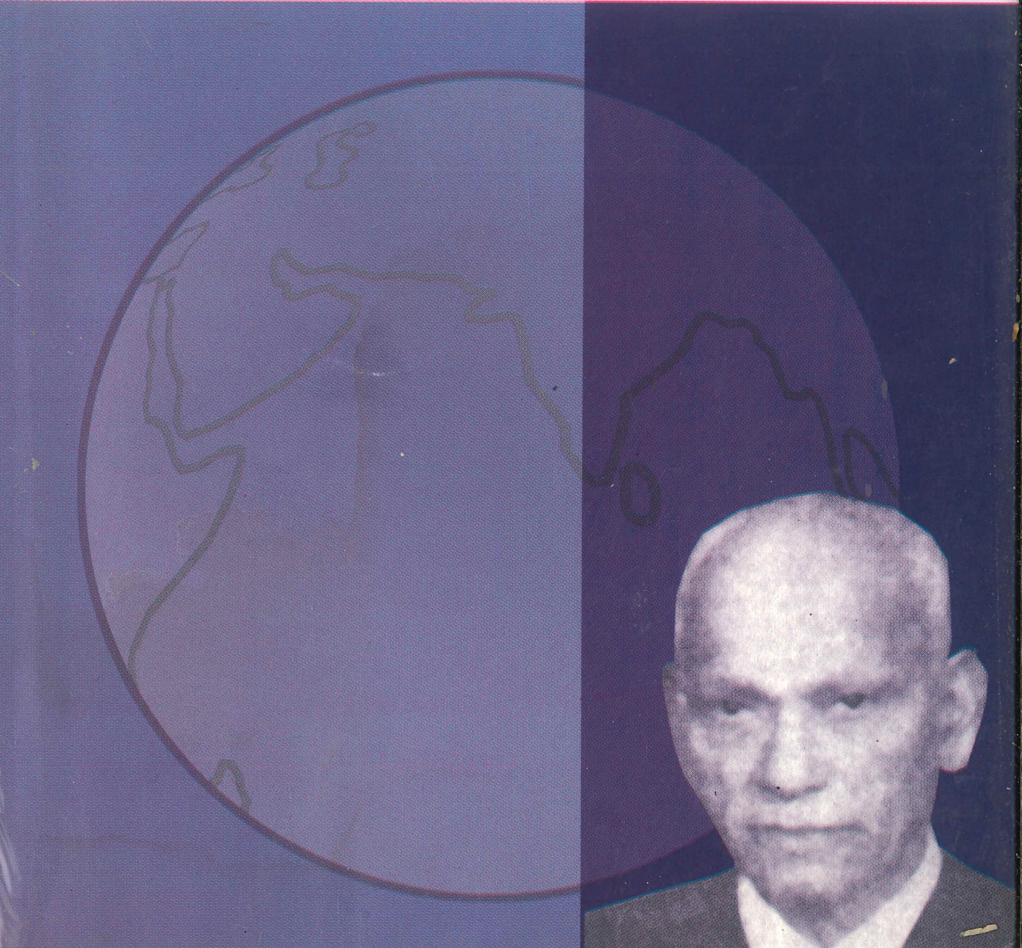
ECONOMIC PROPHECIES

B R SHENOY



Edited by R K Amin & Parth J Shah

Economic Prophecies

B R Shenoy

Centre for Civil Society
New Delhi

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editors' note

Milton Friedman described B R Shenoy as a prophet unhonored in his own country. P T Bauer has described him as a hero and a saint – a hero for resisting widely accepted fads and fancies, and a saint for remaining serene in the face of disparagement, neglect, and even abuse.

A few days before Professor Shenoy's death on 8 February 1978, I met him at the Gangaram Hospital, New Delhi, where he was undergoing treatment for a heart ailment. He looked worried. He said to me, "Amin, I feel sorry I could not change the mind of the government. I have to see our country's economy going to the dogs."

I replied, "Shenoy *saheb*, don't worry. Truth always wins, you have always spoken whatever is the truth. Surely, you are going to win."

Professor Shenoy was always tuned to ground realities. He never built up empty economic models, he never ignored empirical evidence. He was in fact, like a skylark which soars up in the sky but always keeps an eye on the nest. While theorising, Professor Shenoy always kept day-to-day problems of life in mind.

While delivering a lecture on national savings and industrial finance at Kerala University, he described his role in the following words:

"Dialogue with industrialists, bankers, businessmen and other men of affairs, and with subjects other than one's own, especially students of physical sciences, is always a rewarding experience. Men of affairs help to weigh our ideas in the scales of realities of life, and may save us from being catapulted away into speculative unrealities by false and impracticable concepts; and scientists remind us that every statement that we make must survive the rigorous test of logic and proved data. This double influence of men of affairs and of the scientific method is in evidence in the trend of effort in all social sciences, in economics no less than in other subjects."

Economics is not astrophysics. It deals with problems which have a bearing on daily events and the circumstances which confront and surround man and society. If economic theorising does not throw light on these mundane problems of man and society, that is, if the theorising does not explain and also help to prescribe, it is a waste of an economist's own time and that of those paying attention.

Sometimes it is remarked that a certain proposition may be correct in economic theory; but not in practice. But if economic theorising is not scientific and realistic, it may not be worth the while. We have perhaps the best results when economic theory is well-informed with the realities of life and of the market and policy measures are well informed with the guidelines provided by economic theories.

This suggests the need for – and the importance of – two things. First, economists should gaze at the model of the world around them on which to build their theories, instead of relying wholly or mainly on models of their own creation. They should use much more freely than some of us seem to be doing the mass of statistical data now available on almost every phenomenon of significance. Secondly, it is desirable to have, not merely dialogues, as at seminars and lectures, between economists, men of affairs and administrators, but closer association of professional economists, business, industry and administration, preferably on a consultation basis.

Consultancy works better because there is a need to isolate the role of an economic analyst from his role as an independent counsellor-adviser. The merger of the two functions not only damages the stature and dignity of the profession, it also detracts from the development of the science and from the constructive contribution of economists to economic and social progress. In the case of resident staff economists, there is a danger of the two functions getting merged, and the role of the adviser getting lost. Professor Shenoy was able to strike a balance between the two.

Professor Shenoy was a brilliant orator. His lectures were lucid and eloquent, keeping listeners spellbound. Normally, it is difficult to keep an audience riveted on financial subjects, but his voice was sonorous, his style of presentation forthright and his arguments so convincing that the lay public would be attentive, sometimes captivated by his lectures. His writings were also frank, logical and supported by facts and data. That is why even the lay reader can enjoy this book.

As I told him in his last days, truth ultimately wins. China introduced economic reform in 1978. Margaret Thatcher introduced privatisation and deregulation in England. Soon after, America accepted supply-side economics and hard-headed socialist New Zealand introduced liberalism in 1984. With the fall of the Berlin Wall in 1989 in a short span of two to three years, all communist countries in Central and East Europe, including USSR, gave up communism and became liberal democracies. And last but not too late, India took a U-turn in 1991 and got rid of the license-permit *raj*.

This is our attempt to pay homage to the great soul by keeping his message alive through his writings.

prologue

The title *Economic Prophecies* has been given to this book for two reasons. First, no less a person than Nobel Laureate Milton Friedman saw, as early as 1963, the voice of a prophet in B R Shenoy's writings. Second, today many of us realise with a sense of wonder – and hindsight – how true were Professor Shenoy's analyses and conclusions on various economic issues about which he spoke during his lifetime. Many of his insights are worth remembering even today since we may be required to fight an onslaught of socialist ideology any time in the future too.

Economic Prophecies is the first of a two-volume set of his writings, and reaches out to the general reader. The second volume *Theoretical Vision* is geared more towards students of economics. This, the first volume, contains his writings from 1954 until his death in 1978. Many of these were published either in economic periodicals, or in widely circulated newspapers, some in the form of books. Several of them were originally delivered as lectures at reputed forums. All these writings, which are rather difficult to access, have been brought together here.

This volume has been divided into five sections dealing with different aspects of the Indian economy and society. Providing an overall perspective, Section A contains three articles in defense of free enterprise. He wrote these three articles when he saw that communist infiltration was taking place in the government; when Indian entrepreneurs, by joining hands with the government, were working as enemies of capitalism; when the government shut its ears, refusing to hear any criticism of its socialist policies.

Section B contains articles pertaining to planning in India. These run the gamut of the beginning of his crusade against socialism – with the criticism of the plan frame of the Second Five-Year Plan – till his last appraisal of 25 years of planning in India. He often urged the need for an alternative to planning, and an entire article is devoted to this exposition. Another article with rare insights is the one on fallacies of plan finance, which contains the core of his criticism of Indian planning.

Throughout the book, we can see evidence of how he took it upon himself to sound the warning to politicians and the public on the wrong path taken by the Indian economy, replete with suggestions on what can be done to put it back on track – unfortunately, we did not give heed to what he said.

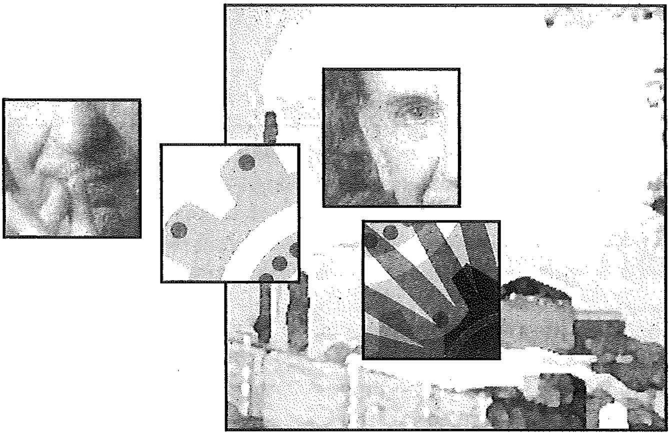
Section C contains four articles on foreign aid. In Professor Shenoy's view, massive aid from governments and multilateral institutions had become an easy passport to grandiose government projects and luxurious living for the people involved in those projects. Foreign aid was, in his opinion, being wrongly invested by way of constructing prestigious but unproductive monuments. He urged that care should be taken to invest aid wisely in productive investment, which may lead to higher productivity and growth of the economy.

