professor Milton Friedman, the potentialities of economic freedom and of the free pricing mechanism as an engine of truly socialist progress i.e., progress for the common man - has been, time and again, demonstrated under all climate, historical and social conditions. "This is true", je sans, in the broad survey of history" and also "around the world today : contrast West Germany with East Germany, Malaysia, and Singapore with India and Indonesia; Thailand with Burma; Hong Kong, Formosa and Japan with Red China; pre-Castro and post-Castro Cuba". He continues : "I do not know of a single example of a predominately collectivist and centrally planned society in which the ordinary citizen has achieved a major and sustained improvement in the conditions of his everyday life, or a real hope for the future of himself or his children,"

XI. Effect on Defence Potential

To appraise the significance of the foregoing discussion to India's defence potential, economic activity may be classified under three broad categories : Consumer goods Trades, Capital Goods Trades, and Defence Trades. The consumer goods Trades, which cater to the consumption requirements of the community, are the largest of the three trades in all countries. In India, they may account for an order of 85 per cent of total productive activity. The percentage may be smaller in richer countries. In Japan, where the rate of saving is high, it may be of an order of 60 percent.

Capital Goods Trade come next. These trades provide the community with the machinery, equipment, accessories and spare parts to maintain undiminished its capital stock, and to expand this capital stock, at the pace determined by the flow of savings. In India, this part of economic activity may be about 10 per cent of total economic activity and perhaps, an order of 35 per cent in Japan. Most other countries may fall between the two limits.

Defence Trades represents that part of economic activity which caters to the needs of the defence services, and include munitions works, army workshops, and such fractions, large or small, of the civilian industries and traders which provide these services with food, clothings, vehicles, defence hardware and so on. In peace-time, Defence Trades are comparatively quiescent. In India, and perhaps, also in Japan, the defence sector may, currently, account for an order of five per cent of total economic activity.

In times of war, the relative importance of the three trades changes. Consumer Trades and Capital Goods Trades yield room for the expansion of the Defence Trades. The growth of Defence Trades may be slow or rapid, depending on the tempo of the war; correspondingly, the growth of the other two trades may taper, stagnate or even wane, as may happen towards the end of a prolonged, major war.

The growth of defence Trades may take place in several ways (1) taking up the slack or wholly idle resources, as when women, in place of gossiping at home, take over office work or drive trucks, to release men for the armed forces, or when unemployed workers and resources are drawn into the fighting machine; (2) acquiring directly the men and things needed by Defence Trades, through conscription or commandeering; (3) reducing personal consumption to a minimum so as to maximise savings with which to purchase war needs; (4) restricting fresh investments in Consumer and Capital Goods trades to a minimum so as to release resources for war production; (5) using the existing capital equipment of the community to exhaustion, with the minimum necessary maintenance, so as to divert capital maintenance resources for war production; (6) acquiring war needs through inflationary finance; and (7) imposing exchange control, to permit allocation of the maximum possible foreign exchange for feeding the war machines.

These seven several ways are a matter of machinery to feed the growth of Defence Trades, at the expense of the other two Trades. The upper limit to the growth of Defence Trades is determined by the magnitudes of the other two Trades and of their capacity to shrink, whereby to release resources for the building up of the Defence Trades. The larger these latter trades are, the larger may defence Trades grow to be. If we may define defence potential as the growth potential of Defence Trades, it follows that the larger the magnitudes of consumer Trades and Capital Goods Trades, the larger is the defence potential of the country. As rapid economic progress implies a corresponding expansion of Consumer Trades and Capital goods Trades, the faster the economic progress the larger becomes the defence potential, overall. Economic development does not detract from, but adds to, the striking power of a nation.

XII. Industrialisation and Defence Potential

If economic growth and defence potential move in the same direction, clearly, the peacetime interests of the Ministry of Defence lie in fostering policy measures which accelerate - not decelerate - economic and social progress, i.e., maximise the national product. The aim of policy, then, should be to let Consumer Trades and Capital Goods Trades grow as rapidly as possible, while keeping Defence Trades and the fighting machine in excellent trim and having in press - button preparedness, well stream-lined plans for a speedy expansion of Defence Trades. If so, it may be, generally speaking, short sighted policy to insist on accelerating the growth of Defence Trade in Peacetime at the expense of overall economic progress.

If the economy is as poor as India is currently, with the standard of living of the masses hovering close to the margin of subsistence, defence interests demand a speedy lifting up of this level of living. A starving people cannot have much leeway for tightening belts in order to feel well, or to feed for long, the fighting machine. We may insist in turning out, say, 12 Gnats a day from the production lines in Bangalore, in place of only four, per day, on the reasoning that this will add more to our defence potential. But the defence potential of a people cannot be great, whatever may be the number of Gnats produced each day, with famine conditions behind the fighting lines. As the saying goes, if in peacetime we have enough butter, we can hope for enough guns in war-time.

It may be short-sighted, too, to insist that we develop industries, in particular, heavy engineering industries, on the specious ground that they may be speedily switched over to the production of war needs. It may be true that, of two countries both at about the same stage of economic growth, the one having industries, which could be easily oriented for war production, may do better in a war than the other with lesser industrialisation. But the more normal experience is that economic progress brings with it growth of industries, too, consumer industries, the output of which is in universal demand coming first and capital goods industries following, in due courses; these developments may result from larger savings, ensuing from the larger incomes which attend economic progress. seeking diversified investment, when the yields on investments in the traditional lines tend to fall below the norm.

Economic growth of a vast country like India, with a large and growing domestic market, must, as a matter of course, induce industrialisation. Thus, it is not in the interests of the Defence potential of a country to foster industrialisation at the expense of the pace of overall economic and social progress; the accent on overall progress should bring with It progress in industrialisation as well, as has been demonstrated by the experience of country after country. In the case of India, it is a matter of the utmost urgency that the level of living of the masses should be lifted up, as speedily as may be, above the margin of subsistence.

XIII. Planification and Defence Potential

The economic complex that has emerged from Planification of the past 1.5 decades cannot be said to have materially added to India's defence potential. May be that we are today in a position to manufacture, within the country, much of the critical items needed in a war, including aeroplanes, heavy-artillery, tanks, trucks, fire-arms, munitions, and radio and telephone equipment. But, as we have seen, the defence potential of a country does not rest on the mastery of the technological know-how for fabricating these items, though this mastery may be, doubtless, of great value in times of war, as in times of peace. If a country has, ready at hand, the economic wherewithal for doing so, it may, on balance, do vastly better to purchase outright the sophisticated needs of war from friendly and neutral nations, than attempt to fabricate them at home at tremendous cost in resources and in economic progress.

This aspect of the defence potential merits our attention lest we imagine that this potential has grown materially because we have progressed into the supersonic age, with the nuclear era within our grasp. It may be much more relevant to dwell on the development that our standard of living today measured in real terms, i.e., in terms of the consumption of food and cloth, may be poorer than before world war II, and hardly better than when the second plan began. India's defence potential may take strides forward if the industrialisation of the country took the more natural course, via the accelerated expansion of the overall national product, instead of being artificially fostered through a pressurised diversion of resources away from agriculture and consumer production, to the detriment of the overall national product. A basic policy shift away from Planification is, thus, essential, too, in the interests of adding to our defence potential.

Possibly, the defence potential of Pakistan is progressing a shade faster than India's. In 1955, India's dollar assets were five times that of Pakistan; in 1965. they were only 2.7 times. During the same interval, India's national income, as a multiple of Pakistan's national income, fell from 5.5 times to 4.6 times; simultaneously, per capita income (at current prices) in Pakistan rose by 8.2 per cent, per year, as against a rise of 7.1 per cent, per year, in India. Though the inflationary pressures in both countries - judging from the expansion of money supply - remains bad, the position in India is perhaps, a shade worse than in Pakistan. The difference in the pace of progress of the two countries may due to certain flexibilities in the policy measures pursued in Pakistan, in particular, in respect to import restrictions and exchange control; and our policy rigidities in these matters.

STUDY TOPIC - 8

THE RIGHT ROAD TO INDIAN PROGRESS *

The increasing interest of the U.S. in Indian economic development is naturally most welcome to the Indian people. India offers a magnificent opportunity to prove that there can be no conflict between progress and freedom, and that poverty can be overcome more quickly through the dynamics of a free-market economy than through statist totalitarian planning. Unfortunately, India today is deeply committed to the philosophy of government planning, and has been urged to continue along this road by many Western economists. It will be the thesis of this article that such planning is dangerous for individual liberty, is particularly unsuited to India's economic needs, and is in fact resulting in the large-scale wastage of foreign aid given to India.

It is a cliché of the times that underdeveloped countries like India must resort to wide-scale planning if they are ever to progress. But the great industrial democracies of today, including the U. S., were once underdeveloped countries and achieved their development through the market system of economy. In recent years the potentialities of the free market have also been strikingly demonstrated in the case of West Germany, Italy, Japan, and Hong Kong. Such policies have never had a fair chance in free India. The dynamics of progress were weighed down by controls inherited from the war, and before the Indian economy could gather momentum it fell victim to increased statist direction. India's two five-year plans (the first completed in March, 1956, and the second now in operation) have aimed to increase national output by increasing investment, according to an elaborate government program. While this program has so far avoided the total controls of Communism, it has resulted in increasingly dangerous forms of government intervention. As C. Rajagopalachari, one of the India's great elder statesmen, has warned; "the state is becoming a giant entity in itself, menacingly poised against the citizen (and) interfering with his life at all points."

The general commitment of India's ruling Congress party is to establish, as speedily as may be, a "socialist pattern of society." This objective includes "state ownership or control of the strategic means of production." state participation in "banking, insurance, and trading," a "ceiling on land holdings" and a "ceiling on net personal income after tax" of thirty times the national average income per family. In addition to direct government ownership of certain industries, the state seeks to guide most investments by fixed priorities; it allocates and controls the price of steel, cement, and rubber; and has preempted over 50 per cent of all imports, including food grains, for its own account. Some 85 per cent of foreign aid has been pushed into the public sector of the economy.

Meanwhile, direct tax rates in India are among the highest in the world. At certain income levels, total personal taxes (income tax, super tax, wealth tax, expenditure tax, gift tax) exceed total incomes. This has inevitably discouraged individual initiative and has invited widespread tax evasion. While revenue receipts have exceeded planned targets, this has not benefited Investment. For the increased receipts were wholly absorbed by increased social-service expenditure. In seven years of planning, the administrative expenditure of the government rose nearly three times as fast as the national income. The public debt of the central government and the state rose by over 80 per cent.

This expansion of state activities is not only politically dangerous but has led on to unhappy economic consequences. Over the past decade India has, of course, made some economic progress, but statistics can be misleading. India's national income has risen fairly sharply in money terms, but India has also suffered from persistent inflation, and in the past three years prices have risen at an annual rate of 8 per cent. While real national income has advanced by 25 per cent since 1950, or at an average rate of 2.8 per cent per year, population has been growing by between 1.3 per cent and 1.6 per cent per year. Hence income per capita and income per family have shown relatively little change. Indeed, for the past three years income per capita has stagnated at about \$ 58 per year, just when the government has been intensifying its planning efforts.

What Planners Forget :

Moreover, such bureaucratic planning, with its emphasis on heavy industry, has little to commend it in view India's vast size and existing structure of production. Agriculture today accounts for 47 per cent of the Indian National Product, and is predominantly in small farm operations. The national average of farm land per agricultural family is 8.5 acres, and there are some 50 million holdings in the country. Industrial factory establishments account for only 13 per cent of the Indian National Product, and small industrial enterprises for 9 per cent. In an economy of this kind it is essential that desperately scarce capital should find its way to the small farmer and factory proprietor. It is also essential that the economy be flexible and largely self-regulating. This cannot be done by centralized bureaucratic planning from the top down. The bureaucrat may well keep track of a few big enterprises. He simply cannot allocate savings and other resources efficiently over India's tens of millions of small production units, each requiring a knowledge of local circumstances and conditions. What India and other low-income economics require is the guidance of the free market, which disperses, rather than concentrates, economic decisions, and which provides a self-adjusting and humane process for allocating scarce resources to competing needs.

To advocate the philosophy of the free market for India does not mean returning to the free booting methods of laissez faire. In an enterprise economy, the state has obvious responsibilities for defence, the maintenance of internal law and order, the prevention of monopoly, and the provision of a flexible and efficient monetary system. It must also undertake such needed works and services as irrigation, roads, communications, education, and public health. Through fiscal and administrative inducements, the

government can also see that heavy industry keeps up with the needs of society, though in general the development of heavy industry should follow, not precede, the growth of light industry. In an expanding economy of 415 million people, low down on the scale of development (there are seven phones in India per 10,000 people as against 4,000 in the U. S .A.) such a minimum program should be enough to stretch the genius of any administration for several five year periods.

Farmer in the Net:

The point is that the government should concentrate on the essential tasks that only government can perform. While allowing private initiative and private choice to determine the course of production and distribution. Such an approach is particularly needed in Indian agriculture, from which 70 per cent of the population draws its living. With agricultural yields among the lowest in the world, the returns on improved farming methods could be enormous. Maximization of output would overcome poverty and unemployment and at the same time provide the sinews for industrialization. Feeding and clothing a hungry people must have priority over more sensational schemes.

Unfortunately, restrictive government measure are curbing agricultural development. These measures include curbs on credit, land transfers, and the prices of food grains, tea, coffee, rubber, sugar and sugar cane. In addition, the government has now divided the national grain market into zones, ten for rice and seven for wheat, which has accentuated regional price variations, penalizing consumers in the deficit areas and producers in the surplus areas and threatening a fall in certain export crops. The entry of the State into the food grains market as a buyer, along with inflation, stiffened prices in 1958-59, despite favourable harvests and large imports. Now some want the government to take over trading in food grains entirely, and before the current fiscal year is out, all fourteen states in India are expected to limit land-holdings. It has even been proposed that the nation adopt "cooperative" farming, which some interpret as the end of family farming and private ownership of land.

Ceiling on Dhoties:

Even if this does not happen, it is obvious that over regulation - actual and contemplated - is inhibiting a sustained and intensive effort to develop agriculture. What now of industry? The case of textile production, which accounts for 36 per cent of all industrial production. is significant. Textile manufacture is in the first place severely controlled by import regulations, which apply to machinery, spare parts, long-staple cotton, and chemicals; a change in any one of these regulations may upset production schedules and lead to a costly search for substitutes. In addition, efficient enterprises cannot freely expand to optimum capacity if they are located in larger so-called "surplus" textile centers. Meanwhile the government resists the closing down of inefficient mills for (ear of putting men out of work and instead takes over the operation of such mills on its own

account. There are production ceilings on certain types of cloth (dhoties and prints); the borders of white saris must satisfy certain restrictive requirements; the production of dyed saris is banned; and there are limitations on the counts of the yarn used in the warp and weft. The output of yarn further more is subject to distribution control. Some curbs are designed to protect the market for hand-loomed products, but the cost has been tremendous. Evidence of this cost is found in the semi-stagnation of mill-cloth output at a time when national income and industrial production have been advancing, and in the steep rise in the price of certain types of mill cloth.

The case of textile regulation, however, is simply typical of government regulation of all enterprises. Under the Indian Companies Act of 1956, the government has comprehensive control over the working of joint stock companies, including their promotion and capital structures, meetings and procedures, formation of and changes in boards of directors, limitation of dividends, and even such details as "the power to make loans, the power to enter into contracts, the power to sell, lease, or otherwise dispose of property, the power to remit or extend the date or repayment of debts, and the power to borrow on behalf of the company". The aim of these provisions is "to prevent abuses and malpractices". But in practice, they detract from flexibility and quick policy implementations, which are essential to full business success. Their effect is loss of efficiency, which is all too often covered up by artificial profits due to inflation.

Planned Overcapacity :

More seriously, the government's own program of planned investment is also contributing to inefficiency and to the misuse of resources. Indeed, planning has actually created overcapacity in some instances as a "precaution" against scarcities. It is ironic in this connection that use of water from major and medium irrigation projects, for instances, is now of the order of only 65 per cent of capacity. Unused capacity, though of a lesser order, exists, too, in the power projects. Excess capacity of 40 to 90 per cent exists in forty industries, the bulk of the excess falling in the range of 40 to 50 per cent. Investments leading to excess capacity of course, increase the national income figures. But when such facilities remain idle, they do not add to the stream of output.

In addition, the planners have needlessly reduced India's output by their efforts to direct savings away from agriculture and lighter industries, where returns are high, into heavy industry and state-run enterprises, where returns are low. The average return of various state enterprises, involving an investment of \$185 million, has been estimated at less than 1 per cent, or far below the return on capital in other industries. The whole publicly owned and directed sector of the Indian economy has grown much faster than the availability of trained personnel to direct the effort. There have been frequent charges of incompetence and even corruption among State officials.

The economic effects of the misdirection of resources have now begun to show up in the statistics. In the first five-year plan an increase of a little more than \$3 billion of gross investment yielded an annual increase of \$1 billion worth of gross output. But during the first two years of the second five-year plan, it required over \$ 5 billion of investment to yield a similar increase in product. In other words, increased investment is resulting in

relatively less product. The worsening of the employment situation in India is directly related to the misuse of capital under central planning.

In India's present situation, certain theories propounded by "visiting experts" are dangerous. Most of these visitors have been ardent advocates of the government-directed economy. At his monthly press conference in December, 1959, the Prime Minister stated that more and more people of completely different ideologies who had come to India and studied these matters had come to identical conclusions on the importance of planning and building heavy industries". In November, 1959, at New Delhi, Professor Max Millikan of the Massachusetts Institute of Technology supported the theory of the "big push" and argued that since India has "huge untapped reserves" of real resources, the nation had a better chance of going over the hump into the modern age, if it "tried to do too much rather than too little". He also argued that these resources will be augmented if programs of development are well "synchronized", and that the resulting "momentum" may catapult the country into a satisfactory "take-off.". It is hard at times to know what this kind of familiar jargon means specifically, but it is in general highly misleading. Except for the idle capacity in certain industries, which the planners themselves have created, there is today no vast reservoir of unused resources in India; nor can these be conjured up by talk of "synchronized" programs. There are, of course, potential natural resources in the ground and there is an abundant supply of unskilled labour. The real job is to put these to productive use by releasing the forces of enterprise and initiative that central planning now throttles. As experience has shown, 'planned over-investment, particularly in heavy industry, is simply self-defeating.

The Cost of Inflation:

Central planning, plus big government spending, must also be held responsible for what is perhaps the most troubling aspect of the Indian economy—namely, inflation. Inflation has nibbled away the real income of the Indian masses. At the same time, inflation has all too often benefited the wealthier classes. Inflation brings to traders; businessmen, and industrialists windfall gains to which they have no moral or economic claim. Price controls have given rise to black markets, which in turn, yield "black" incomes to clever traders who are frequently able to escape taxes. As the result of inflation and other factors, it is estimated that what may be called "anti-social" shifts in income in India now run to some \$630 million per year, or 2.5 per cent of the national income. Indeed, the British economist, Nicholas Kaldor, estimated that in 1953-54 tax dodging alone ran to between \$420 million and \$630 million. These shifts in income, whatever their size, account for the fact that the business and industrial classes of India are comparatively prosperous, even though real national income per capita has not been advancing rapidly. And this prosperity of the upper classes in turn may explain the paradox that businessmen and industrialists have so far not mounted an intense and effective opposition to the obviously socialist policies of the government.

Inflation has also had more far-reaching repercussions. Domestic inflation invariably penalizes a country's exports, since it raises costs and at the same time swells the potential demand for imports. Despite the fact that Indian national income and production

have increased, Indian exports remain at an average of only 65 per cent of previous war levels while imports have been held at about 90 per cent of those levels through the imposition of import restrictions and exchange controls. Instead of a healthy balanced growth of both exports and imports, there has been an unhealthy disbalance punctuated by desperate sudden efforts to make both ends meet. In 1957-58 imports, including those used by industry, were drastically slashed and production suffered. Today India is faced with the dilemma of unemployment if import restrictions are tightened, and of large external deficits if the restrictions are liberalized.

Import restrictions and exchange controls have had other adverse effects. They have led to attempts to manufacture in India products that could be produced more cheaply abroad. They constitute a subsidy to favoured import groups and industries and are an immense and perverse addition to statist power over the economy. Controls, plus an artificial exchange rate on the rupee, have furthermore produced phenomenal gaps between the internal and external prices of import goods, and hence have encouraged attempts to beat the system. There is today in India an unseemly traffic in import licenses, which are sold on the black market at 50 to 300 per cent above their face value. There is also a large smuggling trade in gold and diamonds and other goods such as watches, spices, playing cards, and cigarettes, which slip through the control network and use up needed foreign exchange.

The Wastage of Aid

Beyond all this, controls have not solved India's balance-of-payments problem. In 1955-56 the gap between India's total payments abroad and income from abroad was on the order of \$ 64 million. During the first three years of the second five-year plan-i.e., between April, 1956, and April, 1959-this gap widened to a record figure of \$ 2.7 billion as the result of increased imports, inadequate exports, and concealment of foreign exchange. This enormous gap was covered in part by India's drawing on its currency reserves, and in part by aid from various foreign governments. But India cannot afford to draw on its currency reserves indefinitely and in February they were only about \$260 million above legal requirements. Hence India is increasingly dependent on foreign aid, which in 1958-59 actually covered 89 percent of its payments deficit. Such aid takes many forms. It includes large quantities of surplus agricultural products shipped to India from the U. S. under Public Law 480, as well as loans and grants from the U. S. the U. K., Canada, Germany, the World Bank, and other sources. During the first five-year plan, foreign aid actually utilized amounted to \$450 million. During the first three years of the second plan, such aid was more than tripled and reached \$1.56 billion.

There is no doubt that such aid has kept the economy going and has patched up the effects of mistaken policies. But it must be asked by both the receivers of this aid and the donors whether it has really been used effectively toward the ends It is supposed to serve-i.e., real capital formation and a rising standard of living for the people. Here the answer is discouraging. There is strong evidence that during the first five-year plan much of the foreign aid given to India was in effect diverted into gold smuggling, and that in fact

most of the planned investment of the period had to be financed out of domestic savings. During the second five-year plan the diversion of aid to non-development uses has continued. Between April, 1956, and April, 1959, gold smuggling alone may have run to as much as \$365 million, using up scarce foreign exchange. While the planners have been talking about investment, inflation and government spending have swelled the demand for consumer goods of all kinds; and this demand has been further increased by the rise in "concealed incomes" derived from sales of commodities at illegal prices, black-market sales of import licenses, and widespread tax dodging.

In addition, inflation and the fear of rising prices have stimulated undue accumulation of inventories, particularly of food grains, the largest single item of trade and consumption. During the past three years imports of food grains have run to 10 million tons, costing \$890 million, and in 1959 imports continued at a high level despite record domestic harvests. At least in 1959, the increase in imports seems to have gone hand in hand with increase in imports seems to have gone hand in hand with increased hoarding. What has happened is that grains, originally stockpiled in the U. S. under its own farm program, have been transferred to India in the belief that this would alleviate distress and strengthen the economy. But at the same time Indian traders and farmers have been increasing their holdings of grains in inferior storage facilities that are plagued by rats. This, in effect, is a wastage of aid, and in any case the net effect of the transfer has not benefited Indian consumption or increased real capital investment. It is, of course, pointed out by advocates of the present aid system that rupees paid by India to the U. S. Government for food or other imports can be and often are, re-loaned for development projects. But such re-lending of funds can be highly inflationary and in effect makes the situation worse, not better.

The critical point is that foreign aid has not augmented capital formation nearly as much as its volume indicates. As already noted, during the first three years of the second five-year plan, aid plus drafts on currency ran to \$2.7 billion. But net capital formation from budgetary sources (and most aid flowed through the budget) amounted to only 1.5 billion. Even allowing for private capital formation, these figures reinforce the conclusion that funds have been diverted to non-development uses. This may come as a surprise to many people who point out that often foreign aid (for instance, loans from the World bank) is "tied" to specific development projects-dams, steel mills, harbour development, etc. Hence, it is argued, aid in these cases must have forwarded development. But "tied" loans do not in fact ensure this result. Foreign aid and domestic savings get collected into the same reservoir of resources. If total resources are being wasted, it is pointless to argue that foreign aid has been somehow magically insulated from the wastage by leakproof accounting systems. No system of accounting can prevent inflation from diverting resources to non-productive uses. And this experience is not confined to India. Inflation in Turkey has led to the same result. As a World Bank Survey of 1951 observed: "The ratio of real investment to the gross national product of Turkey did not increase appreciably in the postwar period as compared to 1936, even through substantial amounts of foreign assistance were received to finance investment".

The Way Out

It is essential for India, no less than for the U. S. and other donors of aid, to remedy the present situation. For it should be emphasized that many types of aid are not outright gifts. They involve for India a growing burden of amortization and interest payments, which today may be on the order of \$250 million per year. The servicing of debt is a manageable problem, if productive capacity is being increased. It becomes an intolerable burden on people, if the debt is incurred for wasteful uses. The current thinking of the Indian planners seems to be that debt service can be met by increased borrowing. This, of course, avoids rather than solves the problem. Nor is there any hope of bettering the situation by instituting more vigorous specific controls, of which India already has too many.

The real way to make foreign aid effective is to adopt a radical change in policy. There is overwhelming need for fiscal retrenchment on the part of the Indian Government. There is need for restriction of state enterprises and welfare measures to their rational limits. There is need for monetary and exchange-rate stabilization, for a cessation of monetary inflation, for the lifting of exchange controls, import restrictions, Price controls, and for the restoration of the price system and the competitive market. Were these things done, the forces of private initiative would go to work; and limited foreign aid would fulfill its purpose, stimulating both domestic and foreign private investment. In the process both light industry and heavy industry would benefit; and it would be perfectly possible to ensure control of key industries by Indian nationals. Free from useless regulations and assured of sound money, all India could prosper. Normal and healthy growth would replace forced-draft Improvisation.

There is no doubt that when foreign aid is made conditional on sensible internal economic policies on the part of the receiving country, it raises difficult issues of sovereignty. But we must not despair that these could be overcome. The International Monetary Fund, for instance, has found a way to be useful without abridging sovereign rights. When the United Kingdom drew on the Fund for help in 1956, it guaranteed that "strict financial and credit policies would be pursued, that quantitative restrictions would not be reimposed, and that the value of the pound sterling would be maintained". Going further back, Marshall-plan aid was canalized through a special agency, the Organization for European Economic Cooperation which took as one of its principal aims the monetary stabilization of European countries, and the relaxation and removal of their restrictionist policies on trade and payments. It well may be, following these precedents, that a special agency, representing both borrowers and lenders, is needed in the case of the underdeveloped countries. But such an agency will succeed only as it puts first things first, and as it insists that tested and proved economic principles replace the modern fad of central planning.

Back Door to Communism

Above all, it is necessary to see the issues now facing India, as well as other underdeveloped countries, in large perspective. The generous aid so far given by the American people and others is not animated just by humanitarian motives important and welcome as these may be. Aid to India in particular has been justified by the realization that India is the key to the prevention of the further spread of Communism throughout Asia. But the Communist threat is not just an external one. The fact is that if a nation carries statist measures too far, it can unintentionally slide into a Communist form of economic organization. In India today there is considerable danger of this happening, and choice between the free and the socialist economy cannot be indefinitely delayed. Present planning measures are clearly breaking down, yet India is now contemplating still a third five-year plan more grandiose than those that have preceded it. The obvious threat is that in trying to carry through this new effort, India will adopt ever more stringent totalitarian controls with consequent loss of individual and political freedom.

Such a denouement would be a tragedy of the first order —the more so because it is wholly unnecessary, India, though poor today, has a magnificent potential and future ahead. That potential can be realized only as government confines itself to its proper sphere of activity and allows the forces of initiative and freedom scope on the farm and in the factory. It can be realized only as India takes its stand for the principles of liberty under the rule of law and builds an economy consonant with those principles. This in the first instance is the responsibility of the Indian people and their government, but the outcome may well be affected, also, by the policies of the rest of the free world. Nations extending help cannot divest themselves of their responsibility to ensure that aid, in fact, aids.

STUDY TOPIC – 9

FREEDOM AND ORDER* IN THE UNDERDEVELOPED COUNTRIES AND THE PROBLEM OF FOREIGN AID

We shall examine the issue of "Freedom and Order in the Underdeveloped Countries and the Problem of Foreign Aid", in its Indian manifestation. At the close of 13 years of centralised planning, authoritarian control of the economy has assumed proportions which should cause great concern. This control operates, in the field of international trade, through import licensing, monopolistic acquisition of the foreign exchange receipts of the country and of their allocation to importers and other claimants: and, in domestic economic activity, through control over the disbursement of national savings, delimiting the area of operations of private enterprise, price control, allocations of essential commodities in short supply, other distribution controls, regulation in minute detail of the working of industrial and business enterprises, and the spread of public sector undertakings.

Import licensing and exchange control are legally comprehensive. No imports-minor items in the personal baggages of travellers apart-of any kind are allowed without a licence. Most licences are strictly rationed, the Open General license being now applicable only to small gifts of books, blue prints and drawings and bona fide samples. No foreign exchange, for whatever purpose, may be had without an official permit. Export are generally free - the failure of exports to move has, in fact, led to the offer of various kinds of export incentives - but all export receipts have to be surrendered to the Reserve Bank, or, which is the same thing, to the authorised foreign exchange dealers.

Some flexibility to this legally rigid arrangement is provided by illicit imports of commodities and by illicit transactions in foreign exchange at above the official exchange rates, the foreign exchange finance to pay for the illicit imports being provided by the illicit market in foreign exchange, the latter becoming a free market when the transactions are put through outside the national frontiers, as in Honk Kong, Zurich or New York.

Clearly, there is no data on the amount of the exchange transactions put through the illicit (or free) market, to give us a rough measure of the illicit imports, and of the concealed transfers of capital and other funds abroad. But market gossip believes the magnitudes to be considerable, one commentator venturing out a figure of Rs. 2 billion per year, which is roughly one-third of the open exports of the country.

Control over the disposal of domestic savings is exercised through capital issues control and the rule that no enterprise may started, or an existing one expanded, without an

official licence: through requiring insurance companies, the banks and trustees to invest parts of their funds in government debt; through collecting small savings by way of the post office savings banks, and special government debt to attract small savings; through the sales of ordinary government debt to the public, to the commercial banks and by passing on to the Reserve Bank the residual of an issue, not taken up by the public and the commercial banks; and by the control operating through the monopoly over all exchange transactions over the inflow of funds from abroad, whether as foreign aid, commercial capital, or private funds of foundations or other agencies.

In this manner, the bulk of the national savings are channelled into public sector undertakings, some of these savings being forced savings, momentarily extorted.

It is difficult to estimate precisely the amount of the national savings appropriated by the public sector. From plan statistics we find that the public sector appropriated over 50 per cent of the total plan resources in the First Plan (1951-52 to 1955-56) and about 60 per cent in the Second Plan (1956-57 to 1960-61); the percentage in the Third Plan is well over-thirds. These percentages (as a result of two factors) understate the actual ratio of the resources forced into the public sector.

First, plan statistics of investments in the private sector, and in agriculture, in particular, are believed to be exaggerated; this means that the ratio of public sector appropriations to total plan resources is under-estimated. Secondly, the amount of foreign aid, received in foreign currencies, is valued in the plan accounts at the official exchange rate of the rupee. The rupee being very much over-valued, this considerably understates not only the actual magnitude of foreign aid, but also the amount of plan resources appropriated for the public sector. Since 1958-59, private sector earnings of foreign exchange have exceeded the amount of foreign exchange allotted to the private sector by over Rs. 2 billion. The entire amount of the foreign aid, whether meant for the public or the private sectors, has, therefore, in effect, gravitated into the public sector. If we allow for this factor, the actual ratio of total resources drawn Min the public sector may be larger even than the magnitude emerging from an adjustment for currency over-evaluation of the foreign aid granted to the public sector alone. On the other hand, when foreign aid is tied to be spent in the country of the donor government, purchases made against the aid may not be at competitive world prices.

With this essential processing. the share of total plan resources currently acquired by the public sector may be about 70 per cent of the total resources, including foreign aid. This is a very serious matter for the survival of economic freedom. With the marginal pace of nationalisation of the available resources so high, it is a question of time before the State becomes the major owner of the capital assets of the economy, and the major employer.

The delimitation of the area of operations of private enterprise is to be found in the Industrial Policy Resolution of the Government of India issued in 1956.

It classifies industrial activity into three categories. The first category, which is reserved exclusively for the State includes the bulk of heavy industry, mining, the processing of minerals, most heavy machinery and equipment, telephones, much of electric equipment,

defence equipment, aircraft and the operation of air and rail transport. The second category, which will be progressively State-owned and will have assured fresh room for private enterprise only to supplement the effort of the State includes machinery and equipment outside the first category most of heavy and fine chemicals and road and sea transport. The third category will include all the remaining industries, and will in general constitute part of the private sector, the State having the right to establish undertakings in this area as well; moreover, the aim of policy would be for private sector enterprises to be in the hands of cooperative societies and for the spread of state trading.

Price controls and distribution controls apply to a number of essential commodities, consumer goods, raw materials, accessories and equipment, the list being extended following the emergency of October 1962. But price controls are generally not effective. They amount to little more than notification in the official Gazette, of the controlled prices, the posting of these prices in shop premises, and occasional prosecutions. Even in cases of official control over stocks and their distribution through permits, as in the case of cement and iron and steel, most buyers obtain part or whole of their supplies at black-market prices, payments being made in cash, not cheques. We do not have in India, price-repressed inflation, with its counterpart of excess liquidity, as during the war in some countries where price controls were generally effective; the pattern of economic disorder which has resulted from price controls is index number-repressed inflation, black-markets, and (tax-free) black incomes (to dealers, producers, and their corrupt official collaborators), a counter-part of black markets. The total costs of price control to the body of consumers, viewed as whole, would be more than the costs in the absence or price controls, as the costs of the black-market set up have now to be added on.

The ineffectiveness of price controls is reflected in the divergent movement of the quantity of money and index numbers. From 1960-61 to 1963-64, money supply rose by 34 per cent, but the general index of prices rose by only 11 per cent, and there was no excess liquidity in the economy. The index numbers did not register the full amount of the price rise, as the calculating machines computing the index number were fed with controlled prices. On the other hand, from 1955-56 to 1959-60, when price controls were less extensive, money supply rose by 16 per cent, and prices rose by 11 per cent.

The Joint Stock Companies Act provides for comprehensive control and regulation of joint stock undertakings, in the public interest. The establishment of a company, the expansion of an old one or the closing down of an inefficient one, - all require licence. The Act provides for government intervention in such details as the manner of conducting the meetings of Boards of Directors, appointments to and retirements from the Board, dismissal, transfer and recruitment of the staff, borrowings, investments, access to the capital market through the issue of shares and debentures, ownership of subsidiaries, and so on. The vexatious character which governmental intervention can take may be illustrated by the case of cotton textiles, which account for about one-third of industrial activity in India. and which provide the clothing needs of virtually the entire population. The progress of rationalisation of the existing units in the textile industry is subject to approval by the Government and the Trade unions; the addition of spindles and looms is not possible without permits, and permits are not ordinarily granted in the case

of mills located in the established textile centres, even to replace discarded spindles and looms; the closing down of inefficient mills is not generally permitted, the government even stepping in to run such units; the production of certain varieties of cloth, dhoties and prints, are subject to ceilings, each mill being assigned a quota; the borders of sarees have to satisfy certain restrictive limitations; the production of dyed sarees is banned; limitations exist on the counts of the yarn in the warp and weft and on the quantities that may go in the reed and pick: the output of yarn is subject to price and distribution control and the output of cloth is subject to price control; certain percentages of the production of mills must be exported, failures involving fines on the shortfalls of the exports on the quota.

These hurdles in the way of the flow of textile output has caused a slowing-down of the most efficient and the largest part of the cotton textiles industry, its output going up by but 22 per cent in 10 years; while the output of the decentralised sector, the favoured sector of the industry - small, scattered units of power looms and hand looms - rose by 135 per cent during the same interval. The total output of cotton textiles, however, remained semi-stagnant since 1955, or the increase in output lagged behind the rate of growth of population, in the context of a 100 per cent increase in industrial production and a 47 per cent increase in the national product. Moreover, the preference of the consumers was for the output of mill cloth, not for that of the favoured sector; this is evidenced by the fact that, during this period, the prices of mill cloth rose much more sharply - by more than double the range of the rise in the brands of handloom cloth - though some of the difference is due to the official subsidy to handloom.

The government has similar powers of superintendence, control and direction over the banking system, the cooperative movement and the commodity and bullion markets. It has powers for influencing the press through official advertisements which bring considerable revenues to newspapers, the volume of which has increased with expansion of the public sector, through its control over the distribution of newsprint, and, as one national newspaper complained, also through the Wage Boards, which arbitrate between the managements and the trade unions.

On top of these strangleholds, the Administration can paralyse or financially ruin any business enterprise, large or small. through restricting, delaying or denying the issue of import licences to meet its import needs, or the issue of permits to acquire the domestically produced essential supplies. This sledge hammer is accompanied, on the positive side, by the colossal patronage at the disposal of the Administration, the largest portfolio of patronage being. first, import licences and, second, contracts from the Administration and public sector undertakings; the money value of the two may be of the order of Rs. 6.5 billion per year. Though controls harass, they also bring windfall gains in the form of monopolies, semi-monopolies or sheltered markets. Many cotton textile mills, for instance, were in the red in 1955-56. With the restrictions imposed on the additions to spindles and looms, though the quality of the output and the efficiency of production remained unchanged, losses were soon replaced by profits; and despite the irksome textile controls, the mill-owners as a body became active supporters of planning. For similar reasons big business in India is, generally, a strong advocate of planning, the

Federation of Indian Chambers of Commerce and Industry arguing that the Third Plan was not big enough. The government and its agencies are a large employer today of the current additions to the educated labour force at all levels, including highly skilled professional men and technicians. This brings to the Government employment patronage.

The sledge hammer and the patronage exercise their sway-over the more vocal urban population; the rural parts of plan projects and the so-called community development schemes exercise their sway over the more influential among the rural population. With 80 per cent of the people illiterate and most of them perhaps fatalistically resigned to a life of poverty, opposition to the policies of planning is meagre. The powerful body of vested interests, which have gravitated around it, would in any case, strain every nerve to perpetuate planning.

The planners, therefore, seem to be firmly in the saddle. They have availed of major national crises to tighten and spread government's hold on the economy. The emergency powers assumed upon the Chinese attack on India in October, 1962 remain in the armoury of the Administration, through the need for them perhaps no longer obtains. The prevailing food crisis - in particular, the soaring food prices - is blamed in large part on the trade; we are told that the trade cannot be relied upon in times of emergencies to collaborate with the Government to prevent food prices from soaring and that it is, therefore, intended to extend state trading in a big way as part of long-term measures to prevent recurring food crises. The nationalisation of all commercial banks - the largest bank in the country has already been nationalised - and of the external trade of the country are often suggested, the former for combating inflation and the latter for combating balance of payments difficulties. Private property in agricultural land beyond prescribed limits, generally 50 acres per family, is illegal. This, in effect, limits agricultural income to Rs. 300 per month per family. Limitation of urban private property has been promised its turn in the Congress election manifesto. None of these drastic measures and proposals have aroused any extensive opposition or resistance.

The policies of the past 13 years have produced disastrous economic and social effects. First, the appropriation of 70 per cent of the investment resources (including foreign aid) by the public sector has led to agriculture proper — the 67 million farmers with 5.5 acres of land each, on average, who have been always the most neglected part of the economy in respect to the supply of credit — getting less than its due share of these resources. The outlays on the agricultural parts of the public sector but create and feed agricultural white elephants, the mammoth river valley and irrigation projects, and the so-called community development schemes. Much of the latter represent the creation of extravagant rural overheads which ill-befit the poverty-ridden and capital-starved rural landscape; and about 30 per cent of the irrigation facilities remain unused, the result of uneven economic development. Industry, and iron and steel, heavy engineering and heavy chemicals, in particular, have received the lion's share of attention. The credit-starvation of agriculture is reflected in the fantastic interest rates on farm credit. The Rural Credit Survey, 1954, conducted by the Reserve Bank, placed these rates at 88 per cent, per annum. There is no indication that the situation has improved since the date of the Survey.

Secondly, the over-emphasis on industry at the expense of agriculture has led to industrial production being pressed far beyond the margin of production — as may emerge under entrepreneurial freedom and an equilibrium exchange rate — regardless of costs and the quality of the output; and agricultural production and the production of cotton textiles, are prevented from reaching the margin. The extension of industrial production beyond the margin - the uneconomic use of investment resources — is reflected in the vast disparities between the landed costs and the market prices of import goods, though these disparities reflect, too, domestic inflation and the over-valuation of the rupee. The gap between landed costs and market prices may vary from 30 per cent to 500 per cent or more of the landed costs, depending upon commodities. The prevention of agricultural production and the production of cotton textiles from reaching the margin is reflected in the semi-stagnant domestic output of foodgrains and of cotton textiles, in the context of the expanding population. The shortage of food is partly covered by massive, imports of foodgrains from USA; and the shortage of cloth is partly covered by a decline in exports and a rise in cloth prices. Thus, planning has landed the country into an extremely odd situation, seeing that 70 per cent of the working population is engaged in agriculture and 70 out of every 100 acres of the gross cultivated area is under foodgrains; and cotton textiles, the oldest industry in the country, accounts for about one - third of industrial activity and, until recently, India was the largest exporter of cotton textiles in the world.

Thirdly, as a result of each plan wanting to over-reach itself. and the attempts to invest beyond the sum of domestic resources and foreign aid, there has emerged continued inflation. From 1955-56 to 1962-63, the money supply rose by 49 per cent, while the net national product at constant prices rose only by 27 per cent. Inflation has gathered momentum since 1960-61. For the reasons indicated above, the index numbers of prices do not provide a correct index of the extent of inflation.

Continued inflation and uneconomic, production have retarded exports. Despite export promotion, exports In 1961-62 amounted to but Rs. 6.7 billion as against Rs. 6.5 billion 1950-51, though in the meanwhile the national product rose by 50 per cent. Stagnant exports have produced chronic balance of payments difficulties as import demand has been getting stronger. Mounting foreign aid, which, currently, is about 4-5 percent of the national income, has failed to remedy the problem as aid merely patches up the III effects of inflation and uneconomic production on the balance of payments; aid does not correct these causes of the trouble. In fact, it feeds and sustains uneconomic production and to that extent tends to perpetuate itself.

Fourthly, though investment has multiplied by about three times (at current prices) during the past 13 years, the expansion of employment has fallen short of the natural increases in the labour force, so that the Second Plan bequeathed more unemployed to the Third Plan than it inherited from the First. National income has been increasing at a snail's pace in recent years; in 1961-63 per capita income declined for the second year in succession. This is in line with the proposition that overall employment is a function of national income, not of total investment and indicates that much of investment has been misdirected.

Fifthly, as a result of inflation, import controls, currency overvaluation, distribution controls, price controls, and the other interventions in the economic life of the community, illicit shifts of income have taken place from the masses of the people to the upper-income groups. The total magnitude of these income shifts the largest amounts being from the traffic in import licences - may amount to the larger part of the annual increases in the national income so that planning has not produced any noticeable relief from mass poverty. We have supporting evidence for this in the continued low levels of the consumption of food and cloth, the former persisting below the nutritional norms and the latter, already substandard, tending to decline.

It is not a welcome reflection that the policies behind this economic mess have the moral support of the more enlightened part of the world. The Indian economic situation is subject to at least one annual scrutiny by the IMF, frequent reviews by the World Bank, of which India is the largest single debtor, periodical study by the United Nations, expert assessment by a reputed body of international bankers, and quite a few high-brow analyses by academic specialists in growth economics. There are, besides, full-time observers in New Delhi, of the World Bank, of USAID and of MIT watching developments for report to their principals. Though the assessments by some of these agencies are critical, and perhaps all recognise today that the economy is in a bad state, the policy criticisms generally are that the economic mishaps have been the result of unforeseen difficulties, inefficient execution of policies, and inept planning; none of them seem to question the efficacy of the technique of planning as a means of economic development and social progress. Yet, it is clear that there is little hope of the Indian economy being rescued from the prevailing predicament without a basic policy re-orientation, replacing centralised planning by policies of economic freedom.

More than moral support, the more enlightened parts of the world have virtually underwritten the finance of Indian planning. Currently, considerable budget support for policies of centralised planning comes from foreign aid. During the two years ending 1962-63, total plan investments in the public sector amounted to Rs. 15.44 billion and foreign aid, including US agricultural surpluses, to Rs. 7.80 billion. If we may assume that all foreign aid accrued, in effect, to the public sector, about one-half of public sector investments were financed by foreign aid; adjustments being made for the over-valuation of the rupee, the foreign aid finance of public sector investments may be about three-fourths of the total.

About 60 per cent of the aid came from USA, about 45 per cent of the U.S. aid being in surplus agricultural commodities. Aid from West Germany was the next largest, being about 12 per cent. Russia and U. K. contributed about 7 per cent each.

Despite its large magnitude, foreign aid has made little positive impression on economic and social progress. No prorata positive contribution to development is possible so long as the prevailing policies continued.

Foreign aid has but provided the foreign exchange counterpart of the construction of idle production capacities. A part has financed the creation of uneconomic industries. Some of it provides the foreign exchange finance for illicit exports of capital; the smuggling in of

gold and of consumer goods, the imports of which are banned or are severely restricted, the speculative inventory accumulation, induced by inflation; the construction of less essential urban property; as a hedge against inflation; and of luxury living, the result of inflation and of the corrupt incomes born of economic controls. Monetary and fiscal stability are essential pre-conditions for the fruitful use of foreign aid.

STUDY TOPIC – 10

THE FAILURE OF INDIAN PLANNING*

The aims of planning in India are four fold; abolition of poverty, liquidation of unemployment, reduction of income inequalities, and industrialization. Yet its actual achievements are in dismal contrast to these laudable aims. After 13 years of planning and 2.6 plans, we find, instead of prosperity, poverty; instead of full employment, heavy and growing unemployment, instead of social justice, ever more widening income inequalities; instead of healthy industry, high-cost plants producing shoddy and inferior goods at several times the price of superior-quality imported products.

To be sure, the statistics of production have gone up. Indian national income, at constant prices, rose by 36 per cent or at an annual rate of 3.6 per cent, from 1950-51, the last pre-Plan year, to 1962-63. Yet these figures are no evidence of growing prosperity - since to the statistician, guns as much as butter count as additions to the national product. Yet welfare is increased only by production of the latter, not by the former. Hence we have to modify these figures in the light of four important deflating factors.

(1) The rise in Population : According to the 1961 census, Indian population rose by 22 per cent during the past decade. We have to use this deflator because per capita figures tell us more about the welfare of the people than mere absolute national income figures. When we have adjusted for population growth, per capita income rose by but 18.5 per cent over the last decade, or by less than half the increase in overall national income.

(2) The second deflator we have to apply consists of two magnitudes : (a) excess production capacities, and (b) excessive additions to inventories. This is because welfare can be gauged only by the output of consumption goods. Output which does not add, directly or indirectly, to consumer satisfaction, is waste. Planning has led to the creation and maintenance of excess capacities in both consumer and capital goods industries. They are estimated at 35 per cent in the major and minor irrigation works, of a lesser order in the power projects, and at an average of 40 to 50 per cent, in 40 industries.