According to him, India did have a need for import of wheat under PL 480, but it should have been limited only to meeting our market deficit or building up necessary buffer stocks. He also objected to PL 480 finance because it led to inflation. He skillfully pointed out how aid was used to finance gold smuggling or export of private capital in foreign countries, especially places like Switzerland. The government of India was very perturbed by Professor Shenoy's criticism of foreign aid because the weakness of the government was exposed all over the world.

Section D contains ten articles which critique different aspects of government policy – such as the population control policy, wage policy and export promotion. The common theme running through these is that socialist policy created so many distortions in our economy: sometimes the government did put correctives in place, but these too defied economic logic. Professor Shenoy suggested from time to time what the correct solution can be for every ailment of the economy.

The last section is devoted wholly to his views on Indian agriculture, which remained a chronically neglected area throughout the plan era. He felt the problems of agriculture were primarily the consequences of government policies. The government was intervening without understanding the root causes and hence his perception that all efforts of the government were bound to fail.

The last article in this section is very important because it is probably the last piece of Professor Shenoy's writing available to us. On 19 January 1978, a little more than two weeks before his death, he wrote a comment on the *Note on a New Price, Trade and Marketing System on Agricultural Produce* as issued by the ruling Janata Party in December 1977. His comments indicate the great importance he gave to growth of agriculture, and how deeply he felt for the plight of farmers and others in the rural areas.



context

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3. No redemption in present policies

section A

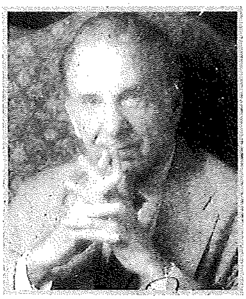
Free enterprise in danger

12 MAY 1975

Written in support of the statements made by industrialist J R D Tata at a seminar organised by the Associated Chambers of Commerce and Industry, this article sounded a warning about the impending extinction of the private sector

The institution of free enterprise and the liberty of the individual are in a critical phase in India. J R D Tata has stated that "the time has come for a cry of alarm that the private enterprise part of the mixed economy is threatened with early extinction". The communist strategy in India aims at over-throwing the government and the established order of society not by violent revolution but through peaceful infiltration.

As part of the strategy, 'a number of persons' who 'had been members of the Communist Party' had, Mr Tata averred, gained 'access to critical important positions in government'; and though 'momentous changes' of a Marxist nature have been 'introduced in our economic life', this process has taken place with such 'gradualness' that neither the 'intelligentsia nor the public at large seem to be fully alerted as yet' to the 'incipient dangers' of the mixed economy being replaced by the 'totally planned and regimented economy'.


J R D Tata

P N Haksar, deputy Chairman, Planning Commission, reacted to these home truths in extraordinarily strong terms. Addressing the annual meeting of the Federation of the Indian Chambers of Commerce and Industry, India's premier trade association, Mr Haksar asserted that the mixed economy was not in the morgue, but very much up and doing. He argued that, as 90 per cent of the national product came from the private sector, there was no factual basis for Mr Tata's alarm.

The high percentage of private sector output is no evidence against Mr Tata's assessment. His forebodings rest on, first, the vast control which government has acquired over the establishment, expansion and functioning of businesses and industrial undertakings; secondly, on the option to convert loans to public sector financial agencies and private companies into equity capital of the latter; and, thirdly, on the annual appropriation by the public sector of as much as 65 per cent of the total investment resources (the sum of current domestic savings, foreign aid and drafts on currency reserves). It has been estimated that by 1980, the third factor alone may bring under government ownership 50 per cent of the industrial and mining capital in the country. Government ownership may rise to 80 per cent if loans are converted into equity capital.

THUS, UNDER THE prevailing 'mix' of the mixed economy, the Marxist doctrine of the public ownership of the means of production may become an established fact with the simple lapse of time – a case of communism, or a leap forward into it, without tears. Witness, moreover, the political ease with which the wholesale trade of wheat was nationalised in 1973. The prevailing political climate in India is such that if electoral exigencies called for it, the takeover of the so-called 'monopoly houses' – the top-grade business undertakings in the private sector – should raise no political problems.

This possibility is not idle speculation. It is in the mainstream of the ideology to which the top policymakers and the dominant wing in the Congress party subscribe; and it may receive the same public approbation and ballot box windfall as the bank nationalisation of July 1969 had done. Moreover, most observers believe that there is nothing the party in power will shrink from in order to remain in power. It is these features of the Indian scene that constitute the credentials of Mr Tata's evaluation.

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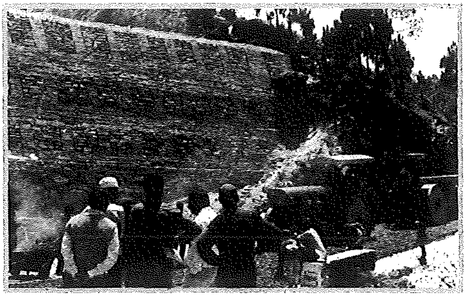
The continued high proportion of the private sector component of the national product, cited by Mr Haksar, is but the joint reflex of, first, agriculture constituting about 50 per cent of productive enterprise and, secondly, the expansion of public sector output at less than snail's pace, despite the galloping investment in this sector – the result, as we sharply presently see, of corruption and resource wastages.

Strangely, the predicament facing private enterprise has not alarmed the Indian business community. Businessmen argue that India has survived, to quote Mr Tata, 'disasters which had destroyed other civilisations' in the past, and that somehow we would escape the communist menace too. During two decades of socialism, some businessmen amassed wealth and affluence on a scale beyond their own dreams; and they have been among the strongest supporters of socialist measures, though they like to describe them as mixed economy measures.

The third factor reviewed above as being responsible for undermining private enterprise – the appropriation by the public sector of 65 per cent of


A PWD team building a road

the total available investment resources – merits closer attention. This appropriation is not only out of all proportion to the contribution of public sector to the Indian national product, a mere 4 to 9 per cent, it is also responsible, in large measure, for the rather odd phenomenon of stagnation of per capita output and income since 1964-65, in the context of a continued acceleration of total investment. These investments multiplied by as much as 5.3 times (at 1961-62 prices) the expansion of population, as between the First Plan (1951-56) and 1973-74.

The link between the two – heavy public sector appropriation and economic stagnation – is easily stated. First, when Rs 1 billion ($ 124 million) are 'invested' in public sector projects, what really goes into them may vary, depending on projects and the parties concerned, from Rs 600 to 800 million ($ 74.4 to 99.2 million). The balance Rs 200 to 400 million ($ 24.8 to 49.6 million) is distributed as corrupt payments by contractors and others – 'kickbacks' in American usage – and, consequently, gets transformed into consumer income.

Though such transformation is part of the old PWD (Public Works Department) tradition, the amounts involved are no longer peanuts. With public sector outlays in 1973-74 at Rs 41,250 million (US $ 5,124 million), the corrupt payments, i.e. investments converted into private incomes, may be of an order of Rs 8,250 to 16,500 million ($ 1,025 to 2,050 million). This is about 17 to 34 per cent of total domestic savings during the year. To the extent of these conversions, Plan investments are only paper investments and can make no contribution to the national product.

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Second, unused production capacities, which in recent years have ranked as high as 35 to 55 per cent, add nothing to current output. On the other hand, the national product would be less by the capital maintenance costs of unused capacities. To this must be added the debit effect on the national product of the various inefficiencies and laxities of public sector undertakings – which include overstaffing, worker idleness, wastage of raw materials and accessories, neglect of capital equipment maintenance and poor attention to quality control.

Third, the private sector, which accounts for 84 to 92 per cent of the national product, receives but 35 per cent of the total investment resources, the balance left after the draft of these resources into the public sector. As manufacturing industry in the private sector receives priority resource allocations, the abnormally heavy public sector appropriations have involved the capital starvation of agriculture. Evidence of this capital starvation lies in the decline in rural per capita private investments in agriculture, still the main source of agricultural finance, and in the consequent decline, at an annual rate of 0.14 per cent (compound) in agricultural production per head of the rural population during the period 1961-74.

THOUGH INDUSTRIAL PRODUCTION rose simultaneously at an annual rate of 4.9 per cent (compound), as agriculture accounts for 47 per cent of national product and industry only 14.3 per cent, the decline in per capita agricultural output negated, almost wholly, the expansion of per capita industrial production; and the net per capita income in 1974-75 was still at Rs 339 ($ 42.11) as against Rs 338 ($ 41.99) in 1964-65, both at 1960-61 prices. Corruption has eroded not only the moral standards of the people but also the pace of Indian economic growth. We have been standing still while most parts of the rest of the world are marching forward, some – like Japan and the several mini-Japans in Asia – at a galloping speed.

The expansion of employment being a function of the expansion of the overall national product, with the latter remaining semi-stagnant, natural additions to the labor force have not been fully absorbed into employment. Consequently, unemployment in 1971 was 5.7 times the unemployment in 1951 (3.3 million).