Inventory additions are inevitable under inflation, although it is difficult to assess their precise magnitudes. Circumstantial evidence confirms the build-up of food grains inventories during the three years ending 1958-59. In that period, foodgrains supplies (domestic production plus imports) went up from 65.81 million tons in 1955-56 to 77.70 million tons in 1958-59. This was a much faster rate of increase (over 5 per cent per year) than the increase in money incomes (3.9 per cent per year). Since in spite of increased production, prices rose, it seems proper to infer that part of the increased supplies was hoarded; as prices should have fallen if all the increased supplies had flowed into the market. Since in spite, then, on the same reasoning, some decumulation of food grains

stocks has taken place. This is evidenced by the fact that although money incomes were 20.6 per cent higher in 1962 than in 1958-59, and foodgrains supplies rose by only 5 per cent, foodgrains prices remained steady, their index being 100.1 in 1959-60 and 100.0 in 1961-62 (1952-53=100). Apparently, market supplies were larger than the sum of domestic production plus imports, inventories being drawn upon for the difference.

The third deflator is the considerable sums of illicit and unmerited income shifts from the masses to a fraction of the people. Mass well-being must be assessed in terms of more general economic conditions, and not the overall national income figures.

Three factors have been responsible for these income-shifts; Firstly, inflation, which has corroded the incomes of the fixed and "sticky" income groups, - the masses of the people - and added correspondingly to the incomes of a fraction of the community - traders, businessmen and industrialists.

Secondly, controls, which, in addition to corruption, have created sheltered markets and semi-monopolistic positions, bringing windfall gains to their beneficiaries.

Thirdly, the great expansions of the public sector, which has meant phenomenal addition to the illicit gains of contractors and other participants in this expansion.

What is the magnitude of these income-shifts? We have estimated them to be, in recent years, of an order of Rs. 800 crores per year - or more than the rate of increase in the national income, which has averaged Rs. 761 crores (approx.) over the last seven years.

However, even our estimate may fall short of the real magnitude of the income-shift. Let us see how this comes about.

During the seven years ending 1961-62, the inflationary expansion of the money supply (i.e., expansion of money in excess of expanded production at constant prices) amounted to Rs. 650 crores, or about Rs. 90 crores per year. This may be taken as a rough measure of the anti-social income-shifts resulting from inflation.

The anti-social income-shifts resulting from import-licensing may be measured by the enormous gap between the landed costs and the market prices of virtually the whole range of imported goods. This gap has emerged as the result of inflation, an unrealistic exchange rate, and exchange controls; and the price-gaps vary from 30 to 500 per cent of the landed cost of the imported commodities.

Assuming an average of 75 per cent, the total net gains -i.e., unmerited windfalls from import licenses may amount to Rs. 500 crores a year. The bulk of these anti-social gains occur to the comparatively well-off; Importers, "contact" men, touts, and corrupt state functionaries.

Public sector investment outlays have shot up from Rs. 3760 crores in the First Plan to Rs. 7900 crores in the Second Plan. However, when Rs. 100 is accounted in the books to have been invested, not all the money goes into the project; a part gets converted into illicit private incomes. in the form of payments for obtaining business, made by contractors and successful bidders. These payments again accrue to the well-off.

Assuming that such payments average 20 per cent of book investments, they have amounted to Rs. 200 crores per annum during the Second Plan period.

If to all the we add monopoly revenues from controls, anti-social income-shifts may come to Rs. 750-800 crores per annum. But even this figure is arrived at before including illicit earnings from price and distribution controls, and other restrictions.

The fourth factor to be taken into account in assessing national income figures, is the price-index. National income at constant prices, as obtained mainly by deflating national income at current prices, understate actual price paid, since the indexes are based on controlled prices where these apply and controlled prices are generally below market prices. We find evidence (or this understatement in the divergent movements of the price index and the money supply. From 1960-61 to 1962-63, the money supply rose by 15.3 per cent while prices (officially) rose by only 2.4 per cent. Even allowing for the expanded money supply necessary to maintain a constant price level when production expands, the price index should still have risen by at least 11 per cent. The use of these defective official Index numbers has led to an insufficient deflation of national income at current prices, and a corresponding exaggeration of national income at constant prices. This may be of an order of 8 per cent during the period 1960-61 to 1962-63; which all means that the actual rate of income growth in this period may well be less than the rate of population growth.

The conclusion we may well arrive at after all these adjustments is that the well-being of the people has stagnated during more than a decade of planning. We find further evidence for this in the consumption of food and cloth : which in the context of Indian poverty should be sufficient indicator of plan achievements. Data on food consumption are in the Economic Survey, issued with the Union Budget. Per capita "availability" of foodgrains per day fluctuated downward with the progress of planning, from 15.7 ozs. in 1954 to 14.0 on. in 1958, recovered to 16.20 ozs. in 1961 and stood at 15.8 on. in 1962. These figures are not adjusted for additions to stocks by traders and farmers; with these adjustments, per capita consumption would be less than "availabilities." Jail rations are 16 on.. army rations 19 ozs. and the nutritional norm 18-19 ozs. During the five year ending 1960, annual per capita consumption of cloth. statistics of which are published in the "Indian Textile Bulletin" issued by the Textile Commissioner, Ministry of Commerce and Industry, declined from 14.66 metres in 1956 to 13.99 metres in 1960.

When we turn to employment. we find that here too, planning has failed. Although investment outlays rose steeply, by 110 per cent from Rs. 3760 crores in the First Plan, to Rs. 7900 crores in the Second Plan, the former added 4.7 million to employment, and the latter, only 6.5 million - an improvement of but 36 per cent. Moreover, even this increase in employment was less than the natural additions to the labour force - and hence the Second Plan bequeathed more unemployment - roughly 9 million - to the Third, than it inherited from the First, - about 5.3 million. These figures are, however, based on the 1951 census, which indicated a rate of population growth of 5 million per annum, of which 40 per cent is treated as additions to the labour force. The 1961 census, however, revealed that population had actually been rising at a rate of 7.9 million per year. On this

last figure, plan achievements in employment have been even more dismal failures. However, these employment figures, though official, cannot be taken at face value as they are guesses, and may embody a large margin of error. Nevertheless, we may broadly say that expansion of employment has probably lagged behind expansion of the labour force.

In contrast to the disappointing record under these three objectives of planning, the statistics of industrial production seemingly exhibit striking progress in Industrialization. The general index of Industrial Production went up at an annual rate of 6.7 per cent - from 100 in 1957, the base year, to 191.8 in 1961. This rate is even higher than that of many developed countries, including the USA, West Germany, and Great Britain. But these figures, far from being evidences of progress, are in fact evidences of pyrrhic victory. This is so, for several reasons.

Firstly, the increases in industrial production hardly added overall to national income as industries accounted for only 16 to 19 per cent of total economic activity. Moreover, the expansions were greatest in the categories of capital and intermediate goods and upper-class consumption goods, and least in the category of mass consumption goods. Between 1950 and 1960 outstanding increases were recorded in the production of such things as machinery (e.g. 1960 production of diesel engines was 8.9 times output in 1950), machine tools, electrical motors, automobiles (2.9 times), coal (1.6 times), iron and steel and other metals, cement, heavy chemicals, electricity, rayon yarn (21 times) sewing machines (9.6 times), electric lamps and fans, radios, sugar, vegetable oil products (1.9 times). By contrast, production of cotton textiles - the item of the greatest mass consumption - expanded the least from 100 in 1951, the base year, to 117 in 1961.

This pattern of industrial production reflects the unduly large diversion of resources into heavy industries at the expense of agriculture; the pattern of consumer goods production reflects the anti-social income shifts-and the vast improvements in the welfare of upper income groups in comparison with the stagnation of that of the masses of the people.

Secondly, most of this industrial expansion has been in defiance of the law of comparative costs, - it has been forced by official policy. Import restrictions and exchange controls. The extremely scarce productive resources are used for home fabrication of commodities which may be had from abroad in unlimited quantities in vastly superior quality, and at prices vastly lower than those charged for poor quality home products. Thus, for instance, Indian sugar costs about Rs. 1210 per ton, while the world price is Rs. 330 per ton. Other examples are in the casts of fertilizers, penicillin and refrigerators. Imported penicillin may be bought for about 10 np per million units, the estimated Indian cost of production is about Rs. 1.30 per million units. An English refrigerator costs about Rs. 950.00. in India. the cost is Rs. 2365.00.

All these examples indicate the inconscionable costs of forced industrialization in a closed market, and also the tremendous waste of resources involved in producing goods at home which can be had far more cheaply from abroad.

Thus planning has resulted in the diversion of resources from sectors where they produce greater output to areas where real costs are higher and returns lower. It has been estimated that Rs. 1 crores of additional investment adds Rs. 57 to 69 lakhs to gross output in agriculture, and only Rs. 14 to 45 lakhs in five manufacturing industries. The same amount of investment would employ 500 persons in large-scale investment goods industries, 1150 persons in large-scale consumer goods industries, and 4000 persons in agriculture and small-scale and household industries.

How may we rescue India from this economic morass into which planning had led her? By allowing production and international trade to be directed by the basic economic forces of comparative costs and efficiency. Growth of agriculture would then provide a broad-based demand for the output of industry, and the growth of light industry provide an assured demand for the output of heavy industry. This pattern of economic development, one sector aiding and sustaining the progress of the other, would eliminate the present wastages, and so contribute to a more rapid growth of the Indian economy. Under economic freedom, control over investment resources would be acquired by tens of millions of individual entrepreneurs competing in the open market, and economic power would be correspondingly diffused over the community as a whole. Financial success would be governed by efficiency, quality and price of output, i.e., in proportion to what the individual added to the national product.

STUDY TOPIC – 11

INDIA : 'PLANNING' FOR ECONOMIC DISASTER *

India's economic scene today gives rise to more concern and less hope than at any time in the recent past.

The economy is afflicted by a host of ills Budget deficits; inflation; stagnant exports; defiant balance-of-payments difficulties; interest rates of 18% to 24% in the private market that has sprung up outside commercial banks; rising unemployment, especially in the more sophisticated industries; mass indigence, which has spread to the middle classes; social and political tensions and, on top of it all, unmerited abundance flowing to a privileged minority. Overseas visitors do not fail to notice the rise in luxury living by the few.

It would be most dangerous to blame all this, as official spokesmen have been doing, on droughts or border wars. Though these misfortunes have undoubtedly added to India's miseries, the roots of the maladies go much deeper.

It would be misleading, too, to describe these difficulties as a case of cyclical recession, as is frequently done. This faulty diagnosis has led to advocacy of the Keynesian prescription of deficit budgets, to make good the alleged gap in effective demand. The prescription has gained influential support. although resort to it might well spell disaster

Most of the ailments listed above have their roots in the Indian economic policies of the past decade and a half. Though these policies are called "planning," they have produced - as in other underdeveloped countries pursuing similar policies - more chaos than order. They have involved, despite colossal foreign aid, over-spending and over-investment, with the resulting budget gap covered by the use of the printing press. This has been driving prices higher.

Link not Recognized

Stagnant exports and recalcitrant balance-of-payments difficulties are the direct consequences of this inflationary deficit spending. This link, though still not recognized by policy makers in India and elsewhere, is easily discerned. Deficit financing pumps inflated money into the market, where it appropriates goods for domestic consumption or investment. This reduces the goods available for export. In 1966-67, for example, the national production thus diverted amounted to U.S. \$385 million, the budget deficit of the year. The Indian national product rose 45% in the 12 years ended 1966-67. Yet because

more and more of this product was retained for home use, exports declined from 6.4% of the national product in 1955 to 4.3% in 1966. Exports expressed in constant 1968 prices fell from U.S. \$1 billion in 1955 to \$6.3 million last year.

Ignoring this obvious link, policy makers in India have been seeking to improve conditions by tightening physical restrictions on imports and by fabricating local substitutes for imported goods to "save" foreign exchange. Both measures have failed though they have been operating 25 years. They have failed, because neither measure can prevent inflationary-funds from eating into exports.

Deficit financing and the resultant price inflation have had another effect : Colossal income shifts (not to mention causing government expenditures to rise twice as fast as the national income).

That inflation causes income shifts is obvious. It cuts the real income of wage-earners and salaried workers, the largest section of the community, and correspondingly adds to the money receipts and real incomes of traders, businessmen and industrialists, a fraction of the community. In India, these transfers have assumed ominous dimensions.

The way income is transferred through import licenses is less obvious, though the amounts shifted are much larger. The rupee prices of goods imported to India are generally far higher than their international prices, because of inflation and the physical restrictions on imports. Consequently, imports bring windfall profits -money not earned by the license holder but shifted from the rest of the community.

Other economic controls that produce income shifts include price controls, controls over the movements of food grains and official allocations of certain essential supplies. They work mainly through tampering with prices : If they depress prices below their competitive norms, producers are penalized and the buyers are rewarded. If they increase prices, consumers are penalized and some of their incomes are shifted to producers.

One effect of these transfers is that the real earners of the income, and the parasitical recipients live off the same money. That is, the same amount of income is now subjected to two consumption claims. Consequently, the flow of savings suffers. The damage to savings is reflected in the fact that, though per capita income rose 18% in the decade ended in 1964-65, the rate of saving stagnated at around 7.5%.

Recent closures of engineering production units reflect this decline in national savings, though they are commonly attributed to the deceleration of plan investments in the public sector (which in turn is said to cause a decline in the demand for engineering goods). But the decline in savings is the real cause, with the consequent slowing of fresh investment activity and with it the demand for investment goods.

But harm to savings, though important, is not the only reason income shifts, merit attention. More particularly, they inflict ruthless social injustice. They have been responsible for the growing mass indigence, for the withering prosperity of the salaried middle classes and for the unmerited affluence of a privileged minority.

Production statistics confirm the growing abundance for a fraction of the population at one end and a decline in the standard of living by millions of families at the other end.

The living standards of the Indian masses are so low that the consumption of the necessities of life provides a dependable index of their economic condition. We find that the consumption of food grains, edible oils, sugar and cotton cloth kept moving up while per capita incomes rose, reaching a peak in about 1961-62. Thereafter, with the decline in mass well-being, the consumption of these items fluctuated downward.

On the other hand, the curves of consumption of luxury and semi-luxury goods, which are generally beyond the reach of the masses, kept moving up throughout the Fifties and Sixties. Witness the flaunting of income and wealth by the few at weddings and other ceremonies, the enormous increase in status-symbol possessions and consumption, the over-crowding of holiday resorts, the capacity loads of jet planes and the luxury flats and structures, especially in New Delhi and the larger seaports and urban centers.

The downtrend in the consumption of the basic needs of life from 1961-62 bespeaks of the family budget pressures produced by perverse income transfers. These pressures which operate on a wide social front, are undoubtedly the prime driving force behind the recent lawlessness stalking the land. Political parties and professional agitators organizing these phenomena are but immediate agents taking advantage of this human unrest to serve their own party ends.

Are Bombs the Answer?

Tear-gas bombs are not lasting solutions to this problem. So long as the inner turmoil remains unrelieved, the outbursts may keep repeating. If India is to have social and political peace, an indispensable background for accelerated economic growth, then every one's income must represent an honest measure of his contribution to the Indian national product.

Yet Indian planners, duly supported by expert advice from developed countries and United Nations agencies, have unwittingly created, in a decade and a half of hard work, not the promised socialist millennium, but near-ideal laboratory conditions for the spread of communism.

Stepping up foreign aid is no solution. Aid, in fact, has already assumed phenomenal proportions - it now averages \$1.5 billion a year and comprises 75% of India's savings.

There is little hope that aid funds and domestic savings will make their due contribution to economic and social progress if the economy is not freed from its basic ailments. Price inflation, perverse income transfers and erosion of savings, and from the major complications these fundamental ills give rise to : Balance-of-payments difficulties, capital market decay, closures of production units and unemployment.

These ailments have all sprung from and are sustained by deficit financing, exchange control, import licensing, crushing taxation and undue expansion of public-sector

activity. Deficit financing and Import licensing are by far the worst of these factors and merit priority attention.

The situation calls for basic policy shifts, not tinkering. Failure to act boldly involves risk of the demise of democracy.

PART III

FREEDOM, CONSUMERS' SOVEREIGNTY AND INJUSTICE TO AGRICULTURE

STUDY TOPIC – 12

CONSUMER SOVEREIGNTY LEADS TO RAPID ECONOMIC DEVELOPMENT"

Professor J. K. Galbraith has made planning a theme of his weighty pronouncements more than once during his tours round India. At a Press Conference in Ahmedabad, commenting on the fears expressed "in some quarters in India" that the present tempo of our planning might lead to an authoritarian regime, he observed that "lack of planning" in underdeveloped economies "carried a greater risk of leading to authoritarian regimes than proper planning".

He utterly ridiculed these fears, saying that "whenever somebody wants to denounce something, he says it is likely to lead to authoritarianism". In addition to planning, he continued, public ownership, agricultural price support, trade unions and large corporations had been accused, by different sections of the people, at different times, as precursors of authoritarianism. But their cry of "wolf" had proved false alarms. It was safe enough guarantee against this calamity, if the "spirit of democracy is deeply implanted in the mind of peoples and in their institutions".

The logical basis of Prof. Galbraith's conviction, which is widely shared in India, is simple. A country facing the problem of lifting itself from poverty and of providing a better life for its people would be condemned to frustration "without planning"; from the "discontent" born of the tyranny of unrelieved poverty, they might fall an easy prey to the promises of Communism. This danger can be averted by a "proper planning of its resources".

It will at once be agreed that the greatest single problem before underdeveloped countries is their abject poverty. Everything hangs on its eradication. Failure to tackle it effectively might engender social and political instability, though the fear in this regard is often unduly overdrawn.

The question is whether this central objective—the eradication of poverty—may be best and most speedily achieved through planning, as we have seen it in action during the past decade; and as Prof. Galbraith, a devotee of Indian planning, seems to understand the term. The answer centres round the problem of maximising output from our meagre resources, as output provides the wherewithal (or liquidating poverty). The faster the growth of output, the sooner is poverty liquidated.

Any programme for maximising output cannot ignore the prevailing, extremely complex, pattern of production of the Indian economy. Fully 50 per cent of the national product is from agriculture and about 70 per cent of the population lives on it. Agricultural

production is in the hands of 67 million independent farmers scattered round the country, the average holding per family being 5.5 acres. Cotton textiles comprise about 36 per cent of industrial production. Textile output ensues from 478 mills, 80,000 to 90,000 power looms and 2 million handlooms. The remaining sectors, too, comprise tens of millions of independent production units. Save and except under the Communist steam-roller, this production set-up cannot change overnight, so to speak.

Two policy compulsions emerge from this set-up, if we must accelerate output. First, agriculture, textiles and the basic consumer goods industries, which constitute the bulk of productive activity, must receive first claim on productive resources. Secondly, centralised planning — in the sense of state control over the allocation of resources — is not practical, though simpleton administrators might think otherwise. Centralised planning can only produce chaos and retard the hand of progress, when the planners have to deal with tens of millions of production units scattered round a sub-continent.

We have violated both policy compulsions in the name of planning. The Public Sector will appropriate, in the Third Plan, 65 per cent of Investment resources. The percentage was 57 in the Second Plan. These resources will go into heavy Industries, mammoth river valley projects and costly social overheads. Large parts of the remaining resources would also be forced into heavy industries and industries producing intermediate and other non-consumer goods. through exercise of the control over capital issues, import licensing, permits for raw materials, concessions and quotas.

This leaves little of the productive resources for use in agriculture and for producing cloth and the other consumer needs of the masses. Resources drawn into heavy industries would add to the national product, but an order of 14 per cent of their value; they would add an order of 36 per cent if employed in consumer goods industries and 65 per cent if employed in agriculture. The out-come of our developing heavy industries at the expense of consumer goods industries, and of developing both at the expense of agriculture, has been two-fold; Indian national income has risen during the past decade at an annual rate of about 3.5 per cent; and the consumption of food and cloth by the masses has declined, or is semi-stagnant.

In the absence of planning — forced diversion of the largest bulk of Plan finance into wasteful projects — productive resources would flow into channels where they yield the highest output, through the usual market mechanism. Two results would ensue from this, simultaneously : first, national income might increase at an annual rate of 8 to 10 per cent: secondly, output of the basic consumer needs of the masses — principally food and cloth — would go up simultaneously with the national product, as investments in these directions yield the highest returns and as economic activity would now be controlled and directed by the consumer, not by the Planning Commission.

This is not to say that, under the free-market system and the sovereignty of the consumer, there is no room for any planning. Orderly progress is inconceivable without planning. In the private sector, then, planning will be done by the millions of individual production units; in the Public Sector, by the State. The Public Sector will be confined to activities which cannot be effectively undertaken by private enterprise. e.g., the provision of an

honest rupee, the rule of law, basic transport and communications, standardisation of weights and measures, education and public health. In particular, the state should not stray into trade and industry, or interfere with the distribution of productive resources. To do so would be to up-set the planning of millions of production units, to the detriment of the national product and social justice, causing untold human suffering, in the Indian context, of extreme poverty.

Thus, the "discontent" and possible explosion, which must ensue from the pursuit of the prevailing economic and social policies, carries the very "risk of authoritarianism", which Prof. Galbraith thinks we would avert through the so-called "proper planning of our resources". These risks cannot be averted with greater certainty than through planning for the free market under the banner of consumer sovereignty.

Planning for the free market has yielded blinding economic and social dividends wherever it has been given a chance. In the post-war world, it produced the first miracle in West Germany. It then spread, with as good or better results, to the other E.E.C. countries. Israel, Japan, Hong Kong, Spain and, latterly, the Philippines. The eagerness of U.K. to join the E.E.C., even risking severance from its political kith and kin, is evidence of the vitality of the new movement. News of this powerful reaction away from statism has not reached New Delhi yet, nor the Indian Universities generally, where economists still fondly cherish outmoded dirigiste doctrines, fancying them to be tenets of the nuclear era. The Galbraiths, Millikens, Rostows and Wards, not to mention the pronounced left-wingers like the Baloghs, Bettleheims. Langes and Robinsons - all sincere friends of India and hot favourites of our Government - through their expositions, probably stand in the way of our properly appreciating the tremendous potentialities of planning for the free market under the aegis of consumer sovereignty. The illicit beneficiaries of planning, now the power behind the throne, who, too, are champions of mass prosperity, are another great hurdle to be overcome. But neither economic nor social salvation is possible except through policies of economic and social freedom.

The task before the policy reformer is indeed over-whelming. The situation provokes the prayer; "Good Lord, protect me from my friends; against mine enemies, I can defend myself".

STUDY TOPIC - 13
ECONOMIC GROWTH WITH SOCIAL. JUSTICE *

I. Communism, Socialism and a Free Society

Contemporaneously, there exist three broad economic systems or patterns in the world — free societies, communist societies, and socialist societies. The last are varying mixtures of the doctrines of the former two systems.

Though socialism had, for long, been the established article of faith of India's first Prime Minister, the late Pandit Jawaharlal Nehru, and this had, inevitably, influenced Indian economic policies since Independence (1947), socialism as the goal of all governmental effort dates with the acceptance of the "socialist pattern of society- by Parliament in Dec. 1954, following its adoption earlier, in the same month, by the Indian National Congress, at its Avadi session. The socialist pattern, in due course, got metamorphosed, imperceptibly, into socialism; and, at times, looked like being further metamorphosed into communism. This last danger has disappeared with the election victory of the Janata Party.

Though an economic policy package of the Janata Party is currently under discussion within the Party and within the government, the Independence Day-eve message of the President indicates that, presently at any rate, the Janata Government have no intention of departing from socialism, the Congress policy system. The message merely seeks a shift of emphasis in planning — the overall description of the socialist policies — in favour of agriculture and the rural sector. There is nothing in it to suggest recognition of any need for a change in the overall policy pattern. The disappointing state of affairs to which the President has referred has been the end outcome of the working of these policies during the past three decades. The question that calls for an answer is : Can the danger of the "volcano of discontent and frustration blowing its top" be averted by a mere shift in emphasis in favour of agriculture within the framework of the prevailing policy system?

II. Economic Constituents of a Free Society

A free society is so called because its citizens are free individuals, free in the sense of "independence of the arbitrary will of another",. Individuals in a free society function, in the economic sphere, under the guide-lines of the doctrine of pragmatism, pursuing the line of success and discarding the path of failures, success and failure being assessed by their own subjective criteria. Viewed functionally, a free society may also be termed, therefore, as a pragmatic society. As the terminal aim of the individual's activity is the maximum satisfaction of his consumption needs, and he is unfettered in this as in other matters, a free society is described, too, as a society of consumer sovereignty.

The Principal economic constituents of a free society may be briefly stated :

- (i) First and foremost the economic affairs of a free society are controlled, directed and governed by truly sovereign consumers. Therefore, by definition as it were, all economic activity other than those delegated by consumers to the government — which they do in their capacity as sovereign voters — have, for their end objective, maximum consumer satisfaction.
- (ii) Consumer control and direction of the economy is effected through a price-regulated market mechanism. Consumers register, in the shopping centers or other markets, their votes regarding their requirements continually, and their preferences get reflected in commodity price changes and in turnovers.
- (iii) Traders interpret these price and turn-over signals, and direct producers to adjust their production programmes to match the consumer needs, thus recorded.
- (iv) Available Investment resources, i.e. domestic savings and inflows of foreign savings, get shifted, through such activity of traders and producers, and via the capital market — which is an integral part of the overall price-regulated market mechanism — or otherwise, into production channels which meet consumer-p references.
- (v) In a modern society — whether it is free, communist or socialist — production involves time, and the production process has, for technological reasons, to commence in anticipation and in advance of demand. The forward market, which is another integral part of the overall price-regulated market mechanism, helps such anticipatory production. The forward market may reduce to a minimum or eliminate, resource wastages from production errors, by projecting the changing market situations.

III. Functional Pre-suppositions of a Free Society

(i) Trade, the First Link in the Operational Chain

Operationally, the first link in this chain of consumer-directed economic system is. it will be noted, trade which interprets and transmits to producers consumer decisions. That trade is the spear-head of all economic development emerges graphically when we imagine a community cut off from the rest of the country, of which it had been traditionally an integral part. Production (or the national market will then soon be replaced by production to meet the limited needs of a small community; and its people are consequently destined to slip down into poverty and, possibly, into more or less primitive way of life, depending on the size of the isolated community's market. A pre-condition for the full and efficient functioning of a free society is, therefore, the absence of barriers to internal and external trade. Logic and experience have shown that this freedom will permit continued prosperity for the economy - the result of the use to capacity of its specialised talents through integration of the national economy with the

world markets, the demands of which — unlike the demands of the limited national markets — may not be easily satiated.

(ii) Institution of Private Property

Secondly, the full and efficient functioning of a free society demands recognition of the institution of private property, not only in respect of a family house, the durable consumer goods in it and a car, but also in respect of capital assets, the means of production. In a free society, because of the discipline of a most ruthless consumer, the management, under the duress of survival, has to keep a continual watch over cost, quality and turnover. This calls for perpetual flexibility of decisions. Consumer discipline operates, in the case of the larger corporations, through its impact on the stock-market quotations for the scrips of the corporations. It is just not practical to achieve the requisite decision flexibilities under social ownership — i.e., the ownership of no one in particular! — of the means of production. Experience has shown that the magic of ownership is among the most powerful forces making for progress.³

The power of the magic of ownership of the means of production is nowhere more convincingly demonstrated and highlighted than in Soviet agriculture. In 1964, the output of 3% of the land under collective farms, the private plots allotted to their workers, accounted for no less than 1/3 of the gross farm output of USSR and W of the Soviet livestock production'. Russia's dependence on the capitalist world for its food and other agriculture needs — this dependence is, incidentally, rather amazing as about 1/3 of the Soviet labour force is engaged in, and an equal proportion of the total population lives on, agriculture — would have assumed disastrous dimensions, if Communist ideologies were to prevail and abolish completely private ownership of the means of production in Soviet agriculture. Will our own ideologues ever learn from this experience?

(iii) Economic Freedoms of the Individual

The third pre-condition for the full success of the consumer directed economic system is the economic freedom of the individual particularly in respect of :

- (a) the distribution of his income between consumption and saving;
- (b) the choice of consumption and the power to direct entrepreneurs, through a price-regulated market mechanism, to import, or to fabricate at home, the commodities of his choice;
- (c) the distribution of his savings among the several alternatives; and
- (d) the choice of his occupation.

These four freedoms constitute fundamental economic freedoms of free citizens. When then freedoms are infringed, the charms of mundane life correspondingly diminish.

IV. Built-in factors making for Growth and Social Justice in a Free Society

Quite obviously, a consumer controlled system cannot come into being, nor function, without freedoms (a) and (b). Freedoms (c) and (d) are essential to ensure that the material and the human resources of production get drawn into channels where their output is the highest. These latter freedoms will, through continual resource shifts, minimise or eliminate less effective resource deployments and thus make for the maximisation of the national product from a given quantum of resources.

(i) Tendency to Maximise Production, Employment and Income

Under consumer sovereignty, four desiderata are integral to the functioning of the system. First, to seek consumer patronage, entrepreneurs would strive to reduce costs and improve quality. With consumer approval and appreciation of such effort, high-cost and low-quality products would continually tend to be replaced, through resource shifts and technological progress, by low-cost and high-quality products; and, as already pointed out, this will continually tend to lift up production, and hence employment, income and the level of living.

(ii) Expansion of Employment

Secondly, rapid expansion of employment is built into the economic system where everybody's concern is to meet the demands — which, it may be noted, are most exacting, in addition to being ruthless — of the consumer. The expansion of employment at current, or rising, wage rates is a function, not of investment. as Indian experience has shown; nor of stepping down the technology of production- which is currently in use. It is solely a function of the expansion of overall production. Since consumer sovereignty makes for rapidity of growth of the national product, it may, therefore, liquidate unemployment with corresponding rapidity.

To illustrate the working of this built-in urge to expand employment : in Japan, low wages, the heavy pressure of population on land, 291 persons per square kilometres, — the average land holding in the country, as a result of this population pressure, is but 1.01 hectares — the scarcity and high cost of capital, induced farmers to adopt labour - intensive methods of cultivation in agriculture. Japanese agricultural output IS well above the world average', and Japanese agriculture employs 2,031 workers per 1,000 hectares of cultivated land. In USA, on the other hand, capital is less scarce, the average holding is 157.6 hectares, population density is but 22 per square kilometre; and the country adopted capital-intensive methods of cultivation, the labour employed per 1,000 hectares of cultivated land being a mere 17. These differing systems of cultivation were adopted, not under the direction of a planning commission, but by independent farmers in free economies, the course and destinies of which are, on the whole, determined by sovereign consumers. By contrast, the Russian Gosplan copied the American method of capital-intensive cultivation, notwithstanding low wages, with none too complementary results.

(iii) Social Justice

Thirdly, under full consumer sovereignty, there is no need, nor room for monopolies in production, distribution, imports or exports; and incomes of all individuals — wages, interest, rent and profits — would correspond to their respective contributions to the national product. Such a situation permits no windfalls. Hence, none can appropriate someone else's earnings. i.e., there can be no social injustice. Social injustice, on the other hand, is inevitable under socialist economic systems, which abound in monopolies, privileges and subsidies; and hence bring to privileged Individuals and groups unearned and also unmerited incomes, at the expense of the rest of the community.

(iv) Reduction of Income Contrasts

Fourthly, income contrasts tend to decline as economic development progresses, under consumer sovereignty. This is so not merely because of the absence of social injustice - see factor (iii) above - but also as a consequence of, on the one hand, a natural decline in interest, rent and profits, the earnings of the economic elite, and a natural increase, on the other, of wages and salaries. As a free economy progresses, the proportion of wages and salaries to the national product tends to increase and the proportion of interest, rent and profits tends to decline.

In Japan, wages and salaries rose continually from 41.3% of GDP, in 1960, to 50.8%, in 1974. In West Germany, this percentage rose from 46.9 to 54.7. By contrast, in Socialist India, this percentage fluctuated within a narrow range and was, in 1974-75, 28.2 or lower than in 1960-61, 29.9.

The growing prosperity of the masses of the people in free societies is evidenced by the overwhelming proportion of economic activity being directed to the turning out of articles of mass consumption and by the vast multiplicity of departmental stores, safe ways, shopping centres and the endless series of retail shops which purvey these products. Many of these products would be, if then available, matters for envy among the noblemen and the elite of the 18th century. The shoppers that crowd these places are not plutocrats but farm and factory workers and salaried people. Except in Communist countries, cars are no longer a luxury transport, accessible only to the favoured top crust of the community.

In a communist society, none of the economic constituents of a free economy, outlined in Sections II and III above, hold true. The state determines the needs of consumers, arranges the distribution of goods and services and allocates resources among alternative uses. Individuals do not enjoy fundamental economic rights; and forward markets do not exist.

V. Record of Socialism in India

It is much more relevant to review socialism as we have been practicing it during the past three decades. Under our socialist policies, consumer control and direction of the

economy is hindered, among other ways, by exchange control; by import and export restrictions; by the control of capital issues; by the industrial policy resolution, 1956; by the allocation of investment resources, including capital inflows from abroad, by a planning commission; by nationalisation of numerous undertakings; by state trading; by state financial agencies; by Reserve Bank control of credit; by a multiplicity of economic legislation both by the Centre and the States; by the creation of a series of monopolies of varying degrees; by numerous subsidies and privileges; and, until last April, by internal barriers to the movements of raw foodgrains.

As a result of the working of these measures, we may identify four sectors in the economy, a public sector, which receives priority attention, an industrial sector, which is policy-favoured, an agricultural sector, which is harassed and neglected, though it receives much lip sympathy, and a corrupt sector. The industrial sector is inherently unviable, viability being assessed by reference to cost-quality standards of the output, its competitive ability in world markets, and this sector's contribution to employment and income. Exceptions, if any, apart, there is not a single major industrial product which is not subsidised-more generally, this subsidy may be exceedingly heavy-by the consumer in the home market, and the export of which is not subsidised by the state in the markets abroad. And yet, this sector has galloped ahead, through deliberate policy inducements and by preferential allocations of resources. Its contribution to employment has been most disappointing, in relation to the resources employed. Industrial production (manufacturing) accounted for but 16.3% of the national product, in 1975-76, having risen from 12.9% two decades ago, in 1955-56.

The public sector is the most pampered sector. Taking an overall view, objectively and realistically - leaving alone doctrinaire dogma - public sector undertakings in India have by no means, been a striking success. This is but inevitable when management and stakes are divorced. Even without including the gaps between landed costs and market prices of the import goods acquired against foreign aid, the public sector absorbs, from the data in the National Accounts Statistics, about 55% of the total available investment resources, though the contribution of this sector to NNP, was, in 1975-76, but 17%. Save and except when a powerful and selfless individual may be at the helm of affairs and is assisted by a team of like mettle, and this body of rare people is free from interference by interested parties, operating with the aid of politicians, public sector undertakings may be more or less milch-cows of those who may gain control over them. The illicit, though not always illegal, gains which they may gather are-being cases of resource wastages - a drag on the performance of these undertakings and a heavy debit, because of the magnitudes involved, on the national product. The nature of the operation of these factors in the nationalised coal industry is well brought out by Mr.B.P. Pai in his book, Save Coal India, Vol.1, published last month. Mr. Pai is Deputy Chief Mining Engineer, in a subsidiary of Coal India. His revelations of mismanagement merit the serious attention of the public and the Government.

The agricultural sector is as inherently viable as the industrial sector is unviable, this viability being assessed by the same yardsticks cited above. No agricultural product receives any subsidy from the consumer in the home market, nor any subsidy from the

state on exports. Agricultural exports, which are able to stand on their own in world markets, account for about 40% of total exports. The rupee prices of many agricultural items, e.g., rice, coffee, and Bengal desi cotton, are way lower than international prices, and their exports are banned, restricted or are subjected to penalty export duties. In desperation, some agricultural produce, like rice, is smuggled out! For all its viability, agriculture, however, is the least cared for of the three sectors. With the public sector and the industrial sector appropriating the lion's share of the resources, agriculture is starved of capital, though it accounts for about one-half of the national product and 72% of the population lives on it.

The corrupt sector, to which the President referred^o, is fed by the public sector, by exchange control, by import restrictions, by licensing policies, and by the complex network of economic legislation and administrative measures, which, as noted earlier, have created numerous monopolies and other privileges, that yield windfalls and hence give rise to corrupt payments. Until April 1977, rabi food zones, across which foodgrain movements were not permissible except under permits, were among the major sources of corruption and the generation of black money. Shri Y.B. Chavan, when he was Finance Minister, stated that black-market transactions were probably as large, in the aggregate, as those in white money. Black incomes being generally cases of investment funds converted into private incomes, through corrupt payments, they turn back the hand of development.

The National Accounts Statistics, issued by CSO, help to present the ultimate end product of these measures. The per capita income of the agricultural population, which constitutes 72% of the total, declined from a near-peak of Rs.219.20 in 1960-61 to Rs.195.50 in 1976-77, or Rs.2.30 below its level in 1950-51, on the eve of the adoption of socialist policy measures. During the census decade, 1961-71, agricultural workers, the lowest rung of the economic ladder, rose by 75%, the number of cultivators fell by 16%, and the population below the poverty line moved up from 39% to 45% of the total population. The income of the rest of the population, mostly the urban people, on the other hand, more than doubled from Rs.400 in 1950-51 to Rs.813 in 1976-77. In these statistics is writ large the neglect of agriculture and of the interests of masses, the pampering of industry and of the urban elite, and the fostering of corruption and the monopolies, in all of which the vile crowd of politicians and the corrupt among the businessmen, industrialists and administrators have been working hand in glove, even throwing to the winds, when required, human decencies and ethical standards.

VI. Redemption and Progress through Pragmatism

There is no remedy to these consequences other than to extinguish the corrupt sector, and divert resources, in a big way, from the public sector and the industrial sector into the agricultural sector. Our analysis demonstrates that the most effective and the most appropriate method of achieving this is to make right-about turn and move rapidly in the direction of the Gandhian concept of the role of the State in economic affairs. This involves the release of the consumer from the socialist chains and taking the other consequential policy U-turns, more particularly :

- (i) channelising more funds into the agricultural sector, both under public and private investments;
- (ii) removing the barriers to internal and external trade;
- (iii) revising the industrial policy resolution, 1956;
- (iv) abolishing industrial licensing and the system of subsidies;
- (v) scaling down drastically overall public sector outlays, even withdrawing part of public sector investments;
- (vi) limiting state activity to its natural and proper duties; removing exchange control, and adopting a fully floating rupee;
- (vii) reducing taxation, and balancing the budget at a vastly lower level of expenditure and investment than now;
- (viii) reviewing all economic legislation and administrative measures with a view to their abandonment or for restructuring them to match the needs of a free economy.

The legacy of the Janata government is both complex and difficult. The Government may not be able to fulfill its election promises, if it merely continued the Congress policy framework. These policies need to be abandoned in all major respects. If the approach is pragmatic - not doctrinaire - there is every hope that the Government would be led, through the most sound and dependable technique of trial and error, along the right road to progress. The people have had enough of dogma and scapegoats. They are now looking for tangible achievements.

Experience has shown, again and again, that no country which has been directed, in its economic affairs, by the collective counsel of sovereign consumers, has come to grief. The dividends harvested have invariably been of the "miracle" order, both in respect of growth and social justice. In the contemporary world, West Germany (under Professor Erhard), Spain, Japan and the several mini-Japans in Asia are outstanding examples. On the other hand, no country which has fallen victim to any significant policy-mix of socialism, - which has generally been under the guidance of self-seeking businessmen, industrialists and administrators, and aided by deluded ideologies • has escaped chaos and overall semi-stagnation or decay. India, Burma, Sri Lanka, Pakistan and Bangladesh are classic examples.

The sovereignty of the consumer, on which hinges rapid economic growth with social justice, and the sovereignty of the voter, the foundation of all democratic institutions, are but different aspects of a free citizen. We may have an ideally free society when the two sovereignties go together. Given sovereign voting rights, if the rights of citizens as sovereign consumers are infringed and the economy decays as a consequence, the citizens may react in protest, first in the bye-elections; and, if the government failed to take heed, more massively in a general election, as happened in March 1977. In this destiny—election, the Garibi Hatao slogan having turned out to be but a political confidence-trick, the traditional voting loyalties of the scheduled castes and scheduled

tribes-who account for 21.5% of the total electorate-was shifted away from the Congress, virtually en masse. The danger of a political disaster which may attend the inability of the Janata Government to fulfill public expectations, should not be under-rated as 45% of the population is below the poverty line and 70% illiterate. These lowly folk have little value for fundamental rights, civil liberties and constitutional niceties. In frustration and beguiled by promises, they may well vote into power a dictatorial regime, which it may not be easy to dismiss. Not only the Janata Government but also those who wish well by it are, so to speak, on trial. Let us hope that we will succeed in holding high both the sovereignty of the consumer and the sovereignty of the voter ;and firmly establish in India a truly free society.

STUDY TOPIC – 14

JUSTIFICATION FOR INCREASED RESOURCE ALLOCATION TO AGRICULTURE *

1. Importance of agriculture :

We are a nation of farmers, as USA was before world war II. About 70% of the workers and people of India draw their living from agriculture and nearly 50 percent of the national product constitutes agricultural output. USA grew to be the greatest super-power of the world economically through first developing its main industry, namely, agriculture, cattle wealth and allied trades. It built its industries, both light and heavy, on a strong agricultural foundation. Economics being the heart of politics, USA, simultaneously, grew to lie a political superpower.

We too can do the same, perhaps faster than USA, as we constitute about one-fifth of the entire mankind, but only if we first build a secure, sound and vigorous agricultural base, on which the whole economy rests today. We cannot achieve internal and external economic viability if we neglect agriculture. It is no exaggeration to say that the Garibi Hatao programme of the Congress has miserably failed almost wholly because of our failure to take good care of agriculture, the mainstay of the masses.

Expert studies have shown that, in India, an investment of Rs.1 crore of capital in agriculture adds to output Rs.57 to Rs.69 lakhs annually, in iron and steel Rs.19 lakhs and in textiles Rs.36 lakhs. The inference is that Indian economic development would take place several times faster than has been the case, if only we reversed order of priorities in our investment policies; i.e. gave high preference to agriculture in place of a wholly uneconomic accent on industry, at the expense of agriculture.

Nor is it a matter of production alone, Agriculture would liquidate unemployment at a much faster pace than the same investment anywhere else in the economy. It has been estimated that an investment of Rs.1 crore in heavy industry - i.e. industries producing machines - would provide employment for 500 persons; for 1,150 persons in large-scale industries producing consumer goods; and for 4,000 persons if invested in agriculture.

The most important problem of the Indian economy being poverty and unemployment, it follows that Indian national interests would be best served if we give priority attention to agriculture. And yet, since Independence, the accent has been on excessive development of industry, which, ipso facto, has involved stepmotherly treatment of agriculture. We appropriate over 65 percent of the total investment resources for the public sector, though this sector accounts for but 3.5 to 6.3 percent of the national product.' The private sector,

i.e. the rest of the economy, which accounts for about 87 to 92 percent of the national product, receives the remaining 35 percent. As the industrial part of the private sector gets preferential resource allocations, agriculture has somehow to manage with the left-overs. This seems Incredible. But we have been pursuing this strange investment policy during the past over two (now four) decades. Most of our major economic ailments have their roots in this malallocation of our resources.

2. Capital Starvation of Agriculture :

The resulting capital starvation of agriculture is the crux of the problem of the low overall productivity of agriculture and of our failure to achieve food self-sufficiency, despite the impressive array of the high yielding varieties of seeds, which our scientists have evolved, and the vast progress we have made in agricultural technology.

The most conclusive evidence of the capital starvation of agriculture is in the rate of increase in the per capita investment (input) in farming. The rate dwindled from 1.7 percent per year, during the decade ending 1961 to 0.3 percent per year, during the subsequent period, 1961-72. Reduced inputs led to a contrast between the per capita agricultural outputs of the two periods. During the former, this output rose at an annual rate of 0.8 per cent, during the latter, it declined. instead of rising and at at equal rate.

Moreover, potentialities exist for substantial increase in food production at costs much lower than the costs of U.S. foodgrains. Per acre yield of foodgrains in India is among lowest in the world. It is higher only than the average for African countries. In 1961.62 in the case of wheat, the Indian yield (9.5 maunds) was about one-half the average yield in the U.S.A. (18.0 maunds). In the case of rice (paddy) too, the yields contrasted. And the yields are easily capable of being stepped up by better seeds and better methods of production like transplanting in place of broadcasting (seeds), by rotating paddy after gram, by pest and disease control and also by better ploughing, more fertilisers and better irrigation.

The removal of the capital starvation of agriculture is not possible without heavily slashing public sector outlays and without putting a stop to uneconomic extension of industrialization. This alone can make adequate resources available for agriculture. This reform, however, calls for a complete U-turn in our overall economic policies, which is no easy task. Such drastic measures would be doubtless resisted, tooth and nail, by the powerful vested interests which have been flourishing on the corrupt and the wholly unmerited windfalls, which the prevailing policies bring. But the choice before us is, clearly, between, on the one hand, keeping the present corrupt and wasteful system going and, on the other, continued economic growth, a thriving agriculture and an abundance of food for all. These vested interests which are well entrenched in power, are looking for a solution which will produce economic development but consistently with the corrupt and other windfalls to which they have been accustomed. Such a solution, however, does not exist.

The situation is one of extreme difficulty and calls for rare economic and political statesmanship. There is no room for both massive parasitism and adequate well-being for

the masses. There can be no Garibi Hatao under the prevailing policy system. Mass starvation is but the economic counterpart of the unmerited affluence of the power elite, the innumerable Taj Mahals, which we have constructed in the heavy - industry sector, and the output of factories which just would not stand international comparison in respect of cost or quality. We can have either the one or the other. Unfortunately, (or the parasitical vested interests, there is no room for both.

3. Price Sensitivity of Farmers

We would be missing what is perhaps the most important aspect of India's agriculture, if we did not refer to the price factor. The subject is a vast one. But we may review its essential aspects, which are intimately related to the subject of our discussion. Of the several prices, the crucial ones are, the procurement price, at which farmers are called upon to surrender their produce, the issue price, at which consumers obtain their rations from the fair-price shops, the open market price, if open market transactions are permitted and the black market price where open transactions at other than controlled prices are banned. The actual receipts of farmers are the sum of the sales at procurement prices and at the prices ruling in the free markets; and the actual cost to consumers is the sum of the purchases from fair-price shops and from open market. In each case, the "mixing" price of the transactor would depend upon the relative amounts of the transactions in the official and the free markets.

Procurement prices have a crucial bearing on production and on the success of the procurement drive; and the issue prices influence the pressure of demand on the public distribution system. If the gap between the official prices and the free market prices of wheat is significantly large, procurement of wheat will suffer, as has happened in 1973. The procurement target for the year was 8.1 million tonnes; the great difficulty in procurement led to a lowering of the target to 6.0 million tonnes; and an actual procurement as on 3rd August 1973 was 4.3 million tonnes.