One must realise that even a hypothetical government of Gandhian ascetics – with J.P. Narayan or Vinoba Bhave as prime minister – could make no significant difference to these developments under the prevailing 'schizophrenic policies', as Mr Tata aptly describes them. It is not possible to clear the chaos created and place the country along the right road to progress without a thorough restructuring of these policies, of which heavy cuts in public sector outlays are among the first essential steps.

2

Image of the Indian entrepreneur

26 OCTOBER 1970

The writer defends the traditional business caste – the Vaishyas – as their business practices have a solid foundation, and explains why they sometimes engage in dodgy practices in a scenario where big business is often under attack by the leftists

Traditionally, the entrepreneur belongs to the third of the four Indian castes: Brahmin, Kshatriya, Vaishya and Shudra. It is believed that in early times the Vaishyas – like members of other castes – were identified as such by their 'duties' or occupation: not, as today, by birth in an entrepreneur family. It was presumed that men would generally seek to move into occupations – castes – the 'duties' of which were 'homogenous' with their nature, i.e. 'the qualities which predominate' in their 'disposition', and having thus chosen an occupation, it was deemed 'better to do one's own duty...than to perform another's duty well' as the 'duty' of another was 'full of danger'.

This flexible set-up had the advantages of comparative cost and maximum production from a given social complex of human aptitudes and talent. But through the ages, flexibility evaporated; caste came to be determined by birth; the number of castes proliferated; and the system assumed detrimental cast iron rigidities.

Contemporaneously, members of the Vaishya castes by birth dominate Indian economic life in the private sector. The 'commanding heights' – to borrow a term frequently used by socialists – in the urban as well as rural centres, in all departments of economic activity, trade, business, industry, mining, construction, finance, banking, insurance, commodity exchanges and the stock market, are largely manned by entrepreneurs who are Vaishyas – more commonly described as Banias – by caste. The 'merchant princes' of the country may be more generally Banias or allied castes from

Rajasthan and Gujarat or, less frequently, Chettiars, the name of the Banias of Tamil Nadu. Other states, too, have their share of entrepreneurs.

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Though third of the four great castes, Vaishyas enjoyed the advantages which control over finance, wealth and income bring, and which other castes lacked. And, through the ages, as the centre of gravity of social values shifted more and more towards materialism, the social status of successful entrepreneurs forged ahead. Like the princely ruling families, Vaishyas supported good causes – they endowed temples, educational institutions, public rest-houses and hospitals, and, in times of famine or famine-like conditions, provided relief to the distressed. It is part of the Vaishya tradition to set apart a fraction of profits for charity. The more successful Vaishya entrepreneurs have been generally among the elite or leaders of the local community of the town or of the country, depending on their eminence.

THE TRADITIONAL IMAGE of the Vaishya, as it has emerged through the ages, is a mixed one. An abiding trait of this image has been a high sense of integrity. The *hundi* – the Indian equivalent of the bill of exchange – embodies integrity and trust. The *hundi* is a draft for a sum of money by A on B, in which B may be resident in a distant part of the country, issued to C; the latter gets the amount, in cash, from B, on presentation. An undocumented piece of paper, bearing only the signature of the drawer, it has been in traditional use by traders, who proceed upcountry to make purchases at harvest time or visit sea-ports or industrial centres to purchase manufactured goods; by businessmen and bankers for transfer of funds or for borrowing from banks; and by travellers.

An old bank in Bombay

An 18th century historical anecdote brings out the high rating of integrity and trust in the undocumented word of Vaishya bankers. Warren Hastings, colonial head of the Indian government, proposed to his principals in London, in 1773, the establishment of a 'General Bank' with branches in district towns to receive revenues and remit them from the districts to 'the Residency or from place to place'. Two bankers, 'Bauboo Hazurimull, and Roy Dalchand, the former an ancient and respectable merchant of Calcutta, the latter a banker at Moorshidabad, and a branch of the family of Jagat Seth', were requested to constitute the Bank.

The revenues being considerable, the bankers were asked, at London's instance, to 'enter into an engagement with the government and give security for the performance' of their responsibilities. Both bankers, however, refused to give security, stating that 'it would materially affect their credit in the country; they having themselves been hitherto considered in such a light of responsibility as never to have had occasion in the course of their extensive dealings to enter into securities'. The receipts given by their *gomasthas* (clerks) for the revenues should be sufficient security.

London, at first, pressed for security but withdrew this condition when it became clear that the bankers would much rather forgo prestigious government business than suffer the humiliation of entering into security. The *shroffs* were appointed to constitute the General Bank.

On the other hand, the terms Bania, Marwari, Chettiar – the contemporary names of the Vaishya – generally bring to the popular mind an image of a person of quiet shrewdness, capable of a hard bargain, even harsh or ruthless, who assesses situations on a *quid pro quo* basis. These terms easily became unwelcome epithets as free enterprise is a subject of disdain in socialist literature. Though virtually all have to deal with Vaishyas in one or more roles, he may not always be the most popular person.

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Contemporary image

In pre-war days, businessmen generally financed and supported the movement for political freedom at the risk of official displeasure. This helped to improve their public image. But the gains got eroded during the war years, when the trading community was accused of profiteering. Inflation drove prices up, price controls led to concealment of stocks and the latter were sold at black market prices. High and rising prices were blamed by the public generally and also by economists on manoeuvrings by entrepreneurs, not on inflation solely. The Bengal famine of 1943, in which 1,873,749 people are stated to have perished, is widely presumed to have been aggravated by speculative foodgrain hoarding by middle-men; and this misfortune is frequently listed by socialists and others as evidence of the inhumanity of entrepreneurs, of the danger or unwisdom of relying on them in matters relating to food and other essentials of consumption in critical times, and of the importance of 'nationalising' the foodgrain trade.

The Industrial Policy Resolution of 30 April 1956 asserts that 'the adoption of the socialist pattern of society as the national objective, as well as the need for planned and rapid development, require that all industries of basic and strategic importance, or in the nature of public utility services, should be in the public sector'. The implication was that entrepreneurial freedom is incompatible with both mass well-being and rapid development. In line with this theory, the Resolution classifies industries into three categories, the third, the residual category, being 'left to the initiative and enterprise of the private sector'. It is, of course, 'always open to the state to undertake any type of industrial production'.

Since the adoption of the objective of a socialist pattern of society by Parliament in 1954, socialism and communism have been on the ascendant. This further weakened the position of the entrepreneurs. Big business is a favorite target for attack by leftists – they avail of every suitable event and opportunity to tarnish the image of entrepreneurs. Under interventionist policy measures, events and opportunities for doing this seem to flow endlessly. Socialists have been in power without a break at the Centre since independence. A coalition led by the communist party is in power in Kerala, and a similar coalition was in office in Bengal until 16 March 1970, when it was replaced by President's Rule – the result, mainly, of differences between the 'Russian' and 'Chinese' factions of the communist party.

The growing popularity of socialist concepts has led to the Samajwadi Party – almost the only political party in India supporting the competitive market mechanism as a regulator of economic activity – to advocate a 'welfare economy'

The New Delhi central office of the Communist Party of India (Russian) claims that, during the past one year, its membership has gone up by 42 per cent, the largest gains being in Bihar and UP. The growing popularity of the socialist concept has led the Samajwadi Party – almost the only political party in India supporting the competitive market mechanism as a regulator of economic activity – to advocate a 'welfare economy', and the Jan Sangh has produced a *swadeshi* plan of economic development, though the party seems to be quite opposed to centralised planning.

Currently, the image of the entrepreneur seems to be in bad shape. Big business, in particular, has hardly any overtly enthusiastic political supporters. Even the Swatantra Party, and some public figures who are by no means hostile to entrepreneurial freedom, do not seem to have a kind word for businessmen in general. The following quotations are only a sample:

(i) The mid-term report of the Swatantra Party, dated November 1969, observes: "Unfortunately, a large section of the leadership of Indian businesses has betrayed its obligations to the free way of life and cheerfully got on the bandwagon of 'state socialism lured by a desire for a quick rupee through permits and license."

(ii) Jayaprakash Narayan, leader of the Sarvodaya movement, while felicitating Sumatiben Morarjee, chairperson of Messrs Scindia Co. on her company's exemplary record of public service, is reported to have observed that "very few business houses have a sense of ethics."

(iii) M R Masani, Member of Parliament, now president of the Swatantra Party, in a paper read before the 6th International Colloquium on Democracy and Development, held at Coonoor in October 1968 observed, "Now, we too have a new class in India. It has three sectors: the corrupt politician, the corrupt bureaucrat and the corrupt businessman. They all work together hand-in-glove."

Lately, attacks by spokesmen of government on entrepreneurial freedom have tended to be more open and also more frequent than in the past. The supposed conflict between the entrepreneurial system and social justice is the main theme of certain recent reports, notably the Report of the P C Mahalanobis Committee on the Distribution of Income Levels of Living (1964), the Report of the K C Das Gupta Monopolies Inquiry Commission (1965), the Interim Report of Professor R K Hazari reviewing the operation of the Industrial Licensing System (1966), and the Report of the S Dutt Industrial Licensing Policy Inquiry Committee (1969).

The rapid expansion of the public sector provides a measure of the prevailing state of inroads into the entrepreneurial system. Currently, over 70 per cent of investment resources, comprising domestic savings and foreign aid, are appropriated by public sector undertakings; the nationalised sector includes 15 commercial banks, which account for 82.5 per cent of total bank deposits, all life insurance companies, all industrial finance corporations, the Unit Trust of India, as a practical matter the entire co-operative sector, railways, much of road transport, telephones and certain other means of communications, some hotels, some large dairies, some bakeries, and about 60 per cent of the import trade.

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Despite these developments, the business community – exceptions apart – has whole-heartedly supported policies of centralised planning. The latest affirmation of this support was from J H Doshy, president, Indian Merchants Chambers, Bombay. Welcoming the prime minister at a reception by several chambers of commerce on 25 October 1969, Doshy stated, "We have accepted democratic planning and the system of mixed economy as best suited to provide opportunity for every individual to live a life of dignity, freedom and fulfillment."

The main explanation of this paradox would seem to be that these policies have brought continued prosperity to the business community. Their income and wealth accelerated in the wake of the expansion of industrial production. In 1969 the index of industrial production was about 2.5 times that in 1955 and the paid-up capital of non-government joint stock companies was more than double.

With assets and incomes pulsating success, businessmen – being primarily pragmatists – cannot be expected to campaign against policies which yielded these successes. The case for entrepreneurial freedom, therefore, went by default on the part of capitalists. Little opposition emerged from academicians, as an overwhelming proportion of them advocate socialism of varying hues. Political opposition is ineffectual. Heavy majorities vote down the Swatantra and Jan Sangh, the rightist splinter groups in Parliament.

The prevailing bias against entrepreneurs is not merely the result of socialist propaganda; this bias seems to be rooted in two inter-related phenomena. Tax dodging of entrepreneurial incomes – honorable exceptions apart – has become almost axiomatic. Income tax is mostly drawn from incomes from manufacturing and allied occupations. Agricultural incomes are not subject to income tax. It is, therefore, reasonable that income tax collections should show some correspondence to the pace of expansion of industrial production.

Tax dodging is common knowledge among accountants, office employees in general, auditors, tax experts and income tax lawyers. It has done not a little to lower the image of entrepreneurs.

Income tax collections should, in fact, rise faster than industrial production as, under inflation and controls, entrepreneurial earnings are augmented by the earnings of the rest of the community. But the index of income tax receipts, at constant prices, was at 127 in 1968-69, though the index of industrial production for the same year had risen to 224. This suggests extensive tax dodging.

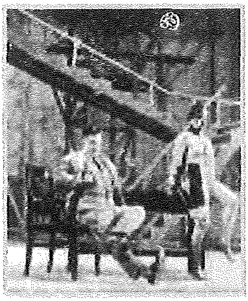
STATISTICS OF BANK deposits seem to provide corroborative evidence of tax evasion and tax avoidance. Most bank deposits arise in the industrial and allied sectors. In a context of, first, an increase in industrial production by about four times the pace of increase in the aggregate national product and, secondly, a rise in per capita income, the percentage of bank deposits to the total monetary circulation should ordinarily go up. But bank deposits remained at or below 20 per cent of the total money supply from 1950-51 to 1962-63.

An increase in the percentage of bank deposits was, possibly, held back by the growth of concealed incomes. The latter cannot be deposited in banks. These incomes turn around in cash. The increase in these percentages since 1963-64 is related to the shift of savings deposits to demand deposits, mainly by the banks themselves – the result of the distinction between savings and current deposits having largely ceased to be meaningful.

Concealed incomes are also manifesting, among other places in the economy, in real estate transactions. As much as 30-40 per cent or so of agreed real estate prices may be payable, currently, in cash ('black money'), the sale documents recording only the amounts paid by cheque. Payment for real estate partly in cash may be an origin or a consequence of concealed income.

The law having failed to tackle tax dodging, so general a phenomenon has not remained hidden – it is common knowledge among accountants, office employees in general, auditors, tax experts and income tax lawyers. This phenomenon of corrupt practices and tax dodging has done not a little to lower the image of entrepreneurs.

Secondly, affluent living by traders, businessmen and industrialists has grown out of all proportion to the expansion of the national product. This is visible, in addition to the naked eye, in the pattern of production of consumer goods. Finance for this affluent living is drawn not from earned incomes alone; entrepreneurial incomes have shot up considerably, partly as a result of inflation, but mainly the monopolistic conditions created by interventionist policy measures. Income from inflation and monopolies are a case of other people's earnings transferred to entrepreneurs. And the total income transfers may be of the order of over one-half of the annual increases in the Indian national income, which averaged Rs 15.2 million during the past eight years.



These perverse income transfers constitute the single biggest problem confronting India today. In a context of semi-stagnant per capita income in the 1960s, they have had the effect, on the one hand, of keeping down the living standards of the masses, which is evidenced by near stagnation in consumption of the necessaries of life at subsistence levels; and on the other, of the widening gulf between rich and poor. Continued mass distress and luxury living by a privileged minority seem to be the main factors behind the growing social tensions, mass unrest and political instabilities.

In the context of continued poverty of the masses, this parasitical living by entrepreneurs on the income of the rest of the community added to the unpopularity of entrepreneurs. Worse still, this phenomenon is blamed as being fundamental to the entrepreneur system not only by socialists but by economic analysts, financial writers, editors, literary writers, publicists, social and political workers, political leaders and administrators, whose views weigh with the people or who shape public opinion and influence the course of events.

PRONOUNCEMENTS OF LEADING businessmen show that entrepreneurs are well aware of their present image. President of the International Chamber of Commerce Bharat Ram said as much in his address on 12 April 1970 to the National Convention of Foodgrain Dealers at New Delhi, to protest against the proposed nationalisation of the foodgrain trade. He is reported to have observed, "Whatever the reasons, today there exists in the country a deep-rooted bias against the business community...This is the result of clever propaganda by those who have a political axe to grind."

More than one national seminar and conference has been held in recent years on the social responsibilities of businessmen. The Fair Trade Practices Association (FTPA), Bombay, founded on 2 October 1966, is an effort to improve businessmen's image. Its members undertake, among other things, to charge only 'fair and reasonable' prices, not to indulge in hoarding 'in times of scarcity', not to deal in 'spurious goods', not to engage in incorrect invoicing of imports and exports, and so on. Some have suggested that to the list of FTPA do's should be added obligations towards shareholders, employees, the local community and society; and that certain other reforms, including the ownership of shares by employees, creation of a charitable foundation by contributions from profits and voluntary social audits, should be accepted.

These measures may, doubtless, help to improve the image of entrepreneurs in ordinary times. But it is important to emphasise that they are basically incapable of operating on the main factors responsible for lowering the image of the entrepreneurs. How could any or all these measures put together provide any relief to the fixed-income groups from the inflationary erosion of their incomes, or compensate for the levies accruing to entrepreneurs on the earnings of the rest of the community through import licenses, permits and quotas? The impact of these reforms may be less than chickenfeed.

As long as inflation and monopolistic legislative and administration measures continue, entrepreneurs will continue to receive windfalls to which they have neither a moral nor economic claim. While this phenomenon has lowered the image of entrepreneurs, the latter cannot be held responsible for the evil. The responsibility lies almost solely on policies – and the authors of the policies – which give rise to inflation and monopolistic conditions. If prices rise because of printing press finance and imports bring incredible income because of severe restrictions on import, it is little use educating entrepreneurs on their social responsibilities or remedying the resulting social tensions. It is policy-makers that need to be educated.

Nor can entrepreneurs be wholly blamed for tax dodging. What is an entrepreneur to do if he gets less than his required import license? He may close down part of his factory, acquire an import license through corrupt payments or purchase his needs in the black market. He cannot enter the costs of the latter devices in his accounts; all the same, he must realise this amount from sale proceeds, as these payments constitute part of costs. He is, therefore, compelled to sell some of the produce without showing the deals in his books; and the relative incomes have, of necessity, to be concealed. Situations calling for tax evasion, under similar duress, arise endlessly in an interventionist economy.

What is at stake is not the image of entrepreneurs alone. The existing social order and the democratic system of government are under attack, and the efforts of socialist politicians, who have been in power for over two decades, have been attended with remarkable success. There is little hope of retrieving the situation without basic policy shifts, such as those suggested above, so as to put an end to parasitical living by entrepreneurs and others on workers' earnings; and to ensure that everyone's income represents his contribution to the stream of the Indian national product.

3

No redemption in present policies

12 JULY 1969

In his response to the Economic Policy Note of the prime minister appended to the Economic Policy Resolution of the Congress party at Bangalore, the writer says that wrong remedies are being sought for the inflationary incomes and monopoly windfalls which have resulted from planning

Prime minister Indira Gandhi's Economic Policy Note is, avowedly, 'just some stray thoughts' which were 'rather hurriedly dictated'. It takes some effort to piece these stray thoughts together into an organic entity. It sets out 'policies to be pursued', first, to improve the 'performance of our economy in industry and agriculture'; second, 'to ensure' that economic development 'does not lead to concentration of wealth and economic power in a few hands'; and, third, to take due care to see that the objective of 'social justice does not get clouded'. The Note continues that the need for these measures arises from the importance of lifting up 'the standard of living of tens of millions' who today live at 'or even lower' than the margin of subsistence.

Indira Gandhi

The Note is in line with a main theme of our own analysis. It underlines the prime need to accelerate production and centres round the biggest single problem confronting us today: the extended affluence of a moneyed minority, in the context of the wilted well-being of the erstwhile prosperous salaried middle classes and a marked deterioration in the economic condition of the lower brackets of the fixed income groups, which include school masters, the low-paid office staff, the unskilled and semi-skilled labor and landless agricultural workers, i.e. the masses of the people.

Will the policy measures outlined in the prime minister's Note help to redeem the Indian economy from its present predicament? Analysis indicates that, to achieve this, these measures should be capable, first, of putting a stop to the perverse income transfers and, second, of yielding a continued rise in the national product and per capita income.