Low procurement prices, via their impact on profits, would affect production adversely. Wheat farmers have demonstrated their high sensitivity to prices and profits. We shall cite three outstanding instances. First, with the announcement of the first PL 480 agreement in August 1956 and the subsequent inflow of large shipments of wheat, the price of wheat was repressed. This impinged adversely on the profitability of wheat production vis-a-vis other crops. Thereupon, sensing continued imports and price repressing, wheat farmers re-arranged their cropping programme in the very next sowing season (1957-58). They transferred, during the season, no less than 1.8 million hectares of land from wheat to other crops and the output of wheat declined by 1.4 million tonnes.

Secondly, during the three years, 1963-64 to 1965-66, wheat prices rose by 64 per cent. Yet, the wheat acreage continued to decline, reaching a low of 12.6 million hectares in 1965-66, as other prices accelerated faster and yielded better returns.

Thirdly, with the end in sight of Pl. 460 dumping in 1967, wheat was released from price repression, and the area under wheat spurted up by 2.2 million hectares in 1967-68 and

the output of wheat by 5.2 million tonnes. Thereafter, the area under wheat rose continually.

What is moral or economic basis for this arbitrary income limitation of farmers? In a background of acute shortage of farm products the producers should be given an incentive price. Because of the acute shortage of foreign exchange, we offer various subsidies and incentives to the producers of foreign exchange, the exporters. Why should not the same logic apply to the producers of agricultural products?

A competitive market price for their produce is the birthright of farmers, even as competitive wages and salaries are the birthright of employees. The error of the policy of arbitrarily limiting agricultural prices, thereby restraining unjustly the incomes of farmers, in the context of a general upsurge in incomes, has been demonstrated more than once in the past. Land has been shifted from wheat to other crops when the gap between procurement and market prices was considerable.

4. Have We Allocated Adequate Resources to Agriculture?

Critics of this analysis will doubtless, quote statistics of the increase in the agricultural part of the total plan investments. Even taking these investments at their face value i.e., ignoring the familiar leakages from it - we find, first, that, consistently with importance of agriculture in the Indian economy, both on the basis of its contribution to the national product and the proportion of the labour force employed in agriculture, agriculture should have received a much larger percentage of the total investible funds than the peak of 21 per cent, reached in the fourth plan. even when due allowance is made for the generally low capital-output ratio in agriculture.

Secondly, when due allowance is made for the heavy debits on investments on account of corrupt payments and corrupt practices, for overstaffing and for the manifold management inefficiencies, the de facto and effective investments in agriculture would be much less than the amounts appearing in the budgets.

Thirdly, a distinction must be made between farm finance and finance of social and other over-heads of agriculture. Virtually all public sector investments relate to the latter and hardly any to farm finance proper. Though public sector investments in agriculture have tended upward, these investments have not added to capital formation on farms nor to agricultural inputs, which constitute the core of the problem of the development of agriculture.

5. Conclusions:

Like most other maladies confronting us, the farm problem, thus, has emerged from our own inept policies and the remedy rests in our own hands. The only honourable course is to step up farm production, for which abundant scope exists. Two decades of experience, however, has demonstrated that we just cannot achieve this under the prevailing price and investment hurdles. This policy of hurdles is not only strange in the context of conditions we are passing through, but also conflicts with the late Prime Minister, Lal Bahadur

Shastri's slogan which places the Kisan on the same high pedestal as the national defence services.

It would be a great day both for the farmers and the country if the Administration could be persuaded to revise its policies of hurdles and handicaps and place farmers on a par with other entrepreneurs. I have not the slightest doubt that, if only farmers are given at least this parity treatment and their due share of the national savings and investment resources, India's agricultural problems may well become a bad dream of the past in a matter of one or two crop seasons, and we would then be well on the way to achieving the national objective of Garibi Hatao.

STUDY TOPIC – 15

PLAN SQUEEZE ON AGRICULTURE *

Since Independence, we have made rapid strides in industrialisation. During the nine years ending 1958-59, the national income from factory establishments rose by 82 per cent and from mining more than doubled. Nevertheless, the Indian economy remains, dominantly, an agricultural-peasant economy. About 50 per cent of Indian national income is drawn from agriculture and about 70 per cent of the population lives on it. Quite naturally, the state of agriculture sets the tone of the national economy; we find that aggregate national income fluctuates with agricultural production.

But agriculture stands neglected in our Plans, though all of them pay lip-sympathies to it. Facts indicate more than neglect. Agriculture is squeezed for the benefit of the industrial and other sectors.

This may be seen in Plan allocations. In the First Plan, 43 per cent (Rs. 1,018 crores) of public sector outlay was on agriculture (including hydro-electric schemes). In the Second, allocations to agriculture fell to Rs.980 crores, or 21 per cent of the total outlay, though the latter (Rs. 4,600 crores) rose by 95 per cent. Third Plan allocations to agriculture are placed at 23 per cent (Rs. 1,675 crores) of total outlay, though the latter rose (Rs. 7250 crores) to over three times the outlay in the First Plan.

This is a serious matter, not only to agricultural interests but also to national well-being. To maintain agricultural production undiminished, farm-land and farm-equipment must be prevented from deterioration. To enhance this production, investment in farm-land and farm-equipment must be enhanced. To achieve this, agriculture must receive its due share of savings.

This has not been the case since "planning" began. The public sector appropriated well over 50 per cent of national savings in the First Plan, about 60 per cent in the Second and will absorb 67 per cent in the Third. This is out of all proportion to the contribution of the public sector to the national income, which was a mere 4 1/2 per cent in 1957-58, though it has been steadily on the increase.

If the minor sector of the economy appropriated the bulk of savings, the bulk of the economy must manage with the minor part of savings. Under the Third Plan 33 per cent of savings must be shared by the industrial, the tertiary and the agricultural sectors, which together account for about 90 per cent of Indian national income.

The organised private sector is generally well able to look after itself. Its requirements of short-term credit and long-term capital are provided, the former, by commercial banks and, the latter, by the stock-exchange and specialised institutions. Though interest rates, both short-and long-term, have been on the uptrend in recent years, private trade and industry have not found them too onerous in the context of rising profits. This is reflected in the phenomenal progress of industrial production, to which we have referred above, and the enormous expansion of earnings from "Commerce and Other Services" — from Rs.2,900 crores in 1948-49 to Rs. 4,300 crores in 1958-59, a jump of 45 per cent, as against a rise of 35 per cent in the national income.

As, in an integrated economy, pressures get shifted to weaker sectors, agriculture has been starved of credit and capital. This is evidenced by the interest rates and wage rates ruling in the agricultural sector. The findings of Professor Rene Dumont, of the National Agronomical Institute, Paris, provide evidence on interest rates. His investigations in West Bengal have revealed that public organizations — principally cooperatives and taccavi loans — provided 3 per cent of agricultural credit and relations and friends 15 per cent. The rest, 82 per cent, was drawn from traders, shopkeepers and money lenders. Interest rates on secured loans varied between 19 and 75 per cent a year; on unsecured loans, the rates were more fantastic, cases of 800 per cent a year not being unknown.

If such fancy sums may be earned on farm-credit, how is it that loanable funds do not rush into the rural sector and foil the "Plan squeeze on agriculture"? The answer is that institutional arrangements and legislation, though they were not conceived as part of any "Squeeze", have effectively cordoned off and isolated the market for credit to farmers.

To "protect" the farmer against usury and to prevent his being dispossessed of land, legislation narrowly circumscribes the activities of money-lenders and restricts the transfer of land to non-agriculturists. This has, on the one hand, barricaded the flow of savings into agriculture and, on the other, paralysed the credit-worthiness of farmers by freezing their almost only mortgageable asset. Consequently, loans to farmers have assumed ingenious techniques. They take the form of forward purchases of crops or sales of goods on credit. Where formal money-lending is legally permissible, the sums entered in the loan documents are inflated above the sum actually lent. These devices permit working into the agreements any level of interest rates, circumventing usury laws — through adjusting the contracted sale-prices of crops, the prices of the goods sold and the sums stated to have been lent. When loan agreements are oral, such circumvention presents little difficulty.

Thus, the business of farm credit is a matter of personal relationships, is generally an appendage to trade and involves enormous risks. In such a context, it is unpractical to expect free flow of savings into agriculture. Indeed it is possible that funds may leave the rural for the urban areas, the post-office collections of Small Savings assisting in the process. The farmer has been placed, more than ever, at the mercy of the nearest trader, shop-keeper or money lender.

The prohibitive costs of credit have affected the tempo of agricultural activity, as finance of operations on borrowed funds has shrunk to crops and lands, which can bear these

costs. For most of the rest, cases of finance from relations and friends apart, scratching the surface with a pinch of fertilizers, leaving the rest to the gods of weather, has become a painful necessity. This seems to explain why, despite water scarcity, only about 65 per cent of available water in the major and minor irrigation works is actually utilised. The farmers are without funds to pay for the water and to lay feeder channels to farms.

Constricted activity has affected adversely agricultural wage rates, through reducing the aggregate demand for labour, the number of agricultural workers affected being 72 million. This is revealed in the reports of two officially conducted Agricultural Labour Enquiries, one in 1950-51 and the second in 1956-57. The All India average daily wages of men agricultural workers was Rs.1.09. In 1956-57, it fell to Rs.0.96. Simultaneously, wages of women fell from 68 np to 59 np and of children from 70 np to 53 np.

Constricted activity has also affected adversely agricultural employment. In 1950-51, men workers were wholly unemployed for 90 days. In 1956-57, unemployment rose by 42 per cent to 128 days. In 1950-51 agricultural wages were generally higher than nonagricultural wages. This order got reversed in 1956-57. Lesser wage rates and more unemployment reduced the income of agricultural-worker families from Rs.447 in 1950-51 to Rs.385 in 1956-57 and per capital incomes from Rs.104 to Rs.88. Simultaneously, with the rise in the cost of living, per capita expenditures of agricultural workers rose from Rs.109 to 141. The opposite movements of incomes and expenditures increased the indebtedness of families in debt from Rs.105 in 1950-51 to Rs.138 in 1956-57. The impact of "planning" and socialism has, thus, been the heaviest on agricultural workers. the poorest parts of the community.

The policy outcome of this discussion is to change basically the approach to planning. Historically, development of agriculture has preceded progress in trade and industry. Agricultural progress, while attending to the creature comforts of the people, will provide a broadbased and assured demand for industrial production. Further progress, too, may be broad-based and certain, if heavy industries follow the expansion of light industries, as internal demand for the output of heavy industries grows. The transformation of the economy would be, then, natural and rapid, being devoid of tears and wastages. To bestow undue emphasis on mammoth river valley projects, steel plants, heavy engineering and electrical industries, at the expense of agriculture and leaving the people hungry and ill-clad, besides being asuric may cause the whole edifice to come crashing to the ground, since it would rest on insecure foundations.

PART IV

INTERNATIONAL TRADE

STUDY TOPIC - 16

INDIA'S BALANCE OF PAYMENTS CRISIS (ROOT CAUSE OF THE WEAKNESS OF THE INDIAN RUPEE)

A stock exchange scrip or a commodity is deemed to be "Strong" when its price is firm and moves upward. When the price sags, it is deemed to be "weak".

This concept of strength and weakness applies to currencies as well. A currency is strong or weak according as its

Abridged Version from 'Indian Economic Policy; Popular Prakashan. Bombay, 1968.

Our External payments situation has continued to cause worry. Our ex-ports as the percentage of GDP, during the Sixth Plan period was 8 per cent. but in 1986 it went down to 4.5 per cent. Imports also have diminished from being 8.4 per cent as the average in the sixth plan to 7.7 per cent in the year 1986-87. Invisible also as percentage of GDP have diminished from being 2.1 per cent to 1.2 per cent. Similarly exports from India (in value) as percentage of total world exports was 1.05 in 1960. It fell to 0.48 in 1982-83 and to 0.44 in 1988-89. Thus the total current Balance reveals the same sad story, as its deficit has increased from being 1.3 percent of GDP to 2 percent of it. There has been a chronic balance of payments deficit and the Indian Rupee's one of the weakest currencies in the world. So in order to put our house in order. the true causes of our malaise should be understood and the current remedies based on the scientific study should be suggested and sincerely followed by the authorities concerned.

In this article, late Prof. B R. Shenoy has analysed the problem of our chronic balance of payments deficit threadbare and explained convincingly the true causes of stagnation in our exports and the consequent weakness of the Indian Rupee and suggested remedies which may remove the hurdles coming in the way of rapid growth of exports and in the strengthening of the Rupee. — EDITORS

exchange rate rises or declines. But unlike in case of scrips or commodities, the exchange value of a currency cannot rise or fall unlimitedly. Under a gold standard, a currency cannot rise above the gold import point. When it touches this point, gold will flow into the country and the currency reserves will grow. The gold in-flow will arrest any further rise in the exchange value of the currency. In Place of the rising exchange rate, the country will take gold.

Conversely, a weak currency cannot fall below the gold export point. When it touches this point gold will flow out of the country and the currency reserves will decline. The gold outflow will arrest any further decline in the exchange value of the currency. In place of the falling exchange rate, the country will lose gold.

The rise in the price of a stock exchange scrip or of a commodity is the consequence of an increase in the demand for it. The same applies to the rise in the exchange value of a currency. It is the consequence of an increase in the demand for the currency. And the increase in the demand for the currency is the reflex of an increase in the exports of the country. The one is the counterpart of the other. The larger exports cause a corresponding increase in the demand for the currency to pay for the exports.

The basic index of the strength of a currency, then, is the strength of the exports of the country. If exports are high and rising, the currency will be strong as well-unless non-economic factors vitiate the situation by undue capital exports. In the foreign exchange market, this strength will be manifested in a firm or rising exchange rate; under a gold standard, the exchange rate - seasonal or other temporary variations apart - is apt to be above par and the currency reserves may grow. Rising exports may cause rising imports, or, alternatively, rising capital exports; and the currency reserves may rise less than exports, or may not rise at all. The reserves will reflect the healthful balance of payments position.

Whether it is (a) the exchange rate, (b) reserves, (c) imports or (d) capital exports that keep rising and in what, the measure of each is, is a matter of the collective effects of the relative decisions of individuals; of the decisions of the monetary authority; and of the trade and fiscal policy of the government. These are but the several alternative ways of using the benefits of strong exports. The essential point is that the strength of the currency depends on the export position and the latter provides the basic index of the strength of the currency.

This takes us to the question, what is the criterion of the strength of a country's exports? If exports are deemed to be strong, they cannot lag behind the overall tempo of the economic life of the community. And perhaps the best index of this overall tempo is the rate of increase of the national product. It follows that for the export position of a country to be deemed strong, the expansion of its exports must at least keep pace with the expansion of the national product. The ratio of exports to the national product may remain steady or rise. Since a strong export position will be attended by a healthy balance of payments position, it follows, too, that the expansion of exports will generally keep pace with the expansion of imports. The ratio of exports to imports may remain steady or rise.

In periods of heavy capital imports, imports may jump up correspondingly. In such situations, due adjustments must be made for the rise in imports from foreign aid or other capital imports, before comparing the expansion of exports to the expansion of imports. When, however, the export position of a country is strong, though, in the early stages of development, it may import capital, as the economy develops, it is apt to repay more than borrow afresh and eventually become a capital exporter. By the same reasoning, for the

export position of a country to be deemed strong in the world context, the expansion of its exports must at least keep pace with the expansion of world exports. The ratio of the exports of the country to world exports must remain steady or rise.

Conversely, the basic index of the weakness of a currency is the weakness of the exports of the country. The world's demand for the currency to pay for the export of the country will be less than the supply of the currency placed on the world markets, representing the country's imports and the possible flight of capital from it. So (a) ratio of exports to the national product, (b) to the imports of the country and (c) to world exports will decline. In the foreign exchange market, the weakness of the currency will be manifested in a falling exchange rate. Under a gold standard, the exchange rate - seasonal or other temporary variations apart - is apt to be below par and the currency reserves may decline.

Judged by these tests, the Indian rupee would seem to be among the weakest currencies in the world.

The decline in our exports as a ratio of world exports may be even larger than the relative percentages indicate. The rupee being over-valued, the U.S. dollar equivalent of Indian exports gets exaggerated by the extent of the over-valuation; and the ratio of Indian exports to world exports, both stated in U.S. dollars, gets correspondingly overstated, too.

The ratio of Indian exports to Indian imports are vitiated by two factors. On the one hand, imports, are kept at an unduly low level by rigorous licensing and exchange controls; in the absence of these restrictions, imports would be larger. The ratio of exports to imports in the context of import controls might be, therefore, larger than what the ratio might be in the absence of these controls. On the other hand, some of the imports represent inflows of capital, as foreign aid or equity capital; this calls for an adjustment in these ratios in the opposite direction. It is not possible to say to what extent these opposite adjustments would cancel one another.

The evidence of the weakness of the rupee provided by the declining percentage of Indian exports to the Indian national income is free from any of these obvious limitations.

And why are exports so low? An inflationary rise in prices in the context of a rigid exchange rate meant a corresponding rise in the prices of Indian exports in terms of foreign currencies to the buyers of Indian exports abroad. The latter, as a consequence, switched over to rival producers whose currencies were not over-valued; or to substitute other goods in their place. This acted as a hurdle to the expansion of Indian exports; and the latter lagged behind in a background of continued uptrend of world output and world exports. This contributed also to a fall in the ratio of exports to the national product.

Secondly, the exchange barrier in the way of exports which prevented exports from expanding, was accompanied by complementary changes in the domestic market. On the one hand, import restrictions denuded it of the much needed import goods. On the other, the aggregate domestic demand, being fed by inflation increased. In particular, inflation, and corrupt income (born or controls) produced a bulge of demand for goods consumed by the upper-income groups. In ordinary times, this demand bulge would be met by larger

imports, Severe import restrictions rendered this impossible. Potential export producers hit by the retarded demand for exports were, therefore, easily able to switch over to production for the home market to fill the vacuum caused by the import cuts and to meet the surging demand for fancy goods. Every rise in domestic prices reduced the profits from exports and added to the relative attractiveness of the home market, especially, since the comparative control of inflation in the great trading countries of the world. The rise in the costs incidental to the new and unfamiliar lines of manufacture did not deter this switch over of production; the scarcity of supplies caused by import restrictions and inflation drove prices up perhaps more than sufficiently to cover the higher costs. Trade and industry had little to worry from the retarding exports.

This merely meant a shift of production from exports to the home market. The national product continued to move up, though perhaps at a slower pace because of the resource wastages involved; only exports lagged behind.

Thirdly, the enormous sums invested under planning in heavy industries, on power projects, on irrigation and on consumer goods industries created a correspondingly enormous demand for goods of all kinds to meet the needs of these development projects. Imports being severely limited, this offered opportunities to manufacture on a scale undreamt of before. This made possible almost indiscriminate fabrication at home of all varieties of goods well-nigh regardless of costs or quality. If production in a given line was technologically feasible, entrepreneurs could go full steam ahead. The administration was ever ready to provide the requisite market for the output through adjusting the amount of the import licenses for the corresponding items of imports from abroad. Such production was hailed and welcomed as yielding a "saving" on foreign exchange, while at the same time contributing to economic development. Resource wastages were deemed of secondary consideration even if this aspect of the matter received any attention.

The outcome of this misguided policy has been the production at home of goods -stray exceptions here and there apart - which are mostly unsaleable abroad because of the high cost and poor quality.

Inflation in India except for rare and brief intervals has been a continuing phenomenon since 1941-42, and it may well persist, as the thinking behind the prevailing economic policies subscribes to the view that inflation and development necessarily go together; though, in practice the country has had more of inflation (apart from sectoral growth) and little of overall economic development. The possible continuation of inflation is apt to render worse, the already complex and serious foreign exchange situation.

Continuing inflation and a rigid exchange rate have rendered the rupee a classic case of fundamental dis-equilibrium. First, except for rare and brief intervals when inflation was under control or because of certain favourable fortuitous circumstances, balance of payments deficits have been large and chronic throughout the post-war period, and the pressure on the rupee in the foreign exchange markets has been heavy and persisting.

The chronic pressure on the rupee is not explained by the foreign exchange needs of investment; there need be no pressure on the rupee if investments were matched by

current domestic savings, drafts on past savings held in the form of currency reserves and imported savings represented by foreign aid. The investment demand for foreign exchange would be then met from the available supplies of foreign exchange, despite the balance of payments deficits, there would be no pressure on the rupee. The weakness of the rupee has been the result of the continued finance of investment from inflation and of the consequent over-valuation of the rupee at its official rate.

Secondly the inflationary rise in domestic prices and the rigid exchange rate meant a corresponding rise in the external prices (rupee prices multiplied by the rate of exchange) of Indian exports. This led to a yielding of ground in the export markets of the country, to rival producers or to substitute goods, and a shrinkage of export production within the margin. The marginal export producers, however, were easily able to switch over to production for the home market, as the normal demand in the market was now enhanced by inflation - fed incomes. Every rise in domestic prices reduced the profits from exports and added to the relative attractiveness of the home market.

Thirdly, Inflation in the context of an unchanged exchange rate rendered import goods unduly cheaper than ordinarily, especially in relation to the corresponding home products, which were generally of inferior quality. This added to the pressure for imports, the demand for which was now larger than before on account of inflation. A deterioration in the balance of payments position was natural in the context of the stagnant exports at a low level and the high and rising imports. Drastic cuts in imports have failed to correct the balance of payments deficits. The drastic import cuts merely diverted the demand for import goods to the domestically fabricated goods on the home market; potential export goods or the resources devoted to export production got drawn into home uses as a consequence, this phenomenon taking the form of exports remaining semi-stagnant in a back-ground of rising national product. The forced fabrication of domestic substitutes to import goods was often effected regardless of (factor) costs and the quality of the product, much to the detriment of national income and of the expansion of employment, as the latter is a function of the overall expansion of output.

Fourthly, also as a result of continuing inflation and an unchanged exchange rate, there have emerged vast gaps between the landed costs of import goods and their market prices. The benefit of the comparative cheapness of imports, a counterpart of currency over-valuation, has not, that is to say, accrued to the consumers. The market prices of these goods have for long ceased to be equal to the external prices multiplied by the rate of exchange plus the incidental expenses, customs duties and normal profits; these prices have soared far above landed costs and have been yielding enormous windfall gains to the import trade. The gaps between landed costs and market prices may vary from 30 percent to 500 percent or more of the landed costs depending upon the import commodities concerned; these gaps are reflected in the prices which import licences fetch in the market. This explains the unseemly scramble for import licences. Though the licences are legally non-transferable, their Prices are freely quoted in a section of the press, the transfers being effected under legal dodges such as fictitious forward purchases (of the import goods which the licences entitle their recipients to import) by the de facto transferer of the licences, the transferees functioning, in the eye of the law, as import

agents of the holders of the licences. When the import licences are not sold, the cheap import goods inflate the recipient's profits or of the transfers of the licences or the profits of the manufacturers; in any event the consumers do not get the benefit of the cheapness.

Finally, analogous to the price gaps in the import goods, there is a vast gap between the internal and the external - which is the same thing as the official - price of gold. The gaps between the landed costs and the market prices of import goods and of gold appeared in 1941-42 with the emergence of inflation during that year; the gaps widened with the progress of inflation. These gaps are the effects of, firstly continuing inflation and secondly, the over-valuation of the rupee at the official exchange rate, the result of the past inflation.

Conclusions

From the foregoing analysis, we see that the solution to India's balance of payments problem and to the softness of the rupee, is fourfold : (1) firstly, a policy of zero inflation should be followed; (2) secondly, a shift-back from production for the home market to production for exports is required to correct the shift in the opposite direction which the policies of the past decade or more have brought about; (3) thirdly a downward adjustment in the exchange value of the rupee is necessary to remedy the over-valuation in this rate which has resulted from inflation hitherto; and (4) finally, the elimination of the price gaps between the landed costs and the market prices of import good and between the official and the market prices of gold is essential.

STUDY TOPIC - 17

THE NEED FOR AND CONSEQUENCES OF DEVALUATION*

(1) Factors Responsible for Devaluation

The basic factors, which called for the corrective step of devaluation, may be stated briefly. During the past two decades, continued inflation and the consequent rise in costs had progressively over-valued the rupee at the official exchange rate which, throughout this period had remained unchanged. If the prices in our major trading partners had risen in the same measure, the over-valuation of the Indian currency would have been cancelled by the over-valuation of the currencies of these other countries. But this was not the case. Prices in the major trading countries of the world had been remarkably steady in recent years (1956-66) in Japan and the U. S. A. - or lagged behind Indian prices.

This meant that exports became less and less attractive. While £100 worth of exports brought no more than Rs.1,333 the costs of producing export goods continuously went up and general prices rose by over 60 per cent, as a counterpart of the depreciation of the rupee. Export producers, consequently, saw that profits from exports were being continually reduced; or turned into losses, the marginal producers, in particular, being in difficulties. By contrast, the domestic market was much more attractive. Here, if costs were rising, prices rose even faster in line with universal experience in times of inflation. As an escape from this penalty on exports, manufacturers, switched their attention increasingly to the home market, at the expense of overseas markets. This switch-over has been taking place almost since inflation began in 1941-42. There thus ensued a change in the relative attractiveness of the home market and the overseas markets, the appeal of the former gaining at the expense of the latter.

The shift from export production to production for catering to home needs was accelerated by policies of pressurised import substitution. Currency overvaluation and policy pressures for fabricating at home manufactures to replace import goods has a two-fold effect. It led, first to enormous shift of resources from export industries into industries catering to the needs of the home market; and, secondly, to increased consumption at home of tea, cotton, oilseeds and other export goods.

The effects of the massive shifts of investment away from export production are obvious in the country's export statistics. If export industries and industries catering to the home market, expanded at about the same pace, the ratio of exports to the national product may be roughly constant. In recent years, some of the leading economies of the world have been expanding export industries faster than industries attending to home needs. Even the Communist economies are trading with the rest of the world more than before and, perhaps, are devoting a larger proportion of the total resources to export industries than in the past. In U.S.A. exports remained steady in relation to national income, being around 5 per cent of the latter. The steadiness of the percentage indicates that the relative attention to export industries has remained unchanged.

In India the position is the reverse. The ratio of Exports, in relation to the national product declined from 6.4 per cent in 1954-55 to 4.0 per. cent in 1964-65. During the same period, total investments in the Indian economy rose from an annual average of Rs. 670 crores during the First Plan (1951-52 to 1955-56) to Rs. 3,200 crores in 1965-66 (the last year of the Third Plan), or by nearly 5 times; and national income at current prices about doubled. Declining exports in the context of mounting aggregate investments and expanding production bespeaks of comparative neglect of export industries and weighted attention of industries meeting hope needs.

Evidence of the increased consumption or use at home of exportable goods is in the statistics of the production and consumption of these goods. The exports of tea fell sharply from 72 per cent of total production in 1950-51 to 58 per cent in 1964-65; of cotton fabrics from 34 per cent to 11 per cent; and of cotton yarn and twist from 6 per cent to 1 per cent.

This shift in production and the consequent decline in exports had a establishing effect on India's balance of payments position. The rising national product necessitated rising imports to keep the wheels of production moving. Since, however, exports failed to rise simultaneously, the economy was without sufficient means to pay for the rising import needs. In such a context, every expansion of production necessarily widened the gap between the foreign exchange needs of the country and its foreign exchange earnings. The establishing shift in production and trade, and the resulting decline in exports, in the context of expanding national production, constitutes the crux of India's balance of payments difficulties.

But the policy makers and their advisers saw, and many still see, the problem differently. They believed that, since balance of payments difficulties ensued from a shortage of foreign exchange, the solution to the problem lay in measures for economising the use of foreign exchange. They, therefore, advocated increasing production at home of manufactures, to replace imports and thus "save" foreign exchange. Drastic cuts in imports constituted part of the same policy, import cuts and import substitution being mutually complementary. These policies had extensive public support, being welcomed as progressive, and as leading the country to greater "self-reliance."

But instead of solving the problem, these measures rendered the position basically worse. The logic of his process of basic deterioration may be briefly stated The sum of the national product (Y) and imports (M), visible and invisible, represent the total available supply of currently produced goods: these goods are drawn upon for exports (E), visible and invisible, investment (I), including additions to stocks, and consumption (C) The available supply of goods and services (Y + M) being equal to the aggregate drafts on them (E+C+I), we have the following equations*

$$Y+M=E.+C+I \dots\dots\dots(A)$$

It follows that,

$$Y-C-I=E-M \dots\dots\dots(B)$$

Domestic savings (S) being equal to the national Product (Y) less consumption (C), or $Y - C$, equation (B) is the same as:

$$S - I = E - M \dots \dots \dots (K)$$

Equation B states that, when the domestic product is not all used up at home, for investment (including additions to stocks) or consumption, the balance of the domestic product would appear as an export surplus; which may be added to currency reserves, or utilised for investment abroad. Conversely, when the sum of domestic investment and consumption exceeds the domestic product, there will emerge as an import surplus; which has to be made good by drawing down the currency reserves, or by foreign aid, using the latter term to cover all forms of inflows of overseas savings into the national economy. Both these propositions represent important economic truths, which underline the virtue of living within the means available to the national economy; and of the dangers of living beyond the available resources.

Equation K states that the magnitude of the export surplus (E-M) represents the difference (S-I) between domestic savings and domestic investment. It follows that, when investment is balanced by savings, i.e., when $S = I$, exports would be equal to imports and there would be no export surplus, as E-M would be then, equal to zero. It follows, too, that when domestic savings exceed domestic investments, exports will be larger than imports; and the excess savings would assume the form of an export surplus, i.e., the excess savings, then, would be transferred abroad, or, if they come back, they could take the form of foreign exchange additions to currency reserves. When investments exceed savings, i.e., when $I > S$, the left hand side of the equation will be negative. Necessarily, the right hand side of the equation will be negative, too. In other words, when investments exceed savings, the excess investment has to be financed by an import surplus, the necessary foreign exchange being found either from foreign aid or from currency reserves. This is unexceptionable as no investment can take place from non-existent resources.

Equation A, from which equations B and K follow, refers to the major categories of economic variables and the relationship among them when expressed in real terms. These equations would hold true also when the national product, consumption and investment, and exports and imports are all reckoned in money terms. This is so because money incomes are but monetary counterparts of the contributions, in real terms, to the national product on the part of the several factors of production, i.e., under conditions of zero inflation.

It follows that, when these variables are expressed in money terms, equation A, would continue to present the identity that the sum of national income and imports would be equal to the sum of the money values of exports, domestic consumption and domestic investment. The flows of moneys to purchase the national product and imports ($Y + M$), would be equal to the sum of the moneys received against (E), and the money values of investment goods (I) and consumer goods (C). In such a context, there will be balance of payments equilibrium, as S will be, then, equal to I, and E will be equal to M. There will not be, therefore, any pressures on currency reserves.

If part of domestic investment is financed from foreign aid' (a) the left-hand side of equation K would be $S-(1+a)$, Since S would remain unchanged while domestic investment would rise from I to $(1+a)$, $(1+a)$ would be greater than S and $S-(1+a)$ would be a negative figure. It follows the right-hand side of equation K would be, negative, too, the two negative magnitudes being equal to one another. The right-hand side of the equation would be negative because imports would be now larger than E by a, the amount of the aid-financed imports, while the magnitude of E will remain unchanged.

That is to say, investments in excess of domestic savings will be financed by an import surplus, the imports surplus being paid for by foreign aid. Though there will be a balance of payments deficit on current account, of an amount 'a', there will be no pressure on currency reserves. The national product will rise by 'a', the additional investment financed by foreign aid, and the economy will develop in a background of price stability, balance of payments stability, and therefore, foreign exchange stability.

This healthy phenomenon of progress with stability would get impaired when investment is financed by inflationary creation of money (B). This would raise the money amount of domestic investment to $I+B$; and as S would continue unchanged, the money amount of investment would be, then, greater than S. Consequently, the left-hand side of equation K would become negative; as the two sides of the equation are quantitatively identical, the right-hand side, $E-M$, of equation K would be negative, too, the values of both sides of the equation being $(-B)$. In other words, the new situation would call for an import surplus of $(-B)$ to provide the import goods necessary for the investment embarked on by money creation (B); i.e., finance of expanded investment through money creation would cause the pre-existing balance of payments equilibrium to get transformed into a balance of payments deficit, the amount of this deficit being $(-B)$. It is a matter of detail and of little substance whether the balance of payments deficit ensued from a reduction in E, or increase in M, or partly the one and partly the other. In all three cases, the amount of the balance of payments deficit would be equal to the amount of money creation.

The balance of payments impact of inflationary credit creation would be the same as above, when such credit may finance consumption, instead of investment. If the credit created to finance consumption is 'r', national consumption would increase by this amount. Consequently, national savings would decline by the same amount. National savings would, then, be $Y-(C+r)$, or $Y-C-r$. The pre-existing volume of savings being $Y-C=S$, the new magnitude of savings would be $S-r$. Credit creation to finance consumption cannot impinge on the pre-existing money flows of investment expenditure; the magnitude of I will therefore, continue as before. Since, however, savings are now less than prior to expansionary credit creation, $S-I$ will be now negative, i.e., the left-hand side of equation K turns negative by 'r', and $E - M$ must be negative, too, by the same amount. The right-hand side of equation K may turn negative either from a reduction in E, or an increase in M, or partly the one and partly the other. In all three cases, the magnitude of the negative figure would be 'r'. This amounts to saying that the finance of an increase in consumption of 'r' through credit creation, would necessitate an import surplus of an equal amount to provide the import goods necessary for the increased consumption financed by credit creation. Thus, credit creation to finance investment has

not any special economic virtue over credit creation to finance consumption. The impingement of both on the balance of payments equilibrium is equally bad; this equilibrium would get shifted into a deficit, the amount of the deficit being the amount of the money created.

How would this shift in balance of payments come about? The total disposable output ($Y+M$) comprises domestic product plus imports. From equation A, we see that some of it is exported and the rest is either consumed or invested at home. When investments increase from I to the additional investment goods 13 have to be found from $Y+M$, as it cannot come from anywhere else; i.e., B must be debited to one or more of the components of the stream of the national product, $Y+M$, namely, E , C or I . Since investment is increasing from I to $1+13$, clearly, B cannot be debited to I . The consumption habits of a people are linked up with their real incomes. And real incomes of the community, viewed as a whole, do not change merely because credit creation has taken place, though credit creation may shift real incomes sectorally. Aggregate consumption of the people may, therefore, continue as before; so that C in the equation would remain unchanged. It necessarily follows that the addition in investment resources, B , is apt to be drawn from E , the exportable part of $Y.M$.

Prior to credit creation B , there is no domestic stream of money demand seeking to take any part of E . The money demand for this flows from abroad; and this demand may seek satisfaction from other competing sources of supply elsewhere if they are not now available and have been claimed by created money B . The easy shiftability of this external demand for E , enables B to feed on it. Exports will, therefore, decline by the amounts of them withdrawn for domestic use (B).*

This line of reasoning does not conflict with the familiar Hayekian phenomenon of "forced saving". comprising (i) sectorial decline in the consumption of the fixed and sticky money-income groups; (ii) the subsequent tug-of-war between the favoured and penalised sectors, the fixed and sticky money-income groups, on the one hand, and the residual money-Income groups, on the other, with regard to their respective shares of aggregate consumption; and (iii) the eventual economic distortions resulting from inflationary credit creation. These consequences constitute so to speak, the Second Act of the drama, which follows from the First Act. Though the events in the Second Act grow from the First, and we have to take due note of them, when they precipitate into manifestation, our concern now is with the events in the First Act, which still occupies the stage. There is a time lag, of about 9 months or so in the case of India, between money creation and the rise in prices. Meanwhile, created money operates on a healthy body economy, prices rising only later*.

It is not necessary that the whole of the investment resources should be debited to exports. It is possible, indeed likely, that a part may be provided by increased imports, as the new investments, financed by credit creation, may call for import goods (B_2), these import requirements being in addition to the pre-existing import needs of the economy. With the (all in exports to $E-B_1$ and the rise in imports to MaB_2 , the right-hand side of equation K Would be $(E-B_1)1M+132$), $131+132$ being equal to B ; i.e., in place of a

balance of payments equilibrium, we would now have a balance of payments deficit of $13I.132$, or B , the amount of credit creation. This deterioration in the balance of payments would be made good either by drafts on currency reserves or by foreign aid.

It may be noted that there is some difference in the effects of increased investment financed by foreign aid and the effects of increased investment (or consumption) financed by credit creation. Though in both cases, $E-M$ turns negative, when investment is financed by aid, the deterioration in the current account deficit in the balance of payments would be wholly corrected by the amount of aid; E will continue unchanged and the equilibrium in the overall balance of payments position would remain unchanged. On the other hand, when investment or consumption is financed by created money, E will fall, M will increase, the balance of payments position will deteriorate by the amount of credit creation; and, to correct this deterioration, currency reserves would have to be drawn upon, or the country would have to obtain more foreign aid.

The damage to the export surplus, which ensues from increased investment or consumptions financed by credit creation, cannot be corrected by cutting down imports, as is so frequently believed, especially by administrators. The logic behind this belief is that, if exports fall, because of increased domestic investment or consumption, and the export surplus deteriorates by an equal amount, a cut in imports by a corresponding amount would restore the pre-existing equilibrium in the balance of payments. In terms of the symbols we have used, this logic may be stated as under : If, when exports fall to $E-B$, (as a result of the increase in domestic investments to $I.B$, financed by B amount of credit creation), imports are cut by B , 'imports would be now $M-13$; so that the export surplus would be $(E-R) - (M-B)$, or back again $E-M$. Thus, so the argument runs. by the simple device of import restrictions, we could eliminate the balance of payments deficits resulting from credit financed expansion of investment; and, what is more, will have also achieved an increase in the gross national product by B . the amount of new investments, without equivalent drafts on reserves or any foreign aid.

This is a fallacy. To be able to achieve an addition to the gross national product without using any resources other than printed money and imposing quantitative import controls seems too good to be true. If by this simple technique we may add to capital formation, underdeveloped countries need not queue up for foreign aid, for accelerating economic growth. Water-marked paper could do the job.

The fallacy of the argument is that when credit is created to finance investments (or consumption) and, at the same time. imports are cut by an amount equal to this created money, It is not as if exports would decline by only B . Exports, in fact, may decline by 28 . The logic of this position is somewhat as follows: When imports are cut by 0 , following credit creation by an amount B , money flows knocking about the market looking for consumption or investment goods would amount to 211 , B on account of the new moneys created and another 13 representing part of the pre-existing money flows, which used to feed on import goods. When imports are cut by 8 , the flow of money in the economy seeking to acquire goods does not fall also. This flow of money is determined by the national product Y , of which the money (flows are but a counterpart. When imports

are cut by B the flow of moneys seeking to purchase B goods would find them missing from the market. This flow of money would then move to other counters in the market and, as we have explained above, would soon impinge on E. the exportable part of the national product.

The right-hand side of equation K would be now (E-213)-(M-8), or E-M-B. Thus, notwithstanding the cut in imports, to M-B, the balance of payments position would deteriorate, from one of equilibrium, to a deficit, the amount of the deficit being 13. This demonstrates the simple truth that there is no short cut to capital formation. There is no such thing as a free lunch. If we should attempt capital formation through credit creation, and seek to "remedy" the resulting deficit in the balance of payments by a physical cut in imports, we would be seeking to correct one error - credit creation - by another error, physical restraint on imports. In mathematics double negatives may get transformed into a positive. In every day affairs of life, if we attempt to correct one deviation from the right path by another deviation of the same kind, we would leave behind the ill effects of two deviations to attend to.

(2) Case for a Floating Rupee

From the foregoing discussion we see that the central problem of India's balance of payments difficulties comprises two factors, namely, first, the low level of our exports and, secondly, the shifts of investment resources away from export industries, caused by the three pressures reviewed above. These two factors being inter-related, increased exports may not ensue without a shift-back in production to its normal pattern of relationship between the home and overseas markets. The prime function of devaluation was to bring about this shift back in production, and so to increase exports and remedy the recurring foreign exchange crises. The mechanics of the shift-back process was (i) to offer to exporters, through devaluation, the full rupee worth (consistent with the extent of the depreciation of the rupee) of their export earnings in foreign exchange, instead of only Rs 333 for every 100 of exports, as was the case before devaluation; (ii) thereby to remove wholly the penalty on exports and the attendant weighted attraction of the home market; (iii) thus, to restore to its norm the relative attractiveness of the home and overseas markets; so that (iv) producers may retreat from their preference for the home market, towards the old order of investment attention to foreign markets; and exports may increase.

Full success in bringing about the necessary shift-back in production depends on the rupee being devalued to the equilibrium level. If devaluation fell short of the equilibrium level, i.e., to the extent that some measure of over-valuation may still remain, there will exist a commensurate penalty on exports, the shift-back in production and the recovery in exports may not be complete and sufficient, as the weighted attraction of the home market would, then, linger; and balance of payments difficulties may not be wholly eliminated.

The crucial problem, Therefore, is to keep the exchange rate at the equilibrium level. This may be achieved in two ways:

- (a) by devaluing the rupee to its equilibrium level;
- (b) and floating the rupee; so that it always remains at the equilibrium level.

Under an equilibrium exchange rate, the aggregate demand for foreign exchange would be balanced by the available aggregate supply of foreign exchange, i.e., the prevailing demand for foreign exchange would be met in full at the rate of exchange of the rupee, ruling in the integrated market.

To resort to alternative (a) above, we must first ascertain the correct equilibrium value of the rupee; otherwise, there is a danger of the rate chosen being short of the equilibrium point, or beyond it. More usually, the danger is that it may fall short of the equilibrium point; and we may, then, have a continuation of the old troubles of two markets for foreign exchange and persisting balance of payments difficulties, though, if devaluation is substantial, the pressures of these difficulties may be of a lesser order than currently.

But it is a near-impossible task to arrive at the equilibrium value of the rupee, through any slide-rule technique. We have to go as far back as the period beyond 1939 for a base of reference when the Indian rupee was free from any shackles of exchange control and import restrictions; and the period beyond September, 1931, for a base of reference when the Indian rupee was freely convertible into sterling. Divergent developments since then in money incomes, costs and pattern of production and international trade, both in India and in the major trading partners of the country, have deprived the historical equilibrium exchange rate of the rupee of much meaningfulness as a starting point for deriving a possible equilibrium exchange rate today.

The free market quotations may provide a rough guide to the order of magnitude of the equilibrium value of the Indian rupee. But the unknown order of the margin of error in these quotations rules out their practical value, as it is of paramount importance that the new rate should be an equilibrium rate, as precisely as may be. The difficulty and danger of relying on free market quotations for fixing the new exchange rate may be seen in the wide margins between the buying and selling rates, which prevail in the free markets. Currently, the quotations in the Zurich free market, expressed in terms of Indian rupees for Swiss Francs, were Re. 1 = Swiss Franc 0.39 ("Bid") and Re. = Swiss francs 0.41 1/2 ("Offer"), a difference of 6.4 per cent over the Bid price. It is not clear what the margin of error may be, if we were to select the buying or the selling prices, or the average of the two prices, at which to fix the new exchange rate of the rupee.

Possibly, both the buying and selling rates of foreign exchange in the free markets may be below the equilibrium exchange rate and diverge from the latter by unascertainable margins. When a currency is freely convertible into gold (or into another currency, on a free gold standard), its exchange value in the foreign exchange markets, will remain within the gold points. Under the prevailing I.M.F. gold standard arrangement - which conforms to the gold exchange standard more than to the gold standard proper - sterling-dollar exchange rates may not stray beyond the limits of $C 1 = \$2.78$ and $C I = \$2.82$, the limits determined, by agreement with the I.M.F., on the principles governing gold points. The market rates are held within these limits through the technique of Bank of England

intervention in the market by offering dollars freely when the market rates tend to fall below the lower limits of $C 1 = \$ 2.78$; and by offering to purchase freely dollars when the market rates tend to rise above the upper limit of $C 1 = \$2.82$.

When free convertibility is abandoned and exchange control and import restrictions are imposed, as is the case in many under-developed countries currently, two markets will emerge for foreign exchange, the official market and free-market for foreign exchange, where quotations, for foreign exchange may diverge from the official rates such divergences varying with the extent of over valuation of the currency at the official exchange rate.

In a regime of exchange control and import restrictions, banks in the country concerned cannot legally engage in exchange transaction at rates other than the official rates. Traders and others using the free markets for foreign exchange cannot, therefore, put their transactions through banks. They have to purchase or sell foreign exchange against currency notes. Imports, financed by foreign exchange purchased from the free markets have to be smuggled into the country; and outward remittances, financed through the free markets, have to remain concealed. When smuggled goods are sold, the local currency notes thus acquired are smuggled out of the country -as open exports of these notes are banned under Exchange Control — and disposed of in the free markets against foreign exchange, in order to repeat the smuggling transaction. These notes are picked up by traders, who bring foreign exchange to the free markets, acquired through smuggling out exports, under-invoicing exports, or over-Invoicing imports; they may be picked up-top, by tourists or by others who have funds to remit to the country. The currency notes purchased in the free markets have to be, again, smuggled back, as, open imports of notes are banned under Exchange Control. The notes smuggled in, place the traders in funds for repeating the operation of smuggling out export, under-invoicing exports and over invoicing imports.

The insuperable hurdle of ascertaining the equilibrium exchange rate apart, there are certain basic difficulties which suggest deferment to a more propitious date - if not abandonment for an indefinite period - of alternative (A). Devaluation of the rupee to another fixed point would call for continued monetary and fiscal discipline to ensure that the new rate remains in equilibrium. Any inflationary deficit financing, or lax monetary policies, beyond the capacity of the External Assets to suffer depletion, may drive domestic prices up and render the rupee over-valued again. Under-developed countries, in particular, can ill-afford the luxury of fixed exchange rates. Their foreign exchange reserves being generally close to rock-bottom, their capacity to absorb inflation by depleting their reserves is extremely limited, so that an appreciable expansionary deficit financing would impinge, more on prices than on reserves. Moreover, the political pressures confronting the Administrators in these countries frequently get the better of the need to stick rigorously to tenets of non-inflationary fiscal policies. Expendiency therefore, suggests that a floating exchange rate would suit the needs of under developed countries vastly better than a fixed exchange rate.

On both counts - the difficulty of ascertaining the equilibrium exchange rate and the paramount need for non-inflationary fiscal and monetary policies — alternative (B), namely, a floating rupee seems, therefore, preferable to alternative (A). There is no better device of discovering the equilibrium rate of exchange than to release the rupee to the pressures and supports of the free market forces. A floating rupee and currency over-valuation cannot go together. Any lapses from fiscal and monetary measures, appropriate to the prevailing economic complex, would show up in exchange rate depreciation, automatically; and the floating rupee will be always in equilibrium. With so many other problems of great moment to attend to, relief from this major distraction of self-created foreign exchange scarcity may be a gain of no mean order.

Both measures - devaluation to the equilibrium level and floating the rupee - fall within the jurisdiction of the relationship between the I.M.F. and its member countries. Though the I.M.F. may have a bias for fixed rates, in view of the special circumstances of India, it may not be difficult to persuade the I.M.F. technicians to agree to a floating rate in the initial stage, pending the ascertainment of the equilibrium exchange rate, at which to proceed to stabilise the rupee.