The prime minister's Policy Note makes no reference whatever to the need to eliminate inflation though, at the time it was written, prices were rising at a near-record annual rate of 24 per cent, causing considerable anti-social income shifts

To stop perverse income transfers, we must stop the inflationary price rise and eradicate monopoly gains. There is no way of preventing prices from rising other than to balance the budget. This would call for abandonment of over-spending and over-investment. Once we resort to printing press finance, the amulets of price control, fair price shops and government run super markets cannot hold the price line. The prime minister's Policy Note makes no reference whatever to the need to eliminate inflation though, at the time it was written, prices were rising at a near-record annual rate of 24 per cent, causing considerable anti-social income shifts.

Monopolies

The Note seeks to tackle the problem of monopoly gains, among other measures, in six ways: (i) nationalisation of imports; (ii) pending nationalisation, a more equitable distribution of import licenses; (iii) the appointment of a monopolies commission; (iv) heavy penalties on restrictive trade practices; (v) ceilings on unproductive expenditure and conspicuous consumption by corporate bodies; and (vi) profit-sharing in industrial establishments.

The first two measures listed above would but shift monopoly gains into the pockets of the new licensees. This can bring no relief to the victims of the monopoly income transfers. Already, about 62 per cent of total imports are on state account; and measures have been adopted to ensure that import licenses are not issued to the 'bigger houses' alone. These 'reforms' have not reduced the harshness of the monopoly levies.

Nor will a monopolies commission and heavy penalties on restrictive trade practices help to cure the malady. Once monopolies come into being, monopolists would extort from the community monopoly profits. Virtually the whole range of monopolies in India have sprung from controls, the most pernicious ones among them import control monopolies. It is much simpler not to create monopolies than seek doubtful redress from them through a monopolies commission and through penal action against restrictive trade practices.

Much conspicuous consumption and non-essential expenditure by corporate bodies are, doubtless, fed by inflationary incomes and monopoly windfalls. It follows that, if we stopped inflation and abolished monopolies, the malady we are up against may largely cease to be. If, however, inflation and monopolies continued, ceilings on these expenditures may be of little avail. There are no ways of preventing fish from drinking water. If limits are imposed on certain heads of expenditure, it is not as if corporations and firms would have no alternative but to surrender the monopoly gains to the government in taxes. The moneys and the personnel concerned may be shifted to other heads to dodge or to by-pass expenditure ceilings. Profit-sharing is incapable of solving the problem of perverse income shifts.

Under profit-sharing, manoeuvrings by entrepreneurs – more especially in a competitive labor market – may reduce wages such that wages plus the worker's share of the profits may be about equal to the level of wages in the absence of profit-sharing. Workers may not get any net gain. Profits being residual gains, both logic and experience have demonstrated that profit-sharing – to scoop out some of the 'exploitative' profits into the pockets of workers – may turn out to be an economic variant of the futile exercise of squaring a circle.

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Acceleration of production

The measures in the prime minister's Note which impinge on saving and investment and the expansion of production include nationalization of banks; a change in the criteria of credit-worthiness for the grant of loans; special efforts to develop backward regions; and extension of more credit to agriculture.

These measures do not add to savings; they would merely shift investments, without enhancing the overall resource availability. Nor will they correct the wastage and misdirection of savings. Bank nationalization and changes in the criteria of credit-worthiness may accentuate these maladies through, among other ways, diverting bank funds into extravagant and low return public sector projects at the expense of more lucrative outlets; and through piling up bad and dubious debts.

The record of political influence in the management of undertakings in the public sector has been more dismal than encouraging. We have an extreme case of this in the working of agricultural co-operative credit societies. In 1965-66, the overdue loans -- these may be some measure of bad and dubious debts – by these societies were about 96 per cent of their paid-up capital. The risk of the commercial banks being drawn along the same dangerous path may not be imaginary. The other measures cited above may also divert savings into the politically favored sectors, with less than due regard to the danger of this to the national product and to the relative soundness of the investments. We cannot achieve economic development by an organised dissipation of savings.

The problem of larger credit to agriculture is an extremely complex one. To tackle this problem, public sector appropriations of capital must be drastically scaled down; legislative measures which undermine the creditworthiness of farmers and obstruct the flow of credit into the farm sector must be repealed. Most of the peasants and much of the rural population are bankable only in one direction – banks readily accept their deposits. Generally, banks do not advance loans to them. Consequently, the more common experience is that the rural branches of commercial banks have a surplus of deposits over loans. This might render the farm credit position worse as, on balance, they may then shift rural funds to urban sectors. The old rural bankers, now no longer very active, took urban funds to the rural sector.

As in the case of bank nationalisation, the other measures in the prime minister's Note may bring rich political dividends to her and to her supporters. But these measures are not capable of relieving mass suffering. They may render it worse.

Inevitability of communism

Critical observes would seem to agree that India is currently in the midst of a major transformation. Recent events, in particular, bank nationalisation and reports of further policy measures harmonising with bank nationalisation, strongly suggest this transformation.

At the Faridabad session of the Indian National Congress last April, the prime minister had observed that the country was at the cross-roads of history; and that the future of the Congress depended on which road the party took – whether it went with the people or in the opposite direction. In all her public pronouncements since the Faridabad session, and since bank nationalization in particular, she has emphasized her identity with the people; we are assured that her policy measures are designed to better the lot of the people.

Our own analysis of the Indian economic situation is fully in line with the assessment that India is, at present, at the crossroads of history. The accumulated pressures which have ensued from our policies of the past 15 years are so compelling that, short of a miracle, the Indian caravan would take the road to the extreme left. The chances of the caravan being drawn along the road to the extreme right are too remote to merit much attention.

India is, at present, at the crossroads of history. The accumulated pressures from our policies of the past 15 years are so compelling that the chances are that the Indian caravan would take the road to the extreme left

I venture to say this regardless of whether it is the leftists or the so-called rightists in the Congress who eventually win the present power struggle. It is misleading to describe the present power struggle in the Congress as being between rightist and leftists. There are hardly any rightists in the Congress in the sense of advocates of a free society. The so-called rightists would control prices, wages, rent, interest, profits, the exchange rate and the movement and supply of essential materials; would nationalise 'key' industries, 'sick' mills and factories, hotels, dairies, bakeries and departmental stores, impose ceilings on income and on the ownership of land and other wealth;

and may do several other things besides if they are 'satisfied' that such things are in the 'public' interest.

The differences on these issues between the two factions in the Congress – wrongly labeled rightists and leftists – generally relate to the timing and the extent of the intervention.

A major gap between communists and the so-called rightists in the Congress is that the latter would adopt these socialist measures by Parliamentary legislation, while communists would scrap the Constitution altogether. Otherwise, communists find little difficulty in generally supporting the policy measures of the Congress. They stood solidly behind the prime minister in the nationalisation of banks.

None in the Congress would risk being dubbed a 'reactionary' – all like to be called 'progressive'. To revile or pillory capitalists is a popular theme among politicians seeking public approbation. At the Bangalore session of the AICC in July 1969, the so-called rightists 'bitterly complained' that the Economic Policy Note of the prime minister, presented to the AICC made it appear as though 'the prime minister alone held progressive views.' This complaint was made even by Nijalingappa, president of the Congress, a leading rightist.

Morarji Desai, former deputy prime minister and supposedly a rightist, addressing Delhi's Press Club on 2 August 1969, protested that he was 'not against nationalisation'. He reminded his audience that he was, indeed, 'the first minister to nationalise road transport'.

It is significant, too, that the third candidate for the Presidential election put up by the Jan Sangh and the Swatantra parties, the splinter rightist groups in the Parliament, took no time to tell the press that he was not a rightist. He announced himself as being left-of-centre and of having been apprehensive of the rightist ascendancy in the Congress after he resigned as Finance Minister in July 1956. He recalled that he was responsible for various socialistic measures, among which he included nationalisation of the State Bank of India, nationalisation of life insurance, and the massive Company Law legislation.

IN RECENT YEARS, THE Communist and like-minded parties have forged ahead at an ominous pace, while most other parties have been on the defensive or on the decline. Congress president Nijalingappa had remarked that a vote for V V Giri (for President of India) was a vote for communism, and a vote for N Sanjiva Reddy, the official Congress candidate, a vote for democracy. It may not be correct to dismiss wholly Nijalingappa's dichotomy as an election campaign overtone. Giri got 51 per cent of the votes and Reddy 49 per cent. This would seem to reflect broadly the present strength of the leftist forces among the legislators in the Centre and in the states, the electoral college for the presidentship.

The ascendancy of the communists would seem to be linked up with the growing economic chaos in the country. India presents a classic case of economic intervention on the theory that the first harvest of chaos was due to half-hearted or inadequate intervention; and of chaos mounting on chaos in this manner. In the Indian background of poverty, where the masses are not far from the breadline, the waste of resources that economic chaos involves has led to resource scarcities in the production of the necessaries of life and, therefore, to a deterioration in the economic condition of the people. This is fertile ground for the spread of communism. They blame the condition of the people not on the policies of economic intervention, but on capitalism and the existing social order. The theme of their propaganda machine is that in the destruction of this system alone lies the hope of any lasting prosperity of the people.

Even as the corrective to boiling water is to remove the fire from underneath the cauldron, the only corrective to the prevailing turmoil is to strike at the tap roots of India's ailments. We have seen that this calls for the adoption of reforms which will, first, put a stop to social injustice and, secondly, accelerate production. The policies which we have pursued hitherto are incapable of achieving either. As our analysis demonstrates, it is, indeed, these very policies that have produced what we have called economic tuberculosis.