Some commentators have observed, not without seriousness that, if the rupee is left to float, its exchange value may sink toward zero. Floating cannot take away from the intrinsic worth of a currency; nor can exchange control add to it. Exchange control is an attempt to conceal the true worth of the rupee; floating or free pricing, brings out its true worth, as in the case of tea or silver, under free-market conditions. The rupee may become worthless only if through our own misdeeds, we worked the Nasik printing press non-stop and landed into runaway inflation, as Germany and China had done. If this should happen, can exchange control be of any avail? Or, can floating the rupee make matters worse?

The technique of the floating rupee does not require that all customs duties, either on imports or on exports, should be removed. Customs duties may influence the course and pattern of domestic production; and, therefore, of imports and exports. What the technique of the floating rupee requires is a removal of the physical restrictions, on imports and exports, namely, the restriction or regulation of imports or exports by licences, quotas or such other devices. As, under a floating rupee, the balance of payments of a country would be always in equilibrium, the case (or these physical restrictions would disappear with the adoption of the floating rupee.

The frequent assumption that an "economy of planned development" is "totally incompatible" with a floating rupee is not logically sustainable. It is the magnitude of national savings and the most effective investment of these savings that make for accelerated economic growth. To lay this stress on savings and capital formation is not to under-rate the vital importance of the favourable background of institutional and human factors, including social attitudes. But institutions take time to grow and their growth itself may be conditioned by overall economic development; and the favourable human factors may take much longer to manifest, though economic development may contribute to this, too, through facilitating increased investment of capital in man. Because of the

difference in the institutional and human background, a dollar worth of domestic savings and capital formation may yield much more economic growth in, say, a country in Western Europe than in, say, a country in Asia or South America. But in both categories of countries, the pace of development, in the short run as well as in the longer run, would depend on the pace, care and effectiveness of capital formation.

(3) Exporters' exchange earnings are their working capital

If so, it is difficult to see how exchange control and import restrictions may accelerate economic development. The exports of a country do not represent its savings. They are comparable to the sales of an individual trader. Like these sale proceeds, they represent part of the working capital of the national economy, more specifically, the aggregate working capital of those engaged in international trade; and, in their function as capital, are indistinguishable from the working capital of traders who engage only in domestic trade, except that, by the very nature of things, the working capital of exporters gets transferred across the national frontiers, being transformed into foreign currencies, while, in the case of domestic traders, the sale proceeds - the working capital - retains the garb of the national currency. This temporary change of clothes does not alter the character of the inner entity, which, in both cases, is circulating real capital.

In the case of the domestic trader, the sale proceeds are converted, as rapidly as may be, into fresh purchases, for repeating the sale transactions and, thus, to add to the turnover of the working capital, in an effort to maximise his income. Even so, export proceeds are converted, as rapidly as may be, into import goods, for sale in the home market; the sale proceeds of the latter are, then, used to purchase home goods for export. The working capital employed in international trade, by repeating this turn-round, from export goods into import goods, over and over again, adds to the incomes of the export-import traders and of national economy. That imports and exports may be generally undertaken by different firms is a matter of specialisation of economic activity. This does not negate, though it may obscure, the basic truth that what moves across the national frontiers, as import goods and export goods, is but part of the currently existing circulating real capital of the national economy.

This circulating real capital, like the stock-in-trade of domestic traders, is an integral part of the community's stock of capital, the other components of this capital stock including factory buildings plant and equipment, arable land, farm houses, and goods in stock, in transit and in process of production. Since import goods and export goods are but mutual transformations of one and the same basic entity, namely, the circulating real capital of the economy, they do not both figure in the national accounts. The gross national product of a country is the retained domestic output (Y) plus imports (M). When credit is taken for the import goods added to the national product, there is no need to take credit for the foreign exchange receipts against exports. To do so would be double counting.

Thus, the foreign exchange "earnings" of a country, acquired against exports, visible and invisible, do not represent resources available for current additions to investment, i.e., for current capital formation, as they are already part of the existing capital stock. The dissection and overall curtailment of the purchases of a trader, operating in a competitive

market, cannot add to his income and savings; nor help in the expansion of his business. Analogously, the dissection and restriction of imports do not add to national savings; nor can this add to aggregate capital formation. Indeed, it is more than likely that restrictions on imports, like the curtailment of the purchases of a trader, may detract from the maximisation of income and savings from the capital employed in trade, through keeping the volume and turnover of business at below their possible maximum. It is not generally appreciated that, even as the continued curtailment of the purchases of a trader must ipso facto cause a curtailment of his sales, any continued restriction of imports necessarily restricts exports as well.*

We have seen, above, that, as a result of the rigorous restrictions on imports into India, during the past about a decade, exports, expressed as a ratio of national income, declined from 6.4 per cent in 1955 to 4.0 per cent in 1964; expressed at 1958 prices, they fell from Rs.780 crores in 1955 to Rs.612 crores in 1964.

It follows that the circulating real capital employed in international trade declined, during this period, both absolutely and as a ratio of the total capital stock of the community. Correspondingly - as, in the meanwhile, the total capital stock of the community increased - the circulating real capital employed in domestic production and trade increased. This development was a counterpart of the phenomenon of the shift of attention away from exports and from export production to domestic trade and to production for the home market. The hurdles on exports caused, too, a retardation of the turnover of the circulating real capital. This correspondingly reduced India's income from international trade.

Nor was this loss of income made good by any compensatory increase in the income from the expanded domestic production and trade. As we have seen elsewhere, the expansion of production for the home market, to replace production for the overseas markets, may amount to shifts of production from sectors where factor costs of production are lower to sectors where production costs are higher with a corresponding debit incidence on GNP. Aggregate national income, therefore, would be lower as a result of exchange control and import restrictions.

Nor can any dissection and restriction of imports assist in the most effective deployment of the available investment resources, to subserve the overall objective of achieving the most fruitful capital formation. We have seen that maximisation of the national product from the given investment resources rests on, first, freedom to entrepreneurs over resource appropriations and their disposal: and, secondly, no less freedom to individuals to invest their savings in accordance with their own schedule of choices. In the absence of these two freedoms, there is apt to be malinvestment of resources, detracting from aggregate national product. As every investment and also the operation of the existing plants, involve use of import goods in lesser or larger measure, exchange control and import restrictions militate against the exercise of these two freedoms.

Exchange control and import restrictions, then, not only do not add to the available flow of investment resources, nor help in the most productive use of these resources, but may

do the reverse, in both respects. Clearly, therefore, removal of exchange control and import restrictions is a major pre-requisite for speeding up economic growth.

Removal of import restrictions is essential also in the interests of social justice. Because of the severe restrictions on imports - necessitated by policies which rendered the exchange value of the rupee unrealistic and which prevent import liberalisation - artificial gaps have arisen between landed costs and market prices of import goods. The benefit of these cost-price gaps accrues to industrialists and businessmen, who receive import licences, and who frequently find it necessary to share it with the corrupt among the politicians and administrators, who issue these licences, and with the now well organized body of touts and intermediaries. The extent of the cost-price gaps is a measure of the windfall gains which the permitted imports bring; and is naturally reflected in the prices offered for import licences.

Before the devaluation of the Indian rupee in 1966, the market values in respect to 10 per cent of the licences varied from 500 to 700 per cent of the c.i.f. values of the import goods authorised to be imported by the licences and up to 200 per cent of the c.i.f., values in respect to the rest of the licences*. Assuming the average price of 75 per cent, the present writer conjectured that the pre-devaluation values of the import licences relating to imports in the private sector might have been of an aggregate order of Rs.470 crore**. Devaluation of the rupee lifted up the c.i.f., values of imports by the margin of devaluation, without causing the Indian market prices of these goods to go up. Devaluation, therefore, led to a sharp drop in the market values of import licences, though, with the progress of inflation since devaluation, there has been a rapid recovery in these values.

The pre-devaluation aggregate values of import licences represented the largest part of the annual expansions of national income. Since the wind-fall gains corresponding to aggregate values of the Import licences accrued to people in the upper-income groups, a thin top layer of the community, we may say that the benefit of the largest part of the annual expansions of the national income was appropriated by this thin top layer, leaving the condition of the masses unchanged, or worse than before. With the rich becoming richer and the poor remaining poor, if not becoming poorer, income contrasts between the rich and the poor have become sharper. This has been causing a great deal of social tension already. Any prolonged persistence of this phenomenon may imperil political and social stability.

(4) Exchange/controls cannot stem capital flights

Some have fancied that, in the absence of exchange control, capital might flow out of the country and jeopardise development. This is a paper argument as distinguished from an argument applicable to the realities of life. When movements of funds abroad are free, and no doubt exists on the continuance of this freedom, it is unreasonable to expect a general flight of capital; capital movements in such a background may be influenced by differences in interest rates and returns on investment, due weightage being given to the innate preferences for investments at home rather than abroad, other things remaining equal. General flight of capital in a back-ground of rigid exchange rates, implies -the

extreme case of political insecurity apart - doubt regarding the ability of the country to maintain the existing exchange rate and, therefore, the possibility to the Government resorting to exchange control and import restrictions, or, alternatively, devaluing the currency. This doubt would induce shifts of funds abroad, such movements of funds assuming the dimensions of capital flight when the doubt deepens, as devaluation or exchange control might seem imminent; the motivation of such capital flight is the windfall gains, which ensue when the funds are brought back, following devaluation.

This phenomenon of capital hopping out and hopping in, which may impinge on development via its effects on the short-term capital market, is linked up with exchange rate instability and a possible devaluation. This phenomenon has no room when the exchange rate is continually in equilibrium, as under a flexible exchange rate system, i.e., a floating rupee.

Capital flights of this category, for which the remedy lies in ensuring continued exchange stability, should not be mixed up with outflows of longer-term capital, which stem from continued monetary instability, political uncertainties, inordinate taxation and the necessity to conceal from easy detection illicit earnings. Exchange control is ill-suited to stop such capital movements, as Indian experience well demonstrates. Such capital would move out, availing of in the bargain, the subsidy of an over valued exchange rate, through under-invoicing exports or over-invoicing imports; or, alternatively, foregoing this subsidy, via the free-market for foreign exchange. On the other hand, continued exchange control and import restrictions might cause capital to seek refuge in countries with convertible currencies; and might deter the inflow of capital from abroad under internationally competitive terms - countries having exchange control and import restrictions may have to offer more attractive terms to induce capital inflows than countries where these controls and restrictions do not exist. Thus, so far from assisting development, exchange control and import restrictions might hinder development through inducing capital outflow and retarding capital inflow.

It is not exchange control and import restrictions but production that feeds a hungry people, and keeps levering up their level of living. It takes exchange control and import restrictions and other measures of economic regimentation to produce the strange phenomenon of rising per capita incomes, food shortage and starvation deaths. To quote Professor Ludwig Erhard, the man behind the German economic "miracle, exchange control is perhaps the worst form of control ever devised by man. Our experience is in line with this observation. True socialist progress calls for a truthful exchange rate i.e., devaluation to the equilibrium level, or a floating rupee.

(5) Consequences of Devaluation

We have seen that the crux of India's balance of payments difficulties was, first, the pressurised diversion of resources from export industries into industries catering to the needs of the home market and the diversion for home use of home consumption of exportable goods like tea, cotton textiles and oilseeds; secondly, the resulting semi-stagnation or lag behind of exports in the context of expanding national product; and, finally, the widening gap between the foreign exchange earnings and the foreign

exchange needs of the country, which it is not possible to cover otherwise than through non-project foreign aid. Since the gap between foreign exchange earnings and foreign exchange needs must widen under these conditions, clearly, the dependence of the country for its internal as well as the external viability must grow, too. This explains the mounting demand for general purpose aid in recent years.

We saw, too, that exchange control, Import restrictions, and import substitution are not only no solution to this problem, but that these measures worsen the situation basically. Import substitution which has been carried to extreme lengths already, would add to the perverse shifts in resources and trade and widen the balance of payments gap: exchange control and import restrictions would decelerate economic progress and increase the gap between the rich and the poor, by feeding and fattening a thin upper crust of privileged and over-affluent people at the expense of the living standards of the masses, already around the margin of subsistence.

There is no solution to this economic and social malady other than to bring about a shift-back in production and trade away from the home market into export production and exports. And this shift-back cannot come about in the full measure necessary except through restoring to exporters the full rupee equivalent of their export earnings. This necessitates the devaluation of the rupee to its equilibrium level.

We shall now examine, (a) the impact of devaluation on the Budget, (b) on domestic prices and on the overseas prices of Indian exports; and, the follow up measures to ensure the success of devaluation in the next section.

(a) Impact of Devaluation on the Budget

Devaluation may convert budget deficits into budget surpluses by stepping up receipts under foreign aid and under import duties, the sum of the two being much more than the sum of the higher rupee costs of external debt services and of defence imports. Foreign aid would be now worth more in rupees by 57.5 per cent and the receipts under foreign aid in 1966-67 may be Rs. 638 crores (in respect of non-project aid alone), a gain of Rs.233 crores over the amount (Rs. 405 crores) at old rate of exchange. Secondly, as import duties are paid on c.i.f. values of imports, these values would go up by somewhat more than 57.5 per cent and the same imports and the same rates of duties may fetch larger receipts under import duties.

To these budgetary windfalls must be debited the larger rupee costs, at the new exchange rate, of the service on external debt and of defence imports. The rupee cost of external debt services, which is placed in the budget for 1966-67 at Rs.121 crores may be now Rs.191 crores, instead. We have no data on defence imports, but their rupee costs, too, would go up by 57.5 per cent, though this may not be larger than the order of Rs.100 crores. Devaluation may not add any burden on the budget on account of food imports, apart from the larger working capital requirements and the larger rupee needs for holding stocks: nor on account of the imports of public sector corporations, as, in both cases, the government merely plays the role of trader or middle man.

The impact of devaluation on public sector undertakings is not dissimilar to such impact on private sector firms. Both would now forego the unmerited subsidies which they had been receiving from the community through the device of the artificially high exchange rate, these subsidies coming in the form of incredibly low landed costs of import goods. With devaluation of the rupee, the landed costs would rise by 57.5 per cent and the windfall gains of importers would decline correspondingly. Public Sector undertakings cannot reasonably claim any special or differential treatment in the matter of the incidence of devaluation. Like private sector firms they should re-adjust their balance sheets to allow for the loss of subsidies and seek to function as business concerns, basing their operations on sound financial principles. There is no case for replacing the concealed subsidy by any open subsidy. If they are unable to stand on their own feet, a solution may be to denationalise the public sector undertakings concerned. In private hands, they may turn out to be a much greater success as business enterprises.

We have argued elsewhere that export duties imposed simultaneously with devaluation should be withdrawn, as these duties correspondingly nullify the corrective incidence of devaluation. To continue export duties would be, in fact, to continue currency overvaluation in another guise. The expected receipts from these duties, therefore, cannot be legitimately included in the effects of devaluation on the budget.

(b) Impact of Devaluation on Prices

Since Independence, inflation has ensued mainly from budget deficits. Deficit financing of private sector investments through expansion of bank credit has been a secondary development consequent on budgetary deficit financing; it has been the result of the commercial bank expansion of credit upon the increase in commercial bank reserves, an outcome of public sector deficit financing. It follows that, as devaluation would materially improve the budgetary position, there is no logical basis for the belief that it may deteriorate price inflation. On the contrary, unless governmental outlays should gallop ahead and exceed the windfall benefits of devaluation, there is every reason to expect price stability as a consequence of devaluation.

Devaluation may lead to an increase in the national product in two ways. First, the logic of devaluation involves liberalisation of imports, consequent upon the increase in exports, which may follow devaluation, Action to liberalise imports is in process. As the increase in exports and the improvement in the foreign exchange position may take time, on the strength of the expected non-project aid of \$ 900 million* from the Aid-India Consortium, the Government of India announced on 21 June 1966, "their intention" to liberalise imports of raw materials, components and spare parts, "in order to secure higher levels of production in agriculture and industry.". As a first step, (a) special arrangements are being made to import large quantities of fertilizers, pesticides and raw materials for the manufacture of fertilizers; (b) the imports of raw hides and skins, tanning materials and chashew-nuts, which are, "needed primarily for export production", "will be allowed" to be Imported unlimitedly under Open General Licence, in the first instance, until 31 March 1967; and (c) import licences "will be provided" for imports of raw materials, components and spare parts "for production up to full capacity for six months" in the case

of 59 priority industries. Industries to which import liberalisation applies include, in addition to engineering and manufacturing industries, jute textile, tea, coffee, and oil pumps and other requirements of agriculture. Liberalisation of imports may cause the national product to grow through mobilising into activity idle capacities, or through speeding up production.

Secondly, devaluation may lead to an expansion of the national product through inducing a more effective and economic use of our resources. During the past 1 1/2 decades, under the protection of exchange control, import restrictions and currency over-valuation, as also under policy pressures, we have been producing at home, for the home market, goods, which are frequently several times more costly than the import goods, which they replace. In the case of commodities, which are both produced at home and imported, we have some evidence of the higher costs of the domestic product in the incredible margins between landed costs and market prices of import goods. The market prices may be said to represent a rough measure of the resources which have gone into the fabrication of the domestic product; and the landed costs at c.i.f. values reflect the prices at which the same commodities may be had through imports. These margins are still large in a distressing number of varieties of goods.

The fantastic prices which import licences fetch are, thus evidence of the wastage of resources and of the basically uneconomic character of the import substitution industries concerned. In the case of colours, for instance, the current price of the import licence is 115-120 per cent of the landed cost of the commodity, i.e., the rupee price of the commodity in the Indian market is 115 to 120 per cent higher than the landed cost. This difference between landed costs and the rupee prices of the commodities concerned provides a rough measure of the enormous resource wastages of the policy of indiscriminate import substitution, which we have been pursuing. It seems odd that we should be doing this in the name of "planning", under the label of "self-reliance" and the belief that thereby we "save foreign exchange and help to solve the balance of payments problem.

The opposite in the case, in reality. Indiscriminate import substitution, first, withdraws resources from the traditional export industries. Secondly, as a consequence of reduced export production in the traditional export industries, our exports of the traditional items remain semi-stagnant. The new industries, which we have brought into being, are incapable - exceptions here and there apart - of making up for this lag in exports, as, being vastly more costly than the comparable manufactures abroad, they have little chances of entry in overseas markets under competitive conditions. Thirdly, as we have explained elsewhere, this policy has rendered chronic, India's balance of payments difficulties. Finally, it would impinge adversely on the national product. The price of a motor car in India is about Rs.20,000. A corresponding car imported from U.K. may cost at c.i.f. value less than one half of this price. With the resources consumed in the making of one car, the community could have a little more than the two cars in place of one. The car component of the national product would be more than double for the same-quantum of investment resources, if the resources could be used economically, instead of wastefully.

Devaluation would help to correct this. C 100 worth of exports would now be bringing Rs.2,100 to exporters' as against Rs.1 333 before devaluation. Correspondingly, the c.i.f value of C 100 worth of imports would be now Rs. 2,100, as against Rs. 1,333 before devaluation. Devaluation would, therefore, cause export production to increase under the inducement of the higher profits on exports. Correspondingly, the rupee costs of the import component of the import substitution industries will go up by 57.5 per cent. Import liberalisation might tend to lower the price of import goods. Under the double pressures of higher costs and lower prices, industries engaged in import substitution at the margin of production would curtail output under the penalty of reduced profits or losses.

Devaluation would, thus induce a shift away from pressurised import substitution, into export industries. In proportion as this may happen, the national product may be larger than now for the same quantum of resource investment. If, as is not unlikely, the manufactures fabricated at home are, on an average, 75-100 per cent more costly than the import goods they replace, the addition to the national product ensuring from every installment of the shift-back in production from import substitution to export production may be considerable.

If, notwithstanding these favourable factors, prices in general should rise, the blame cannot lie on devaluation. It may be due to over-spending and over-investment by the state. During the first three weeks following devaluation, The Economic Times general index of prices remained virtually steady, price variations being around 1 per cent. On 1 July the index spurted up to 158.0 (1959-60 = 100), a rise of 2.5 per cent above the predevaluation level. Since then the index has been steadily moving up. It was at 161.3 on 16 July 1966, a rise of 4.5 per cent over the pre-devaluation level. Available evidence indicates that the price rise may be due to continued deficit financing. During the slack season, which lasts from May to October, in the absence of inflationary financing, the volume of money supply with the public ordinarily contracts. In 1965-66 heavy deficit spending by the State had produced the unusual experience of an expansion of money even during the slack season. Currently, money supply with the public is on balance expanding, not contracting. If this is an indication that during this year's slack season too we may have a net expansion of money supply, instead of a net contraction, the possibilities are that heavy deficit spending still continues. The price rise must be attributed to this factor and not to devaluation.

What is logical and necessary under devaluation is a rise in the rupee prices of export goods, as the same amount of export receipts in foreign currencies would now bring a larger number of rupees; and a fall in the rupee prices of import goods*. The actual rise in the prices of export goods would depend upon the proportion exported of the total output of the goods concerned. If exports constituted a small part of the output of a commodity, the rise in its prices, following devaluation, may be small, too. When a significant proportion of the total output is exported, the price rise may be larger. On this basis, the rupee prices of tea should rise much less than of jute fabrics; and of cotton textiles, only about 10 per cent of which is exported, less than both. This rise in the rupee prices of export goods need not, however, lift up the general index of prices, as Indian exports constitute but 4 per cent of the Indian national product. De facto devaluation, as we have

seen, being small, the rupee prices of export goods have risen by but a little over 3 per cent, following devaluation.

The rupee prices of import goods may fall despite the rise in the landed cost of import goods by over 57.5 per cent, though, it is conceivable that in cases where the gap between landed costs and market prices was less than 57.5 per cent, the prices of the import goods concerned may rise commensurately. The impact of devaluation would be on the landed costs of import goods, which will spurt up, moving closer to their market prices. The market prices of import goods cannot rise because these prices are determined by the prevailing state of demand for them, which would depend on the flow of money incomes, in the case of consumer goods and the flow of savings, in the case of investment goods. Devaluation does not change either money incomes or savings. Prices of import goods may in fact, fall, instead of rising, as a consequence of the increase in their supplies, following import liberalisation.

While the logic of devaluation does not involve an inflationary increase in the flow of money incomes, it does involve a shift in money incomes to correct the injustices of currency over-valuation on income distribution. Currency over-valuation deprived exporters of their legitimate dues in rupees against their foreign exchange earnings. They received for C 100 worth of exports only Rs.1,333, while at the equilibrium value of sterling in terms of rupees, they should be entitled to Rs.3,000, assuming the equilibrium rate to be C I 16, Its.311 This had meant a penalty levy of 55.57 per cent on exporters and equal subsidy to importers. The subsidy to importers assumed the market phenomenon of incredible values which import licences fetched. The total of these values on private sector licences alone averaged an order of Rs.500 crores annually. These colossal sums accrued to traders, businessmen and industrialists, who shared a part with the corrupt functionaries of the State, touts and other go-betweens.

Following devaluation and import liberalisation, the windfall gains of importers, and the penalty on exporters, declined by 57.5 per cent. This meant a shift-back in the flow of funds from importers and the other co-shares of the values of import licences, to exporters for correcting in part, the unjust impact of currency over-valuation on the latter. The whole of the fall in the windfall gains of importers. however, would not flow into the hand of exporters. The major part of it would be intercepted by the Finance Minister by way of export duties on "traditional" exports. To correct this injustice wholly, these export duties must be withdrawn, the rupee must be devalued to the equilibrium level and the values of import licences must fall to zero.

The foregoing analysis demonstrates that the increased receipts of exporters is not inflationary. These receipts would be balanced by the fall in the windfall receipts of importers, and of other beneficiaries of import licensing. There would be no net increase in the aggregate flow of money incomes, so that devaluation would not release into the economy inflationary funds. The rise in the rupee prices of export goods may be balanced by a fall in the rupee prices of import goods, so that general prices may remain steady.

Another misconception, which, too, has an extensive and also a distinguished and influential following, is that devaluation may cause a collapse of the prices of our exports

in foreign currencies, in the overseas markets. The export duties, which we have imposed on 12 "traditional" items of exports, rests on this misconception.

Justifying the export duties, the Finance Minister argues in his broadcast talk on 5 June that, in the case of "few commodities" such as "tea and jute", Indian exports constitute a "substantial part" of world trade and that the total "world demand" for them is also relatively inelastic"; and that "in their case" there was the danger of a decline in prices" following devaluation.

Devaluation is no more than an accounting change. Its immediate impacts are on factors internal to the Indian economy. It affects the rupee receipts of exporters; and the rupee payments for foreign exchange by residents in India; and may, therefore, affect the rupee incomes arising from imports and exports. It may also affect the relative returns on production for the overseas and home markets. As we have seen, it may correct the perverse incidence of currency over-valuation on income distribution. Immediately, it should have little or no impact on the external markets for Indian exports or Indian imports; except in case of monopoly, or near-monopoly transactions - to this category belong bilateral trade agreements in terms of which payments are made, and received, in rupees - business may continue in these markets as usual, both with regard to commodities of which India may be a major supplier and to others of which Indian exports constitute a minor or negligible part.

What the mechanics of devaluation involves is not collapse in the prices of Indian exports in world markets but an equilibrating movement of change in India's production and trade. It involves, first, a diversion of part of the output now consumed in the home market for use in the external markets; and, secondly, a diversion of resources from industries catering to the needs of the home market for increased export production. Both phenomena take time to manifest, the second longer than the first. In the case of jute, the domestic consumption of jute manufactures being a negligible or minor part of total production, the danger of unduly large supplies of this commodity rushing on world markets, by withdrawing it from the home market, cannot arise. The same applies, though not in the same measure to tea as well, especially to superior quality tea. Expansion of export production through transferring resources into export industries from the rest of the economy is a slow process, the time taken to increase supplies being at least one production period. The gradualness of the process may ensure price steadiness in world markets for Indian products.

Price steadiness may ensue from the working of another factor as well. Reflecting the expansion of world incomes, world trade has nearly doubled during the past decade. The increase in world incomes, which is behind the increase in world trade should cause a commensurate increase in the world demand for all Indian exports, including tea and jute, though the rate of increase may vary with commodities. If, therefore, the expansion of export production should keep step with the secular expansion in world incomes and world trade, there need be little apprehension of a price decline in Indian exports as a consequence of devaluation.

During the past two decades, Indian exports have shrunk both as a ratio of world trade and as a ratio of the Indian national product. This has been largely the result of currency over-valuation. Indian producers have been increasingly preferring the home market to the overseas markets under pain of the penalty exchange rate. The breach thus caused by our forced retirement from our traditional markets has been filled by our rivals in world trade or by substitutes to our traditional exports. Currency devaluation, by restoring the attractiveness of the overseas markets, as against the domestic market, would only be helping us to recover lost ground in world trade. This return to the traditional norm may not produce disturbances such as may arise when a country seeks fresh inroads in world markets.

Thus, the whole super-structure of the theoretical reasoning, that the low elasticities of demand for some of India's traditional exports may cause devaluation to end up in India receiving less foreign exchange for a larger quantum of exports, rests on wholly imaginary suppositions of a fall in the world prices of Indian exports, as a result of devaluation. Such price declines are, as we have seen, without logical or factual support. Speaking philosophically, pursuit of untruth cannot bring truthful and harmless results. This doctrine has applicability in the economic sphere as well. A change from an untruthful to a truthful exchange rate cannot be productive of damaging economic and social consequences. Devaluation to the equilibrium level would help to clear the chaos in the critical sectors of the economy and, therefore, would place it firmly along the road to continued social and economic progress.

It is conceivable that in some cases, the expansion of export production may exceed the secular increases in the demand for the products, in the world markets. It does not, however, follow that, in such cases, we would be condemned to receiving lesser foreign exchange for larger quantum of exports. Though this may be the statistical inference suggested by the relatively inelastic character of the demand curves of such products, the actual position in the practical world may be different.

Trade and industry, under its natural dynamism, presents a phenomenon of continual shifts in production in response to changing consumer preferences, through the impact of the latter (shifting consumer preferences) on the returns for the capital and effort invested in the several products. The guiding policy of entrepreneurs is to achieve the best permissible results, by way of aggregate incomes on the capital invested and on the efforts they put in.

If, in the case of some commodities, the ratio of returns to capital and effort should show an adverse turn, rather sooner than in the case of other commodities, as would be the case when their demand curves should be relatively inelastic; there is nothing to prevent entrepreneurs from transferring their capital and attention to other products with more propitious demand curves. This essential shiftability of capital and effort between commodities and trades, suggests that the supposed damage, from the differential demand elasticities of our exports, to India's export earnings is little more than a statistical nightmare; it has no counterpart in the real affairs business, industry and international trade.

If the circumstance of relative inelasticities of demand should stand in the way of rapid expansion in the export production of some commodities, exporters would switch over their attention to other commodities, to which the world markets are more hospitable, the demand for these commodities being more price elastic.

There is more than ample scope for the operation of this principle in India's external trade. Indian exports are less than 2 per cent of world exports. This suggests a very high elasticity of demand to Indian output. Even a 50 per cent increase in Indian exports may not make much of an impression on world market prices, as the total quantities we would be then pulling on the world markets would be still 3 per cent of the total. The price impact of this may be small or nil, especially in the context of rising world incomes and rising international trade.

(6) Follow-up Measures

We shall now briefly indicate the follow-up measures which are necessary for ensuring full success of devaluation. The foregoing discussion has demonstrated that for devaluation to be productive of continued balance of payments equilibrium the export duties, which were imposed simultaneously with devaluation, should be withdrawn and devaluation must be by the full measure essential to take the rupee to its equilibrium level. This major pre-condition must be followed, secondly, by rigorous fiscal and monetary discipline to ensure zero inflation. This implies abandonment of all deficit financing. The rupee may be soon over-valued again, if inflationary finance should continue. Devaluation to the equilibrium level should yield a budget surplus through stepping up budgetary receipts under foreign aid and import duties by much more than the higher rupee costs of external debt services and of defence imports. The necessary fiscal discipline may not, therefore, impose undue strain. Thirdly, the policy of forced import substitution should be abandoned in favour of more natural import substitution, to correct the uneconomic lengths to which import substitution has been pursued. Fourthly, in order to facilitate the shift-back in output, from the home market to the overseas markets, the bewildering maze of permits, quotas and other controls should be discarded. Finally, in order to release investment resources for more productive uses and to step up national savings, public consumption and public sector investments must be cut down drastically, revenue collections being scaled down to match.

Evidence is lacking that policy makers and people that matter have clearly perceived the dangers of the failure to adopt these measures. The risks involved are not just a repetition of the same old errors, which may force on us another devaluation in due course. The stakes may be much greater. The perverse income shifts in the context of semi-stagnant per capita income, the inevitable counterpart of the policies which we have been pursuing, may undermine social and political stability. Though massive foreign aid may defer for some time the pressures for basic policy shifts from assuming compelling dimensions, it cannot stem the rot indefinitely.

(7) Conclusions

We shall now bring together the main conclusions emerging from the foregoing discussion :

1. The need for devaluation arose from, first, continued inflation which had driven up Indian prices far ahead of prices prevailing in India's principal trading partners, and in countries competing with India in world markets. Secondly, this inflationary upsurge in domestic prices was not accompanied by a downward adjustment in the rupee exchange rate to allow for the depreciation in its value. The devaluation of the rupee in terms of the U.S. dollar, in September 1949, was insufficient even at that time, and the real worth of the rupee has depreciated further considerably, since then. The combined effect of these two factors was that profits on exports declined, or were converted into losses.
2. By contrast, the domestic market was much more attractive. Here if costs were rising, prices rose even faster, in line with universal experience in times of inflation. To escape the penalty on exports, producers, therefore, switched their attention increasingly to the home market at the expense of overseas markets. Policies of import substitution to "save" foreign exchange accelerated this shift of attention away from overseas markets to the home market.
3. Evidence of preferential attention to the home market and of a corresponding neglect of markets abroad is in India's production statistics and export performance. While the production of non-export goods rose phenomenally, the production of export goods, notably tea and jute, the major earners of foreign exchange, lagged behind world production or world demand.
4. The crux of India's balance of payments difficulties lay in two factors, namely, first, the low level of Indian exports and, secondly, the shift of investment resources away from export industries. These two factors being inter-related, increased exports may not ensue without a shift-back in production to its normal relationship between home and overseas markets. The function of devaluation is to bring about this shift-back in production and so to increase exports, thus relieving the recurring foreign exchange crisis.
5. It is a delusion to suppose that drastic cuts in imports and indiscriminate import substitution may help to solve the balance of payments problem. Import cuts do not reduce the flow of moneys hitherto utilised for the purchase of import goods. When imports are cut, the corresponding money flows feed on exportable goods and exports decline. The cut in imports, thus, causes a drag on exports and the pre-existing balance of payments difficulties may continue.
6. Moreover, it is a fundamental fallacy to think and act as though foreign exchange "earnings" constitute a resource for development, like foreign aid or domestic savings. Foreign exchange acquired against exports is not different, as an economic category, from the sale proceeds of the stock-in-trade of domestic traders. In both cases, the sale proceeds - foreign exchange in the case of exporters and rupee receipts in the case of

domestic traders - represent circulating real capital, and constitute part of the overall capital stock of the community. It represents past savings, not current savings for channelising into current capital formation and economic development. Like the sale proceeds of the domestic traders, export receipts are not part of income; though a small fraction of it may, become income, if the year end accounts show net profits but not otherwise - and savings from this income would represent a current resource for economic development, this would be but a negligible part of total export receipts; and it is not this part of export receipts that planners vainly set about "mobilising" for economic development.

7. The income of a trader, in a competitive market, may not increase if we dissected and restricted his purchases; this would correspondingly restrict his sales, his turn-over and his income. There is no better device of increasing a trader's income than to leave his purchases free from all hindrances and restrictions as this will add to his sales. Even so, a nation's income, savings and development may not grow by dissecting and restricting its imports. This would correspondingly restrict its exports - in the manner described in these lectures - and restrict national income from exports. There is no better device of increasing national income from international trade than to leave the import of the country free from all hindrances and restrictions, as this will add to its exports. It is most unfortunate that the fallacy that export receipts are a resource of current economic development has gripped the minds of virtually all planners. This fallacy has done not a little damage to economic and social progress in under-developed countries. Removal of exchange control and import restrictions is a major pre-requisite for speeding up economic growth.

8. Removal of exchange control and import restrictions is essential, too, in the interests of social justice. These measures have caused artificial gaps between the landed costs and market prices of import goods. The prices offered for import licences are a measure of these price-cost gaps. The benefit of these gaps accrue to industrialists and businessmen, the recipients of the import licences, the corrupt among the politicians and administrators, touts and intermediaries, all of whom belong to the upper-income groups. The total value of the import licences on private sector imports alone may be of order of Rs. 470 crores, annually, or the largest part of the annual increase in Indian national income. Import licensing has been, thus, functioning as a powerful lever for shifting incomes from the masses to feed the affluence of a thin top layer of the community. There is no remedy to this social injustice other than to abolish exchange control and import restrictions.

9. The link between indiscriminate import substitution and balance of payments difficulties is easily stated. Import substitution, being pressurised, has withdrawn resources away from the traditional and other export industries; this has impinged adversely on export production and exports have remained semi-stagnant, as a result, in the context of expanding national product. The expanding national product, on the other hand, calls for larger imports to keep the wheels of production moving, Exports remaining semi-stagnant intractable balance of payments deficits are inescapable.

10. So long as we pursued the policies of import substitution recklessly, there can be no exit from balance of payments difficulties, as the poor results of export promotion incentives have shown. Strangely, the World Bank and the Aid-India Consortium are willing parties to the measures of wasteful import substitution.

11. The only solution to this malady is to put a stop to the swing in import substitution; and induce a shift-back in production and trade from the home market to the overseas markets.

12. This shift-back in production and trade cannot come about in the measure necessary, to restore continued balance of payment equilibrium, unless the attractiveness of the overseas markets is increased to its norm relatively to the attractiveness of the home market. Success of all measures of reform hinges on the achievement of this eventuality.

13. The attractiveness of the overseas markets cannot return to norm, unless exporters receive the full rupee worth of their export earning, so that they may not find that to cater to the home markets was more remunerative.

14. Exporters will not receive the full rupee worth of their export earnings unless the rupee is devalued to the equilibrium level, or in a background of continuing inflation, the rupee is floated. To the extent that currency over-valuation may still remain behind, a corresponding measure of weighted attraction of the home market will remain, too, and the shift-back in production and trade will not be complete.

15. Devaluation by 57.5 per cent applies only to a fringe of exports; to invisibles; and to imports. De facto devaluation in the case of most exports may be of an order of 15 per cent or less. Much of the benefits of the jure devaluation have been cancelled by export duties; and by the loss of export promotion incentives.

16. Even devaluation by 57.5 per cent does not take the rupee to the equilibrium level. This is evidenced by the double criteria of the high values, which import licences still fetch, and the high premiums on foreign exchange in the free and black markets, though both are now less than before devaluation. Under devaluation to the equilibrium level, the values of import licences will fall to zero and the premiums on foreign exchange will disappear.

17. Devaluation is only one of a package of reforms for taking us out of the economic crisis, of which the foreign exchange crisis is but a part. To begin with, the export duties should be withdrawn and the rupee should be devalued, or, preferably, floated. The other reforms in the policy package include, first, fiscal and monetary disciplines to ensure zero inflation; secondly, abandonment of forced import substitution in favour of more gradual import substitution; thirdly; import liberalisation, removal of exchange restrictions and disbandment of all controls which clog the springs of production and obstruct the flow of output; fourthly, drastic cuts in public sector investments accompanied by denationalisation of public sector undertakings; and, finally, heavy slashing of governmental expenditures, revenue collections being scaled down to match.

18. Evidence is lacking that policy makers have clearly perceived the dangers of the failure to adopt these measures. What is at stake is no less than social and political stability. Foreign aid may defer for some time the pressures for basic policy shifts from assuming compelling dimensions. It cannot stem the rot indefinitely. By delaying basic reforms, aid acts as a disservice in disguise.

STUDY TOPIC – 18

DECLINING INDIAN EXPORTS*

Bare statistics of exports, viewed in isolation, might suggest that India and some other developing countries in Asia are doing well enough on the export front. Indian exports - export receipts being converted into U.S. dollars - rose from \$ 1,330 million in 1960 to \$ 1,833 million in 1969, a rise of about 38 per cent in nine years, an annual rate of 4.2 per cent. During the same interval, the exports of Pakistan rose by 46 per cent and of U.A.R. by 31 per cent. This is a misleading picture.

The true criteria of export performance are in the percentage of exports, first, to the national product of the country concerned, and, second, to world exports. Under economic good health, logic and experience demonstrate that exports should generally keep pace with the expansion of the national product. The first percentage, then should be about steady; and the second may even move upward, when, as in the case of West Germany, Hong Kong and Japan, the vigour of the economy may push up production and exports to above the world average.

Applying these criteria to India, we find that Indian exports fell continually from 7.5 per cent of the national product in 1960.61 to 4.3 per cent in 1967-68; and, in relation to world exports, Indian exports fluctuated down-ward from 1.2 per cent in 1960-61 to 0.75 per cent in 1969.

Similar is the record of many of the developing countries in Asia. The exports of Burma, which fared the worst among this group, declined from 18 per cent of her national product in 1960 to 8 per cent in 1967; and of Pakistan from 6.4 per cent to 6.0 per cent. In relation to world exports, too, they slipped downward, Burma again faring the worst. India's rank as an exporter fell from 15th place in 1960 to the 25th place in 1969, and of Burma from 49th place to 87th place.

By contrast, Japanese exports multiplied by about four times during the nine years ending 1969, Hong Kong exports by over three times and West German exports by over twice. The performance of Hong Kong merits special attention. The population of Hong Kong is 0.75 per cent of that of India and its area about 0.03 percent. So recently as 1960, the exports of this tiny island were much lower than those of India. In 1969, they rose to U.S. 2,178 million, while Indian exports fell behind, being at U.S. \$ 1,833 million. While the other Asian countries cited above were marching backward, Hong Kong exports kept forging ahead and its rank as an exporter rose from the 30th to the 18th place during the ten-year period under review.

While Hong Kong does not subsidise its exports, India and the other countries, under review, have a series of export promotion measures and incentives. In India, they include the issue of import licences to replenish the import content of exports, outright cash

payments, income tax development rebate at 35 per cent, supply of indigenous raw materials at subsidised prices and deliberative bodies such as Export Promotion Councils, Commodity Boards and the Board of Trade to assist, and function as watch-dogs of export promotion. In addition, U.S.A.I.D., New Delhi, has a special Export Promotion Division, which organises export promotion researches with the usual American munificence.

The replenishment import licences, the most lucrative among the export promotion incentives, more generally, vary from 5 per cent to 60 per cent - in rare cases 90 per cent - of the f.o.b. values of exports. As the prices of these licences - "premiums" in market parlance - may range from a minimum of about 35 per cent to several times their face value, the cash worth of this incentive alone may be, in extreme cases, so large as to render exports profitable, on balance, even if the commodities concerned should be sold abroad at knock-down prices, far below domestic costs.

Export promotion measures and incentives of varying money values exist in all these countries. While this may be evidence of their eagerness to solve their balance of payments difficulties, their exports have failed to look up, notwithstanding these incentives. Quite obviously, the problem of low exports in these countries has deeper roots than can be tackled by a programme of export subsidies.

Three major hindrances to the exports of these countries merit attention. First, trade is a two-way traffic. It comprises buying as well as selling, never either alone. The two are functionally inter-related, even like up-breathing and down-breathing. If we should restrict the purchases of a trader, his sales will get restricted too, as he can only sell what he has purchased, Nor can he go on buying without selling. Shortage of funds will soon compel him to sell before adding further to his stock pile. This applies to international trade no less than to domestic trade. Imports compare with the purchases of a trader, exports with his sales, and imports and exports are inter-linked like a trader's purchases and sales.

To cut imports is, therefore, tantamount to a cut in exports. The organic relationship between the two is easily seen. When we cut imports, the funds with which we had acquired the goods now kept out of the country do not disappear in vacuum. These funds will move from counter to counter and would purchase the comparable domestic product, which may meet the needs concerned; alternatively, trade and industry will collaborate to produce at home substitutes to the foregone import goods. The latter would involve diversion of the necessary resources from export trades. In either case, exports would suffer. The more drastic the import cuts, the more severe will be the adverse effect on exports.

Import restrictions of lesser or larger severity exist in all these countries. And these restrictions seem to be on the increase. This is evidenced by the fact that imports in all of them, expressed as percentages of their respective national products, fell during the period 1960-68, in the case of India from 13 per cent in 1960 to 7.5 per cent in 1969, in the case of Burma from 21 per cent to 8 per cent, in the case of Ceylon from 34 per cent to 28 per cent and in the case of Pakistan from 11 per cent to 8 per cent.

The second major factor behind the decline in exports is the continuing budget deficits. Budget deficits have been releasing into the Indian economy a flood of funds, which averaged Rs. 250 crores during the past ten years. These funds draw into home use, at the expense of exports, commensurately more of the national product; consequently, less of this product now becomes available for export; and exports suffer. Budget deficits prevail, as a rule, in the other countries cited above and have had similar effects on their exports.

The third major hurdle holding back exports is the shift of interest of manufacturers in these countries from the overseas markets to the home market. An Indian trader exporting 100 worth of goods to U.S.A. obtained for these exports Rs. 476 in 1952-53. He continued to receive the same amount until June 1966, though, in the meanwhile, Indian costs moved up in the wake of the inflationary price rise of about 65 per cent. Consequently exports yielded less and less profits, if not losses.

On the other hand, profits in the domestic market continued unaffected, as, if Indian costs went up, Indian prices went up too. Possibly, as under inflation costs generally lag behind prices, the domestic market may yield even more than ordinary profits. The devaluation of the rupee in June 1966 did not fully remove the penalty on exports; and, since devaluation, with the inflationary erosion in the value of the rupee, the penalty on exports (and the preference for the home market) has increased. The free market premium on the U.S. dollar, which on 13 November 1970 was about 57 per cent is a rough measure of this penalty.

Similar penalties on exports exist in all these countries. The evidence, and the approximate extent, of these penalties is in the premiums, in terms of the currencies of these countries, on convertible currencies. In Zurich, on 15 October 1970, these premiums amounted to 141 per cent in terms of the Ceylon rupee and 131 per cent in terms of the Pakistan rupee. The penalties being heavier than the subsidies, exports fail to move up.

Clearly, therefore, for the exports of these countries to look up, they must, first, put a stop to inflationary budget deficits, secondly, relax and eventually, abolish import licensing and exchange control, and finally eliminate the system of two prices - an official price and a free-market price - for foreign exchange in terms of their currencies. It is easy to see that the last reform calls for an honest valuation of the currencies of these countries; as internal political pressures are leading them irresistibly to over-spending and printing press finance, floating exchange rates may, possibly, meet best the needs of their balance of payments difficulties.

Given these reforms, export subsidies are wholly unnecessary; without these reforms, exports subsidies would add to economic chaos without yielding any improvement in the over-all export performance. Moreover, every subsidy has its complement of a social injustice. In the Indian context, subsidies may amount to taking away morsels from the plates of the hungry to finance the subsidies. Blooming exports of no country rest on a system of subsidies.

IMPORT LICENSING IN DEVELOPING COUNTRIES

I. MYTHS THAT HAUNT DEVELOPING COUNTRIES

Confusion abounds in much of the economic thinking of the governments of under-developed countries generally, and more especially of those who have adopted interventionist policy measures, (mis) called "planning". The prime objective of the interventionist measures, which extend to all the principal functional sectors of the economy, namely, prices, (including interest rates, wages and salaries) production, international trade and balance of payments is two-fold: first, speeding up economic growth and secondly, social justice.

These interventionist measures have extensive popular support. The need for price control and minimum wages legislation in the interest of "social Justice; the importance of cheap money policy for accelerating investment and economic growth; the necessity for directing production to subserve a "social purpose"; and the inevitability of exchange control and import licensing, to prevent foreign exchange being squandered on luxuries and to ensure its use for "essential" imports have become powerful mass myths. And, stray voices apart, these myths have the approval of professional economists in the universities generally, in the government and in Central banks almost invariably, and also in business, industrial and financial firms. This has imparted to the myths a high degree of respectability and opponents of them run the risk of being dismissed as "old fashioned" or as "reactionaries".

II. As a Drag on Economic Progress

Not only this, the belief is near universal that import restrictions are a necessary means of speeding up economic development; and more or less severe restrictions on imports exist in most of these countries, especially in those which have "plans" for economic development. Imports may not be permitted without import licences, usually issued by the Ministry of Commerce.

Discussions in these countries on problems of economic growth generally assume away three propositions as being self-evident axioms, calling for no proof. They assume, first, that foreign currency receipts from exports are an important source of finance for building up capital and, therefore, for economic growth. It follows from this assumption that export proceeds must be prevented from being dissipated into nonessential uses. To

conserve these proceeds for developmental purpose alone, it is thought necessary to impose exchange controls, whereby all foreign currency receipts are compulsorily surrendered to the government; and this foreign exchange may be spent only for financing carefully screened essential imports.