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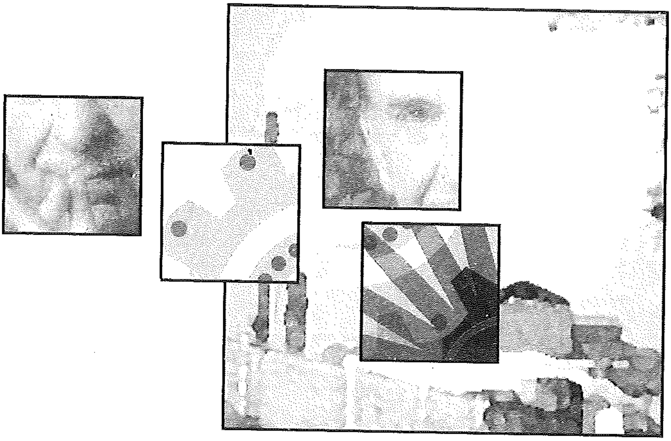
Both wings of the Congress put the accent on nationalisation. Though this commands extensive public support, it is no remedy to India's economic ills. The captive cormorant sea-birds, used for fishing in parts of China, well illustrate our condition. A strap is fastened around the bird's neck such that while the bird may breathe freely and otherwise function naturally, it cannot swallow the fish it may catch: it is obliged to surrender this to its keeper. We have seen that, though industrial workers produced in 1964-65 two-three times their output in 1951-52, the net rise in their own wages was less than 20 per cent. The balance to the employer and others.

All of us today – not merely factory workers – are like these sea-birds. We have no escape from surrendering a part of our earnings to monopolists. To replace private monopolies by state monopolies will make no difference, even as the cormorant sea-bird would still be unable to swallow its catch, if the color of the rings round its neck was changed. If we must have social peace and economic progress, the rings round our necks of import licensing, other economic controls and printing press finance must be removed. If the rings remain, we may have communism or other form of dictatorship, sooner or later.

The blame for India's predicament lies not on Indian policy-makers alone – aid-giving countries must share the responsibility. In the absence of such colossal aid, shortage of foreign exchange would have compelled us to review of our policies; these countries have, in fact, been feeding policies leading to communism.



planning

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section B

4

Need for a policy alternative

19 SEPTEMBER 1976

This is the text of a paper read at a seminar on 'Development Strategies: Need for Alternatives' organised by the Leslie Sawhny Program, Bombay. Here Professor Shenoy pointed out that planning had failed as, among other things, unemployment had gone up almost six times since 1951

The broad structure of the policy measures adopted in the 1950s is founded on the belief, outlined in the Second Plan (1956-61) document, that there is an innate conflict between 'private profit' and 'social gain'; that the state alone is 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 are not possible except 'within the framework of a comprehensive plan' formulated and implemented by the state. The model for the comprehensive plan is the Russian plan.

The objectives of these policy measures, which were structured and interpreted in the Five-Year Plans, were four-fold: (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 US, 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 per capita income bracket, 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, hopefully without boring readers.

Per capita real income

The impact of these policy measures on the poverty and income inequalities front 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 the 1950s, the per capita real income showed – in line with the more common universal experience – a virtually unbroken uptrend.

The per capita income fluctuated around a shifting norm, spurting up with good harvests due to favorable weather, and tending downward thereafter, waiting for another good monsoon to push it up again. Thus, the dependence of income on the weather increased

With the coming of the policies of planning, the income trend changed from watershed year 1960-61. In place of a steady rise, per capita income fluctuated around a shifting norm, spurting up with good harvests due to favorable weather, and tending downward thereafter, waiting for another good monsoon to push it up again. Thus, the dependence of income on the weather increased. The net result is that the per capita real income (NNP at 1960-61 prices) in 1974-75 Rs 341, was only nominally higher than that a decade ago, Rs 335.

During the decade ending 1960, 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, 0.8 per cent. The per capita income being a national average of a hotch-potch 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. Consumption trends of other articles tell the same story.

Animal proteins as a regular article of diet being, as a rule, 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 the 1950s, reaching a peak of 2.43 ounces per capita per 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

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 present-

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 labor force

ly see, of the earnings of the masses shifting 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 per capita incomes of the agricultural and non-agricultural populations. In 1960-61, 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 (1960-61 prices). 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. All benefits of developmental activity under the prevailing policy system have, on balance, accrued 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 changes in lifestyle, 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 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 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 labor force. Unemployment in 1951 was placed at 3.3 million. By 1971 it multiplied 5.7 times to 18.7 million, according to the estimate of the Unemployment Committee. The progress of the prevailing policy measures involved the progress of unemployment.

Alone among plan objectives, industrialisation has made outstanding progress. Industrial production multiplied four 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 falls 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), UK (3.1 per cent) and USA (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 technologists and the export of knowhow 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 NDP in 1950-51, the pre-Plan year, and was still only 14.3 per cent in 1974-75. Agriculture and allied activities which contribute 50.5 per cent to NDP remain the major influence on the trend of per capita income.

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 crore), 20 times as high in the Third (1961-66) and is placed at nearly 4 times as high in 1973-74 (Rs 3,260 crore). The rise in investment was 5.7 times as fast as that of the population. Total investments from 1951-52 to 1973-74, at 1961-62 prices, amounted to Rs 44,342 crore. 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 handpicked 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.

Where have all this investment, foreign aid and dedicated effort gone? The explanation lies, almost wholly, in resource wastage and misallocation, which have generally attended the prevailing policy measures

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 labor force, why should unemployment continually increase when plan investment has risen 5.7 times the population growth? The explanation lies, almost wholly, in resource wastage and misallocation. The debit incidence of these two factors has negated the investment effort so much that the impact of this effort on NDP has been far less than its magnitude.

Resource wastage

Perhaps the largest and the worst case of resource wastage is corruption in the form of 'kickbacks' as applied, primarily, to public sector investments, although corruption may obtain in private sector investments too. While the concerned parties alone can be aware of the correct position, if the kickbacks are placed at 20 to 40 per cent of the amount invested, this proportion of public sector investments is a case of transformation of national savings, through kickbacks, into private incomes. Thus, in 1973-74, when Plan investments were at Rs 3,260 crore, the amounts actually going into Plan projects would be less by the amounts of the corrupt payments, although the account books would not show any change in investments. To this must be added the kickbacks in the private sector.

UNUTILISED PRODUCTION capacities are another large case of resource wastage. 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 underutilisation 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 to 55 per cent of the production capacities remained unutilised. As 60 to 66 per cent of total plan resources are drawn into the public sector, this would make resource wastage of an order of 21 to 36 per cent of the aggregate plan investment, the public and private sectors being viewed together. Although the percentage of idle capacity (35 to 55 per cent) may not hold true of the public sector as a whole as it applies to the major undertakings, the resource wastage in idle plant and equipment during the three years concerned should be substantial.

As 60 to 66 per cent of the total plan resources are drawn into the public sector, this would make resource wastage of an order of 21 to 36 per cent of aggregate plan investments, the public and private sectors being viewed together

The position has considerably improved since 1968-69. 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 wastage under this head to 20.5 per cent of the total plan investments. To this must be added idle capacity in the private sector.

A third head of resource wastage is overstaffing and laxity in management and expenditure. 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, overstaffing and laxity in expenditure may be devices of absorbing, in the form of costs, windfalls from licenses, permits and quotas, and from sheltered markets which might otherwise, in large part, get lost in taxation.

The socialist policy package includes the belief, which has persisted in underdeveloped 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 ignored, too, that it may be perilous for a country to neglect agriculture, when 72 per cent of its total population derives its income from agriculture and allied activities.

This has rendered virtually the whole range of Indian manufacture uncompetitive in world markets; and has necessitated more or less heavy subsidies and incentives to enable the exports to move

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 control 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 world markets; and has necessitated more or less heavy subsidies and incentives to enable export of manufactured goods to move.

By contrast, agricultural export, crude as well as processed, which accounts for 35 to 40 per cent of total exports, satisfies the international cost quality standards and has been able to move without subsidies, and even under the handicap of an unrealistic exchange rate.

Unmerited income transfer

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 transfer 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, second, 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 restriction on imports through the system of import licensing. This has created vast gaps, varying with commodities, between the c.i.f. (costs, insurance and freight, or landed) cost and 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 licenses by way of windfall profits, or as sale proceeds of the licenses. When to these sums are added 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 NDP. The share of the poor from these increases would, therefore, be small.

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 already poor masses has been harsh. This explains the strange phenomenon, reviewed above, of the per capita income of the rural population moving downward and the per capital income of the urban population moving upward.

Outline of a policy alternative

It is clear from the foregoing review that, if the prevailing policy measures continue, it is most unreasonable, under ordinary circumstances, to expect 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 labor 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 labor 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 level, I expend no more than what I earn; and cases of 'I earn and you spend' are eliminated at all income levels below the upper income levels, save doles to the distressed by the state or by private parties.

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 the resource wastage and resource misdirection which necessarily attend these measures.

> **When to these sums are added monopoly gains from the remaining instruments of planning, the amounts of the income transfers may add up to a substantial part of the annual increase in NDP**

Expectation (b) is most unreasonable because, in a set-up that permits public sector appropriations of 60 to 66 per cent of national resources and priority allocations to industry, the capital starvation of agriculture – the remaining sector – is unavoidable. 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 wastage and misdirection, production and hence employment becomes a most reasonable prospect. When the expansion of employment falls short of the natural additions to the labor 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.

The vital need is to restore the sovereignty of the consumer. This has to be implemented through the instrumentality of consumer directives to entrepreneurs, and to a price-regulated market mechanism

If these expectations, which are but the integral parts or 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 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, businessmen, 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 even though, as in the case of industrial workers, their real incomes may have gone up relatively to the 1950s. For the salaried classes, in particular, these policy measures have yielded little more than wilted well-being.