It is assumed, secondly, that, in the absence of import licensing and exchange control, two consequences - both damaging to economic growth - might emerge . that the foreign exchange resources of the country might be wasted only luxury imports and that domestic capital might flee the country. Prevention of this double danger is thought to justify import licensing and exchange controls.

It is assumed, thirdly, that production at home substitutes for imported goods is an act of public service. This is believed to bring the double advantage of reducing reliance on import goods and of "saving" foreign exchange, which would be otherwise eaten up by these imports. The foreign exchange thus "saved" may then be utilised, so the argument runs, to import essential supplies, which cannot be easily manufactured at home. Extensive programmes of import substitution, often in utter disregard of the cost and quality of the domestic output in relation to imports, are in operation in many underdeveloped countries to-day, much of the finance and know-how for these programmes being found through foreign aid.

The dogma of inevitability of import restrictions, exchange controls and forced import substitution - if we must accelerate economic growth has the active support of financial writers, government departments and also of visiting experts from developed countries and UN agencies, and they are firmly rooted in the minds of policy makers and of other people who matter.

Nevertheless the validity of the argument that export proceeds constitute a resource for capital formation and economic growth must be tested. To recall a basic economic truth, the raw material for capital formation is saving: and no capital formation is possible without saving. It necessarily follows that if export proceeds constitute a resource for capital formation, export proceeds must represent the current savings of the community. This, however, is not the case, as may be easily seen.

A country's export receipts are the proceeds from sales overseas of traders engaged in export business. These proceeds belong to the same economic category as the receipts from sales of domestic traders. Both — the sale proceeds of domestic traders and export proceeds — constitute the operating funds of traders, in technical terminology, their working capital or circulating capital. It is a continually rotating fund, taking the form of goods when traders purchase stocks and becoming cash once again when stocks are sold.

The circulating capital of domestic traders always remains within the country. But the circulating capital of export traders regularly assumes the form of foreign currencies, though it returns back into the hands of exporters (via the foreign exchange market) in order to purchase more goods at home for export. This difference is no more than an intermittent change of clothes. It does not alter the basic fact that the real character of the sale proceeds of export traders as of domestic traders - is circulating capital. It is

unpintam to note, too, that even as in the case of buildings, machinery and other block capital, circulating capital is built up from past savings. Export proceeds (like the sale proceeds of domestic traders) do not, therefore, represent current savings; and cannot be deemed to be raw material for capital formation and economic growth.

This demonstrates the utter futility of exchange controls and import restrictions as a means of speeding up economic growth. In resorting to these measures, we do no more than tamper with the free use of the past savings of the community in the employ of export traders. How could any tampering with past savings help to create fresh capital, as fresh savings alone can achieve this? By curtailing "less essential" and luxury imports, we do not reduce consumption, nor add to national savings. We merely cause these goods, or substitutes for them, to be manufactured on this side of the frontier, at uneconomic costs, instead of overseas, where these costs are much lower. How could economic growth be accelerated through uneconomic production? Indeed, import restrictions and indiscriminate import substitution retard, or, if persisted in long enough, even reverse, economic growth and social progress through their adverse effects on the flow of national savings; through misdirection of savings; and through tampering with the natural and orderly distribution of national income.

Import licensing causes social injustice and slows down the flow of savings, because it permits perverse transfers of income - from the masses into the pockets of a minority. This phenomenon of income transfers has assumed near explosive dimensions in India and is in evidence in many other parts of the underdeveloped world. It merits much closer attention than it has hitherto received, particularly on the part of aid-giving countries, as the damage it produces may nullify the objectives of aid.

The mechanics of these perverse income transfers are simple. To illustrate from the Indian case, as the combined result of domestic inflation and of the physical restrictions on imports, the rupee prices of import goods in India are generally sky-high in relation to the international prices of these goods. Consequently, imports bring windfall profits, The incredible values which import licences may command reflect, and are a measure of, these windfalls. An import licence authorising the import of, say, Rs. 1 million worth of a commodity may fetch, depending upon the commodity, anything from 30% (Rs. 300,000) to 500% (Rs. 5 million) or more of the values of the imports authorised by the licences. The overall average value of the licences may be 75% to 100% of the values of these imports. The aggregate market worth of these paper documents, relating to public and private sector imports (but excluding food imports), may be of an order of Rs. 9,500 million annually.

These amounts accrue, each year, to the recipients of the licences. But they are not incomes earned by them. The mere act of receiving (or issuing) import licences adds nothing to the flow of the national product. When the licencees take out from this flow the values of the licences-whether they covertly sell the licences, as the unscrupulous among them might, or plough these values into the balance sheets of their undertakings- quite obviously, they acquire incomes earned by the rest of the community and to which they have neither an economic nor moral title.

This predatory arrangement-an apt description of the phenomenon-produces ill effects, both economic and social. When some of A's income is transferred without justification to B the total income of A is subjected to two consumption claims, a legitimate and natural claim of A, the earner of the income, an illegitimate claim of B. When two parties live off the same income, the flow of savings from the income inevitably suffers.

Parasitical income transfers, damaging to savings, are also caused by inflation and controls, notably price controls and controls over the movement of foodgrains and other essential supplies. Income shifts through inflation are a familiar phenomenon today all over the world. Inflation drives prices up. This reduces the real incomes of wage-earners and salaried people, the largest bulk of the community; and correspondingly adds to the money receipts and real incomes of traders, businessmen and industrialists, a fraction of the community. In under developed countries, inflation ensues almost wholly from printing press finance of budget deficits. In India, income shift through inflation since 1960-61, may be about Rs. 3,500 ' million annually, the average budget deficit of the period.

Controls cause income transfers through their impact on prices. They either depress prices below their competitive norms; or lift them above these norms. Controls over the movement of food grains, for instance, depress foodgrains prices in the food surplus areas and lift up prices in food-deficit areas. In the former case, food producers are penalised and incomes are shifted from them into the pockets of buyers; in the latter case, consumers are penalised and some of their incomes are shifted into the pockets of producers and middlemen. Controls effect income transfers also through corrupt payments, which controls give rise to. It is not possible to guess the order of magnitude of the income shifts through economic controls.

During the decade ending 1964-65, per capita income in India rose by 18%. A rise in per capita income should, ordinarily, lead to an uptrend in the rate of saving. But, due to the erosion of savings from income transfers, the rate of saving remained stagnant around 7.5% during this period. In the subsequent three years, per capita income tended to fall. Income shifts, during these years, being particularly heavy, the rate of saving fell from 8.3% in 1965-66 to 6.7% in 1966-67 and to 5.6% in 1967-68; and the amount of savings fell from Rs.16,460 million in 1965-66 to Rs.15,150 million in 1966-67 and was at Rs.15,380 million in 1967-68.

These depressing statistics vividly highlight the damage wrought by the mistaken policies of restrictions of foreign trade in India-and on those other nations which have followed the same wrong-headed course. With the slump in savings, because of the perverse redistribution of incomes, these programmes of controls and restrictions are patently not only inequitable but economically inefficient as well. This state of affairs cannot be condoned by any poor country, striving for development and prosperity.

III. As a Social Injustice

Import restrictions misdirect savings by driving up the rupee prices of goods, the imports of which are restricted. The more severe the restrictions the higher the price rise. While

these goods could be had through imports, their domestic production was uneconomic, as the costs of production were higher than the costs of the import goods concerned. As prices rose, the position changed. Their fabrication at home became worth while. With the expansion of domestic production of substitutes to import goods, import restrictions were tightened, under the urge to "save" foreign exchange; and when this expansion of production was sufficient to meet market needs in full, imports of the items concerned were banned. Thus to cite stray examples, art silk fabrics, certain office supplies, oil engines and pumps for irrigation, "formulated" pesticides and pesticide spray pumps are on the banned list.

The results of these policy measures may be seen in the statistics of the external trade of the country and in the index of industrial production. The index of industrial production accelerated from 105 in 1954 to 245 in 1966 (1953-100), an annual rise of 11%. In 1955-56, when the planned programmes of import substitution had not yet gathered momentum, imports of sugar mill machinery accounted for 95.2% of the market supplies, of textile machinery 67.6% of machine tools 84.8% of caustic soda 62.5% and of bicycles 22.4%. In 1966-67, the share of imports in respect to these commodities fell, respectively, to 0.7%, 58.2%, 51.2% and 5%; and imports of bicycles were negligible. From 1955-56 to 1966-67, Indian national product rose by 28% Ordinarily, the expansion of production should cause import needs to expand correspondingly. But aggressive import substitution led to a decline in imports from 9.8% to 6.5% of the national product.

Import substitution is not an evil per se. As economic growth and technological maturity progress, domestic manufactures-less sophisticated ones first and the more sophisticated ones in due course-tend to replace imports naturally. Natural import substitution implies competitive economic viability of the domestic product. But forced import substitution regardless of the cost and quality of the output, may be an evil per se. In India, forced import substitution has involved considerable wastage of savings and capital. The costs of home-made substitutes to import goods, rare exceptions apart, generally contrast with the prices of the import goods concerned; and the difference between these costs and prices may vary from 30% to 500% (or even more) of the prices of the imports depending upon the commodity.

Thus, taking random examples, a home-made oil engine and pumping set of 3hp for irrigation, costs Rs.2,390; the c.i.f. price of the corresponding German set is Rs.1,172. A Japanese set may be cheaper still. A home-made pesticide spray pump costs Rs.1,150; the c.i.f. price of a pump imported from Europe may be Rs.640. To this price difference must be added the incidence of the higher consumption of fuel, more frequent breakdowns and heavier repair bills, in the case of the Indian product. Quite naturally, imports of pumping sets for irrigation and spray pumps are banned. The controlled price of fertiliser mixtures is Rs.860 a tonne; the corresponding costs of mixtures from imported fertilisers may vary from Rs.490 to Rs.560 per ton. Indian-made DDT and parathion, two of several pesticide chemicals, costs, per ton, Rs. 5,500 and Rs. 20,000, respectively; the c.i.f. prices of these chemicals, when imported from abroad, are, respectively, Rs.2,800 and Rs.9,000.

The higher domestic costs reflect the larger amounts of capital, raw materials and labour, which we employ when a commodity is produced at home, than when it is imported from abroad. Speaking in terms of overall averages, home-made import substitutes absorb about 75% -100% more resources of production than when we may get these goods through imports. This is unconscionable waste for what is about the poorest country in the world. Yet, we have been indulging in it during the past 11/2 decades, calling it "planning".

Two consequences, both damaging to production and economic growth, follow. First, as import substitution progressed, the same amount of savings and investment would yield less and less output than before. In the First Plan, an investment of Rs.8,990 million, in large and small enterprises added Rs. 4.340 million to industrial production or about 48% of capital. In the Second Plan, fresh investment in such enterprises rose to Rs.22,650 million, but the addition to industrial production was but Rs.5,110 million, or about 23% of capital.

Secondly, in the next innings of production, the expansion of the national product would be decelerated still more. We may illustrate this by reference to agricultural production. If we were free to import agricultural inputs, the farmers could have, for the same amount of investment funds, imported products of superior quality and in much larger quantities than the home-made inputs, which they are compelled to buy under the prevailing policy arrangement. They could have, for instance, two pumping sets, for irrigation, in place of only one; about 50% more of fertilisers; about twice the quantity of pesticide chemicals; and nearly two pesticide spray pumps in place of only one.

Agricultural yields in India are about the lowest in the world-they are higher only than the average in some African countries-and vast scope exists for modernising cultivation. The increase in the quantum of production from the use of fertilisers is placed at 4.2 times in the case of rice, 5.8 times in the case of wheat, and as much as 18.5 times in the case of sugarcane and 39.7 times in the case of potatoes. The corresponding response, in terms of value, in respect to the use of pesticides may vary from six times to 40 times.

This suggests that a change in import policy alone may, in due course, step up substantially agricultural production, without any increase whatever in the funds invested in agriculture. As about 67% of agricultural output is foodgrains, the jump in this output may contribute significantly to solve India's food deficits, if it does not wipe out these deficits altogether. Indeed, there may ensue a noticeable difference in per capita income as well, as about one-half of Indian national income is drawn from agriculture and 70% of the population lives on it.

India's policymakers like to assert that industrialisation has helped agriculture through supplying the farmer with their production inputs. The foregoing analysis reveals that the community of farmers is certainly not among the beneficiaries of the policy of high-cost industrialisation. They are, in fact, having the harshest ever deals on the input side of agriculture. The country as a whole has suffered, too, from these policies, in the foregone production, employment and income.

For about, the past 11/2 decades, (now 3 1/2 decades) physical restrictions on imports, inflation and economic controls have been operating in India with special severity. India embarked on a policy of extended industrialisation and Import substitution from about 1954-55, as part of "planning". In 1957-58, with the steep drop in the currency reserves towards rock-bottom, imports into the country were subjected to drastic cuts. The index of the volume of imports remained below 100 until 1963-64 and rose to but 104 in 1964-65 (1958=100) though, in the meanwhile, Indian national product rose by 71% and the pressure for imports increased. Simultaneously, inflationary finance continued at a high level, prices rising at an annual rate of 6.8% during the decade ending 1964-65; and economic controls were extended and strengthened.

The continued capital consumption and wastage of savings, which resulted from these developments, did not, how ever, appear on the surface immediately, in a decline in Indian national product. The latter, in fact, continued its uptrend even after the rot had set in, sometime in mid-1950s. Indian national product rose at an annual rate of 5.5% from 1955-36 to 1960-61. The rise being faster than the rate of increase (2.2%) in population; per capita income, too, moved up. The architects of the new policies thought that their strategies of growth were bringing results.

The optimism of the planners was unfounded. The continuation of the uptrend in the national product was due, first to the time taken for capital equipment and other instruments of production to wear out and to show up in the statistics of output; and, secondly, to the steep rise in foreign aid, from Rs.110 million in 1954.55 to Rs.4,050 million in 1960-61 and to Rs.7,020 million in 1966-67. Aid helped to cover up from public view the damage caused by capital consumption and misdirection of savings.

As, however, the decay spread and deepened, the damage emerged on the surface. The rise in the national product first slowed down, barely keeping pace with the growth of population; and per capita income stagnated around Rs.296, per year, from 1960-61. If it jumped to Rs.314 in 1964-65, this was largely the result of the timely and adequate monsoons; the jump was not an index of any increase in savings or of their most efficient management. Since 1964-65, the national product lagged behind population; and per capita income tended downward. So long as the prevailing policies, miscalled planning, continued, there is little hope of any sustained or significant expansion of the national product—though the apologists of government's policies may keep on blaming, as they have been doing, the weather, the Indo-Pakistan War, and the Chinese attack for the continuing misfortunes of the country.

Would the uneconomic industries, springing up behind the protective barrier of import restrictions, improve the employment situation? When population grows, the national labour force may grow correspondingly. To absorb this growing labour force into employment, at current wage rates, the aggregate national product must accelerate fast enough in order to maintain unchanged, first, the pace of national well being; and, secondly, the pace of capital formation. Roth conditions are important if there is to be a continually rising curve of growth. As however, in a regime of import restrictions and exchange controls, the national product is apt to stagnate or decline and savings get

eroded, the additions to the labour force, ensuring from the expansion of population, may not be fully absorbed into employment. The employment emerging from the new industries would be less than the employment lost from the slowing down of the national product. Contrary to popular belief, the unemployment situation might, therefore, deteriorate from the policies of high cost import substitution.

Available statistics of unemployment illustrate the working of these factors. Unemployment at the close of the First Plan (1955-56) was 5.3 million. It rose to about seven million at the close of the Second Plan (1960-61), The Third Plan (1961-62 to 1965-66) added to this figure 2.5 million unemployed. Unemployment in 1966.67 rose, as a result, to about 10 million. Currently, unemployment is believed to be increasing faster than in the recent past. Apparently, the expansion of employment fell short of the growth of population during this period.

Income shifts and unemployment have added to social injustice. The shifted incomes accrue to a thin top layer of society. The incomes shifted being of an order of Rs.14,000 million, or about three-fourths of the annual increase in national income, the balance left is less than sufficient to maintain the growing numbers of the masses at the pre-existing level of living. In a background of overall income stagnation since 1960-61, or, as during the past three years, of a decline in per capita income, income shifts on so large a scale must involve considerable hardships. Several millions of the already indigent families are being pushed, each year, towards, or below, the bread line. These results of interventionism, which have been in operation for the past 15 years (now 35) in India have been the opposite of its prime objectives.

Mass indigence has grown, and the affluent have become much more so. The widening of income contrasts is visible to the naked eye. Overseas visitors to India do not fail to notice the uptrend in luxury living by the few or by a privileged minority.

Witness the flaunting of income and wealth by the few at weddings and other ceremonies; the enormous increase in the ownership of status symbols; the overcrowding of holiday resorts, expensive hotels, restaurants, theatres and "culture" shows; the capacity loads of air-conditioned coaches and jet planes; and the luxury flats and structures, more especially in New Delhi and the larger seaports and urban centers.

Consumption statistics confirm the growing social injustice. The living standards of the Indian masses are so low that consumption of the necessities of life provides a dependable index of their economic condition. The consumption of cotton cloth fell from 14.8 meters in 1961-62 to 13.8 meters in 1966-67; of foodgrains from 170.3 kgs to 146.6 kgs; of edible oils from 4.2 kgs to 3.4 kgs; and of sugar from 5.7 kgs to 5.1 kgs. In 1965.66, taking 1954-55 as the base year (when "socialist" planning gathered momentum), the registration of motor cars rose 2.2 times; the consumption of art fabrics 2.8 times; of radio receivers 10.6 times; of electric fans 5.3 times; of refrigerators 3.7 times; and of air-conditioners 2.1 times.

On top of this disappointing outcome of socialist planning in respect to its two foremost objectives, (as noted on R 269 first Para) the econ 'my has been afflicted by cease-less

budget deficits and price inflation; fantastic interest rates, which may vary from 18 percent, to 24 percent, in the private market outside commercial banks; near-paralysis of the capital market, where, in 1967, fresh issues of shares and debentures were about one-half of the peak reached in 1962; closures of production units—in the context of sub-standard consumption of cloth by the masses, 10 per cent. of cotton textile mills have stopped working; growing unemployment; stagnant or declining exports; chronic balance of payments difficulties; deepening social tensions and instability as evidenced by the lawlessness in Naxalbari, the unprecedented strike by the Delhi police, Gheraos defined by Calcutta High Court as "a physical blockade" of an employer by workers or other agitators), Bundhs (closure of shops, offices, markets, and public transport), Dharna (squatting without food before the office or residence of an official dignitary) and a multiplicity of senas (private volunteer forces).

Futility has resulted from price controls, movement controls of essential supplies, licensing of capital issues, the care and attention bestowed on "basic" industries, exchange restrictions and import-licensing, all-out measures to produce substitutes for imported goods; and mounting legislative and administrative fiats in the field of "social engineering" to build a "welfare state "with a classless society."

Economic growth and social progress are a complex process. They are the outcome of the interaction of a multiplicity of inter-related factors, economic and non-economic. Non-economic factors include social attitudes, and administrative, institutional and human qualities and effort; and economic factors include savings, capital formation and materials of production. To this must be added correct policy-thinking, in the absence of which favourable economic and non-economic factors may be of the little avail. Institutions and human qualities favourable to economic growth may take time to grow, though their growth itself may be conditioned by overall economic development and social progress.

Because of the differences in the non-economic background, a dollar's worth of domestic savings and capital formation may yield much more "economic" growth in say a country in Western Europe than in, say a country in Asia or South America. Conversely, even with unchanged savings and capital, economic development and social progress may result if favourable changes take place in the non-economic factors.

Among the economic factors making for development, perhaps the most important is saving and capital formation. If we may assume a propitious administrative and policy background (and always given political peace and social stability), we can say that economic development is a function of the magnitude of national savings—factors of production released from catering for current consumption — and the most effective investment of these savings. This is so in the short run as well as in the longer run. We shall examine here the logical basis of the assumption that import restrictions permit additions to capital formation and, therefore, help to accelerate economic growth.

That export proceeds are not a fresh resource, but only part of the existing circulating real capital of the economy, is confirmed by the national accounting practice which regards the gross national product of a country as the sum of the retained domestic output (Y)

plus import (M). Export proceeds are not reckoned as constituting part of the national product, as import goods include export proceeds, the two - export proceeds and import goods-being but different manifestations of the self-same circulating real capital. It would be double counting to take credit for export proceeds when credit has already been taken for import goods.

Imports are related to exports in almost precisely the same manner as up-breathing is related to down breathing. Interference with down-breathing involves interference with up breathing. If we restrict imports we will be correspondingly restricting exports as well. The link between the two is easily stated. If Y stands for the domestic product less exports, M for imports, C for domestic consumption, I for domestic investment and E for exports. then $Y+M=C+I+E$, as consumption, investments and exports would exhaust the whole of the domestic product plus imports. Any curtailment in M would cause a corresponding diversion of the money flows from import goods to the acquisition, directly or indirectly, of potential export goods, so that a reduction of M will lead. immediately or eventually, to a reduction of E.

Thus, even as the dissection and curtailment of the purchases of a trader, operating in a competitive market, cannot help in the expansion of his business, nor add to his income, import restrictions will merely lead to a curtailment of the country's external trade : and of national income from such trade. During the past decade, as a result of the rigorous restrictions of imports, Indian exports declined, as a percentage of national income, from 6.4 per cent. in 1955 to 4.0 per cent. in 1964 and domestic capital employed in international trade, volume of international trade (in real terms) and national income from this trade declined, too. Indian exports at 1958 prices fell from Rs. 7,800 million in 1955 to Rs. 6,120 million in 1964.

Income transfers have been also taking place through price controls, controls over the movement of essential supplies, through their effects on prices and through corrupt payments to which controls give rise. But income transfers through import licensing may well account for the largest of the total income transfers.

Increased consumption through income transfers largely explains the damage to saving during the decade ending 1964.65. During this decade, per capita income rose by 18 per cent. But the rate of saving failed to rise. It remained around 7.5 per cent. During the subsequent three years, when per capita income tended downward, there was a pronounced decline in saving. It fell from 10 per cent to 1965-66 to 8 per cent, in 1966.67 and to 6 per cent, in 1967-68: and the amount of savings fell from Rs. 21,700 million in 1966-67 and to Rs. 17,000 million in 1967-68. The actual decline in savings is larger than these statistics suggest, as the water of inflationary finance must be squeezed out of them. This phenomenon of income transfers with its debit effect on savings and development has been afflicting not the Indian economy alone : currently, it operates in a number of under-developed countries pursuing similar policies.

If import restrictions cannot add to savings, capital formation and economic development, the alarms of the planners and of the neo mercantilists that relaxation or removal of these restrictions might undermine economic growth, through a squandering

of foreign exchange in luxury imports and a flight of capital, are without any basis of logic or fact. The conversion of export receipts, expressed in foreign exchange, into import goods is but an integral part of external trade operations. Through such conversion of foreign exchange into import goods and the sale of the latter in the home market, traders purchase more goods at home for export, thus turning round their working capital. By interfering with this turnaround mechanism, we cannot achieve economic development or social progress. It makes no difference to this conclusion because the axe on imports falls on luxury goods or other non-essentials.

Nor can this interference successfully prevent either the import of goods on the banned or restricted list; or the export of capital. Both are known to be taking place, foreign exchange finance for the operations being found from the free market (commonly referred as the "black" market) for foreign exchange. The scale on which this is taking place will never be known. Officials like to assert that this scale is negligible though the data or logical basis for this opinion is not stated. Market gossip, on the other hand, is that significant amounts of foreign exchange are diverted into the free market. As the gap between the free rate and the official rate may be of an order of one-third the official rate of exchange, it is difficult readily to accept the official view that the leakages of foreign exchange from the one market to the other are negligible. In any case, if exchange control and import restrictions do not lead to capital formation; possibly have a debit effect on the flow of saving and capital formation; and may not successfully prevent exports of capital, it is difficult to see what justification exists for the continuance of this interventionist measure.

The problem of economic development is not at all a problem of restricting luxury imports or "less essential" imports. The problem of development is severely one of maximising savings and the most effective investment of savings. Import restrictions can achieve neither. These restrictions would, on the other hand, retard or reduce the flow of saving and would interfere with the most effective employment of saving. By curtailing the imports of luxury goods and the "less essential" goods, we merely cause the production of these goods to take place on this side of the frontier, instead of on the other side and this artificially induced geographical shift in production has harmful economic repercussions. Contrary to popular misconception it has a debit effect on production, employment and national income; it may not correct-it may aggravate-the balance of payments problem; and worse still, this whole arrangement is a device of robbing the masses for the benefit of the affluent. Import restrictions are easily among the worst form of economic controls devised by man.

Import restrictions (and the allied measure of monopolistic control of export receipts) may be good "siege" or "blockade" economics in times of war, when the needs of national defence may call for the mobilisation of all resources - past and current-including circulating real capital, depreciation funds and the currently accruing savings, to sub serve the war effort. The shifts in the pattern and direction of production, capital consumption and the retardation of economic development, which these operations must necessarily involve, are secondary matters when the stakes involved are of such great moment as defence from external aggression and national survival.

War finance is a case of capital consumption. The techniques suited to such finance do not apply to the needs of development economics. The latter calls for measures to maximise savings and to ensure their most effective investment. Import restrictions and exchange control, a part of the armoury of the war-time "siege" economics, can achieve neither. We have seen that they are damaging to both. Experience has demonstrated that exchange control cannot prevent the export of capital, arising from weaknesses of currencies or political instabilities. It is well known that such exports of capital are taking place from India and other underdeveloped countries, through under-invoicing exports and over-invoicing imports.

Capital consumption, wastage of savings and social injustice, all arising from perverse income shifts, are the biggest problems confronting India today. The family budget pressures, arising from these income shifts, on tens of millions of the already poverty-ridden families, are really behind the growing social and political tensions and instabilities now stalking the land; not the communists and other political parties. The latter are but agents taking advantage of the inner human unrest, caused by the income shift.; to serve their own ends. We cannot stop the rot by tinkering with its symptoms. Nor does the remedy lie in massive foreign aid. Whilst the prevailing policies continued, aid is apt to suffer the same fate as domestic savings. Like the latter, aid, too, might be misdirected. Massive aid might be massively misdirected. if the biggest surviving democracy in the world must be saved from succumbing to the communist or other form of dictatorship, it is time to stop piloting press finance, abolish import licensing and exchange control, and relax or remove other measures of economic intervention, which hinder growth and pervert the orderly and humane distribution of national income.

STUDY TOPIC – 20

ECONOMICS OF GOLD SMUGGLING AND ITS REMEDY

A PROPOSAL FOR GOLD EXCHANGE BANK*

[Even though the paragraphs in the following article were written by Prof. B. R. Shenoy, in the period 1961 to 1968, they are as much valid, if not more, in the current period. The present annual demand for gold is estimated to be 200 tonnes; while the internal supply is barely 5 tonnes. Thus the unsatisfied demand for remaining 195 tonnes of gold is mainly satisfied by smuggling. One of the main reasons for attraction of investment in gold is the rapid and continuous depreciation of Indian Rupee as compared with continuous appreciation of gold. If we look at price movements in gold and equity shares over long period, bullion has proved to be far better investment than equity. In recent times, price of standard gold per 10 grams which was Rs. 369.23 in 1973-74 has gone up to Rs. 3187.5 in 1988.89 and to Rs. 5150 in March 1996". The recent efforts at liberalising the Gold Control Act implies governments recognition of the existing legislation's failure in checking gold smuggling and the tremendous rise in its price-predicted long back in 60s by Prof B. R. Shenoy. His proposed scheme of the Gold Exchange Bank still has a great relevance to-day. and its acceptance may go a long way in bringing in substantial amount of income from, the smugglers to Government treasury without causing increase in demand for Gold Editors.]

I. We shall examine the Gold Problem under four principal heads : (i) What is the Gold problem; (ii) How and when did it arise; (iii) What measures have we adopted to tackle it and with what success; (iv) If these measures have not been successful, What alternative measures could we adopt.

What is the Gold Problem :

Briefly, the problem is two-fold; first gold smuggling and, second the attachment of Indian people for gold. The Finance Minister's concern over gold smuggling and over the Indian people's attachment to gold is due to an enormous wastage of foreign exchange. The amount of gold smuggled into the country is, for obvious reasons, conjectural. Smugglers do not file customs returns nor pay the import duty on the gold they bring in. Nor do they declare their incomes from this traffic to the income-tax officials.

Smuggled gold cannot be sold openly in the form in which it was smuggled. Its fineness is usually 999 per 1,000 The fineness of the product of the Indian refineries is 995 or under. Gold used in the South. sovereign gold, is about 917 fine. Smugglers are, therefore, anxious to get rid of the tell-tale fineness of the gold and bring it down to the

Indian standards. Melting and assaying gold was, thus, some indirect evidence of the inflow it might be of an annual order of 1.23 million ounces valued at Rs. 38 crores. The Forward Markets Commission in its report on the bullion trade states that the value of gold smuggled into India is roughly Rs. 30 to Rs. 40 crores per annum, the figure recently quoted by the Finance Minister. Some have placed it at an order of Rs. 50 crores, which is the figure more usually mentioned today.

The relevant point is that considerable amounts of gold are continually flowing into the country at a conjectured annual 'rate of, say, Rs. 50 crores. It eats up equivalent foreign exchange. This we can ill afford. Gold imports being banned, foreign exchange to finance gold imports cannot be had from the Reserve Bank or the authorised dealers in foreign exchange, the commercial banks. At the same time, the gold that is brought in, is not a free gift. Every tola of it is paid for and in foreign exchange. This foreign exchange is appropriated from the foreign exchange currently accruing to the country. How the smugglers find the exchange is a matter of detail though this is a fascinating inquiry, the more so because we have to conjecture here, too, as we have to conjecture in the matter of the quantum of gold smuggled in. We have the broad picture of it. It is the sort of an exercise of filing in the blanks. I think we can do this with some measure of certainty, though this is a matter of detail.

The first concern of the Finance Minister, then, is the loss of foreign exchange involved in gold smuggling. He is, therefore, out to prevent gold smuggling "at any cost."

The second concern of the Finance Minister arises from the traditional attachment of the Indian people for gold. Though very poor—probably among the poorest in the world we are a gold hungry nation. Much to the satisfaction of the gold mining industry in South Africa, we absorbed large quantities of gold annually.

We have gone on accumulating gold, nobody knows for how long. Ever since recorded statistics in the middle of the last century, we have been importing gold. However, there was a prolonged break in 1931, which lasted for about a decade. During the decade 1931-41, we have been exporting gold, at times faster than the output of the mines of South Africa. They were very sad depression years. This phenomenon is related to the family budget position of the Indian farmers. Agricultural prices having sagged, — they fell more than industrial prices — family budgets were in deficits. The deficits were covered by melting family gold, trinkets, in small quantities. This was a miserable sight to see of families in want, feeding their hunger or clearing their debt by selling gold. Gold in dribbles flowed back to Bombay, month after month, for 10 years. It is said that many of the first line of buildings on Marine Drive, Bombay, were built from the profits on the export of gold.

Though a sad thing for individual families, this phenomenon gave no small satisfaction to the people in that red building in New Delhi. The deficit in individual family budgets, due to low agricultural prices, had showed itself up as trade deficits the resulting gap in our balance of payments was creating a headache to the Finance Member. The exports of gold came as a great relief.

In 1940-41, this reverse flow of gold ended. With the rise in agricultural prices, family budgets were once again in surplus and gold flowed in to meet the demand from the farmers. In September 1939, the imports of gold were banned by the Governor General in Council under the Defence of India Rules. But this made no difference to the flow of gold. Gold was demanded by the people and the market met the demand. Open imports being not possible, imports came by the back doors. This did not create much of the headache, as during the war period and the immediate post-war years, we had abundant foreign exchange because of the large trade surpluses.

The total amount of gold we have hoarded is placed at Rs. 4,100 crores by the Finance Minister at the market price. At the official price, (in the year 1963) it is about Rs. 1,800 crores. It represents about 4 years' national savings, the annual amount of savings being about Rs. 1,100 crores. Gold being a dead asset, these investments are an enormous waste, especially in a poor country. The savings thus wasted could contribute greatly to our economic development if invested in factories and in agriculture. Hence the concern of the Finance Minister over the attachment of the Indian people for gold. His theory is that if gold smuggling could be stopped, he would (a) save large amounts of foreign exchange and (b) make available the savings of the people for economic development.

II. How and when did the Gold Problem Arise?

How did the gold problem arise? This problem is to be divided into its two aspects, how and why, is gold smuggling taking place and what is the economic basis for the attachment of the Indian people for gold?

Let us first examine how and why gold smuggling is taking place. Heavy penalties attend gold smuggling. Penalties include confiscation of the gold and imprisonment. If smuggling continued, even so it is because of the enormous profits which this trade brings. The enormous profits result from the phenomenal gap between the landed cost and market prices of gold. (It is estimated that as a result of this gap smugglers make 100 percent gross profit on smuggled gold.) To arrive at the profit rate per year, this must be multiplied by the number of times a smuggler is able to repeat the transaction i.e., the 'turnover' in commercial terminology. If a trader is able to convert money into gold and gold back again into money six times in a year, he makes the gross profits of 600 percent per year (per 10 grams). I do not know if there is any trade or occupation in India which brings this fantastic rate of profits. The phenomenal gap between the landed costs and market prices is the crux of the gold problem. While this gap remains smuggling will continue. If smuggling must stop, this price gap must be eliminated.

The price gap is the result of two factors: inflation and a rigid official price of gold. If so the responsibility for the price gap i.e., that of the State, as inflation is caused by it and the official price of gold is fixed by it. If there was no inflation, there would have been no price gap: or, if inflation is forced upon us by circumstances beyond our control, there need be no price gap too, if the state permitted the official price to move with the market price.

In either case we will have no gold smuggling. The responsibility for the phenomenon of gold smuggling thus rests squarely on the shoulders of the State even as, if rain-water leaks from the roof, the responsibility for it lies on the contractor. It is little use blaming the law of gravitation for the leaking roof. It is little use blaming the bullion market, the speculator, the smugglers and the goldsmiths, who represent the law of gravitation in our analogy, for the phenomenon of gold smuggling. If there are crevices in the roof, for which the contractor is responsible, rain water will leak into the room. If there is a gap between the internal and external price of gold, for which the Government is responsible, gold smuggling will take place.

The attachment of the Indian people for gold apart from the magical properties, has an economic basis, the soundness of which cannot be easily set aside. The remedy lies in creating confidence in the honesty and stability of the Indian rupee. This remedy is entirely in the hands of the Government and is capable of immediate application. The Government must make up its mind to stop inflation, to stop debasing the currency. It is only under a stable rupee that people's savings may be expected to go into small savings. The preference for gold is the result of the bitter experience of the past.

III. Measures Adopted to Tackle the Problem:

We have been worried over the phenomenon of gold smuggling for quite some time now and we have taken a series of measures to tackle it, though, without any success. We shall consider four measures in particular; (a) intensification of customs vigilance and severity of penalties; (b) amendments in April 1955 of the Sea Customs Act, 1878; (c) the issue in May-June 1959 of special rupee currency notes for circulation in Persian Gulf territories; and (d) the promulgation of the Gold Control Rules on 10th January, 1963.

The intensification of vigilance has produced no visible results. A by-product of this intensification has been probably the spread of corruption. When gross profits are of fairy-tale dimensions, it becomes possible to buy over men with weaker consciences, men with expensive habits which the shrinking real value of the salaries cannot finance, and men with large families and dependents to maintain. Men of this description exist in all walks of life and, therefore, among the Customs vigilance people and they work under pressure of very great temptations, as the Talab smuggling case has revealed. Talab named people in very high places as his collaborators and we have heard of diplomats, visiting dignitaries and their encourage, air pilots and the staff of shipping companies being involved in cases of smuggling. I have heard it said that when gold was smuggled across the Rajasthan frontier, the special constabulary guarding the frontiers had to be changed once every week, for fear of the smugglers establishing intimate contacts with them. Though this doubtless makes a sorry narrative, this is not very much to be surprised at, considering that out of every 100 tolas of gold smuggled about 16 tolas would cover the cost of the smuggling operation, so that the smuggler has a balance of 84 tolas to play with. The use of the mechanical gold detectors at the customs counters, at airports and elsewhere have not, under these conditions, been very effective.

Confiscation of gold has not proved a deterrent. Even if one in every three consignments were confiscated, our arithmetic of the gross profit rate shows that the smugglers could

still continue in business and prosper. In actual fact, the incidence of confiscation would seem to be much lighter. We have data of the gold confiscated. It averaged about Rs. 1.75 crores per year during the three years ending 1958. Expressed as a ratio of the conjectured amounts of the gold flowing into the country, this makes a confiscation incidence of one in every 17 or 20 consignments, which is not by any means harsh.

That confiscation has not proved a deterrent is also conclusively shown by the insurance premium charged by the insurance company, a subsidiary of the smugglers, for insuring against the risk of confiscation. The chairman of the Cold Control Board, Mr. G. B. Kotak, referring to this strange insurance undertaking, in an address to Rotarians at Ahmedabad on 20th February, 1963, is reported to have observed that the premium rates charged by the company were 10.15 per cent of the value of the gold smuggled; he added that the consignees received the insurance claim within 24 hours of confiscation of the gold by the Customs. The insurance company would go out of the business if one in every 7 to 10 consignments or less was detected and confiscated. The premium charged is evidence that this is not the case. The incidence of confiscation is much less frequent than one in ten. As our conjecture above indicates, this frequency is probably one in every 17 to 20. The insurance company would, then, retain 41 to 50 per cent of its premium collections towards expenses and profits.

This insurance arrangement is a great convenience, to gold smugglers. True to the general principle of insurance, it enables the distribution of incidence of confiscation among the fraternity of smugglers. It enables the unlucky ones among them to continue in business, even if fate decreed that the hand of the police should fall on them with much greater frequency than on the rest of the fraternity. If every smuggler took insurance cover none of them trusting to luck, of every 100 tolas of gold smuggled in, 10 tolas would cover the cost of insurance, 16 kilos would cover the cost of the gold and of its transport, and the smuggler would be left with a net profit of 74 tolas.

Under the Sea Customs Act, 1878, when the police seized gold on suspicion, they had to prove before a court of law that the seized gold was smuggled gold. If they failed to prove this, gold had to be surrendered back and the party was set free. The police pleaded that this hindered vigilance and prevention operations. The Sea Customs Act was, therefore, amended to shift the onus of proof from the police to the person from whom the gold was seized. The owner of the gold has now to prove before a court of law that the gold seized from him was not smuggled gold. This legal streamlining did no more than clip the civil liberties of the bullion dealers. It did not affect gold smuggling, as it left unaffected the difference between the landed cost and the market price of gold.

Our attention then shifted to the method of financing gold imports. Studies in the Reserve Bank of India seemed to show that finance of gold imports was greatly facilitated by the fact that Indian moneys passed current in the Persian Gulf territories. Gold was sold in India against rupees, rupee notes thus obtained were smuggled out of the country and utilised to buy gold in the Persian Gulf territories. When the rupee notes flowing into these territories proved surplus to the needs of the local circulation, they accumulated with the banks and the latter passed them on to the Reserve Bank of India in return for

foreign exchange. This meant that, indirectly, foreign exchange to finance gold imports came from the Reserve bank of India through the intermediary of banks in the Persian Gulf territories. The Reserve Bank experts, therefore, thought that gold imports would cease if the rupees in circulation in these territories were rendered distinct from the rupees in circulation in India, as this would deprive the gold smuggler of this easy technique of finding foreign exchange finance. Indian notes in circulation in the Persian Gulf area was, therefore, withdrawn in May-time 1959 and was replaced by a special type of rupee notes. The latter were dyed red and looked different from Indian rupees.

This did not, however, put a stop to gold imports, for the simple reason that it made no difference to the price gap and to the fairy-tale dimensions of the profits in gold imports. The market was easily able to circumvent this measure of the Government. Hitherto, rupee notes were taken out of the country by the dealers in gold. The notes were brought back by the commercial banks in the Persian Gulf. Under the new handicap, this could no longer be done. The notes were now brought back by the dealers in foreign exchange. This reduced somewhat the profits on gold imports, as, following this measure, the discount on the Indian rupee notes rose considerably in the free market. The steep rise in the discount means that to obtain foreign exchange to purchase Gold, for smuggling into India, the smugglers had now to pay correspondingly more rupees. To that extent the gross profit margin got reduced. This, however, could not make much of a dent on gold smuggling since, as even on the basis of a discount of 35 per cent, the gross annual profit rate was 370-600 per cent. Moreover, there were compensations. Because of continued inflation, the market price of gold kept moving higher, widening the profit margin.

The Gold Control Rules issued on 10th January 1963 are not likely to make any significant impact on the gold trade. Gold cannot now be transported by conventional channels throughout India. Beyond splintering of a hitherto integrated market which has quite unnecessarily added to the cost burden of acquiring gold, the Gold Control Rules have not achieved anything purposeful. They are not likely to make any difference to gold smuggling as once the market mechanism gets adjusted to the Rules, the profit margins, which are even now fantastic, will recover to their maximum. These Rules amount to no more than streamlining, from the standpoint of the Administrator, the machinery of the bullion market, so as to permit administrative control of all recorded transactions. But dealings in smuggled gold have never been recorded, and of necessity, cannot be recorded.

The measures we have adopted against gold smuggling have demonstrably failed without exception. The reason for the failure is the same in every case. The "corrective" measures did not reduce the price gap.

Nor has gold smuggling stopped, despite official assertions on the subject. This just cannot be, seeing that, at the current market rates, the gross profit margins per year are of the order of 370 per cent or more of investments. In fact of these profit margins, to assert that gold smuggling has stopped, seems very much like saying that rain water has been stopped from leaking through the roof though the cracks and crevices remain as before. The Press continues to carry reports of detected cases of smuggling. On 16th February

1963 a German couple, visiting India, is reported to have been caught with Rs .2,50,000 worth of gold, weighing 24 kilos. On 31st March an Indian citizen was reported to have been apprehended by the police at the Bombay airport with Rs. 52,980 worth of gold, weighing 54 kilos and 298 grams.

The Finance Minister, speaking in the Lok Sabha on 25th January, 1963, seems to have imparted respectability to the view that the recent improvement of the Indian rupee in the free markets for foreign exchange overseas is evidence of the "halt" in gold smuggling, which the Gold Control Rules have supposedly produced. This argument was repeated by the Secretary to the Gold Control Board sometime later and has been echoed by some financial commentators since.

On 4th January, 1963, the week before the promulgation of the Gold Control Rules, the Indian rupee was quoted in Hong Kong at HK \$ 0.86 the parity rate being HK \$ 1.20 = Re. 1. This quotation has steadily risen since, the rate on 1st March being HK \$ 1.07.

The theory behind this argument is that the smugglers of gold sell the gold in India against rupees, smuggle the rupees out of the country and purchase foreign exchange against rupees in the free markets for foreign exchange abroad, using foreign exchange thus acquired to purchase gold to repeat the smuggling transaction. When the smugglers are active, the demand for foreign exchange against rupees gets active, too, and the rupee might weaken in the free markets. Contrariwise, when smuggling gets halted, the demand for foreign exchange against rupees slackens and the quotations in terms of foreign currencies for rupees move up. It is believed that the converse is also true; that, if the exchange value of the rupee should rise, we have an indication that gold smuggling is getting under control.

The (above-noted) supposed link between the quotations for the rupee in the free market for foreign exchange and gold smuggling does not seem to be valid for three reasons: (1) the demand for foreign exchange against rupees in the free markets does not come from gold smugglers alone. This demand ensues also from the smugglers of a whole series of commodities.....

(2) It is possible..... that a rise in the rupee exchange rate in free markets instead of being an index of halted smuggling, might, indeed stimulate smuggling, as to the extent of the rise in the exchange rate, the profits on gold imports would be higher.

(3) The fact of the matter is that the exchange value of the rupee in the free markets for foreign exchange is not determined by the demand for foreign exchange, on the part of the smugglers of gold and of other commodities. The current discount on the rupee in these markets and in the black markets in India is a rough measure of the risk-cost in unauthorised dealings in foreign exchange.

It is thus.... incorrect to link the improvement in the free market quotations for the rupee with the promulgation of the Gold Control Rules on 10th January 1963, on the false theory that this had reduced the demand for foreign exchange on the supposed halting of gold smuggling.

As the dealers in the bullion market well know, the Gold Control Rules have not halted smuggling. With the steady recovery in the domestic price of gold and the improvement in the free market quotations for the rupee, the gross profits on gold smuggling continue to be of fairy-tale dimensions..., since the Gold Control Rules have left the profit margins unaffected, gold smuggling continues.

IV. New Policy to Prevent Gold Smuggling:

The foregoing discussion demonstrates conclusively that gold smuggling cannot be stopped unless the phenomenal gap between the official and the market price of gold is eliminated. If a commodity commands at one and the same time two prices widely separated from one another, economic stability demands elimination of this price gap. This can be achieved by beating down the higher price in the present case, the market price of gold; or by lifting up the lower price in the present case, the official price of gold. The Government seeks to close the price gap by hammering down the official price of gold. Attempts made in this direction have not been met with any noteworthy success.

The market price of gold, like commodity prices in general, reflects the effects of past and current inflation. If the gap between the official and the market prices of gold must be eliminated, we must take two measures. First, we must put a stop to inflation. This will prevent a further rise in gold prices. Secondly, we must lift up the official price of gold to its natural market level. If the price gap cannot be covered by beating down markets price, it is obvious that this must be achieved by raising the official price. If, however, inflation is forced on us by circumstances beyond our control, we must allow the official price of gold to move with market conditions. These measures will eliminate the gap between the external and the Internal prices of gold and gold smuggling will cease. There is no other remedy to gold smuggling.

The cessation of Inflation and the elimination of the unreality in the exchange value of the rupee might, in due course, create confidence in the continued stability of the rupee and induce people to invest their savings in fruitful ways, rather than hold them in a dead asset, gold....

Banning the manufacture of ornaments of above 14 carat fineness seems to be a queer way of winning a gold-hungry people away from their attachment for gold. Even if illicit manufacture of ornaments of higher fineness were not open, it may cause people to own more units of ornaments of the lesser fineness rather than cause them to abandon the gold-using habit. In so far as the investment of illicit savings in gold is concerned, the limitation on fineness is likely to be Ineffectual as such investments are always concealed and will remain so, so that this category of demand for gold will remain unaffected by the Gold Control Rules.

The question arises whether the remedy of lifting up the official price of gold has a fair chance of early implementation, especially as the foregoing analysis demonstrates that there is no alternative to this remedy. It is not easy to answer this question at this remedy

has serious political consequences. If we lift up the official price of gold to its natural level so as to eliminate the gap between the official and the market prices of gold, and stop further inflation, it may simultaneously eliminate the phenomenal gaps between the landed costs and the market prices of import goods in general. This would be particularly the case if the improvement in the balance of payment position, which is most likely to ensue from this monetary and exchange reform, should lead to liberalisation of imports as it might. This will reduce the value of the import licences to almost nil and the scramble for them will cease. Import licences today are the most highly sought - after instruments of political patronage, and the corrupt functionaries of the state will be deprived of their most highly valued portfolios of patronage. The greatest obstacles to the adoption of our remedy to gold smuggling are these vested interests in the maintenance of import controls, exchange restrictions and the over-valuation of the rupee. If the pressure of these vested interests is set aside, the adoption of the only remedy to gold smuggling becomes politically feasible.