The vital need: a market mechanism

To bring about this revolutionary econcmic 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 reform, on the plane of policy action:

- Termination of organised chaos or 'planning', and allocation of resources among various channels of investment through a consumer-regulated price market machinery
- 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
- The U-turn (ii) above may involve denationalisation of some categories of public sector undertakings

- Elimination of all monopolies, whether in the public or the private sector, and the determination of all incomes through the market mechanism
- An adjustment of money flows to the expansion of the national product, the budget being appropriately balanced to achieve this
- The scaling down of taxation and governmental outlays to match the reduced activities of the state
- 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
- The adoption of a fully floating rupee.

It may not be possible to achieve all these U-turns in one leap, though Professor Ludwig Erhard, architect of the German economic miracle, had scrapped virtually all control measures in one swoop. This package of reforms could be adopted in a phased program. 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 adoption of the U-turns.

5

Economic oddities in the name of planning

1954

These are extracts from the famous dissenting note attached by the author to the Second Plan as the Note of Dissent, B R Shenoy was the sole economist to go against the tide. Here he comes down heavily on deficit financing and nationalisation, and the reliance on legislative measures to increase the rate of saving

The plan frame begins by prescribing the increase in national income which the plan would set out 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.

As no plan can be bigger or bolder than the available resources, the size of the investment program should be reviewed periodically to ensure that it keeps within the limits of savings. If such a review should reveal a shortage of resources, it would be shortsighted to fill the gap by credit creation or deficit financing, as this will be self-defeating. A deficiency of total real resources for development will get manifested, in the sphere of finance, by failure to secure finance otherwise than through an excessive creation of credit, or deficit financing. The inability to place more than about 75 per cent of the resources required for the Plan under the usual sources and the reliance on deficit financing for the rest are broad evidence that the size of the Plan far exceeds the available savings.

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The size of the Plan frame has been unduly inflated as a result, on the one hand, of the over-optimistic growth in national income which it aims at and, on the other, of an unduly high average rate of saving as applied to this assumed income. A much lower figure would result if both these rates were more realistic projections of Indian experience of the recent past. Though a certain measure of accelerated progress may result as income grows and savings increase, a steep upward movement from a background in which the mass of the people live on the margin of subsistence may not be possible except in a totalitarian regime.

Legislative and administrative measures

I am unable to agree to the following recommendation of my colleagues:

It is only when there is a firm legislative and administrative base that it is possible to think in terms of doubling the rate of progress in the Second Plan period, of increasing capital formation, of raising levels of saving and providing the machinery for accelerated development in future. We cannot, therefore, emphasise too strongly the importance of facing up boldly and without hesitation to the legislative and administrative implications of a bigger and a bolder plan.

I apprehend that reliance on legislative and administrative measures to increase the rate of saving which will permit a bigger and bolder Plan may, by degrees, undermine our democratic social order, which would be too high a price to pay for accelerated economic development. Legislative and administrative action should be directed to ensuring the most effective uses of democratically generated savings, rather than risk undue infringements of the liberty of the individual without which, to quote our Prime Minister, "We lose what is the greatest value in life."

It would appear preferable to explore the scope for more ample but unencumbered foreign aid and foreign loans and a larger flow of unencumbered foreign private capital to supplement domestic saving for accelerated economic development. In view of the vast scope of profitable investments, the net profits of the projects may be expected to more than cover the amortisation of the foreign capital within a reasonable period.

Economic history does provide instances of national economic development being financed by foreign capital in the early stages with no loss or sacrifice of sovereignty.

Taxes on lower income groups

There is hardly room for a further reduction in the standard of living of the lower income groups in India. Finance for the Plan must be raised from the middle and the upper income groups. Measures of taxation and other devices, which would tend to reduce further the consumption of the lower income groups, should be avoided. I am unable, therefore, to agree to my colleague's recommendation to amend Article 286(3) of the Constitution in order to permit taxation of articles 'essential to the life of the community'. Amendments to the Constitution, which should be rare, should much rather be in the direction of adding to the liberties, privileges and rights of the common man than otherwise.

Extension of nationalisation

I agree with my colleagues that the scarcity of administrative and specialised personnel, and the necessity of conserving savings for the Plan are factors against extension of nationalisation. But they have no objection for such extension on principle. I would oppose general extension of nationalisation on principle. Nationalisation should be ordinarily limited to public utility concerns and to concerns involving national security. Otherwise, state intervention should be concerned with the prevention of monopolies or quasi-monopolies. Efficient management of business and industrial concerns in a competitive market economy is a highly specialised function and demands qualities which a civil servant is not required to, and in the ordinary course of his training may not, acquire. This function is best left to private entrepreneurs in the prevailing socio-economic order which is dominated by the market economy and the pricing system.

Legislative and administrative action should be directed to ensuring the most effective uses of democratically generated savings, rather than risk undue infringements of the liberty of the individual

Continuance of controls

I do not feel convinced of the economic importance of continuing the remnants of control. Decontrol has proved a noteworthy success. Controls and physical allocations are not a necessary adjunct to planning. The distribution of productive resources, including the ratios in which they are used, are subject to variation and depend upon diverse technological, economic and price considerations. It is quite impossible to take into account these complex and changing considerations and arrange anything like a satisfactory allocation of resources. There are great advantages in allowing freedom to the economy, and to the price system in the use and distribution of the needs of production.

I am unable to agree with my colleagues that a case exists for continuing what controls now remain. Steps should be taken to remove controls as early as possible. Controls and allocations are an essential characteristic of communist planning. They do not fit in very well under planning in a free enterprise market economy.

Price-support of agricultural produce

I wish to join my colleagues in the matter of the urgency and importance of completing speedily the scheme for licensed warehouses, and for the provision of credit and marketing facilities to farmers. My colleagues have stated that the warehousing system 'should be used by the state for purchase and sales of buffer stocks of agricultural commodities not only for the purpose of dealing with any sharp falls in agricultural prices such as we are witnessing today but also with the objective of preventing any sharp seasonal fall or rise in prices'.

In theory, it is possible to distinguish between seasonal price movements from the long-term price trends, and to prescribe that seasonal fluctuations should be smoothed out by state purchases at harvesting time and between harvests. In practice, however, such distinctions may prove to be difficult, and seasonal interventions may turn into long-term price support operations.

Price support of agricultural produce in India is a risky venture and we should be forewarned of the inherent dangers of it. About 50 per cent of Indian national income is drawn from agriculture. A policy of price support is, in essence, a subsidy by the rest of the community to the producers of the price-supported commodity. In countries where agriculture is a minor sector of the national economy, the incidence of the subsidy may be spread out thinly on the larger sector of the economy and the proceeds may provide substantial relief to farmers.

The reverse would be the case in India. The strain of the subsidy will manifest itself in a shortage of budget resources for the open market purchase and storage of agricultural produce. This, in due course, would lead to either abandonment of the price-support policy or inflation. In either case damage would result. If the dilemma does not appear in one season, it is likely to come in the next, as successful price support would stimulate production.

> It is quite impossible to take into account these complex and changing considerations and arrange anything like a satisfactory allocation of resources. There are great advantages in allowing freedom to the price system

In the Indian context, a policy of price support of agricultural produce may force the economy down the inclined plane of inflation. Even in the United States, where agriculture is a minor sector of the national economy, price support has only survived – it has not succeeded. It has led to undue stockpiling of agricultural commodities and, in the past, had evolved a great deal of wastage of stocks through deterioration.

The strain of the subsidy will manifest itself in a shortage of budget resources for the open market purchase and storage of agricultural produce. This, in due course, would lead to either abandonment of the price-support policy or inflation

Selective price support policy is a poor answer to this difficulty. The distinction between crops would be invidious, the relief provided may prove to be a token, and it might cause a distortion in the pattern of agricultural production and economic instability.

The price situation in India today is too complex to be resolved by price support of agricultural commodities or other inflationary measures such as deficit financing. The price decline is neither universal nor uniform. The prices of some major commodities moved in opposite directions. The fall was heaviest among foodgrain, oilseeds and black pepper. Some agricultural produce, e.g. tea, 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 either steady or showed a slight upturn on the average. The cost of living index was either steady or had fallen only slightly.

In a background of dissimilar price movements, simple monetary remedies may aggravate the complexity and difficulty of the price structure. It may, on balance, adversely affect the employment position by stiffening the already rigid cost structure. Price support and deficit financing are no remedies to individual over-production, and to export difficulties which are attributable to quality and to domestic costs or exchange overvaluation. Price support and deficit financing might, in fact, aggravate these maladies.

The complex problems of the prevailing price situation emphasise the importance of economic rationalisation, for progress with stability, whereby the fiscal, the investment, the monetary, the interest rate, the tariff, and the exchange rate policies are rendered mutually consistent and harmonious.

6

Not the best-laid plan

25 JANUARY 1958

This chapter is extracted from the Supplementary Note to the Report submitted by the Panel of Economists of the Planning Commission. Here the writer emphasises that ills like rising prices, fall in savings and foreign exchange scarcity are a result of the plans, not due to poor implementation of these plans, as was being made out

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. Briefly, my assessment is: 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.

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, foodgrain 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 year-wise, 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.

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 crore as against an increase of Rs 5 crore 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 deficit.

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 crore in 1956-57 and Rs 370 crore in 1957-58.

To continue the analogy, the suction pump is operating on a battery and the current in it is fast running out. The surplus reserves today are about Rs 220 crore 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.

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

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 deficit financing. Inflation cannot be contained by controls. The only sure protection is prevention.