Another obstacle to this remedy is foreign aid, in particular, general purpose' foreign aid, which is not tied to any projects. The overvaluation of the rupee, the artificially low official price of gold together with the continuing inflation, which accentuates the degree of this over-valuation, are the basic forces behind the acute scarcity of foreign exchange and the continuing deficits in our balance of payments. Contrary to popular opinion, there is no mystery in this phenomenon, to make it beyond the reach of common understanding. If the state intervened in the market and fixed the price of any commodity, say, electric bulbs, at significantly below its marginal cost of production, the demand for it will soon far exceed its supply. The scramble for electric bulbs will necessitate their drastic rationing. With the price remaining below marginal costs, the domestic output of electric bulbs will fall short of domestic needs and the Government will be compelled to meet the problem by cutting down "non-essential" uses of electric bulbs, by electric bulb production-promotion campaigns, by nationalising industries basic to the production of electric bulbs and by seeking foreign aid in electric bulbs in order to save the country from darkness. Well-meaning foreign governments and humanitarian enthusiasts abroad will organize Aid-India Clubs under the aegis of the world Bank for electric supplies to provide India with enough electric bulbs to prevent the Indian people from being plunged into darkness, pending self-sufficiency of the country in electric bulbs, which according to the export assessment of the World Bank Mission, is certain to be achieved by the close of, say, the Fifth Plan.

Obviously, whatever measures the Government may adopt, the scarcity in electric bulbs will continue so long as its price, fixed and enforced by the Government, remained below marginal costs of production.

Entrepreneurs, instead of producing electric bulbs, will produce with the resources which would be ordinarily utilised for manufacturing electric bulbs, other

commodities — their prices not being artificially held down by the Government — which offer a reasonable return on investments. In the absence of foreign aid in electric bulbs, the Government's system to rationing will soon break down and the Government will be

compelled to resort to the only certain solution of the problem namely, lifting up the official price of electric bulbs to their marginal cost of production, or which would be the ideal thing to do abandoning the policy of intervention in the market for electric bulbs so that the supply of, and the demand for, electric bulbs are continually equated through the mechanism of price variations. Foreign aid, thus, acts as a great obstacle to the solution of the problem of scarcity of electric bulbs.

It is no exaggeration to say that this parable of scarcity of electric bulbs applies in all its essentials to the prevailing scarcity of foreign exchange in India, of which the phenomenal gap between the landed costs and the market price of gold and the phenomenon of gold smuggling are concomitant adjuncts or manifestations. The price of foreign exchange is artificially held below the market price by the Government and we seek to meet the problem of scarcity by drastic import cuts, i.e. rigorous rationing of foreign exchange, and by export promotion measures, by drastic penalties on gold smuggling, by imposing restrictions on the bullion trade and by seeking foreign aid, instead of by raising the official price to the market price.

Remedy

Proposal for Gold Exchange Bank :

Official Purchase and Sale of Gold through Gold Exchange Bank :

It is generally an accepted fact that in spite of legal restrictions, large quantities of gold are being smuggled into the country. This smuggling of gold has an effect of depressing the value of Indian rupee in free markets. One

had hoped that after the devaluation of the Indian rupee in 1966, our foreign exchange position would get stabilised and the external value of the rupee would not go down further. This hope has, however, been belied by actual facts.

One of the main reasons why the external value of the Indian rupee cannot be stabilised is the big pressure on illegal foreign exchange for financing gold smuggling. Not only are large quantities of gold coming into this country but the gold is costing us much more in terms of foreign exchange than it would, if the gold had been purchased by the country at the international price of gold. Seized records of certain gold smugglers indicate that gold is sold by the international smugglers at prices prevailing in the Indian market. As against this, they pay commissions to the carriers in India and their Indian associates who dispose of the gold. In brief the profit of the international smugglers and the commission of his foreign carriers have to be paid to them in foreign exchange.

The object of the proposed gold remittance scheme is (a) to economise the foreign exchange resources of the country by bringing in cheaper gold, (b) to augment Government revenues by levy of customs duty on the gold proposed to be brought, (c) to strengthen the external value of the rupee by ending the smuggling of gold and removing the pressure of demand for illegal foreign exchange by the gold smugglers. The ending of gold smuggling will also bring about an end to the accrual on underhand profit of the smugglers and their associates, on which the country is losing income -tax.

The following are the salient features of the gold remittance scheme :-

(a) To float a limited company which will be cent per cent government controlled and which will be authorised to buy and sell gold on their own behalf or on behalf of their clients or their client's nominees. It will also be permitted to do banking business and be designated as an authorised dealer by the Reserve Bank of India.

This limited company will hereafter be referred to as the Gold Exchange Bank.

(b) The Gold Exchange Bank will have its offices in U. K., U. S. A., Canada, Beirut, Singapore, Honkong, Bangkok, etc. The Gold Exchange Bank will be given a license by the Government of India to import gold either on its own behalf or on behalf of its clients or their nominees on certain conditions.

(c) The Gold Exchange Bank will offer to buy gold in the form of 10 tola bars for persons of Indian origin working or carrying on business abroad who wish to remit gold to India for benefit of their relatives. The following procedure will follow :-

(i) The non-resident Indians will give an authority to the Gold Exchange Bank that the gold so purchased is on his/her behalf or that of his/her nominee in India and will be sold through the gold bank or through an associate concern and proceeds will be given to the nominee of the non-resident in India, whose detailed names and addresses would be furnished by him.

(ii) The Government will impose a custom duty of not more than 40% so that no smuggler of foreign exchange can compete with the gold bank by bringing in cheaper gold. The principle in fixing the duty will be that gold should not be priced more than the premium paid by the smuggler for the acquisition of black-market foreign exchange plus the expenses incurred by him in the process of smuggling. As the open market rate of the foreign exchange drops, the custom duty on gold imported by the Gold Bank will have to be brought down accordingly. If this is not done the smuggler will again find it profitable to smuggle gold.

The Gold Exchange Bank will charge reasonable commission for rendering its services. Buying commission, freight and insurance will be collected abroad in foreign exchange and the selling commission in India in Indian rupees.

All the import formalities i.e., clearing of gold, paying of duty, etc., will be done by the Gold Exchange Bank. After the gold has been cleared, the same will be sold in the open market and the proceeds remitted to the relative of the persons on whose behalf the gold was purchased. Since the Gold Exchange Bank will be an authorised dealer, it will not be infringing any of the Foreign Exchange Regulation Act in making the payments; nor will be the persons receiving payments from them, committing any offence. The payment will be effected by the Gold Exchange Bank in the form of drafts which will be exempt from income-tax.

The advantages of the scheme will be that the profits of gold import (hitherto illegal) which is at present being shared by the international smugglers, their Indian associates

and the relatives of the Indians settled abroad who provide the foreign exchange (more than 70 to 80% of the smuggling is financed through compensatory transactions) will be shared by the country and the relatives of the Indians settled abroad. Since gold will be purchased at the international price and no profits will have to be paid in foreign exchange to any outside agency, it would be possible to get larger quantity of gold and at cheaper rates inside the country which would automatically depress the national price of gold. As such, the smuggler will be wiped off because he will not be able to compete with the cheap gold brought in. This in turn will have a direct effect in removing the pressure of illegal foreign exchange and will strengthen the external value of the Indian rupee. The good results which will be brought by the strengthening of the Indian rupee cannot be over emphasized. The temptation to acquire foreign exchange illegally by certain practices like under-invoicing exports, over-invoicing imports, non-repatriation of commission, export proceeds etc. will also disappear to a great extent.

The legal and administrative details can be worked out later, provided the principal of bringing in gold through the scheme mentioned above, is approved. It would be possible to create legal entities in such a manner so as to obviate any difficulties placed by the I. M. F. or U. K. exchange control authorities. Administratively, I see no difficulty in implementing the scheme.

PART IV

MISCELLANEOUS

STUDY TOPIC – 21

PUBLIC SECTOR WASTAGE*

The latest Annual Report of the Bureau of Public Sector Undertakings covers 85 enterprises run by the Central Government. Adding to this State Government and other official enterprises, the government sector includes iron and steel, heavy engineering, heavy chemicals, mines, railways, road transport, air lines, posts, telegraphs and other communications, banking, finance, internal and international trade, farms, textiles and certain other consumer industries, hotels, dairies, bakeries, and departmental stores. As of 1968-69, the total capital investments of Central Government undertakings alone amounted to about Rs. 4,000 crores. The net return on this colossal sum remains negative, the total cumulative loss, as of 1968-69, being about 10 per cent of capital. Indications would seem to be that the phenomenon of overall net losses may continue.

Behind this picture of waste is the related phenomenon of the incredible extent of idle production capacities in government undertakings. Production averaged 60 per cent of capacity in the Hindustan Machine Tools, Ltd., 9.0 per cent in Mining & Allied Machinery Corporation, Ltd., 2.2 per cent to 22.0 per cent in the several departments of the Heavy Engineering Corporation, Ltd. and was 50-68 per cent in the Hindustan Steel, Ltd. The contrast between production capacities and actual production is among the major factors responsible for the continued heavy losses.

This sorry state of affairs has been attributed by some critics, including the Parliamentary Committee on Public

Undertakings, to faulty planning, to begin with, without any "scientific and accurate assessment of demand"; management with insufficient experience, frequently, with next to no knowledge of business or industry; transfers of personnel at top levels when they may have gained enough experience to function effectively; unwillingness on the part of managerial staff to take decisions and assume responsibility; incredible over-staffing; unconscionable wastages of materials and accessories; gross neglect of maintenance of plant and equipment, notwithstanding over staffing; absence of a planning cell within the undertakings concerned; lack of coordination and communication among the various cadres of the managerial staff, other personnel and the body of workers generally, thereby causing avoidable stresses and strains and poor worker-management relations; almost total lack of cost consciousness; interference by the ministries concerned; pressures by politicians for jobs, contracts or distribution agencies for their nominees; nepotism, bribery and corruption at all levels; and so on.

The end result of all this necessarily involves inefficient functioning and must eventually manifest as high cost and low quality of the output, inability to honour (even what may well be already poor) delivery schedules, inordinate losses, and persisting obsolescence of the machinery, the production processes and the know how. The prevailing set up of government undertakings, thus, has in it the seeds of its own further deterioration. The amounts involved being so considerable and the industries so important, quite naturally government undertakings have been the subject of much public concern.

But it may be fatally misleading to suppose that the problem of government undertakings is a problem of the evils listed above. This problem is much more basic. Most of these evils are an integral part of the very nature of government enterprise and, wishful theorising apart, are really inseparable from it; as a practical matter—and as our own experience has shown— attempts to remedy the evils may turn out to be almost like wanting to separate liquidity from water. Exhortations, committees of enquiry, exercise of Parliamentary control, trial and punishment of the guilty and such other techniques have been tried and found wanting : the evils persist.

Logic and experience have demonstrated, again and again, that the factor costs of any economic service, when undertaken by government-i.e., costs in men employed, payments made for materials and equipment, depreciation and wastages, fringe benefits to employees, absence of economy in staffing, costs in indiscipline and inefficiency, corrupt practices, managerial costs and so on-may be significantly more than when the same service is rendered by competitive private enterprise.

This is so not because people in private enterprise are more ethically bound, and motivated more by the sense of service above self, than civil servants in general. On the contrary, it is possible that from exposure to the rough and tumble of life, and to the rigours of the market place, most private entrepreneurs, who have made a success of their vocation, are more shrewd, more calculating and more self-bound than the managerial cadres of government undertakings generally. But these inner qualities of individuals should be a matter of their own private concern. It is difficult to see how they may enter into the reckoning of the market place, though an ethical image may have a public relations value and, hence, some economic advantages. At all events, the nature of these inner qualities do not provide any rational explanation for the comparative failure of government sector undertakings and the comparative success of private enterprise in general.

If factor costs in private enterprise, under competitive conditions, are generally lower than factor costs in corresponding government undertakings, this is so almost solely because these costs impinge, without mercy, on the incomes of private sector entrepreneurs, even as they do not impinge on the emoluments of public servants. The costs of wastages and such other items, referred to above, are part of production costs of the undertakings conceited; and, in a competitive market, prices are determined not by the costs of individual entrepreneurs, but by the market forces of supply and demand; If a particular entrepreneur makes more wasteful uses of materials and equipment than others, the money costs of this get debited to his income. He cannot, unless he is a monopolist,

pass them on to the consumer. This disciplines him and his managerial staff into taking good care of his costs and general affairs. His moral qualities, or the reverse, do not appear on the scene at all.

As the result of this continued vigilance and economy efforts on the part of entrepreneurs, the community would get the benefit of goods and services of quality, at low factor and money costs; and, what is no less important, entrepreneurial rivalry causing innovations to be harnessed, these costs may tend to decline and the quality of the out put to improve. It may be noted that for the full functioning of these built-in factors making for economic betterment, it is important that the working of market forces should be streamlined, not hindered by (ill-advised) governmental intervention in the working of the market mechanism. These criticisms of the private enterprise system frequently stem from an inadequate appreciation of the efficacy of this mechanism. These criticisms may have validity only when private enterprise gets entrenched in, more or less, monopoly positions; and, more generally, private monopolies arise from - as Indian policy measures have amply demonstrated - socialist planning.

The forces and pressures operating in government sector undertakings, on the other hand, are opposite to those of the free market system. Here, built-in factors tend to induce corruption, wastages, indiscipline and extravagance. This would happen, not because of the good or bad inner and subjective qualities of the personnel running the enterprises; it would happen, as stated above, almost solely because, the increase in factor costs and money costs and

do not impinge on the incomes of the managerial personnel in government sector undertakings. Worse still, as these costs would be under-written by the lax-payer, they may invariably creep upwards, despite the mounting files of efforts for reform. Competition among private entrepreneurs to sell to, or to purchase from, these undertakings may, sooner or later, bring in corrupt practices. And the end result may be high costs and shoddy output.

The incidence of the higher costs of the government sector is borne by the community. For the same factors of production, that is to say, we would get less output when the service in question is nationalised than when it is competitively provided by the private sector. A poor people, in particular, can, therefore, ill-afford the waste of nationalisation.

From the foregoing discussion, it would seem that the remedy to the problem of mismanagement of the government sector, resulting in colossal wastage and losses. does not lie in attempts to correct the manifold evils listed above. The only remedy is for the State to limit its activities to within the natural duties of government. The government should confine itself to such functions and responsibilities as competitive private enterprise may be unable or unwilling to undertake, but which are essential for the efficient functioning of the economy. A corollary of this proposition is that government should be continually on the look out for opportunities to pass on to private ownership and management the projects it has undertaken. To the category of essential services, which the State alone could undertake, belong, Rule of Law (of which the maintenance of law and order is but an aspect), monetary and fiscal stability, public health, compulsory

primary education, standardisation of weights and measures, basic transport and communication, provision of basic marketing facilities. agricultural extension services and defence from external aggression.

Some of these activities are the responsibility of the Centre, some of the States and some belong to the Concurrent List. In defining the activities of the State, care needs to be taken not to step into the area of operation of the private sector. In respect to transport, for instance, the State's responsibility may be to provide and maintain in good condition roads and waterways. But taxi and bus transport, and river or canal boat services, should be left to private enterprise, due care being taken to ensure that monopoly positions do not develop. Similarly, in respect to agricultural extension services, the concern of the government may be to disseminate the know-how of agricultural improvements, providing technical advice and demonstrating the potentialities of the improved techniques. It may not be safe to go beyond this and get involved in trading and supply activities in agricultural inputs.

As the major part of government undertakings fall outside the sphere of the more natural duties and responsibilities of the State, this suggests the necessity of not only putting a stop to any further expansion of the official sector; it calls for the adoption of a phased programme of denationalisation of the government undertakings.

Denationalisation, however, must necessarily take time, as it may involve prolonged administrative procedures. But, pending denationalisation, it may be of considerable help to list the share capital of government corporations on stock exchanges. This will bring under expert scrutiny, free of cost to Government, the balance sheets, and managerial performance in respect to costs and quality of the output, the actuarial cost-return prospects, and the general working of the corporations. The quotations on the stock exchanges may keep the management of these corporations constantly on the alert, which little else may succeed in doing in the same measure, as efficiency and return prospects may get reflected in these quotations. It may be helpful, too, to consider bringing into the management of these corporations, at the level of Board of directors, representatives of private shareholders. This reform is capable of adoption without much delay. It may also provide guidance in preparing the phase programme of denationalisation, as the share values may indicate the worth and prospects of the undertakings and, therefore, give an idea of the capital gain or loss from denationalisation.

The undertakings in the government sector appropriate over 70 per cent of the available investment resources comprising domestic savings and foreign aid. On the other hand, the contribution of these undertakings to the Indian national product is less than 20 per cent. It follows that less than 30 per cent of the available investment resources of the country have to be shared by the non-Government sector, which contributes over 50 per cent to the Indian national product. This shows that the problem presented by the government sector is not merely a problem of misuse, misdirection, extravagance and wastage of investment resources; it also necessarily involves resource hardships on the non-government sector. The industrial and territory part of the latter has been generally able to raise their needs of capital. Governmental policies and the established institutional

arrangements which favour the industrial and tertiary sectors, have facilitated this. Agriculture, which accounts for about one-half of the Indian national product, has been the worst sufferer. Agriculture and allied trades are virtually starved of capital. The prevailing Indian economic chaos is due, in no small measure, to this perverse pattern of resource distribution. There is no remedy to this other than to embark on a phased programme of denationalisation of Government undertakings.

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STUDY TOPIC – 22

ON TAXATION - SAVING AND GROWTH*

THEORY AND PRACTICES :

Economics is not astrophysics. It deals with the day to-day problems of man and society. If economic theory does not throw light on the problems of life, which confront the nation, or the firm of which the economist may be a part. he may be wasting his own lime and that of his audience. Equally, there can be no such thing as a certain proposition being correct in theory; but that the opposite proposition alone may be applicable in practice. What is wrong in theory does not become true in practice. We may have the best results when theory is well informed with the realities of life; and policy measures are well informed with the guidelines which theory may provide.

DISAPPOINTING ACHIEVEMENT :

Our prime concern in India, today, is economic development. By this we mean more food, more clothing, more and better house room, more and better education, and so on. We seek more of the good things of life not for pressure groups alone, but for the masses of the people as well. Our objective is a continued rise in mass well-being. It is well to recognise that during the past 11/2 decade.. (now 4.5 decades) of the so-called planned economic growth, we have not achieved noteworthy progress in mass well-being. Since 1955.56, when an acceleration of these policies began, we had had remarkable sectoral progress in

the so-called Infrastructure industries - in the output of iron and steel, engineering hardware, heavy chemicals, and capital formation in mammoth river-valley projects. Industrial production generally, which accounts for but 20% of national income rose, too, at an annual rate of 10%, though latterly this rate has noticeably declined.

By contrast, agricultural production, from which 70 per cent of the population draws its income, and which accounts for about one-half of the gross national product, rose by but at an annual rate of 1.3 per cent during the same period. The overall incomes of 70 per cent of the population have not gone up. The problem is much more basic than the traditional uncertainty of the weather. If we may assume that agricultural population has gone up in the meanwhile at the national average rate of 2.5 per cent, the inference is that per capita well-being of this sector of the population has gone down. The popular belief among some people in the urban areas that the economic condition of the rural population has gone up in recent years, thus, does not rest on sound statistical data.

This is not to say that we have not made forward leaps. But these leaps forward have been in the assets, incomes and consumption of a thin upper-crust of the community, though the numbers in this upper-crust has, doubtless, grown, at a remarkably rapid pace. If we take 1954-55 as our base year, we find statistical confirmation of this development in the national pattern of consumption. Registration of motor-cars has increased 2.4 times, the consumption of art-fabrics has gone up 2.7 times, the production of refrigerators 37 times. On the other hand, domestic consumption of cotton cloth went up by but 27 per cent, or by about the same margin as the increase in population, which rose by 27.2 per cent. Every politician in power tells us that we are aiming at a socialist pattern of society. He is so absorbed in the ideation of socialism that he may not realise that what he has really produced is Cadillac socialism, or since the upper classes in India have made rapid strides in their habits of consumption and living, Cadillac and champagne socialism.

This disappointing picture of stagnation or worse in the mass well-being, with contrasting prosperity for a minority, is not economic development. We had had during the past about ten years abundant economic development of the affluent sectors of society. Economic development is not a matter of savings and investment alone. The direction of investment is no less important. Capital formation may mount up statistically. But if investment goes into wrong channels, we may be adding to chaos, not to development. This is, in fact, what we have been doing in India, in the name of planned economic growth.

WHY STAGNATING SAVINGS :

It follows that, since we do not wish to lean heavily on foreign aid, the aim of all policy measures should be to stimulate domestic savings and to ensure the most effective utilisation of these savings. During the past 11/2 (now 4) decades, our policies have had the exact opposite effects. The rate of saving has been for long semi-stagnant; latterly, it has declined.

Why is the rate of saving declining? The answer would seem to be four-fold: first, the phenomenal stepping up of Revenue collections and public consumption; secondly, the no less phenomenal increase in public sector investments; thirdly, import licensing and other economic controls; and finally, inflationary finance.

(I) GOVERNMENT REVENUE AND SAVING :

The link between the steep rise in Revenue collections and the decline in saving is easily seen. Revenues shift incomes from the pockets of the people into Government treasuries. Virtually the whole of Revenue receipts are burnt up in public consumption, the amounts saved through Revenue surpluses for capital formation in the public sector being, since 1960-61, a meagre 3.8% of the Revenues. In the hands of the public the same incomes might have added to savings vastly more, perhaps about 25 per cent, as the marginal rate of saving of the more significant groups of the tax-paying public may contrast with the rates of saving of the rest of community.

On this basis, every increase of Rs. 100 crores in Revenue collections may deprive the private sector of Rs. 25 crores of savings, while it may add Rs. 3.8 crores to public sector capital formation; and the net result may be a decline in national savings by about Rs. 21 crores. The converse may also hold true. With every scaling down of Revenues by Rs. 100 crores, private savings may go up by Rs. 25 crores, while public sector savings may fall by Rs. 3.8 crores; and national savings may show a net increase of about Rs. 21 crores.

(ii) NO CASE FOR PROGRESSIVE TAXATION :

If accelerated economic development is the prime concern of under-developed economies, they can ill-afford to pursue the socialist theory of taxation. This theory is almost sadistic in its approach. It envisages the use of the tax instrument for "mowing down" individual earnings to an arbitrarily prescribed ceiling. Taxation is avowedly meant to hurt; and to tax some out of existence. It looks as though the more it does this, the greater the spiritual satisfaction it may bring to socialists.

If we are indeed eager to reach the "take-off" stage of economic growth speedily, we must abandon these policies of expropriatory taxation. India is among the most highly taxed nations in the world. Our marginal tax rates on the upper and top income slabs are higher even than in the socialist countries of Norway, Sweden and United Kingdom; and vastly higher than in U.S.A. and West Germany.

The West German Economic miracle was not produced by an indiscriminate wielding of the tax weapon. It rested on, among other things, to quote Professor Erhard, "a systematic limitation of spending by the State" and "generous allowance for depreciation and a series of other privileges." Professor Erhard reduced taxation "to a point where the top individual tax was no more than 50 per cent". The economic philosophy of the Liberal School of thinkers, which, in some limited measure, animates the European Economic Community, advocates lowering of the tax burden, not stepping it up.

A comprehensive programme of tax reform aimed at maximizing savings and, therefore, of investments, employment and output, should embrace virtually the whole range of taxes and revenues. The effort should be the reverse of the effort currently in evidence, of seeking heads of revenues where rates are low, for lifting up the rates and the collections; with land revenue among the notable exceptions, tax rates all round are unduly high. They all need to be axed drastically if the country must prosper —import duties, excise duties, taxes on personal income and corporate taxation, which account for the largest bulk of Central Revenues.

In this range of taxes, progressive taxation seems to be particularly pernicious, as, to the extent it has been effective, it has caused great damage to economic and social progress. Like other similar measures, it has been smuggled into general acceptance, under false pretences, to quote Professor F.A. Hayek. We have been so reconciled to it that some of us might be taken aback to be told that its economic and ethical foundations are weak, to say the least, and its effects perverse.

First, progressive taxation is generally believed to be just and equitable. But it is a tax on initiative, talent and efficiency. It penalises successful entrepreneurs. It violates the basic doctrine of equality of all before the law. It amounts to paying progressively less for more work by man of the highest productivity. Secondly, it protects individuals and groups, who have already amassed vast wealth, from competition by newcomers, as, if taxes are paid as prescribed, new men of outstanding business talent would find it impracticable to accumulate wealth. The major route to individual capital formation, namely, through business success, being thus virtually frozen, Wealth inequalities would tend to become static. Both these factors might deprive society of the full production advantages of some *of its ablest entrepreneurs and professional men. As experience has shown, wealth and income inequalities tend to be reduced through the dynamism of the vertical mobility in wealth and income acquisition, and through accelerated production, which provides the wherewithal for reducing inequalities. Progressive taxation stifles this dynamism of vertical mobility and, therefore, is apt to defeat its egalitarian purpose. Thirdly, progressive taxation causes perhaps the heaviest damage to the growth of national savings.

The widely accepted view among the Liberal School of economists today favours the abolition of progressive 'taxation altogether and its replacement by a flat rate income tax applicable to all incomes above a minimum. I may mention, in particular, the writings on the subject by Blum and Kalvan, Milton Friedman, F. A. Hayek, E. L. Lutz, Lionel Robbins, and David McCord Wright. The following quotation from Professor Milton Friedman's book on 'Capitalism and freedom' (1962) is perhaps representative of the thinking of this School on this subject:

"All- things considered, the personal income tax structure that seems to be best is a flat-rate tax on income above an exemption ... I would combine this programme with the abolition of the corporate income tax, and with the requirement that corporations be required to attribute their income to stock-holders, and that stock-holders be required to include such sums to their tax return." (p.174).

It is interesting to recall that ancient Indian tradition is in line with the modern trend in tax theory. This tradition prescribes a flat tax rate for all; a tax rate of one-sixth of income was, apparently, so universal that one of the synonyms of the king is Shastamsha - Vrithi one who arranges the governance of his kingdom on a tax levy of one-sixth of the incomes of the citizens.

(iii) LIMITING GOVERNMENT:

How low should taxation be? It is not possible, consistently with logic, to prescribe any arbitrary level to which Revenue collections must be scaled down. A guideline for such scaling down may be for the Government to retire, progressively, to its more natural duties. The State should undertake such activities, which are essential to modern living and which private enterprise may be unwilling or unable to provide. To this category belong law and order; defense from external aggression; public health and sanitation; an honest money medium, standards of weight, length and measure; basic transport, communication and marketing services; compulsory primary education; and agricultural

extension services. The State would progressively withdraw, through a phased programme of de-nationalisation, to these natural limits of its functions. This may be a very unpopular programme of reform. But, if accelerated economic growth is really what we desire, we may not achieve it by the socialist theory of taxation or by policy measures miscalled planning.

This leads us to the second factor which has taken a heavy toll of savings — the phenomenal increase in public sector activity. When Rs. 100 crores are accounted to have been invested in a public sector undertaking, the full amount of Rs. 100 crores does not, in fact, go into the project concerned. What into the project may vary from 60 to 80 percent. We concerned dismiss this as a minor matter, as being inevitable in the case of P.W.D. undertakings. But large corporations have taken the place of the old P.W.D. and the State, today, appropriates over 70 per cent of total investment resources. Considerable amounts, possibly a couple of hundred crores of rupees a year, are converted from savings into private incomes, though in the account books they appear as investment. This is substantial erosion into national savings and economic development.

There is really no practical solution to this problem, even as there is no means of preventing fish from drinking water; it underlines the basic truth: the State is an evil when it strays beyond its allotted functions. The damage to development from the undue expansion of public sector also ensued from the low average returns undertakings has on investments in this sector. These average returns are of the order of 1 per cent or less. The same amounts invested in agriculture and in the basic consumer goods trades, notably, cotton textiles, would take us much faster along the road to progress. So long as the Government sector appropriated the lion's share over 70 per cent — of the total investment resources, was little hope of increased agricultural production and accelerated economic growth, however, impressive may be the list of wonder seeds which agricultural scientists may have evolved.

(iv) EFFECTS OF INFLATION :

Inflation eats into savings through shifting incomes from wage earners into the pockets of residual the masses and income droops. When the level of living is already low, consumption being largely limited to necessities of life, these income shifts cannot be met by cuts in consumption, on the part of the victims of inflation. Cuts in consumption would be resisted. Consumption may continue as before; the income shifts would be drawn from potential savings.

Consumption of the beneficiaries of inflation, on the other hand, would increase. Inflation in a background of poverty would, thus, cause a net debit on national savings.

(v) IMPORT LICENSING :

The fourth factor eating into national savings is the system of import licensing. This factor is rather outside the scope of the subject of our discussion. Briefly, as I have argued in some detail in my book on Indian Economic Policy, restrictive import licensing endows import licences with fantastic market values. The more restrictive the licensing,

the higher would be these market values. These values vary from 30 per cent to 500 per cent or more of the face values of the licences. The market values of private sector import licences alone may be of the order of Rs. 500 to Rs. 600 crores annually. These unearned and unmerited incomes, accrue to the beneficiaries of import licences. Being windfall incomes, they induce extravagant living on the part of individuals; and overstaffing and managerial extravagance in the case of firms and corporations. The amounts involved being so considerable, national consumption goes up, with a debit effect on national savings.

Import licensing also causes misdirection of investment resources into uneconomic production, at the expense of the traditional and other export industries. How this happens is easily seen, Restriction of Imports drives up the prices of the Import goods concerned. The more severe the import restriction, the higher the price rise. This renders profitable domestic production of the import goods concerned, though, in the absence of the import restrictions and the artificial rise in prices, such production would be unprofitable. Investment resources, thus, get diverted from the rest of the economy into uneconomic industries, turning out commodities of shoddy quality and high costs.

Import licensing, in other words, retards the flow of saving and induces wasteful use of savings. It is perhaps the most pernicious measure of interventionism devised by man. Elsewhere, I have argued that neither economic nor social progress is possible without the abolition of the system of import licensing.

STUDY TOPIC – 23

INDIAN NATIONAL SAVINGS*

To accelerate economic growth, we have to accelerate the flow of national savings. And the way of achieving this is not to reduce consumption, which might seem the obvious thing to do from the arithmetic of saving, that it is the balance left of income after consumption. Reduction of consumption to step up savings and achieve accelerated capital formation and economic growth may be a paper prescription. It is not practicable in a free society. In India about two-thirds or more of national savings are from households, about 7 per cent from the domestic corporate sector, mostly self-financing, and the rest by the State. The households, which contribute the bulk of the national savings, number about 110 million; and the firms and institutions may number several thousands. In this context, there is no device of stepping up national savings by pushing a pedal or two or pulling a lever or two. These savings are determined by independent individual decisions regarding the disposal of incomes between spending and saving on the part of households, firms and institutions.

Even with no change in national production and income, it may be possible to step up savings if the existing barriers to increased savings - e.g., pegging of the interest rates on bank deposits by agreement and the ceiling on the interest rates on loans - are removed. But such increases in saving cannot last indefinitely. The increases may cease when the barriers have been all removed. We have no live example of a continued increase in national savings under unchanged or semi-stagnant national income. It is doubtful if increased savings may be extorted for long, in such a context, even with a Communist steam-roller on consumption. As a general rule, individual families may increase their savings only when their incomes rise; and a continual increase in saving may be reasonably expected only when incomes increase continually. What is true of an individual family applies also to national savings, as national savings are but an arithmetical aggregate of individual savings.

Available data confirm this proposition. All known cases of continued increases in savings have occurred in a background of a continued increase in national and per capita incomes; and therefore, of a continual increase in consumption. We have cases of increases in national income not being necessarily accompanied by increases in savings under constant or semi-stagnant national income; or of declining consumption. Empirical evidence permits and supports the generalisation that the safest and the best hope of a continual increase in national savings lies in planning (or a continual increase in national consumption, this increase in consumption being fed by a faster pace of expansion of the national income. To try to step up savings by stepping down consumption is not a

practicable proposition, If national Income did not increase. It cannot succeed even in communist economies. It has no chance whatever in free societies.

Japan provides a good illustration of this. Japanese gross domestic product rose from U. S. \$ 19,185 million in 1953 to \$ 65,453 million in 1963, or over 3.4 times in ten years, an annual rate of 24.1 per cent. The rate of saving in Japan rose, simultaneously, from 24 per cent in 1953 to 36 per cent in 1963. The quantum of saving, therefore, rose from U. S. \$ 4,604 million in 1953 to U. S. \$ 23,560 million in 1963, or 5.12 times (See Tables 1 and 2). Incidentally, though the number of Japanese workers may be less than about one-fifth the number of workers in India, the quantum of savings in Japan exceeds the entire Indian national income.

Table - 1
National Savings and Gross Product

| | (Millions of U. S. A \$)* | | | | | | |
|-------------------------|---------------------------|---------|--------|---------|-------------|---------|--------|
| | Canada U.S.A | Germany | Italy | Japan | Switzerland | U.K | |
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 1953 | | | | | | | |
| Gross, Domestic Product | 24,642 368,000 | 35,000 | 19,928 | 19,185 | 5,550 | 47,040 | |
| Amount of Saving | 6,161 | 7,350 | 3,786 | 4,604 | 944 | 7,056 | 62,560 |
| Amount of Consumption | 18,481 305,440 | 27,650 | 16,142 | 14,581 | 4,606 | 39,984 | |
| 1963 | | | | | | | |
| Gross Domestic Product | 40,796 596,000 | 94,500 | 48,115 | 65,453 | 11,541 | 84,560 | |
| Amount of Saving | 9,383 107,280 | 24,570 | 12,029 | 23,563 | 3,462 | 14,375 | |
| Amount of Consumption | 31,413 488,720 | 69,930 | 36,086 | 41,890 | 8,079 | 70,185 | |
| 1966 | | | | | | | |
| Gross Domestic Product | 54,302 752,000 | 119,750 | 61,003 | 96,651 | 14,652 | 104,160 | |
| Amount of Saving | 15,205 135,360 | 29,938 | 11,591 | 332,861 | 3,956 | 19,790 | |
| Amount of Consumption | 39,097 616,640 | 89,812 | 49,412 | 63,790 | 10,696 | 84,370 | |

Table - 2
Index of National Savings and Gross Domestic Product
(1953=100)

| | Canada U.S.A | Germany | Italy | Japan | Switzerland | U.K | |
|------------------------|-----------------|---------|-------|-------|-------------|-------|-------|
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 1963 | | | | | | | |
| Gross Domestic Product | | | | | | | |
| (GDP) | 165.6 | 270.0 | 241.4 | 341.2 | 207.9 | 179.8 | 162.0 |
| Savings as % of GDP | 23 | 26 | 25 | 36 | 30 | 17 | 18 |
| Amount of Saving | 152.3 | 334.3 | 317.7 | 511.8 | 366.7 | 203.7 | 171.5 |
| Amount of Consumption | 246.8 | 252.9 | 223.6 | 287.3 | 175.4 | 175.5 | 160.0 |
| 1966 | | | | | | | |
| Gross domestic product | 220.4 | 342.1 | 306.1 | 503.8 | 264.0 | 221.4 | 204.3 |
| Savings as % of GDP | 28 | 25 | 19 | 34 | 27 | 19 | 18 |
| Amount of Saving | 246.8 | 407.3 | 306.2 | 713.7 | 419.1 | 280.5 | 216.4 |
| Amount of Consumption | 211.6 | 324.8 | 306.1 | 437.5 | 232.2 | 211.0 | 201.9 |

But Japanese consumption did not decline during the period. It went up, though by a lower multiple than the increase in saving. In 1953, Japanese consumption expenditure had amounted to U.S. \$14,580 million, or 76 per cent of the gross domestic product. In 1963, the quantum of consumption was 2.9 times as large as U.S. \$ 41,890 million, though the rate of consumption had fallen to 64 per cent of the gross domestic product. Savings, consumption and national income all galloped ahead, income faster than both consumption and savings, saving faster than consumption. Both savings and consumption could increase because of the faster acceleration of national income.

Nor was this increase in Japanese consumption in money terms alone. Prices in Japan remained remarkably stable during this period. Between 1953 and 1963, the wholesale prices index varied between 100 and 101 (1953=100). Inflation being virtually absent, the increase in the real consumption of the Japanese people was as phenomenal as the increase in the money value of consumption.

This phenomenon of a continual rise in the quantum and rate of national savings, and of the quantum of national consumption, both being made possible by a galloping gross domestic product was repeated in Switzerland, West Germany, Italy, U. K. and U. S. A., during the same period, 1953 to 1963. During this decade, as may be seen from Tables I

and 2, national income in these countries rose by 62 percent to 240 per cent, the quantum of national savings by 52 per cent to 410 per cent and quantum of national consumption by 60 per cent to 187 per cent.

As for our country, we do not have a regular series of statistics on national savings. While the Social Accounts statistics of member countries, published in the Yearbook of National Accounts Statistics and in the Annual Statistical Yearbook of the United Nations, contain data on savings of a good number of countries, it does not give this data for India. We hope that the Central Statistical Organization, which produces India's national income statistics, will rectify this deficiency before long.

In the meanwhile, we have to rely on the annual surveys on savings- "Estimates of Savings and Investment in the Indian Economy"- conducted by the Reserve Bank of India and published in Reserve Bank of India Bulletin.' These surveys relate to the period 1950-51 to 1962-62. For some unknown reason, this series ceased to appear thereafter.

The Planning Commission paid little attention to the subject. The annual plan documents do not contain any detailed data on saving. Not that the economists of the Planning Commission did not accept the doctrine that under no circumstances can investment over a period exceed the quantum of savings generated during the period plus foreign aid; but, while accepting the necessity of the equivalence between saving and investment, they seriously believed that if only we could embark on, and proceed with, a well integrated, mutually complementary and consistent programme of investment, the economy will produce the required volume of savings to match the volume of investment. They assumed that this would happen automatically as part of the mechanics of the economic process, though they did not pursue this proposition by any realistic or detailed analysis of the mechanics as applied to a live model.

Consistently with this dogmatic assumption, the Planning Commission did not think it at all necessary to make any estimate of the rate and quantum of national savings before formulating their programmes of investments. To them this was a futile exercise; In their line of thinking, it was much more meaningful to assess the "needs" of the people, formulate production targets on the basis of these "needs" and determine the quantum of investments for achieving the targets, leaving alone the actual flow of savings from the economy.

Though the (lilt four plan documents talked vaguely (and in very general terms) of national savings, their programmes of investments were independently formulated by reference to the criterion of "needs" and targets were not designed to be adjusted to any estimated quantum of savings. Formulation of investment programmes independently of estimates of saving holds true also of the annual plan documents, though the latter contain rather laconic statements of the estimates of the rates of savings in the preliminary comments on the "Economic Situation". It is, however, not clear how precise these latter estimates may be. In the Annual Plan, 1967-68, we are told that the rate of saving in 1965-66 was 10.4 per cent of national income; in 1966-67, 8.2 per cent; and in 1967-68, 6.4 per cent.' But the Annual Plan for 1968-69 states the rate of saving in 1966-67 to be 9 per cent, in 1967-68 "around" 8 per cent and in 1968-69 "about" 8.5 per cent.'

The later annual plan document has not cared to explain the difference of 0.8 percentage point in the rates for saving for 1966-67 and of 1.6 percentage points in the rate of saving in 1967-68, between its own estimates and those of the earlier annual plan document.

The dogma that savings will get generated to match whatever investments we could engage in, has caused not a little damage to monetary stability and to economic and social progress in India and in other countries which have pursued similar policies. It has resulted in over-investment, printing press finance of budget deficits (see Table 3) and inflation. As explained elsewhere, 'inflationary finance is the tap root of most of India's economic ailments. The chain reactions of inflation are, briefly, as follows. Inflation has

Table - 3
Union Budget Deficits

| Year | Changes in Cash Balances (Increase-) | Receipts from Treasury Bills | Increase in Longterm Debit of Central Government with Banks | Budget Deficit (1+2+3) |
|------------|--|------------------------------------|---|------------------------------|
| 1959-60 | -34.8 | 72.3 | 232.1 | 269.6 |
| 1960-61 | 24.5 | 49.0 | 101.5 | 175.0 |
| 1961-62 | -4.2 | 68.7 | 110.9 | 175.4 |
| 1962-63 | -18.4 | 124.6 | 110.4 | 216.6 |
| 1963-64 | 9.5 | 82.4 | 190.0 | 281.9 |
| 1964-65 | 60.3 | 61.6 | 104.7 | 226.6 |
| 1965-66 | -45.5 | 168.3 | 139.5 | 262.2 |
| 1966-67 | -62.4 | 307.7 | 90.5 | 335.8 |
| 1967-68 | -41.4 | 164.9 ⁽¹⁾ | 64.3* | 270.6 |
| 1968-69 RE | 13.7 | 264.0 ⁽¹⁾ | 50.0* | 309.7 |

given rise to balance of payments difficulties. The latter has led to drastic cuts in imports and more severe import licensing. This has driven up the prices of import licences to fantastic levels. Inflation and the unearned incomes from import licences have caused enormous income shifts from the masses to a thin top layer of the monied minority. In the context of semi-stagnant national income, this has produced family budget pressures on a wide front, giving rise, in its turn, to social and political tensions and instabilities. Physical restrictions on imports have fostered the domestic production of high-cost and low-quality substitutes to import goods, to the detriment of overall economic development. There is little hope of these multiple economic ailments being remedied if we do not put a stop to printing press finance, i.e., adjust our aggregate investment programmes to severely within the available quantum of domestic savings and foreign aid.

The statistics of savings of the Reserve Bank survey, need processing to yield the correct trend in saving. The Reserve Bank has converted the quantum of saving from current prices into constant prices by using the General Index of Prices. This has inflated the amount of the saving at constant prices, as an example will show.

As may be seen from Table 4, in 1960-61, the quantum of saving (or Investment) at current prices was Rs. 1,370 crores. This amount is made up of two parts, first, non-inflationary and voluntary savings (or Investment) and, secondly, savings corresponding to the investment financed by the printing press, which amounted to, during the year, Rs. 175 crores. Even as adding water to milk does not increase the aggregate milk content of the mixture, the use of printed money to finance investment does not add to total national savings. As indicated above, this is little more than a device for drawing the saving of the rest of the community into the public sector. Total non-inflationary savings at current prices in 1960-61 amounted to 1,195 crores. Expressed as a per cent of national income at constant prices, this yields a rate of saving of 8.2 per cent.

The Reserve Bank, on the other hand, assumes deficit financing to add to national savings an equal amount and, accordingly, states the amount of the national savings in 1960-61 to be Rs. 1,370 crores at current prices and Rs. 1,235 crores at 1948-49 prices; the rate of saving for the year (in either case) being placed at 9.7 per cent. This does not squeeze out the water of inflation from national savings. For doing so, the amount of the printing press finance, must be deducted from the quantum of saving. The balance remaining would, then, represent non-inflationary savings. When expressed in constant prices, the latter become a comparable series.

Table 4 gives statistics of saving for the period 1950-51 to 1967-68. They are drawn from the Reserve Bank surveys for the period 1950-51 to 1962-63; are conjectures for 1963-64 and 1964-65; and are taken, or derived from, the Annual Plan documents for 1967-68 and 1968-69. In arriving at the quantum of non-inflationary saving, adjustments have been made for deficit financed investments, on the lines indicated above, and a non-inflationary rate of saving has been arrived at.

We find from the table that the rate of saving remained stable around 8 per cent of national income for about a decade ending 1965-66. This rate should have, in fact, tended upward as Indian national income, at constant prices, rose during the period by about 40 per cent. Ordinarily, when incomes rise savings may rise too. Apparently, something was holding up this rise.

Since 1966-67, the rate of saving declined. It fell from 8.0 per cent, in 1965-66, to 6.4 per cent in 1966-67. This decline is largely explained by the low level of agricultural production and, therefore, of national income, for the second year in succession. In 1967-68 we had a bumper harvest. Agricultural production rose by Rs. 2,620 crores during the year, lifting up national income by 8.5 per cent. This should have led to a recovery in savings : or more than a recovery. But savings went up by but 0.2 percentage points to 6.6 per cent.

Table -4

Indian National Saving

| Year | National Rate of Income Savings at current prices prices(1) =100) 2 | National Income at constant prices constant (1948-49 =100) as %of(3) 3 | R.B.I. Rate of savi- ng (1) 4 | R.B.I. Quantum of Savings at current prices 5 | Budget Deficits(-) or sur(-) plus (+) 6 | N.I. at Current prices less budget deficits (2-6) 7 | Quantum of Savings of current budget deficits(5-6) 8 | Rate of Savings at prices less prices 9 | Whole Sale prices current =100) 10 | Quantum of Savings at constant (1952-53 (1950-51 11 |
|---------|---|---|----------------------------------|--|--|--|---|--|---------------------------------------|--|
| 1950-51 | 9530 5.6 | 8850 | 5.7 | 542 | +12 | 9542 | 554 | 5.8 | 112 | 495 |
| 1951-52 | 9970 5.5 | 9100 | 5.3 | 529 | +1 | 9917 | 530 | 5.3 | 119 | 500 |
| 1952-53 | 9820 4.0 | 9460 | 4.2 | 408 | +64 | 9756 | 335 | 3.4 | 100 | 374 |
| 1953-54 | 10480 5.6 | 10030 | 5.4 | 565 | -61 | 10419 | 504 | 4.8 | 101 | 557 |
| 1954-55 | 9610 9.2 | 10280 | 8.0 | 764 | -5 | 9605 | 759 | 7.9 | 90 | 947 |
| 1955-56 | 9980 8.7 | 1480 | 9.7 | 971 | -160 | 9820 | 811 | 8.3 | 99 | 914 |
| 1956-57 | 11310 8.6 | 11000 | 9.5 | 1076 | -185(2) | 11125 | 892 | 8.0(2) | 105 | 949 |
| 1957-58 | 11390 | 10890 | 7.0 | 798 | | | | | 106 | |
| 1958-59 | 12600 8.0 | 11650 | 7.4 | 932 | | 12600 | 932 | 7.4 | 112 | 930 |
| 1959-60 | 12950 6.6 | 11860 | 8.5 | 1102 | -270 | 12680 | 832 | 6.6 | 119 | 784 |
| 1960-61 | 14140 8.2 | 12730 | 9.7 | 1374 | -175 | 13965 | 1197 | 8.6 | 128 | 1050 |
| 1961-62 | 14800 8.4 | 13060 | 9.3 | 1374 | -175 | 14625 | 1198 | 8.2 | 123 | 1090 |
| 1962-63 | 15400 8.5 | 13310 | 9.7 | 1498 | -217 | 15183 | 1282 | 8.4 | 127 | 1125 |
| 1963-64 | 17210 8.0 | 13970 | 9.7 | 1669 | -282 | 16928 | 1387 | 8.2 | 139 | 1118 |
| 1964-65 | 20430 9.4 | 15000 | 10.4 | 2125 | -227 | 20203 | 1898 | 9.4 | 151 | 1407 |
| 1965-66 | 20340 8.0 | 14660 | 10.3 | 2095 | -262 | 20078 | 1833 | 9.1 | 174 | 1180 |
| 1966-67 | 23120 6.4 | 14950 | 9.0 | 2081 | -336 | 22785 | 1745 | 7.7 | 203 | 962 |
| 1967-68 | 27500(3) 6.6 | 15792(4) | 8.0 | 2200 | -271 | 27229 | 1929 | 7.1 | 206 | 1049 |

STUDY TOPIC – 24

ECONOMICS OF CORRUPTION*

In the world outside - unfortunately, not in India - there are two distinct camps in Economics : interventionists and non-interventionists. Communists represent the extreme case of interventionists. Interventionists of the socialist hue were in control when we came to direct our own economic-political affairs, after Independence In 1947; and with the growth In economic chaos, which attended the pursuit of socialist policies, Communists have been on the ascendant through infiltration and the propagation of their theory which blamed on capitalism the growing chaos. Their strategists argued that there was no hope whatever of any escape from the chaos other than via the adoption of Communism.

There is little indication of any shift to non-interventionism among economists, in the academies, in government and its agencies, in business firms and in chambers of commerce. This applies, too, to publicists and intellectuals, though there is increasing recognition of the failure of socialists policies. Strange as it may seem, the strongest opposition to a policy U-turn would be mounted by the chambers of commerce and industries.

It is not widely known in India that interventionism has invariably undermined the viability and progress of all breadline economies which adopted interventionist policies, and that no country, whether developed or under-developed, which entrusted the direction of its economic affairs to the price-market mechanism, has had nothing but bumper returns. If we must be saved from economic-

political disaster, it is time that we abandoned ideological predilections and subjected our policies to a basic transformation.

Both theory and experience have shown that corruption is among the inevitable by-products of the policies of interventionism. Corruption necessarily grows with the progress In the pursuit of these policies. India is a classic illustration of the functional link between corruption and interventionism.

I. "Corruption Unlimited"

Picking up a random copy of the Swarajya, Madras — it turned out to be the issue dated 15 October 1974 — I noticed a reference in it to a corruption story in The Hindustan Times, dated 2 October 1974. The New Delhi daily had published, under the head "corruption unlimited", a report from its Jaipur Correspondent of the news conference in

Jaipur. The Maharashtra Government had officially authorized payment of "illegal money to the officials of the "food Corporation of India", presumably for good turns to Maharashtra by FCI.

The medical bills of a Calcutta unit of the FCI had gone up from Rs. 22 lakhs — as if this amount was not fantastic enough — to Rs. 82 lakhs within a short period. Government had entrusted the matter for investigation by CBI and the thoughtful Minister of State had asked the Income-tax Department to check the income-tax returns filed by the doctors, who had claimed the medical charges from the Calcutta Unit.

It is useless asking what happened to the CBI and the income-tax investigations. Both scrutinies are probably still in process. With corruption having grown into a major national activity, the CBI and the Directorate of Income-tax Inspection are, doubtless, over worked. It is not without significance that a stray journal which I chanced to pick up should contain a story of corruption unlimited. Corruption

has become common enough among politicians in power and also in the Administration.

Some people have stated that corruption is an aged-old institution in India, that it goes back to the Muslim and Maharashtra days. We are told that, in the Punjab and elsewhere, when the income of a young official of marriageable age is considered by interested parties, due note is taken not only of his recorded income but also of the unrecorded — though none-the-less real — income opportunities, which his official position offers. Corruption certainly dates back to the Public Works Department of the British days.

We were also told by Pandit Nehru that corruption, like inflation, is a world phenomenon. The same point was repeated by Mrs. Gandhi at a public address in Mangalore on 11 January 1975. She did not relish the idea of the opposition parties levelling the charge of corruption against the politicians in the Congress Party. She complained that "Even though corruption was prevalent throughout the world, the manner in which the slogan was raised in India gave the impression that this phenomenon was peculiar to this country alone".

It tarnished India's image abroad. So, for heaven's sake and also for the sake of India's image abroad, please let the corrupt people pile up their fortunes in peace!

We are not concerned with this argument. Corruption and its ally inflation do not hurt us any the less because they are old and universal ailments. They undermine character and undermine mass well-being all the same. Our concern here is the effect of corruption on mass well-being.

And this effect on mass well-being is considerable. This is the explanation for the mass support of the movements against corruption and inflation. The main objective of the students' agitation in Gujarat, which had extensive support from virtually all sections of society, was the eradication of corruption and the inflationary rise in prices. Great effort and sacrifice went into the movement. But corruption and inflation continue, though, in Gujarat, the politicians being not there, their share in corruption has ceased to be. But the

interesting question still remains — which we shall here try to deal with — where has the politicians' share of corruption gone? We shall try to answer this question analytically.

The J. P. Narayan -led movement in Bihar has also the eradication of corruption and inflation for its objective. At a mass rally in the Gandhi-maidan, Patna, Jaya Prakash concluded the rally on 1 August 1974 by reading out an anti-corruption pledge, which was repeated by the audience. It said that the Satyagrahis would be prepared to "make any sacrifice and undergo any suffering to win the battle against rampant corruption. This scene of tens of thousands of persons taking the pledge was indeed thrilling. The J. P. led movement looks like spreading to other states. But let us be clear in our answer to the question, has corruption shown any signs of abating in Bihar and elsewhere? Our prime concern today would be with this question and the related question, can corruption, in the form in which it exists today, be eradicated?"

It is not as if the opposition to corruption exists in Gujarat and Bihar alone. It doubtless exists in all states of India. And all political parties oppose corruption. Indeed, corruption is openly opposed even by the Congress Party, by far the largest beneficiary of the phenomenon. How is it that an evil against which the opposition is so universal and also deep, refuses to go? That is the question that needs an answer.

The movement against corruption did not begin with the students' agitation in Gujarat. The Indian Press carried reports, on 8 December 1959, that "The President (Shri S. Radhakrishnan) has written to the Prime Minister (Pandit Jawaharlal Nehru) suggesting the constitution of a high-level tribunal to enquire into the allegations of corruption and misuse of position against Ministers, senior officials and other public figures. Earlier Shri D. C. Deshmukh had spoken of evidence being brought to him of corruption in "high place"; and Professor Radhakrishnan, who was then Vice-President, was much distressed over the "crisis of character" which had overtaken the country.

II Corrupt Payments financed by Monopolies

Now, what is corruption? The corrupt incomes we are concerned with are illicit payments made to officials and politicians in power, or payments to party funds, for monopoly documents which bring windfall monopoly incomes. It is a matter of details whether the payments are made directly, through intermediaries or, indirectly, as contributions to election funds or payments at fantastic rates for advertisements in the souvenirs issued on the occasion of Party melas. Payments are made by the recipients of the monopoly documents to those who issue these documents, i.e. the officials, who work under the general or specific directives of politicians in office.

It follows that corrupt payments are part of the monopoly gains. If monopolies did not exist, there would be no monopoly gains and the question of this category of corruption does not arise. Monopoly gains are unearned windfalls, corrupt payments are made to gain these windfalls; and, looking at the phenomenon from the standpoint of accounts they debited, by the recipients of the monopoly documents, to the monopoly incomes. The net gain from the monopoly documents is the windfalls less the corrupt payments

made for acquiring the documents. The transactions, being illicit are, of course not recorded.

III. Corruption from Import Licensing

The most highly sought after monopoly instruments are import licences, as the total amount of the windfalls they bring are enormous. Total import in 1972-73 amounted to Rs. 2,150 crores, of which Rs. 780 crores (36.3%) were on private account and Rs. 1,370 crores (63.7%) on Government account.

The recent Lok Sabha scandal shows that the "premiums" which the licences fetch continue to be enormous. Stray data which appeared in the press confirm this. In the case of copper, the market price is over 3 1/2 times the landed cost*the controlled price, which is based on the landed cost is Rs.10,000 per tonne, the market price Rs.36,000 per tonne. The price of the copper import licences would be, therefore, up to an order of 2 1/2 times the face value of the licences.

The prices of or "premiums" on import licences may vary from 30-35% to five times or more of the landed costs. This meant that, on an average import of Rs. 10 crores, brought windfall profits ranging from Rs.3 to Rs.50 crores, depending on the commodity. At an average premium of 75% the monopoly gain from private sector imports alone will amount to an annual order of Rs. 585 crores

It is not as if nationalization of imports eliminates the windfalls and the corruption. So long as the windfalls obtain, corruption will go with it. Nationalization may shift the recipients of the corrupt payments. The corrupt among the officials and the politicians controlling the operation of STC are now in a position to claim the payments. Alternatively, corruption may change form. The windfalls may get absorbed in over-staffing, raw material leakages, which are but a variant of corruption; or in production inefficiencies.

That the foregoing arithmetic of the gains from import licences is well-founded may be seen from the details disclosed in the Rajya Sabha on 24 December 1969 by Shri R. K. Khadilkar, the then Minister of State for Finance, regarding certain foreign exchange operations of Mrs. Aruna Asaf Ali. She had received, from an undisclosed party, a donation of Rs. 7,95,544 in Swiss francs, apparently for the benefit of Patriot, a daily, and Link, a weekly both Communist papers of New Delhi.

Mrs. Asaf Ali decided to avail of the National Defence Remittance Scheme, which was then in force, to increase the amount of this donation. In terms of the Scheme, she obtained, on the productions of the documentary evidence of the donation, import licences to import — at 60% of the Swiss francs she brought in — Rs. 481,128 worth (at landed cost) of certain commodities. She was not interested in these imports. Her interest was only in the money she could get in the market for the licences. She sold the licences to Messers. J. V. Gokul & Co., Bombay, on 17 May 1966. Incidentally, J.V. Gokul & Co., does not figure in the Bombay telephone directory and the standing of this concern was not easily ascertainable. The licences fetched a premium — the market jargon for the

price of the import licences — of 175% or for Rs. 841,975. And Mrs. Asaf Ali ended up — to the original donation being now added the amount of the "premium" — with a total sum of Rs. 16,43,856, or 205% of the original donation. This sum was used to subscribe to the capital of the firms which owned the two Communist papers.

This doubling trick, a fairy tale come true, produced a minor sensation in Parliament, when it came to its notice, long after the event, in the course of a discussion on the direct taxes paid by Mrs. Asaf Ali. But it is a commonplace of the market for import goods and of the now well-established market for import licences. To quote the Minister of State for Finance, the windfalls, which accrued to Mrs. Asaf Ali, were perfectly "legal" and there was "no mystery" whatever in them.

But all the transactions in the market for import licences are not legal. As a rule, these licences are non-transferable. Though this phenomenon might seem incredible to the public unaware of it, and some visiting experts may be unfamiliar with it, too, it is a major ingredient in the contemporary Indian economic complex. It has ramifications not only in most major sectors of the Indian economy but also in Indian politics. It is, so to speak, an authenticated text-book case of the major source of corruption.

The Alladin's lamp of import licencing, produce fortunes as though from no where, for a large community of importers and dealers in import licences. The cost of production of import licences being zero, the premiums they fetch are windfalls and, when to the gains from private sector imports are added the gains from the nationalized import trade, the total amount of the windfall gains may be of an order Rs.1,600 crores annually.

Unearned monopoly gains on so large a scale cannot be wholly retained by the recipients of the import licences. The inevitable competition to acquire the import licences would necessarily bring a share to those responsible for issuing the licences — the administrators and the politicians. As a practical matter, there is nothing that anyone can do to prevent this. If Mr. A. from among those responsible for the issue of the import licences, is beyond corruption, the only outcome will be that Mr. A. will forego his share of the corrupt payments. Possibly, the shares of B. C. D. and the rest who collaborate in the issue of the licences, would go up. The chances are that these others would conspire to have Mr. A. transferred to another department, in order to make things safe for them. The possibility of the entire body of people, including politicians, responsible for the issue of import licences being beyond corruption is too unreal to merit any analytical notice.

IV. Corruption from Public Sector Contracts

Import licences are not the only gold mine of corruption. Government contracts and contracts in public sector undertakings are among the other documents which are in great demand for the fabulous incomes which they yield. When Rs. 100 crores are accounted to have been "invested" in public sector projects, the whole of it does not go into the projects concerned. Some place the amount actually invested at 60% others at 80%. None at even 90% What happens to the balance? The balance is the windfall of the contractor. For the same reason that the windfalls from import licences cannot be all kept by the

recipients of these licences, the windfalls from the public sector contracts cannot be all retained by the contractors. They have to share a part with the persons whose responsibility it is to accept and issue these contracts. Contractors have to make corrupt payments to the administrators, engineers and politicians concerned before they may get the contracts.

What are the amounts involved? The Rill Report on Currency and Finance for 1973-74 (p.3) places "total public sector Plan outlays in 1972-73 at Rs. 3,960 crores." If contractors have to distribute 10% of these amounts to get the contracts, the total corrupt payments under this head are of the order of Rs. 400 crores. If they have to distribute 15%, corrupt payments in 1972-73 were of the order of Rs. 600 crores.

V. Corruption from Smuggling and other Illicit Transactions.

To this must be added corrupt payments on account of :-

- (1) other control measures — every control creates monopolies and payments are demanded and made for acquiring the monopolies concerned;
- (2) international trade - smuggling in gold, watches, radios, razor blades, clothes, art-silk yarn and such other goods, and smuggling out silver, rice and the like;
- (3) internal trade — smuggling mainly rice and wheat, from the surplus to the deficit states and urban areas;

and

- (4) various administrative services, hurdles or penalties — petty or large bribes paid for pushing files and to the income-tax, customs and police officials.

By the very nature of things, the total amounts of the corrupt payments are not known or ascertainable, even their orders of magnitude. The actual amounts in each corrupt deal can be known only to the two parties to the deal and the intermediaries. But, quite obviously, the totals would be not tens of crores of rupees but several hundreds of crores of rupees.

By far the largest amounts of the corrupt payments would be from import licences, public sector contracts, and smuggling — across our external frontiers.

Any administration exposed to these Himalayan corruption potentialities would succumb to the temptation. With so much money to be had, even the German civil service, which is reputed for its integrity and efficiency, may fall a victim.

If I may quote Haji Mastan Mirza's statement: Smuggled goods do not rain from the heavens, they move on roads. They cannot move so freely without the active co-operation of the officers of the various customs and excise departments.

VI. Need for Policy U-turn

Does it mean that there is no hope whatever of eradicating corruption? The answer is in the affirmative, if the prevailing policies continue. How can corruption be prevented when an import licence — a piece of paper, which costs nothing but the signature of the concerned official to produce — authorising the import of, say, copper worth Rs. 5 crores (etches in the market over Rs. 12 crores. Competition for the document would necessarily bring into being corrupt payments. Schemes to prevent this are not worth a moments' notice. They will not work. The various reform schemes will only shift the parties receiving corrupt payments. Corruption will continue. If, for instance, the issue of import licences is entrusted to an independent Board of men of the highest integrity, corruption activity will move from the Government departments concerned to the independent Board and its staff.

The only hope of eradication of corruption on the current scale is a complete U-turn in our policies — abolition of import control and exchange restrictions, a drastic scaling down of public sector outlays, auctioning away to the highest bidders in the private sector the existing public sector undertakings, removal of the system of permits, licences and quotas as Professor Erhard did in Germany and limiting Governmental activities to their natural sphere.

There is, however, little hope of any U-turn in our policies. The Prime Minister, addressing a public meeting at Mangalore on 11 January 1975, declared that "she would not budge from her party's policies merely for political exigency" she added : we have not done it and we will not do it. We feel strongly about our policies and we are not going to listen to anybody." Corruption being a byproduct of the prevailing policies, this means that corruption will continue; This would not only undermine national character but also economic growth and social progress. It is not for removing corruption that there is great need to adopt these drastic measures. The adoption of these measures is necessary for accelerating economic growth, for reducing and eradicating unemployment, for correcting social injustice and for achieving Garibi Hatao. Removal of corruption is only incidental to the realization of these major national objectives.

Let us illustrate, by reference to import restrictions, the great need for this policy package from the stand point of economic and social progress.

Trade is the spear-head of progress. If a region is isolated from the rest of the world, it would soon shrink back into primitive living, the rapidity of the deterioration in the living standard depending on the size of the community and the rigour with which autarkical measures are enforced.

The trader is the instrument for implementing the theory of comparative costs, which, according to Lord Robbins, is the central theory in economics. The trader buys where things are cheap and sells the commodities purchased where they are dear. By so doing, he benefits both the producer and the consumer; Production expands where costs are low and quality good, in preference to regions (and countries) where costs are high and quality poor, and consumers receive quality goods at low costs, In whatever regions (or

country) they may be produced; The activity of the trader, in this manner, maximises production and consumer well-being. The trader is the key factor in economic development and the spread of mass well-being.

It follows that every cut in imports causes a corresponding diversion of output or of resources away from the export sector into the home sectors and export will suffer. The more drastic the import cuts the more severe will be the adverse effects on exports. There is no escape whatever from this consequence.

India, Pakistan, Burma and Ceylon provide classic examples of the working of these pressures and of their effects on export production, employment and income.

Our theory — shared by many under-developed countries and also by some of their expert advisers from overseas —that, by producing at home substitutes to import goods, we "save" corresponding amounts of foreign exchange does not make any convincing logic. To manufacture these substitutes, we have to draw on resources employed elsewhere, in the present case from export industries. Consequently, when the production of one category of goods, import substitutes, goes up, the production of another category of goods, export goods, suffers: and exports get retarded or decline. This contrary movement between import substitution and export production ensues every time the programmes of import substitution progress.

Therefore, simultaneously with the "saving" of foreign exchange, we incur a "loss" of foreign exchange, the latter being the result of retarded exports. This "saving" and the "loss" must be viewed together, before we may assess the net benefits of import substitution. We have seen that, to fabricate at home goods to replace import goods, we may have to employ, on an average, 75-100 per cent more resources than the cost of the import goods; i.e., we have to withdraw from export production more resources than we save from the reduced imports. It logically follows from this circumstance that exports may decline by much more than the reduction in imports from our programmes of import substitution; which is the same thing as saying that the "loss" of foreign exchange may be larger than the "saving" in foreign exchange. In the prevailing Indian context, the end result of this programme of import substitution may be a deterioration, not an improvement, in our balance of payments position, and, possibly, continued reliance on foreign aid for the solvency of our international accounts.

If we have been able to pursue these self-destructive policies continually for the past two decades and over, it is only because mounting foreign aid has been covering up the mounting balance of payments deficits, which these policies produce. Misplaced American generosity has permitted policy stupidities and we have been (so far) able to get away with it on the balance of payments front.

While this is bad enough, we seek to "earn" foreign exchange through sales of this high-cost output at below cost in foreign markets, the resulting losses being covered (or, as is generally the case, more than covered) by "export promotion incentives", received in cash, in import licences or certain concessions.

This subject calls for separate study. But it will be noted that both these acts of "saving" and "earning" foreign exchange involve inordinate costs to the national economy. It is an interesting enquiry, who bears the burden of these costs? It is not borne by the businessmen and industrialists, who "save" and "earn" the foreign exchange. Import substitution and export production are their chosen vocations, the source of their incomes. When they "earn" or "save" foreign exchange for the "nation", as most of them in like to think, they do not make good the national loss from their activity. The foregoing analysis suggests that the burden of this loss falls on the shoulders of the already indigent masses. And not knowing any other remedy, the harassed workers and other fixed income sectors of the community seek redress in strikes, demonstrations, gheraos and the rest.

Nor has the phenomenal increase in industrialisation added to employment. For employment to increase, we must accelerate the pace of expansion of the national product, as employment is (as already pointed out) a function of the volume of production. The expansion of the national product being slow — thanks to indiscriminate import substitution and other wasteful deployment of resources — as may be expected, we have not been able to absorb into employment even the natural additions to the labour force. Unemployment has grown faster than population, despite the steep rise in investments.

STUDY TOPIC – 25

BLACK-MARKET INCOMES*

Problem of Disposal

We have argued earlier that import licences, Government contracts and other instruments of statist controls over the economy yield phenomenal illicit incomes to the recipients of these instruments. Their total magnitude was placed at an order of Rs. 750 crores annually. The largest bulk of it — an order of Rs. 460 crores — ensued from the traffic in import licences; an order of Rs. 260 crores from contracts in public sector undertakings and other programmes of "development", and the rest from price controls, permits and concessions. We argued, too, that part of these gains was frequently shared with those responsible for the issue of these instruments of controls, middle men and other intermediaries between the corrupt functionaries and the recipients of the instruments.

This phenomenon adds unduly to the undeclared cash transactions in the economy as distinguished from transactions paid for by cheques. First, the recipients of an import licence who has incurred illicit payments for acquiring it, cannot enter these payments in his books. But being part of his costs, he has somehow to recover the amount from the sales of the goods imported against the licence; he arranges to get some of his receipts in unaccounted form i.e. cash. This may take the form of fictitious inter-sales to non-existent parties or receipts of payments partly in cash and partly by cheque, the receipt being made out only for the latter.

Secondly, being illicit earnings, they cannot be entered in the books or figure in the income-tax returns. The earnings must be held in cash — not as deposits with a bank — and payments from them, whether for consumption or for investment, must be in cash.

The amount of the black incomes being so considerable, the attendant necessity for cash transactions has, in recent years, altered the currency component of the Indian monetary circulation. The amount of the currency with the public has risen relatively to the amount of bank money. In 1951-52 the amount of the currency with the public represented 69.5% of the total monetary circulation. Since then the industrial sector of the economy, where the banking habits of the people are better developed than in the rural sector, has expanded by 92 per cent, or at annual rate of 9.2 per cent. Ordinarily, this should have led to an increase in the ratio of bank money - cheque currency — to the total monetary circulation. Yet, it is the currency part of the monetary circulation that has gone up; the latter has fluctuated upward with the intensification of statist economic policies, the ratio of currency to the total money at the close of 1961-62 being 73.20 per cent. The currency

part of the circulation has grown to meet the pronounced increase in black-market transactions.

The annual accruals of illicit incomes are much more than the annual average increase (Rs. 470 crores) in the Indian national income of the decade ending 1960-61. If such large incomes were to remain permanently illicit, their cumulative effect might soon become intolerable, through black-market transactions growing in extent and volume. But "black" incomes are being continually converted into "white" incomes. We may briefly recall some of the devices through which this is affected.

Probably the most common device — because it is the simplest to operate — is to understate domestic expenditures. If a black marketer's house-hold expenditure

is Rs. 3,000 per month, it may be shown in the books as, say Rs. 1000 per month. This would permit monthly drafts on black incomes of Rs. 2,000 to meet house-hold expenditures. Equivalent open incomes being thereby left unspent, they take place of the black incomes utilised (or house-hold expenditure: we have here a case of the conversion of black earnings into white. But the amounts that may be transferred into white incomes in this manner are limited by the magnitude of domestic expenditures and one may have to wait for long for transforming large black earnings.

The application of this technique to marriage expenditures and to the costs of buildings and equipment might enable larger sums being redeemed from the black label. One is often struck by the comparatively low declared costs of impressive residential structures put up by businessmen and corrupt state officials. The explanation frequently is that a house costing, say, Rs. 150,000 is accounted to have cost but, say, Rs. 60,000; the balance Rs. 90,000 represents payments from black incomes. This is a case of Rs. 90,000 of black funds being baptised into white funds, through the former now becoming an openly marketable, asset, a residential building.

Considerable amounts of illicit earnings may be converted into white with the collusion of bullion dealers. An individual Bulchand with illicit earnings of Rs.200,000 may engage in a fictitious "sale" of "ancestral" jewellery of this value to a bullion dealer, Chimanlal. Chimanlal will, then, make an entry in his books of a "purchase" of Rs.200,000 worth of jewellery from Bulchand and of a payment to the latter of Rs. 200,000 in cash, though, in fact, Chimanlal will have neither received the jewellery nor made the payment. This solved the problem of Bulchand. He will have converted Rs.200,000 of black funds into white. He can now deposit the amount in a bank, entering it in his books as the proceeds of the sale of inherited jewellery.

But the transaction presents a problem to Chimanlal, the bullion dealer. His accounts will show a purchase of non-existent jewellery. The security of his position from the clutches of the income-tax people requires that the "purchase" must be balanced by equivalent "sales." To make the fiction realistic, Chimanlal gets the jewellery "melted" at a refinery or gold-smith, the costs of such melting being duly entered in the books of Chimanlal and of the refinery or gold-smith, this operation calling for the collusion of the latter. Having "melted" the jewellery into bullion Chimanlal's straightens out the position in his

books by showing in it "sales" of bullion to numerous benami parties (fictitious individuals). Once the "purchase is cancelled by such "sales", Chimanlals position is well fortified.

For the services thus rendered by Chimanlal to Buichand the former charges the latter a commission at the market rates for such services, the current rates being placed at 8 to 10 per cent of the sums involved. This covers the payments for "melting" the jewellery paid to the refinery or the goldsmith.

Since house construction cannot go beyond needs and "ancestral" jewellery must have limits, black-marketeers may resort to other techniques of changing the table of their earnings. One such is to "purchase" the business losses of individuals. This is a rather complicated operation and needs clarification. A businessman, Premchand, who has suffered a business loss of Rs. 200,000 "may "sell" this loss to another businessman, Mansukhlal, who has black earnings for conversion into white. Premchand would, then make after-the-event entries in his books to show that the losses suffered by him represented the balancing profits of Mansukhlal, the relative transaction being stated to have been effected with the latter. This fiction would enable Mansukhlal to bring out his black funds into the open, as they would be now declared as business profits. Forward transactions especially on the stock-exchange, are rather easily amenable to the application of this technique. It is believed to be in vogue extensively, the transactions being put through specialist brokers and go between who have come into existence to meet the large demand for such services.

Considerable demand exists, too, for the concealment of open incomes, a chief motivation behind this being tax evasion, as the tax rates on the upper-income slabs are exorbitant. We have developed police-proof techniques of affecting this too. These latter are generally the reverse of the techniques for converting black money into white. They include over-statement of domestic and marriage expenditures and of costs of buildings and equipment; and "purchase" of business profits.

With two decades of experience behind us, the needs of the black market have been by now well institutionalised. As has been aptly remarked by one writer, the black-market sector of the Indian economy today is well past the take-off stage of development. The phenomenon is revolting to the national conscience. But there is no remedy to it other than to strike it at its roots — abandonment of the policies of statism. So long as statist policies remain, corruption will remain too.

STUDY TOPIC - 26

GARIBI HATAO*

It is universally acknowledged that the ruling Congress was voted to power both at the Centre and in the States under the powerful influence of the slogan Garibi Hatao. Removal of poverty has been a major element of the economic programme of the Indian National Congress; and we have been at this task soon after we settled down as an independent nation. But, the achievement hitherto has been most disappointing. The slogan was flashed on the horizon in this back-ground of disappointment; and it has brought sensational political success to the Party that did it.

If the political forces mobilized by the slogan are deep-seated and strong, the inference is legitimate that, if the objective is not achieved in reasonable measure and in reasonable time, quite possibly, another dynamic figure might attempt to repeat the phenomenon and throw out of office those who are unable to deliver the goods, and take over the economic and political steering wheel. There are, however, people who think that the Indian masses, like the masses elsewhere, are not only stupid; as in the past, they may blame their suffering on Kismet and may not throw up a spontaneous revolution. If this is true, we need not apprehend any uprising between elections. It does not, however, rule out the possibility of the suffering masses voting for a change at the next general election. But political strategists argue that this is not a very dreadful prospect as, at election time, the ever-changing circumstances, may provide opportunities for other slogans, with similar political windfalls.

We shall here attempt a review of the factors making for Garibi Hatao and indicate, briefly, what the chances may be of the fulfillment of the election promises.

We shall examine the problem of poverty at the microlevel of a family unit. Observe a family moving from poverty into riches. What is the formula or the key rules underlying their success story? Let us attempt to enumerate them.

Rule one : the choice of a vocation which well fits the family talent and environment. Rule two : hard work from dawn to dusk, or even beyond. Rule three : continued vigilance on the cost, quality and price of the output. Rule four : high rate of saving, through restraining the expansion of consumption. Rule five : building up a reputation for soundness and integrity. Rule six : investment of the family resources most productively.

Though economists have unduly mystified the growth process — out of all proportion to the real difficulties of the subject — the rules are not basically different when a community of 1W million families, which is India, wishes to abolish poverty. Though we

have been at this task for two decades now, the real content of mass poverty has shown little change. Indeed, statistics reveal that, relatively to the period before World War II, the position has, probably, deteriorated, as we shall presently see. Internationally speaking, we continue to be among the poorest countries in the world. The World Bank has published an Atlas of income and investment of about 122 countries. We find that our rank is 95th in the list, by the yardstick of per capita income. Our rank is even below 95th, by the yardstick of the rate of growth, the rate of growth being measured by the rate of increase in per capita income.

The audit of the real content of poverty is best conducted by reference to the per capita consumption of the basic needs of life — cereals, pulses, edible oils and cloth. From

Table 1, (p.367) we find that the per capita consumption of cereals remained around 13 oz., per day, from 1954 to 1960. It moved to above 14 oz. in 1961 and remained at about that level for the next four years, with a fall in 1963 and a noticeable improvement in 1965, the year of the bumper harvest. It fell to below the mid-1950's level during the two drought years, has flagged since and is still below the 1964.65 bumper harvest level. The annual average consumption of cereals during the quinquennium, 1961-65, was 14.09 ozs; and during the subsequent quinquennium, 1966-70, 13.39 ozs.

This trend suggests that there has been no improvement in the poverty position — possibly, a deterioration — on the cereals front, since 1965, relatively to the position in the first half of 1960's.

The per capita consumption of pulses remained above 2 ozs., per day, throughout 1950's and the first three years of 1960's. It has slipped downward thereafter, recovering to above 2 ozs. only in 1965, the year of the bumper harvest. Some recovery in cereals consumption in 1971 was counteracted by a drop in the consumption of pulses. The real content of poverty on the pulses front, as in the case of cereals, has tended downward in the second half of 1960's.

The trend in the consumption of edible oils is broadly in line with the trends in the consumption of cereals and pulses. We find from Table 1, that the per capita consumption of edible oils averaged, during the first half of 1960's, 3.16 kgs., per year. It fell below this level during the next five years, being only 2.70 kgs., per year.

Statistics of the per capita consumption of cloth tell the same story. The per capita consumption of cloth is sub-standard. We find from Table 1 that the average per capita consumption of cotton cloth during the first half of 1960's was 14.66 meters. During the subsequent five years, it fell to 13.68 meters, per year.

Many may not be prepared to hear that the per capita consumption of cereals and pulses in India, today and throughout the post-independence period, has been below the rations of "C" class convicts. The "C" class convicts get cereals rations at somewhat above the per adult, or per capita, consumption of the civil population. In other words, it may not be an altogether hopeless idea for one, who has little hopes of growing out of abject poverty, to be a "C" class prisoner than be a free citizen. And what is even more depressing, the

consumption of pulses of the civil population and of the t" class convicts, contrasts: the latter is nearly double the national average. If the convict is a labouring convict, he gets more than double the national average. The same things applies to the consumption of cloth.

We find, too, that the consumption of food and cloth in the post-war period does not compare very well with the consumption of food and cloth before World War II.

What about the Army and Navy? The rations of the Army and Navy are much more liberal, as they should be, than the national average consumption of the civil population or the rations of prisoners. We may regard the cereals rations of the Army and Navy, which is 21 ounces per day, per adult — and they are all adults — as a measure of the nutritional norm. If so, the national average consumption of cereals has to rise by 5 ozs or more, per adult, per day, before we may say that we have removed poverty on the cereals front. The same thing applies to edible oils and clothes: the national average contrasts with the average provided to the Army and Navy.

The explanation for this sorry performance will take longer than can be compressed in an article, but, briefly, this explanation is none other than that we have observed all the key rules of economic growth in their breach. In respect to the choice of occupation — Rule one — we have got lost in the fallacy of basic Industries. Basic industries are not the same set of industries for all countries, for all time. Currently, India's basic industry remains agriculture. It yields not much less than one-half of the Indian national product; and three-fourths of our people draw their income from it. But agriculture never occupied the centre of the stage in our policy making. Industries received priority attention, though, on an average, Rupees one crore invested in agriculture may add to the Indian national product, annually, about Rs.60 lakhs worth of output or over twice the addition from industries; and the employment generated in agriculture may be several times the employment generated in industries, for the same amount of capital invested.

A look at the output and activity per worker in our offices and factories would show how well we have observed Rule two-hard work. How many hours of real, intensive work, have we been putting in, in our factories and offices, during the past two decades? Has the real contribution, per worker, to the Indian national product been tending upward or downward?

The virtually universal inability of our industrial products to make any head-way in world markets, without subsidies, is evidence of the violation of Rule three— continued vigilance on the cost, quality and price of the product.

Our violation of Rule four - high rate of saving - is most pronounced. The rate of saving in India is about one fourth of the rate of saving in Japan. In Japan capital formation may double every less than three years. In India, the rate of saving has been on the decline since 1965-66. In 1970-71, the rate of saving was 8.3 per cent or less than the rate of saving in 1959-60. The rate in Japan is placed at 35 per cent.

In respect to Rule five - reputation for soundness and integrity - I shall only refer to our chronic balance of payments difficulties, a reflex of our own policies. A poor people are not necessarily an insolvent people.

Our violation of Rule six - lucrative investment of savings - is also most pronounced. We appropriate into the public sector no less than two-thirds of the total investment resources of the country; and the contribution of this sector to India's income is less than 20 per cent. Private sector Industry is well looked after. Agriculture is the worst sufferer, though the output and employment potentials of agriculture for the same volume of investment contrast with these potentials in favoured sectors of the economy.

If we continued the same old policy pattern, there is little hope for Garibi Hatao. Hope lies in pursuing the Six Key Rules, which we have outlined above. A close look will show that Japan and the several mini-Japans in Asia, -notably, Hong Kong, Singapore, Thailand and Taiwan - have been doing precisely that.

Table - 1

Per Capita Availability of Food Articles and Cloth

| Year year) | Food grains* (ounces/ day) | | | Cooking fat ¹ (kgs. / year) | | | Sugar ³ | Cloth (metres / | |
|---------------|----------------------------|--------|----------------|--|-----------|-------|------------------------------|-----------------|------|
| | Cereals Man -made | Pulses | Total Total | Edible oils ² | Vanspathi | Total | (Nov. - Oct.) kgs. / year | Cotton | |
| | Fibres 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| 1951 | 11.78 11.0 | 2.14 | 13.92 | 2.7 | N.A. | N.A. | 3.0 | 11.0 | ... |
| 1952 | 11.47 13.5 | 2.09 | 13.56 | N.A. | N.A. | N.A. | 3.2 | 13.5 | ... |
| 1953 | 12.33 14.0 | 2.22 | 14.55 | N.A. | N.A. | N.A. | 4.5 | 14.0 | ... |
| 1954 | 13.68 13.8 | 2.46 | 16.14 | N.A. | N.A. | N.A. | 4.8 | 13.8 | ... |
| 1955 | 13.14 N.A. | 2.53 | 15.67 | N.A. | N.A. | N.A. | 4.5 | 14.4 | ... |
| 1956 | 12.70 N.A. | 2.49 | 15.19 | 2.5 | 0.7 | 3.2 | 5.0 | 14.7 | N.A. |
| 1957 | 13.33 N.A. | 2.54 | 15.77 | N.A. | N.A. | N.A. | 5.0 | 14.5 | N.A. |
| 1958 | 12.35 15.2 | 2.07 | 14.42 | N.A. | N.A. | N.A. | 5.0 | 14.3 | 0.9 |
| 1959 | 13.88 14.9 | 2.65 | 16.53 | N.A. | N.A. | N.A. | 5.0 | 13.7 | 1.2 |
| 1960 | 13.50 15.0 | 2.31 | 15.81 | N.A. | N.A. | N.A. | 4.7 | 13.8 | 1.2 |
| 1961 | 14.06 15.9 | 2.44 | 16.50 | 3.2 | 0.8 | 4.0 | 4.7 | 14.7 | 1.2 |
| 1962 | 14.13 15.5 | 2.20 | 16.33 | 3.2 | 0.8 | 4.0 | 5.7 | 14.3 | 1.2 |
| 1963 | 13.49 15.8 | 2.16 | 15.59 | 3.1 | 0.8 | 3.9 | 5.4 | 14.6 | 1.2 |
| 1964 | 14.05 16.7 | 1.79 | 15.84 | 2.7 | 0.8 | 3.5 | 4.9 | 15.1 | 1.6 |
| 1965 | 14.63 16.3 | 2.16 | 16.79 | 3.6 | 0.8 | 4.4 | 5.0 | 14.6 | 1.7 |
| 1966 | 12.5 16.4 | 1.69 | 14.24 | 2.6 | 0.8 | 3.4 | 5.7 | 13.8 | 1.6 |
| 1967 | 12.59p 15.1 | 1.38p | 13.97p | 2.6 | 0.7 | 3.3 | 5.2 | 13.4 | 1.7 |
| 1968 | 14.00p 16.0 | 1.95p | 15.95p | 3.2 | 0.8 | 4.0 | 4.3 ⁴ | 14.1 | 1.0 |
| 1969 | 13.79p 15.3 | 1.64p | 15.43p | 2.4 | 0.9 | 3.3 | 5.2 | 13.5 | 1.8 |
| 1970 | 13.91p 15.3p | 1.80p | 15.71p | 2.7 | 0.9 | 3.6 | 6.1 | 13.6p | 1.7p |
| 1971 | 14.38 N.A. | 1.74 | 16.12 | 3.3 | 1.0 | 4.3 | 7.3 | N.A. | N.A. |

p - provisional N.A.= Not Available

1 Figures relate to year ending March

2 Includes groundnut oil, rapeseed.....and mustard oil, coconut oil and sesunum oil but excludes oil used for manufacture of vanaspathi

3 Figures relate to sugar season

4 From 1967-68 sugar season is Oct-Sept.

Source: Economic Survey 1971-72: Table 1.7 p. 86 for cols.1,2 and 3

Table 1.9, p.88, for cols. 4,5 and 8 and 9

*Net availability equals Net products plus Net Imports adjusted for changes in Govt. stock
Prouction figures relate to agricultural year July-June; 1951 figures correspond to the production of 1950-51 and so on for subsequent years. Net production, in the case of cereals has been taken as 87.5% of the gross production, 12.5% being provided for feed, seed requirements and wastage

STUDY TOPIC - 27

THE BOGY OF OVER-POPULATION*

Population pressures are frequently deemed to be among the most potent factors responsible for the poverty of the Indian people. Government of India having accepted the validity of this proposition, population "planning" and population control are part of the accepted official policy.

I. Population - Poverty Link :

The link between population and poverty is supposed to be two-fold : the Impact of population, first, on per capita income and, secondly on per capita output. The logic of the link between population and per capita income is, briefly, that, when there are too many mouths to feed, the share of each would shrink, under constant national income (NNI);** or that a rising population would hold back the rate of increase in this share when NNI rises.

This simplistic demographic arithmetic assumes away what must be first proved, before proceeding to present the picture of population supposedly cutting into a family's and an individual's share of what the co-operative enterprise of the community produces. For maintaining the thesis of population being the cause of poverty, the protagonists of this thesis must prove, to begin with, that an expansion of population acts only on the denominator P of the demographic term, NNI/P , where P, the denominator, stands for population, and not on its numerator, NNI, as well.

Arguing on the basis of the fundamental principle that an individual's contribution to NNI determines his share of NNI, let us assume, for instance, that the output of an additional worker to the labour force—ensuing from an expansion of population — matches the per capita income of the pre-existing labour force. Under this assumption, an expansion of population, i.e., an increase in the number of mouths to feed, will not reduce per capita income. The cake of the national income (NNI) will have grown by the number of people claiming a share in it, and an individual's share would continue unchanged, despite population growth. Though NNI would keep moving up, per capita income would be stationary. If we may define a developing economy as one in which per capita income is on the uptrend, an economy in which NM increases but per capita Income is constant, may be designated a stationary economy.

In a truly developing economy, the position should be better. Here, per capita income should keep rising. For this to happen, the flow of savings should be large enough to permit a rising ratio of capital equipment, per worker, (due notice being taken of the

increase in the labour force) NNI would, then, rise faster than population and per capita output and income would move up commensurately.

The position will, no doubt, be different if the expansion of the labour should swell the ranks of the unemployed. But it does not help to clarify an already complex problem - the impact of population on per capita income - to mix it up with another complex problem, cyclical unemployment. The problem of population and the problem of cyclical unemployment must be kept separate, at least for analytical clarity and neatness. In any case, population control is not a solution to the problem of cyclical unemployment.

Rather than discuss basic issues first, it is most unfortunate that popular writers and also demographers should generally skip these issues altogether, and right away proceed to formulate prescriptions for population control as a remedy to Indian poverty, taking it for granted that population has produced poverty, i.e., that the numerator, NNI, remains unchanged when the denominator, population, increases. We seem to think almost as though labour was not an essential factor of production and that it would make no difference to the stream of the national product if the labour force was cut down. As Professor Cohn Clark and other critical analysts have pointed out, this presumption does not hold true of live economic models. In most economies, the developed and also the under-developed, both numerator and denominator move upward, under dynamic conditions. In a truly developing economy, the numerator rises faster than population and per capita income moves up; in a stationary economy, the numerator keeps pace with population and per capita income remains constant.

II. Marginal Productivity of Agricultural Labour :

The untenability of the argument of Indian poverty being related to population pressures, gets reinforced when we examine the second aspect of population pressures, the impact of population on per capita output. Some theorists have tried to maintain that, in under-developed countries generally, population pressures on agriculture are among the hurdles which detract from a rapid increase in per capita production. They have argued that, because of over-population, "people actually get into each other's way" and that, consequently, "the marginal productivity of labour, over a wide range, is zero", or may even be negative"; so that, "even with unchanged techniques of agriculture, a large part of the population engaged in agriculture could be removed without reducing agricultural output". This dismal model of a zero or negative marginal productivity of labour does not apply to India today, if, indeed it ever had applied anywhere. The number of workers on Indian farms generally, is, no doubt, much larger than is usual under conditions of mechanisation of agriculture. But the larger labour force on Indian farms is a case of labour substituting (acutely) scarce capital. It is not by any means evidence of the marginal productivity of labour being near-zero or negative, though this productivity (under the more common Indian conditions) may, indeed, contrast with the marginal productivity under mechanisation.

Leaving alone the phenomenon of unemployment, what obtains in India today, in the rural sector, is a severe seasonal scarcity of agricultural labour, over virtually all parts of the country. It is a common enough experience that, during busy seasons — at the time of

sowing, weeding or harvesting — cultivators experience labour scarcity, which they try to cope up with, by hiring labour, in addition to every member of the family, men, women and children, working from dawn to dusk or beyond. The seasonal pressure for labour is evidenced by the rise in wages during busy seasons.

If the marginal productivity of workers in the family were, zero or negative — because their number was too large -- why should all of them work from dawn to dusk ? Some of them might as well take a holiday -it should make no difference whether the holiday is taken during the busy or dull part of the year — as, ex hypothesi, an increase in the number of hours of work cannot add to output; it may, indeed, reduce output. In such a context, why should a cultivator at all hire labour? If the marginal worker-productivity is nil or negative, how could any cultivator pay wages to hired workers and still continue to remain in business? Quite obviously, the concept of workers "actually" getting into each other's way is but a sensational piece of writing, though it has received more serious attention than it merits. It is not true to the facts of Indian agriculture.

The busy seasons are critical periods in agriculture. Neglect of cultivation during these periods would make a lot of difference to agricultural output and, as agriculture is a major sector of the Indian economy, also to NNI. The loss in output would contrast with the cost of the neglected effort. In the prevailing Indian context of severe seasonal scarcity of labour, it follows that, if some of the population engaged in agriculture is taken away from the farms, there would ensue neglect of cultivation and loss of agricultural output, with debit effect on per capita NNI.

This is not to argue that, currently, agricultural activity in India is not faced with a problem of surplus labour. But this surplus is seasonal and the solution to it does not lie in -removing" a "large part of the population engaged in agriculture". To do so would be disastrous to agricultural output and to Indian economic development. It would accentuate rural poverty, if, as is most likely, the loss in output should contrast with the wage costs of the labour force removed from agriculture. The only sound way of tackling this problem is via the implementation of the basic doctrine that the (expansion of) employment is a function of (the expansion of) GNP.

This doctrine has applicability whether unemployment is open or concealed. It will help to absorb both categories of unemployment in the agricultural sector, if agricultural output is stepped up, for which abundant untapped potential exists. This calls for the removal — not of part of the agricultural population but—of the various hurdles to agricultural development. The foregoing discussion demonstrates that population pressures are not one of these hurdles.

III. Causes of Backwardness of Indian Agriculture:

The list of the factors variously held responsible for the backwardness of Indian agriculture is quite large. It includes (a) the technological limitations or deficiencies in respect of, among other things, seeds, fertilizers, soil culture and management (including conservation measures to prevent soil erosion and the like), irrigation, weeding, crop rotation and pest control, (b) shortages or delayed arrivals of input supplies, (c) insecurity

of land tenure, which prevents peasant farmers from getting deeply interested in long-term land-improvement measures, (d) poor transport and communication, (e) inefficient or inadequate storage and marketing facilities, (f) unduly high interest rates on farm loans, (g) exploitation of farmers by middlemen and foodgrains traders, (h) wide fluctuations in prices, regional and seasonal, (i) fragmentation of land, (j) population pressures and (k) the human factor, including illiteracy, fatalism, inertia, belief in the sanctity of cattle and such other subjective attributes of Indian agricultural entrepreneurs (farmers and peasants) and of farm labour.

These handicaps may be divided into two broad categories : (A) human and traditional factor, (j) and (k) and (B) material and institutional factors, (a) to (i). Both categories of handicaps are of general applicability to the Indian economy as a whole. Neither of them is regional or communal in its operation, nor restricted to any particular crop or crops.

The backwardness of Indian agriculture cannot reasonably be attributed to the subjective qualities of the Indian farming community, any more than the church-going (or the opposite) qualities of farmers in wheat-belt of USA, or the belief in Shintoism of farmers in Japan, can be advanced to explain the high average yields of foodgrains in these two countries. It is not as if the religious faith and superstitious beliefs of the Indian peasants and farmers and of the Indian people are destined to keep them at or about the breadline. The spread and the remarkable success of the use of the High-Yielding Varieties (HYV) of foodgrains is sufficient demonstration that the handicaps covered by factor (A) above is not a major obstacle to the rapid growth of Indian agriculture.

To draw from recent events, the reaction of the Indian farming community to the PL 480 dumping of wheat, and later to the cessation of wheat dumping, was not fatalistic. They reacted very much like seasoned entrepreneur farmers. They showed that they are eminently price sensitive.

With the coming of PL 480 dumping in August 1956; wheat farmer, sensing continued price repression, reduced the area under wheat by 1.8 million hectares, in the very next season, and the wheat output declined by 1.4 million tonnes. During the three years, 1963-66, wheat prices rose by 64 per cent. Yet, the wheat average continued to decline, as other crops yielded better returns. With the end in sight of PL 480 dumping in 1967, the area under wheat spurted up by 2.2 million hectares in 1967-68 and wheat output by 5.2 million tonnes. The output of wheat more than doubled in 5 years to 26.5 million tonnes in 1971-72.

Clearly, therefore, Indian farmers and peasants are no less interested in raising two blades of cereals where only one grew before — thereby to step up the incomes at the disposal of their families — than farmers in materially advanced countries. It is incorrect to think that the progress of Indian agriculture is being held back by any contemplative or religious preoccupation of the Indian people.

If, indeed, this were the case, it has not taken longer than six short years for 40 per cent of wheat farmers, 20 per cent of rice farmers and 15 per cent of bajra farmers — who have adopted HYV seeds — to grow not of the supposed influence, on their farming activities,

of their traditional beliefs and subjective qualities which, visiting experts tell us, are inimical to economic growth. From the rapidity with which HYVP spread in Ludhiana, it would seem that farmers in this district took even less time to emancipate themselves.

The hold of tradition on the life and conduct of the people is generally stronger in the South than in the North. Yet Tanjavur farmers were not behind Ludhiana farmers in adopting high-yielding varieties of seeds. There was a mass conversion of land under rice in Tanjavur from one crop to two crops, with the coming of the HYV rice strain, ADT 27, the double cropped area rising from 1/4 to 3/4 of the total area, of 1.2 million acres under rice in the district.

IV. Capital Starvation of Agriculture :

A scrutiny of the second category of hurdles, category (B), in the way of agricultural development — the material and institutional factors — shows that most of these hurdles relate in essence, to the flow of capital into agriculture. This is obvious in respect of (a) the technological limitations and deficiencies, and (b) shortages and delayed arrivals of the inputs. Better seed, more fertilizers, better irrigation, etc., which factor (a) covers, demand more finance than the cultivators are able and willing to put together at the prevailing interest charges; and shortages and delayed arrivals of input supplies, (b) frequently represent shortages of circulating real capital and insufficiency of the administrative and the organizational set-up-which, too, more often than not, are but manifestations of resource scarcities — responsible for ensuring an adequate and timely flow of input supplies to farms.

This is obvious also in respect of (c), (d), (e) and (f), Insecurity of land tenure (c), prevent peasant cultivators from putting sufficient finance into long-term land improvement, which a long-term view of their business may call for, Poor transport and communications, (d)- which link farms to local, regional and national markets, both in respect to purchases and sales — and poor marketing and storage facilities, (e), are cases of insufficient overhead capital investment in agriculture. And unduly high interest rates, (0., i.e., a contrast in the interest charges ruling in the market for farm loans from that in other money markets, is specific evidence of agriculture receiving less than its due share of national savings.

Exploitation by middlemen and foodgrains traders, (g) th) and, wide price fluctuations between seasons and regions, are among the major handicaps which dampened the developmental efforts of cultivators. Exploitation by middlemen and traders is made possible by the weak economic holding power of cultivators. When the crop is ready for the market, the weight and pressures of their financial liabilities — the service and amortisation claims on account of outstanding credits and loans — together with, as sometimes happens, the needs of a marriage or other ceremony in the family, compel cultivators to release the harvest on the market at post-harvest prices, which are generally much below the seasonal average prices. Harassed by shortage of funds, they are unable to hold the harvest for a recovery or advance in prices. This may be due to inadequate storage and marketing facilities, another manifestation of the niggardly flow of capital into agriculture.

Undue regional price variations — when they are not the out-come of movement restrictions between States and food zones — generally reflect lack of integration of regional markets into national markets, usually the result of deficiencies in transport, communications, grading and standardisation. These deficiencies are but specified cases of inadequate investment of capital in agriculture. Fragmentation of land into uneconomic units, (i), is generally a reflex of lack of capital on the part of descendants, which renders a splitting of the estate into uneconomic units unavoidable. In the event of adequate funds being available, some descendants may opt for cash payments and thus save the estate from uneconomic splitting.

VI. The Need for Basic Policy Change:

The responsibility for building up these handicaps is wholly ours, after we attained political independence. Strangely, instead of removing the handicaps, we have deliberately chosen to add to them, and in an organised manner, during the past over two decades. The hope and chances of removing the handicaps, and of the country marching forward, must be in proportion to our success in re-orienting our policies. If the prevailing policies, which have failed to deliver the goods, continue, there is little hope of progress; on the other hand, the situation may continue to deteriorate.

The whole phenomenon — the deteriorating economic scene and the poor, prospects of improvement — hinges on the system of resource allocations. Under the prevailing system, the public sector, which accounted for 3.5 - 6.3 per cent of the net national product, appropriates 60-65 per cent of the total investible funds; and the private sector, which accounted for 87-92 per cent of the national product, has some how to make do with the balance of 35- 40 per cent. As industries receive priority resource allocations, agriculture has been hit hard. To add to this, the flow of funds into farm finance has been obstructed by legislative shackles on the activities of money lenders, which has caused the elite among them to abandon the business of farm finance! and on the transfer of land to non-cultivating classes, which has impaired the credit-worthiness of farmers.

Thus, the crux of the problem is in first, unduly large appropriation of investible funds by the public sector and secondly, legislative hurdles in the way of the flow of capital into the market for farm credit. That population is not a factor hindering economic growth is evidenced by comparing statistics of the growth of population and of the expansions of per capita national product in a number of countries. Taking a selection of 13 underdeveloped countries, round the globe, we find that during 1960's (1960 to 1969) in India, population rose by 22.1% and GDP at constant prices by 19.1%. In 12 other countries, though population rose much higher, GDP rose faster than in India.

In Korea, population rose by 26.1% while per capita GDP rose by 121.8%. In Taiwan population rose by 30.1% while per capita GDP rose by 99.6%. In the Middle East, in Iran, population rose by 29.6%, per capita GDP by 61.5%. in Iraq. 32.8% and 38.07% (respectively). In the New World, Mexico. Population rose by 31.5% per capita GDP by 53.1%. In S. Africa population rose by 34.00% GDP per capita by 45.2%, in Ecuador population rose by 35.1% and GDP by 26.4%.

In Malaysia population grew by 30.8% and GDP by 26.3%. In all these countries, though population rose faster, per capita GDP rose faster too. If population was potent factor hindering growth, then countries where population rose faster, should have a slower pace of growth (GDP per capita) than India. But this is not the case.

In a selection of 12 countries round the globe Columbia, Equador, Iran, Iraq, Kenya, Korea, Malaysia, Mexico, Philippines, Taiwan, Thailand - the per capita Gross Domestic Product (GDP) rose faster than in India though the pace of expansion of the population in all of them was faster too.

Government's birth control programme not only conflicts with the traditional ethics and philosophy of this land, it merits being scrapped because, it is altogether bad economics. The moneys wasted on it, should be put to better uses.

STUDY TOPIC - 28
INDIAN NATIONAL INCOME AND POPULAR
WELL-BEING

Being without basic data on income distribution, we have to derive the changes in the pattern of income distribution from such indirect evidence as is available. The figures of per capita income in 1950-51 and 1961-62, indicate the extreme poverty of the Indian people. Unlike in most parts of the world, Indian national income has been rising at a disappointingly slow pace. Mass poverty, striking contrasts of individual incomes, and unemployment, are among the principal problems confronting the Indian economy.

The solution to all three problems of poverty, income inequalities and unemployment - is in a rapid expansion of production. Expanded production provides the wherewithal for abolishing poverty. Employment being a function of the national product, the faster the national product grows, the faster will unemployment be liquidated. Reduction of income inequalities is best achieved by lifting up the incomes of the poor through expanding the national product not so much by levelling down the incomes of the rich.

But not only is the rate of increase in Indian national income disappointingly slow; the increase in the national product - 47 per cent since 1950-51 - is not a dependable measure of economic development, the latter being defined as an increase in the level of consumption of the masses of the people. Production being influenced by the planning commission, not directed by the free market mechanism, a distinction must be made between an expansion in the physical volume of the national product and its consumer goods content, the test of economic development being in the latter. To assess the progress in mass well-being, Indian national income statistics must be modified by four deflators.

First, they must be adjusted for the rise in population of 22.0 per cent during the past decade, as per capita income is a more meaningful indicator of national well-being than the national product. Per capita income rose by 18.5 per cent, from Rs. 247.5 in 1950-51 to Rs. 293.4 in 1961-62.

Secondly, due allowances must be made from the national income statistics for (a) the unduly large output of non-consumer goods and the creation of excess production capacities and (b) (or the undue additions to inventories. Excess production capacities are estimated at 35 per cent in irrigation works and at an average of 40-50 per cent in 40 industries, Additions to inventories are inevitable under inflation, though their quantitative assessment may not be possible.

Thirdly, as the well-being of a people must be assessed by the economic condition of the masses, due allowances must be made from the overall magnitude of the national income for the considerable sums of unmerited and illicit shifts of incomes which have taken place during the past decade from the masses of the people in favour of the upper income groups. Such income shifts have taken place as result of inflation, from controls and from an undue expansion of the public sector. In recent years, these income shifts may be of

annual order of Rs. 7.5 billion or of about the same order of magnitude as the rate of increase in the national income, which averaged Rs. 7.17 billion per year during the past seven years.

The inflationary expansion of money - if this may be defined to be expansions of money in excess of the needs of expanded production at constant prices - during the seventh years ending 1961-62 amounted to an order of Rs. 6.17 billion or about Rs. 880 million per year.

Among controls, the largest income transfers ensue from imports licenses. Those licences on account of private imports during the seven years ending 1961-62 averaged Rs. 6.3 billion per year. Import licenses fetch prices of 30 to 500 per cent or more of their face value, depending upon the commodity concerned. Assuming an average price of 75 per cent, total proceeds from these licences may be of an annual order of Rs. 4.7 billion. The largest bulk of the value of these licences accrues to the comparatively well-to-do people — the corrupt functionaries of the State, the intermediaries and the recipients of the licences.

Public sector investment outlays have shot up from Rs. 19.6 billion in the First Plan to Rs. 46.0 billion in the second and are placed at Rs. 80.5 billion in the Third. When Rs. 1 billion are accounted to have been "invested" in public sector projects, the full amount of Rs. 1 billion does not, in fact, go into the projects concerned. A part, varying with circumstances, gets transformed into private incomes, the illicit payments made for obtaining business by the contractors and successful bidders in the tenders. Assuming the latter to be taking place at an average of 20 per cent of "investments", illicit or unmerited earnings under this head, which again accrue to the better-to-do people, may be of the order of Rs. 1.8 billion per year during the second plan period.

Fourthly, national income at constant prices is arrived at mainly by deflating national income at current prices by the index numbers of prices. The latter understate the actual price position, as where price controls apply, they are based on controlled prices. which are generally lower than free market prices. The use of these defective index numbers has led to the national income at current prices being insufficiently deflated and national income at constant prices being correspondingly exaggerated. On the other hand, incomes under small enterprises, in particular power-loom output, fishery, forestry, animal husbandry, and professions, in particular, medicine and law, are understated, the result mainly of manipulation of income-tax returns. On balance, however, national income at constant prices may embody some element of exaggeration.

The net result of these allowances may well be that the well-being of the masses of the people has stagnated during the past decade of planning. Evidence of stagnation is in the availability of food, clothing and shelter. Per capita "availability" of food grains, per day, fluctuated downward from 15.7 ozs. in 1954, to 14.0 ozs. in 1958, recovered to 16.2 ozs. in 1961 and was at 15.8 ozs. in 1962. Jail rations are 16 ozs. army rations 19 ozs. and the nutritional norm. 18-19 ozs. During the five years ending 1960, per capita consumption of cloth per year declined from 14.66 meters in 1956 to 13.98 meters in 1960. The availability of house-room, as reflected in the national income from house property, rose

much slower than the rate of increase in population and as a percentage of national income declined from 4.3 per cent in 1950-51 to 3.8 per cent in 1961-62.

If the consumption of food and cloth by the masses of the people has remained stagnant, since simultaneously the net national output rose somewhat faster than the rate of increase in population, the inference is that there has taken place a shift of income to well-to-do groups. This inference is in line with the view we have taken above; It is also supported by the pattern of the output of consumer goods. The output of the consumer goods used by the masses of the people has risen much slower than the output of consumer goods used by comparatively better-to-do people. Social injustice is reflected, too, in the changes in the price structure. The prices of food articles and cotton textiles have risen much faster than prices of luxuries and semi-luxuries.

In the field of employment, the achievement of the past about a decade seems to be negative; despite a steep rise of 110 per cent in the investment outlay from Rs. 37.6 billion in the First Plan to Rs. 79.6 billion in the Second - the expansion of employment has probably lagged behind the expansion of the labour force.

STUDY TOPIC - 29

INTERNATIONAL COMPARISONS OF NATIONAL INCOME STATISTICS*

Nearly all member countries of the International Monetary Fund, which number B6, have now a running series of national income statistics, available for ready reference in the International Financial Statistics. But international comparisons of these statistics may not be strictly valid or safe. First, the techniques and the principles of their computation may vary. Secondly, the goods and services content of a given unit of income may not be the same in all the countries whose national income statistics are brought under comparison.

The first limitation may, in due course, cease to have full validity with the increasing adherence by countries to international conventions in the use of national income concepts, terminology and techniques of their computation. The Communist countries being show or averse to accepting these conventions, this limitation may persist in this comparison of the statistics of the free and the communist countries.

The second limitation may have much wider and more lasting applicability. In the under-developed countries, the comparatively better-to-do groups of individuals may be able to command various personal services which may be generally beyond the reach of individuals in the same income categories in the richer countries. Thus, in Western Europe, North America and in the highly industrialised parts of the rest of the world, most people generally polish their own shoes, wash their own clothes, do the house hold chores and the gardening work themselves, carry their own baggages in the air-ports and railway station and so on. In the economically under-developed countries, middle-class people may not like to be seen doing these things themselves, apart from fashionable hobbies such as light gardening, now and again.

The explanation lies perhaps in the comparative riches of the industrialized countries. Riches imply high wages, wages being the workers' share of the national income. The richer a country the higher the wages and, therefore, the more costly are personal services. Under the compulsion of costs, more and more people prefer to "do-it-themselves" as national income grows, using the income thus "saved" to meet the endless series of other needs. Every house-holder becomes as a result a general mistry (mechanic) — he knows something of plumbing, carpentry, cycle and car repairs, house painting and he may mend and use garden tools with striking dexterity — with the garage or basement as his workshop; and every house-wife becomes a maid-of-all work, demanding and getting the meek assistance of the husband and teen-age children in the discharge of routine house-hold drudgeries. Dishwashing and carpet cleaning are not strange experiences to the gentlemen of England, of Western Europe, of the more prosperous parts of the Commonwealth and of U. S. A. with domestic help at 4s. an hour and the laundering of a shirt costing 2s.6d.; self-help in house-hold work becomes a natural and normal phenomenon.

Growing riches and higher wages also explain-while being at the same time an evidence of growing riches-the manifold house-hold gadgets and semi-processed foods, which reduce the time and the trouble of the daily cooking and of the other tyrannies of the house-wife. As national income moves up the ladder of affluence, the demand for the gadgets and the semi-processed foods becomes near universal. The disappearance of the house-maid kept pace with the emergence of the washing machine, the vacuum cleaner and the electric heaters; these, together with the television set and the family car — all adults in the family use it by arrangement — are the new symbols of good living for a growing proportion of the masses.

Democracy and Communism may not have succeeded in bringing into being a class-less society, of which their prophets are never tired of elaborating on. But the Western world today is a servantless society of super-markets. The term servant has almost disappeared from common usage; the rare practitioners of this unedifying profession wish to be described by other names and may like to refer to their employers as "clients"; like the legal luminaries and the Harley Street specialists, it is but the few that can afford a full time help in the house, except, of course, under duress such as illness or other disability. Shop assistants being expensive, the customers serve themselves in the super-markets; they pick up into trollies their weekly assortments of the standardised mass produced goods of daily consumption.

Possibly, the virtual absence of the servant class may be a factor holding back the continued acceleration of the economic growth of the high income communities. It is quite common for the people of talent to be engaged like common workmen much of the time at home and frequently like secretaries part of the time in the office; though some physical work may be re-creative and health-giving, an undue imposition of it, on all may cost heavily to the national product; if relieved of some of these drudgeries, they may devote more time to pursuits in their special fields with much better advantage to themselves and to the nation product. If so, the large Negro population of U. S. A. may be viewed as a national asset speeding up the economic growth of the country. By taking

over work which any man can do, they enable people which high production capacities to give to the community the full benefit of their abilities.

This reasoning suggests that a relaxation of the restrictions which prevail in some high-income economies on immigration from the under-developed parts of world may be in the long term interests of the richer countries themselves. This may permit the most advantageous deployment of the human resources of the country. The mass support to the restrictions on immigration, like the protectionist measures on commodity imports, would seem to rest largely on the common fallacy that they are essential to the preservation of employment and incomes at a high level. The relaxation of the restrictions on immigration may also help to relieve the population pressures in the under-developed countries.

On the other hand, in the industrially advanced countries manufactured goods are generally cheaper and of better quality. If the services content of the same range of income is larger in the under-developed countries, its manufactured goods content may be larger in the industrially advanced countries; this may militate in the opposite direction international comparisons of national income statistics.

This last factor has assumed great importance in recent years. Indian visitors to the United Kingdom who run a house-hold establishment of their own, may find that the living costs in London are perhaps about the same as or may be even somewhat less than, in Bombay, Calcutta or Delhi. Rents seem lower, the cost of milk and milk-products may be about the same and manufactured articles are distinctly cheaper.

This strange experience is, however, deceptive. It is a misleading outcome of the unrealistic rate of exchange between rupees and sterling. A three-bed room house costing E 50 a month, a refrigerator of the same value or the miscellaneous house-hold expenditure of a like amount, at the present exchange rate each amount to Rs. 666.50. But it would be wholly delusory to jump from this to the conclusion that living costs in U. K. compare very well with the living costs in India. The pound sterling is worth much more than Rs. 13.33, its value in the official market. In the free markets for foreign exchange abroad, and in the black market in India, it is at a substantial premium, being at one time rated around Rs. 20. Even the free-market rate does not indicate the correct (the equilibrium) value of sterling in terms of Indian money. If the equilibrium rate should be say, Rs. 25= 1, an expenditure outlay of f 50 on rent, on a refrigerator or an house-hold needs at once become worth Rs.1,250 each and the false picture of the comparative cheapness of London changes.

The optical illusion of the cost distortions ensuing from the exchange rate over-valuation apart, ordinarily, the price disparity of manufactured goods as between the industrially advanced and the under-developed economies may not be larger than the cost of transport and the incidental payments, which, highly protected commodities apart, may not be very considerable under normal conditions of freedom in international trade. More usually, therefore, the goods and services content, of the income of the middle-class and the upper-income groups may be noticeably higher in the under-developed economies than in the industrially advanced ones. A family with an income of Rs. 500 per month in many

respects is perhaps more comfortable in India, Burma, Ceylon and Pakistan than a family with the same income in the industrialised west. In the former, such a family may have a part-time servant doing the more irksome house-hold jobs; in the rural areas it may own a house, though it may not have much of furniture. A millionaire in the under-developed countries probably lives in many respects like a multi-millionaire in the high income economies of the West.

Despite these limitations of the international comparisons of national income statistics, India would seem to be about the poorest part of the World. Viewing the Indian people as a whole in 1960, per capita income in India was about Rs. 294. In the same year per capita Income in U. S. A., was about Rs. 10,900, in Japan about Rs. 2,110, in Sweden about Rs. 8,500 and in Israel Rs. 2,825.

Per capita income in India has also been rising at about the slowest pace in the world; from 1951 to 1959 this rise averaged a mere 1.3 per cent per year, the corresponding percentage being 7.2 in Japan, 6.1 in West Germany, 5.2 in Italy, 5.0 in Israel and 3.6 in Burma. Few countries had a smaller rate of increase than India.

This underlines the immensity of the task before the Indian economy. It has a long way to go before the masses of the people may reach and move beyond the line of reasonable comfort for all; in the meanwhile, the industrially advanced parts of the world will have travelled leagues further ahead. The gaps between us and the others will have widened, unless the progress of the latter should get halted and reversed by a catastrophe or by the adoption of statist "planning".

This underlines, too, the great need to step up national savings and to avoid wasteful uses of savings, as economic development is a function of wisely invested savings. Our policies need to be oriented to stimulate savings and to ensure the most productive investment of savings. This is far from being the case. The Indian economic scene presents a picture of private and public extravagance, In the context of an acute scarcity of capital both in the private and the public sectors. This is largely the outcome of misguided policy measures.

STUDY TOPIC - 30

CHALLENGE OF UNEMPLOYMENT*

Unemployment is, among the two major problems confronting this country today, the other major problem being poverty. From what has been stated here and from what has been written elsewhere, unemployment has been on the increase, at a phenomenal pace. Unemployment is an aspect of poverty, in the sense that we cannot tackle the one without tackling the other also; and the solution to the one, will provide a solution to the other as well. References to the extent of unemployment, read horn official documents, saying that unemployment passed on by each plan to its successor, has been larger than unemployment inherited by it from the preceding plan. In other words, unemployment has been growing faster than population; and in the context of conscious efforts in the direction of expanding employment.

Unemployment has grown in the context of a very impressive increase, in investment. Investment has multiplied by more than three times and we have been making efforts to tackle unemployment — to increase employment, through increasing investment — since the early 1950's.

If unemployment has grown despite an increase investment apparently, something is wrong somewhere.

Poverty is such a dominant feature of the Indian economy today that, for some considerable time, Indian economic progress can be measured in terms of consumption, per capita, of the basic needs of life: cereals, pulses, edible oil and the like. What is the evidence on this subject? We have two official references to pre-war per capita consumption, one in Reserve Bank of India Bulletin and other in Bulletin on Food Statistics. We find that in the immediate pre-war quinquennium, the consumption of cereals per capita, per day, was 16.3 ounces. In the post-war period, we have not come anywhere near that figure, except perhaps in 1964-65 when we had a bumper harvest. Before the war again, the consumption of pulses was somewhat less than in the early fifties. But, the increase in the consumption of pulses does not compensate for the fact that consumption of pulses does not compensate for the fact that consumption of cereals is below the pre-war level. In a poor country where the masses of the people are vegetarians, by necessity or choice, pulses provide protein and it is most distressing to see that not only the consumption of cereals but also the consumption of pulses are below nutritional norms.

Many may not be prepared to hear that the per capita consumption of cereals and pulses in India today and throughout the post-independence period, has been below the rations of 'C' class convicts. The 'C' class convicts get cereals rations at somewhat above the per adult, or per capita, consumption of the civil population. In other words, it may be good realism on the part of a person, who has little hopes of growing out of abject poverty, to be a 'C' class prisoner, than be a free citizen. And what is even more depressing, the consumption of pulses of the civil population and of the 'C' class convicts, contrasts: the latter is nearly double the national average. If the convict is a labouring convict, he gets

more than double the national average. The same thing applies to the consumption of cloth. We find that the consumption of cloth in the post-war period does not compare very well with the consumption of cloth before the war.

What about the Army and Navy? The Army and Navy are certainly better off as they should be, than prisoners or the civil population: We might say that the cereals rations of the Army and Navy, which is 21 ounces per day, per adult, — and they are all adults — is a measure of the nutritional norm. If so, the national average consumption of cereals has to rise by 5 ozs. or more per adult, per day, before we may say that we have removed poverty on the cereals front. The same thing applies to edible oils and clothes: the national average contrasts with the average provided to the Army and Navy.

The problem of poverty brings to mind the phenomenon of the growing affluence of a minority in this context of continuing or worsening mass poverty. We have ocular as well as statistical evidence of this phenomenon. Not only the affluence of this minority has grown; their number has grown, too. Ceilings on wealth and income have mass appeal and mass support; and, hence, political parties have come to advocate it. But will these ceilings solve the problem of poverty and unemployment? If the middle and top incomes are levelled down, how well off will the masses be? This device is sometimes suggested by Communists. The question has been already answered by the Central Statistical Organisation. This answer is in the concept of per capita income, at constant prices. Per Capita income is an exercise of what the share of the average Indian citizen would be, if the incomes of all of us, the rich, the middle classes and the poor, were pooled together and divided equally among the population. The share of the individual then would be Rs. 28.30 paise, per month, or, per family of 5, Rs. 141.50. Speaking in real terms, we will all, then, get less than the rations of 'C' class convicts in respect to cereals, pulses, edible oil and cloth. This may give sadistic satisfaction to some, that everybody is down on the floor. But Indian poverty will continue.

There is, however, another solution to the problem, a nobler and an honourable solution. And that solution is not to level down but to level up. This levelling up can be done as there is abundant scope for doing so, through multiplying production. I use the word multiply deliberately, as scope exists for multiplying production over a wide front in the Indian economy. This will not only solve the problem of poverty; it will also solve the problem of unemployment. I say this because employment is a function, not of investment but, of production. If the overall national product expands, overall employment would expand with it. It is not investment that produces employment; it is national production that provides employment.

Our own experience — and ours is a classic experience — has shown that employment does not grow with investment necessarily. Though investment has multiplied about three fold, production is stagnant and unemployment is increasing. Take a close look at our production statistics in 1960's, the first development decade. We find that per capita production remained very nearly stagnant during this decade, except during years when it was pushed up, not by man but by God. It was pushed up in 1964-65, when, because of good weather conditions, GNP shot up. This was followed by two drought years — the

worst droughts in 50 years, we are told. There has been little rise thereafter, neither in the national product nor in the per capita availability of the necessities of life. Some improvement, however, is apparent in 1970-71, for which year we have preliminary figures. The per capita income and consumption of 1970-71 is somewhat above that of 1964-65. Otherwise, the upper limit in 1960's was determined, not by the effort of man but the Meharbani of the weather God.

Now that is not a very attractive picture. The inference that this data background suggests — it is very difficult to resist this inference — is that investment has risen only in account books, i.e., investment, in reality, are not investments; or, in the alternative, capital has not been productively invested. If you dig earth for water and you do not strike water, for the accountant it is an investment all the same. For the economy it is waste of resources. It is quite conceivable that much of our investment during the

past about two decades has been of this character. It is also conceivable that what is shown as investment in the account books is really private income. The device converting investment into private income is, by now, widely understood. Much of the investment becomes income of this kind in the public sector. This is not to say that such things do not happen in the private sector. But, in the public sector, when a crore of rupees are accounted to have been invested in a project, how much of brick and mortar and other things really go in It? Some put it at 60 lakhs, others at 80 lakhs. Nobody puts it at 90 lakhs. The rest is distributed as corrupt payments. If so, when a crore of rupees is supposed to have been invested, the real investment may be somewhere between 60 per cent to 90 per cent of this sum. The rest, 10 to 40 per cent, is "kick- back" private income of somebody, somewhere.

Now, we have here a case of domestic savings and foreign aid — and the crore of rupees invested in the public sector constitutes domestic savings or foreign aid — getting into the pockets of people and becoming consumption income and consumption expenditure, through the accounts books. In other words, we have here a device, a formula, not for converting income into saving, but for converting savings into private income. And this is precisely a formula that anyone could think of to create unemployment. The policies, which we have pursued during the past about 2 decades, are policies which are designed to convert savings into consumption and therefore, to create unemployment.

If we wish to tackle the problem of unemployment, we have to create employment. And what do we mean by creation? What is the Samagri, the material, we require for its creation? The Samagri is savings. If we increase the flow of savings and correspondingly increase the volume of investment, employment opportunities would increase and this would draw in the unemployed. If, during the past about a decade and a half, despite multiplying investment, unemployment has increased, it is attributable to this phenomenon which converts savings into private income. We may not like to discuss this phenomenon in public. But if we missed this phenomenon, we would fail to identify a major factor responsible for the expansion of unemployment.

How does our poverty look in the global context? Very depressing. The World Bank publishes an Atlas of income and investment of about 122 countries. Where do we stand

in this list of 122 countries? The list is arranged in accordance with per capita income, expressed in US dollars, at the prevailing official exchange rate. We find that over rank, by the yardstick of per capita Income is 95th. And the countries below us are mostly non-descript countries. By the yardstick of rate of growth — rate of growth is measured by rate of increase in per capita income — our rank is even below 95th.

What is this due to? Is it that we are in inferior race? This is a conclusion which the background data suggests. We have made, during the past about two decades, a conscious effort — all the talent in the land, in the industrial sector and in the official sector, has been mobilised — to achieve growth, and, through growth, to tackle the problem of poverty and unemployment. We have had more foreign aid than any other country in the world. Looking into aid statistics, we find that United States is the largest aid giver and India is the largest aid receiver. Now, to cover up this fact, the publicity machine of Government of India, and the publicity machine of United States express aid on a per capita basis. This places India low down among aid receiving countries. We cannot properly assess developmental aid on a per capita basis. When a bank gives you a loan, it does not count the number of people in your family. Among the criteria it applies is the volume of your own assets. When aid is assessed by reference to the volume of domestic savings, we are among the top aid receivers in the world. We can assess, on a per capita basis, charity collections of beggars.

In spite of massive aid and the massive effort at development, by per capita income our rank is 95th, and by the rate of increase in per capita income even below 95th, in a list of 122 countries. In Japan, per capita income is growing at an annual rate which is 9.9 times ours, Hong kong 8.1 times, Taiwan 6.5 times and Thailand 4.6 times. To repeat what I have said above, a question that suggests itself is: Are we an inferior race after all? It is difficult to say 'yes to this question. Since we are in the area of business and industry, are our Banias — businessmen and industrialists — inferior to the businessmen and industrialists of Japan, Europe and America? Perhaps, man to man, our Banias can give a point or two to the Banias in the outside world.

But how is it that, in spite of all this, we are so low down in the ranking among under-developed countries in the world? Some non-descript countries are alone below us; all other countries are above us. My answer is, that what is wrong is not man. What is wrong is our policy. Our own traditional culture — I am quoting from Gila if you will permit to do so — says that, if you wish for victory in a conflict, take care of your policy. The problem here is victory over poverty and unemployment. If you wish for success in this problem we have to take good care of our economic policies. We have not done so.

To come back to my point, what is ingredient, Samagri, for creating employment? This ingredient is two-fold. First, we have to so arrange our policies as to ensure that the flow of savings from the national economy is the highest. Having ensured maximisation of savings, we must ensure, secondly, that what we have saved is invested most productively, i.e., such that the national product rises the fastest. Let us examine these issues at the micro-level of family unit. How does a poor family grow from poverty to riches? And each one of us knows several families that have done so. What is the formula

by which they get this success and in a matter of a few decades? The first ingredient of the formula is hardwork, work overtime, not looking at the clock. Everybody in the family including the head of the family, works hard, from dawn to dusk. Secondly, they do not allow consumption to increase beyond real requirements, not that they starve. To starve would be to defect the objective, as it will reduce efficiency. They do not allow consumption to increase as fast as income. Thirdly, they take the greatest care to see that what they have saved with so much effort, is properly invested; invested securely and invested to yield the highest income. And what more safe and better outlet for investment can there be than our own business? The savings go into the family business.

Very soon the family builds up a reputation for integrity and soundness. And once it does so, it could go to a bank or a financier, who would readily advance it funds. This would enable the family to supplement its own savings by the savings of the community. The rate of expansion of the family business thereafter would be very much faster than before. And the neighbours may wake up one morning and see that well directed dynamism has produced good results; that the poor family is no longer poor but rich, a result of its own efforts.

Does this formula cease to apply in the case of a community of 120 million families, which is India? And have we pursued this formula, in the past two decades, for abolishing poverty? I am afraid, the answer is 'No'. Indeed, we have deliberately violated the formula. We have been giving big names to wrong things. The concept of the welfare state may or may not suit the richer countries. But the consumption programmes by the State, which this concept implies, render it an extravaganza for poor countries. In the big name of welfare state, which has a deceptive magic appeal, we have been making a bon•fire of potential national savings. Via the instrument of expropriatory taxation, we divert resources, which should be saved and invested, for demonstrative consumption. Our economy is a capital consuming economy; and a capital consuming economy is not the best device of abolishing poverty and unemployment.

Quite obviously, to quote Mr. N. A. Palkhiwala, we cannot divide more than what we have produced. If we must have more wages, if unemployment must be liquidated, if mass incomes must rise, if the State must have more revenues, if we must have a large enough defence forces to guard our frontiers, if we must receive our due rank and status internationally, and so on, our per capita, and national, production must rise. Everything hangs on the production curve. And the wherewithal for expanding production is savings and a policy set-up which ensures effective investment of savings. We have let down ourselves in both respects.

Statistics published in the Mid-term Report of the Planning Commission shows that the rate of savings in India has been on the decline. The peak rate of saving was a little over 11 per cent, achieved in 1965-66 — the result of the bumper harvest of 1964-65. The peak rate was a gift of God. not a consequence, which the Planning Commission might claim as being an outcome of its efforts. The rate of saving has not recovered since. Currently it is around 8.5 per cent; probably, less if we fully squeezed out the water of inflation from it. The projected rate of saving in 1971-72 is below that of 1970-71. It

passes comprehension how any one could plan to abolish poverty, abolish unemployment, increase mass incomes, reduce social tensions, finance welfare state measures and so on, when the rate of saving is on the decline. Not only something is, apparently, wrong with the Indian economy; something is, apparently, wrong in our thinking, as well. Can an individual family progress from poverty into riches, when its own savings are on the decline and its past savings are misdirected or otherwise wasted?

What then is the way out of the mess in which we have landed? The way out is in our own hands. The solution does not lie in continued massive foreign aid or relief in external debt repayments. To think so is to think the way a prodigal may do. The solution lies in pursuing the policy measures of Japan and of the several mini-Japans in Asia — of which Hongkong is a good example — which have dwarfed the "miracle" pace of economic progress of West Germany. The Japanese economic miracle and the economic miracle of Hongkong are an object lesson for Asia. Yet, strangely, we have taken a fatal fascination for the Russian and East European economic set-up. A close look will demonstrate that the economic miracle of Japan and of the mini-Japans in Asia rests on their implementation, on a national scale, of the economic formula which take a poor family from poverty into riches. If we must achieve the objective of Garibi Hatao, there is no substitute to hard work, high and rising rate of saving and the most productive investment of savings.

STUDY TOPIC - 31

INDIAN ECONOMIC MALAISE*

I - MEAGRE GROWTH AND SOCIAL INJUSTICE

Though we began with great hopes and abundant international goodwill, our lot in the economic sphere, since independence, has been more frustration than achievement. The complex of the multiphased economic crisis, a subject of profound concern, did not come upon us suddenly. Most of the components of this complex — inflation, social injustice, lop-sided industrial expansion, shortages in key sectors, lag in agricultural production, food scarcities, balance of payments difficulties and erratic overall economic growth with per capita income rising at less than a snail's pace — have been our companions, or familiar periodical visitors, since about 1955-56, by when we had firmly settled down to the now prevailing economic policy system. The coming malaise had been foreseen at least by some.

The ailment has but surfaced again in an acute form and is defying correctives. An attack on one front makes the position worse elsewhere, yielding little or no net relief. Thus, the effort to feed the domestic food grains distribution system, and to replenish the depleted buffer stocks of food grains, by imports, is over straining the already grim balance of payments position. The effort to save the plan, the demands for more funds from numerous directions to meet rising costs and the budget burden of the Pay Commission's recommendations threaten to push up deficit financing in face of the urgency to control inflation. The effort to correct balance of payments difficulties by slashing imports, impinges on essential supplies and hence on production, employment and income. These examples can be multiplied.

Apparently, something has, rather basically, gone wrong somewhere. Could it be that we put too much faith in investments — giving less than due weight to other factors — as a means of accelerating growth? To quote professor Colin Clark, the "mythology" that the key to growth lies in investments may, under certain conditions, cause more damage than good.

The belief that the pace of development depends on the magnitude of the plan, continues to dominate our thinking. Total investments in the public and private sectors, at 1961-62 prices, multiplied 214 times, from Rs. 827 crores, the annual average for the first plan (1951-56), to Rs.2,061 crores, the annual average for the first four years of the fourth plan (1969-74); and the Approach to the Fifth Plan visualises total fifth plan investments of Rs. 27,160 crores — Rs. 51,170 crores at 1971-72 prices — or 2.2 times the fourth plan.

The prime objective of accelerating investments was two-fold: an overall increase in per capita income and a reduction in income disparities. The achievement in both respects has been disappointing.

Total investment in 1966-71 was 138 per cent larger than that in the first plan, which makes an annual rate of increase of 9.2 per cent (simple). During the same interval, per capita real Income rose at an annual rate of but 1.4 per cent.

The trends in the consumption of foodgrains and other basic human needs show that the contrast between investment and development is even more glaring. The per capita consumption of foodgrains, after rising by a total of about

10 per cent during the second and third plans, relatively to the first, declined during the quinquennium, 1966-71, the net overall gain being but about 4 per cent. The trend in the consumption of cotton cloth was about the same. There was a net overall loss of 25 per cent, during the same interval, in the consumption of pulses, the principal source of protein for the masses. (See Table 3, P 413).

The failure of investments to correct income disparities is best evidenced by the contrast between the living standards in the urban and rural areas, the latter accounting for 80 per cent of the total population. During the first plan, per capita rural incomes averaged 27 per cent of urban incomes. This percentage slipped down to 24 in the second plan to 20 in the third and was at 18.5 during the four years, 1966-70. (Table 1).

During the census decade, 1961-71, the number of agricultural workers rose at an annual rate of 1.6 million to 47.5 million in 1971; and the number of cultivators declined at an annual rate of 2.1 million to 78.2 million in 1971. Apparently, the better placed among the rural population are sliding down into the ranks of agricultural workers, the lowest rung of the economic ladder in the rural sector. Simultaneously, unemployment multiplied 5.7 times: from 3.3 million at the beginning of the first plan to 18.7 million in 1971.

These developments did not interfere with the continued affluence of the upper crust of society, which includes businessmen, industrialists, the more substantial entrepreneurs generally, the corrupt among the politicians and administrators, favoured and trusted business executives (who are believed to receive more than the recorded emoluments), professional men of all categories and those who cater to the manifold luxury needs of the affluent. The prosperity of this power elite is visible to the naked eye and is also reflected in steep rise in the production and supply of luxuries, as witness the proliferation and over-crowding of four and five star hotels, growth of lavish residences, display of abundance at marriages and other social functions and the enormous increase in the output of cars, air-conditioners and other luxury goods.

A critical review of data shows that the contrast between investments and development is largely the result of the working of five principal factors.

First, when Rs.1 00 crores are "invested" in public sector projects, what really goes into them varies with projects and the parties concerned. If we may place actual investments at Rs. 60-80 crores, the balance of Rs. 20-40 crores is distributed as corrupt payments, the "kick-backs" of American usage, though the accounts will continue to show "investments" of Rs. 100 crores.

Secondly, during the three years, 1966-69, 35-55 per cent of production capacities are estimated to have remained unutilised in 20 selected public sector undertakings. Plan statistics show that 60-65 per cent of the total investment resources are appropriated by the public sector. On this basis, an order of 21-36 per cent of total investments are wasted in idle plant and equipment.

Thirdly, public sector undertakings show net overall losses which averaged 27.7 crores in 1966-69. These losses absorb equivalent national savings and correspondingly reduce the overall net supply of developmental finance.

Fourthly, we resort to import substitution with less than due regard to the doctrine of comparative costs. It has been estimated that, on an average, domestic substitutes take 75-100 per cent more in resources, at the current exchange rate, than comparable import goods. This correspondingly reduces the national product from a given quantum of investments.

Finally, during the past about two decades, the private sector accounted for 87-92 per cent of the national product and the public sector 3.5-6.3 per cent. The total resource needs of the private sector are, therefore, vastly larger than that of the public sector. But it gets vastly less. The public sector appropriates 60-65 per cent of the total investible funds, leaving the rest of the economy to make do with the balance of 35-40 per cent.

As industries and the allied parts of the private sector — being pampered by official policies — receive priority resource allocations, this has resulted in the neglect of agriculture, financially the weakest part of the Indian economy. We have perhaps the most conclusive evidence of this neglect — on the principle that the taste of the short-availability of capital to an industry is in the pudding of its production — in the statistics of agricultural production. During the decade ending 1960.61, agricultural production rose at an annual rate of 4.1 per cent (compound). Thereafter, and as at the close of 1971-72, it slowed down by about one-half to an annual rate of but 2.1 per cent (compound).

As the output from additional investments in agriculture is, on an average, several times that in industries generally, the weighted investment attention to industries, at the expense of agriculture, has had an adverse effect on the national product, employment and income.

II - Corrective Measures

We suffer not only from misdirection of capital. Since about 1955-56, accelerating investments exceeded the flow of real resources and we have been covering the gap between the two, plan after plan, by printing money, under the euphemism of deficit financing. This has driven up the general index of prices 31/2 times in about 18 years, from 71.1 in April 1955 to 248.8 in July 1973 (1961-62=100). In the current fiscal year, the general index of prices has been rising at an annual rate of 45.9 per cent, an all-time record.

Price inflation has brought with it its familiar ill effects, among them, perverse income shifts and erosion of the external even like the internal — value of the currency, further confounding an already complex situation.

Perverse incomes shifts have been feeding luxury living by the few at the expense of food and other necessities of life for the masses. This has added to social tensions and class conflicts. Rising prices have led to price controls of certain essential commodities. The inevitable efforts to circumvent controls have interrupted the free flow of supplies, have enhanced distribution costs and, therefore, the prices actually paid by consumers, have swollen middlemen's profits at the expense of producers and consumers, and, to the extent that producers receive but controlled prices, have impinged adversely on the production of the commodities concerned, thereby accentuating the problem which price controls sought to remedy.

The chain effects of the value-erosion of the rupee externally, have been similar. This value-erosion has inevitably given rise to two parallel markets for foreign exchange, an official market and a black market; and the dual market system has produced balance of payments difficulties. Among the measures to correct the latter, we have resorted to uneconomic import substitution on an extensive scale. By diverting investment resources from export trades into import-substitution trades, this has further reduced exports, so that import substitution, and the matching import cuts, have not brought any lasting relief from balance of payments difficulties. On the other hand, the heavy resource costs of producing substitutes to import goods, have, as already noted, retarded the expansion of the national product.

The Prime Minister, finding the economic malady too complex and stubborn, is reported to be looking for an economic wizard to steer the economy from heavy seas into safe waters. The foregoing review shows that no magic formula that a wizard may summon up is likely to have any effect on the economy, if the tap-roots of the malaise—capital misdirection, corruption at all levels; resource wastages from inefficient production and from uneconomic import substitution; and neglect of agriculture—are not all first removed.

What can a wizard do when—if we may draw on the data for the triennium ending 1968-69—from every Rs. 100 crores of the total investments in the economy, an average of about Rs. 19 crores disappear as private incomes and an average of about Rs. 28 crores go to waste in unutilised plant and equipment? These figures understate the case as they are based on the assumption that the evils of kick-back and idle plant and equipment do not obtain in the private sector, which is not true. Though, under competitive conditions, both evils—because they necessarily impinge on costs and profits—tend to be eliminated, monopolies and sheltered markets foster them and they exist in the private sector as well. When to this is added our insistence in producing at home substitutes to imports at an average of even 134 times to double the costs of imports, the wizard can only be one more inside witness to the worsening economic malaise.

Our review shows that the remedy to the malaise does not lie in stepping up investments still higher or in more massive aid to finance the larger investments, the prescription of

the Pearson Report. So long as the leakages from, and the misdirection of, capital continue, massive investments may do little else than further fatten the already affluent upper crust of society, the power elite who have developed a vested interest in more and more investments. It may bring no relief to the ailing economy.

Indeed, our review underlines the need to cut down investments to the quantum of the real resource available. For, there is no device of investing non-existent resources. Any attempt to do so must inevitably produce inflation.

When non-inflationary finance is not possible. Government must cut down its outlays, not tax the masses for the benefit of the affluent, which is what inflation does.

If we must liquidate poverty at a miracle pace, it is time that we took note that this cannot be achieved by squandering resources. All economic miracles in the post-war world were made possible by the most effective use of the available investment funds. Per capita real income in Japan multiplied no less than 10.2 times, during the two decades ending 1971. Many mini-Japans in Asia, which pursued the Japanese pattern of resource allocations, have done quite well, too. During the same period, per capita real income multiplied 3 1/2 times in Taiwan, rose by 93 per cent in Thailand, by 74 per cent in Philippines and by 60 per cent in Malaysia. The per capita real income of Singapore went up, during the decade ending 1971, by 87 per cent and that of Hong Kong, during 1960-70, by 84 per cent. By contrast, per capita real income in India rose, during 1960-70, at an annual rate of 1.2 per cent.

It is well to recognise that the Indian economic policy system of the past over two decades has failed to bring the promised results in both vital sectors, economic growth and social justice. As, in the prevailing context, capital leakages and resource wastages seem to be inseparable from this system, no political party or leader can possibly do any better. Persistence in this policy is, therefore, destined to lead us, via increasing social tensions, class conflicts and political instabilities, into the ranks of centrally planned economies.

But there is an alternative, if we are prepared for a basic policy transformation. We could then restructure our policies, benefitting from the experience of Japan, the several mini-Japans in Asia, the comparative performance of the Cameroons and the Ivory Coast, West Germany, Spain, Switzerland and other miracle-economy countries.

The new policy package would include, first, zero-inflation budgets, unification of the two markets for foreign exchange, through floating the rupee, initially, and other monetary-fiscal reforms and discipline, to ensure an honest rupee; secondly, a drastic scaling down of governmental outlays, which, doubtless, would necessitate a review of the role of government in business and industry; thirdly, a review of all policy measures, including autarkical measures, which create monopolies of varying degrees, with a view to their repeal or reform; and, fourthly, relaxation or removal of the complex of controls and restraints, which hamper individual initiative and hence the expansion of production, hinder the movements of capital and commodities, and interfere with the smooth working of the pricing system.

No country adopting this policy pattern has had anything but impressive or bumper returns. It would enhance our international stature, by transforming our image of a beggar into that of a self-reliant nation. A political party or leader implementing it would have an enviable harvest of economic and political dividends and continued stability in office. The same thing cannot be said of the prevailing policy system.

The multiple crises, now upon us, have placed us at the cross roads. If we do not deliberately decide on the path to take, events may present us with a fait accompli.

The overall strategy of the business community has been to support the prevailing economic policy system as, although described as leftist socialism, it has enriched them at a pace beyond their own dreams. Viewing this phenomenon under economic X-ray, we find that the counterpart of their windfalls is social injustice, not — as in the case of the profit incomes of the entrepreneurs in the "miracle" economy countries — economic progress and mass well-being. If the resulting social tensions should assume explosive proportions — some think that this is very nearly the case, already — it may multiply the risks of capitalists being wiped out as a class. There is, therefore, great need for a change in strategy, in their own and also in the wider

social interests. Hope lies in supporting liberal economic policy measures, which alone can cure the Indian economic malaise and place us along the right road to accelerated large enough fortunes- not all of which, it will be noted, are well- merited, as they include, in varying measure, monopoly gains from privileged positions and sheltered markets- should take the lead in doing so, rather than indulge in sonorous pronouncements on the "Social responsibilities of businessmen", which can achieve nothing and deceive none.