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 crore (Rs 4,350 crore 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.

Fall in savings

Since 1955-56, the savings of the community do not seem to have gone up. This is evidenced by the increased consumer goods bias of domestic production. Though import of consumer goods has been severely restricted, import of 'Materials Chiefly for (the manufacture of) Consumer Goods' rose from Rs 358 crore in 1955-56 to Rs 1,032 crore in 1956-57, a jump of 2.9 times. We have here a case, so to speak, of rations being carried to this side of the frontier for cooking because of import restrictions. Notwithstanding severe cuts in the import of consumer goods, consumption has been, thus, taking place at the expense of inflation and may be, partly, also the outcome of the increase in consumer bias or 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 prevailing foreign exchange scarcity cannot be remedied by intensified import restrictions. This 'remedy' might prove to be worse than the disease

The need to restrict investments in the public as well as the private sectors to the available genuine savings was never greater than today. The question of saving the 'core' of the Plan is linked up with 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.

Foreign exchange scarcity

The amount of foreign aid required to fulfill the Plan is not 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 to Rs 2,000 crore (for the public and 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 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 measure in seeking a solution to this problem, we have to take note of four important factors:

(1) the low level of our exports relative to the pre-war period
(2) the large gap between the internal and external prices of gold

(3) 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

(4) the rapid progress of the rest of the world towards *de facto* convertibility.

Planning which involves controls of this character and magnitude is close to, if not identical with, total planning. I believe planning in India would not be consistent with democracy

Exchange control leakages today apply to our dollar trade, which is about 19 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.

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 involves controls of this character and magnitude is close to, if not identical with, total planning. I believe planning in India would not 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.

Food policy

The problem of price stabilisation of agricultural production 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 in the future. The Foodgrain 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 outcome of inflation, to correct it we have to, first, put a stop to inflation and, second, import sufficient foodgrain 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 of the wholesale trade. We cannot be too sure that the farmers, in the long run, can 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 Foodgrain Enquiry Committee has recognised this eventuality.

The example of Canada, Italy and Japan in the matter of price support of agricultural produce are little justification for the colossal undertaking, which socialisation of the wholesale trade in foodgrain 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, foodgrain occupies 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.

7

Planning or authoritarian control?

1964

This article appeared in the annual edition of *Swarajya*. Even at that early date, B R Shenoy spoke against control of capital issues, restriction on cotton textile mills and forced industrialisation, predicting that they would have an adverse effect on the economy – as indeed they did

The keynote of Indian economic policy has been centralised planning. At the close of 13 years of this policy, authoritarian control of the economy has assumed proportions which should cause great concern to freedom-loving people in India as well as abroad. The authoritarian hold over the economy operates through government control over international trade and payments, government intervention in domestic economic activity and through the spread of public sector undertakings.

In the field of foreign trade, government control is legally comprehensive. No import of any kind is allowed without an import license. Though exports are generally free, all export receipts have to be surrendered to the Reserve Bank, the monopolist dealer in foreign exchange operating on behalf of the government. The same applies to foreign exchange accruing under any other head, including foreign aid. No foreign exchange, for whatever purpose, may be had without a Reserve Bank permit.

Some flexibility to these rigid limitations on imports and on foreign exchange transactions is provided by illicit imports of commodities and by illicit transactions in foreign exchange. Foreign exchange to pay for the illicit imports and for the concealed transfer of funds abroad is found from the illicit market for foreign exchange. The rate of exchange prevailing in this market is well above the official rate, the premium above parity being about 62 per cent currently.

The illicit market draws its supplies of foreign exchange from the Reserve Bank through over-invoicing imports, or, at the expense of the Reserve Bank, through under-invoicing exports, or through smuggling out exports. The illicit market becomes a free market when the transactions are put through outside the national frontiers, as in Hong Kong, Zurich, or New York.

Statistics of exchange transactions in the illicit (or free) market, if available, would provide a rough measure of the illicit imports, and of the concealed transfers of capital and other funds abroad. Market gossip believes the magnitude of these transactions to be considerable, one commentator venturing the figure of Rs 200 crore per year, which is roughly one-third of the open exports of the country. In recent years, the magnitude of the illicit market, as a ratio of the open market, has doubtless grown.

Centralised control over the disposal of domestic savings is exercised through capital issue control and the rule that no enterprise may be started or expanded without an official license; through requiring the insurance companies, the banks and trustees to invest part of their funds in government debt

Monopoly control over the disposal of foreign exchange enables the government to appropriate the entire amount of the foreign exchange requirements of public sector enterprises, regardless of the acuteness of the foreign exchange situation.

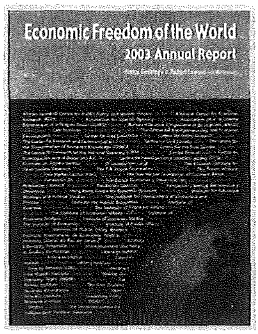
Authoritarian control of the economy through intervention in domestic economic activity operates through control over the disposal of savings and foreign aid; through delimiting the area of operations of private enterprise; through regulating the working of joint stock companies, commodity markets, the stock exchange, the banking system, and the bullion market.

Centralised control over the disposal of domestic savings is exercised through capital issue control and the rule that no enterprise may be started or expanded without an official license; through requiring the insurance companies, the banks and trustees to invest part of their funds in government debt; through the sale of government debt to the public and the collection of 'small' savings by the post office savings banks; and through deficit financing. In this manner, the bulk of the national savings are channeled into public sector undertakings.

From plan statistics we find that the public sector appropriated over 50 per cent of the total plan resources in the First Plan and about 60 per cent in the Second; the percentage in the Third Plan may be well above two-thirds. These percentages are an understatement – if due allowances are made for errors in Plan statistics of investments in agriculture and for the gross overvaluation in the official exchange rate of the rupee at which foreign aid is converted into Indian money in the Plan statistics, public sector appropriations may be about 70 per cent of the total investment resources.

This is a very serious matter for the survival of economic freedom. With nationalisation of the current capital formation proceeding at so fast a pace, 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 area of operation of private enterprise is delimited by the government's Industrial Policy Resolution 1956. This *fiat* classifies industrial activity into three categories. The first, comprising the so-called 'basic' industries



No heavy hand of the state...

is reserved for the state. The second, comprising another category of 'basic' industries, will be also progressively state-owned with room for private enterprise only 'to supplement' the effort of the state. The third, which will include the remaining industries, will be, 'in general', open to the private sector; but the state will always have the right to enter this area as well and the aim of policy would be to extend state trading in this sector and for enterprises to be run by cooperatives, the working of which, in India, is habitually subject to official control, direction or cognisance.

The Industrial Policy Resolution, thus, envisages the progressive liquidation of the private sector, its place being taken by the public sector. This process will eventually establish a social-economic order which will be indistinguishable from communism. This program harmonises with the financial arrangements, reviewed above, under which about 70 per cent of the current accruals of savings and foreign aid are drawn into the public sector.

THE DAY-TO-DAY functioning of private sector undertakings is constantly confronted by the heavy hand of governmental intervention. They have continually to contend with price controls, distribution controls, capital issues controls, exchange controls and the like; the Joint Stock Companies Act provides for governmental intervention in such details as the manner of conducting board meetings, staff appointments, borrowings, investments, access to the capital market and so on.

Addition to spindles and looms is not possible without permits; the production of certain varieties of cloth is subject to ceilings; manufacture of dyed sarees is banned

The vexatious character which governmental intervention may take is illustrated by the case of cotton textiles, which, incidentally, account for about one-third of Indian industrial activity and provide the clothing needs of virtually the entire population. The list of restrictions on cotton textile mills is long. Additions to spindles and looms are not possible without permits; the production of certain varieties of cloth is subject to ceilings; the manufacture of dyed sarees is banned; the borders of sarees have to satisfy certain restrictive limitations; the counts of yarn in the warp, weft, reed and pick in certain varieties of cloth are subject to specifications; and so on.

The government has similar powers of superintendence, control and direction over the banking system, the stock exchange and the commodity and bullion markets. It has powers for influencing the press through the favors of official advertisements, 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 either import licenses to meet its import needs or permits to acquire the domestically produced 'essential' supplies.

> The gains in money and power which planning brings are colossal. The money value of import licenses and the illicit earnings from government contracts alone may be of an annual order of Rs 650 crore

Though controls harass, they also bring windfall gains through the monopolies, semi-monopolies or sheltered markets which they create. Many cotton textile mills were in the red in 1955-56. With the coming of restrictions on the additions to spindles and looms, the expansion of production soon lagged behind the growing demand and, though the quality of the output and the efficiency of production remained unchanged, the losses got transformed into profits.

No wonder the mill-owners are staunch supporters of planning; for similar reasons, so is big business in India generally. The gains in money and power which planning brings are colossal. The money value of import licenses and of the illicit earnings from government contracts alone may be of an annual order of Rs 650 crore. These gains are shared by traders, businessmen, industrialists, politicians in office and outside, administrators, the hangers on of these groups of persons, and the touts and go-betweens.

THE CO-SHARERS OF THE benefits of planning being from among the more influential and the more vocal sections of the community and 80 per cent of the people being illiterate, the weather conditions for planning appear favorable. The planners seems to be comfortably able to keep themselves in power for long, through the use of the double weapon of the sledge-hammer of controls and the patronage of licenses, contracts, permits and concessions.

Economic development manifests in increased savings, larger investments, expansion of employment, growth of national and per capita incomes, and a rise in the standard of consumption of the masses of the people. The foundation and the sustaining factor of economic development is savings. Our monetary, fiscal and economic polices must be aimed at stimulating the flow of national savings and at achieving the economically most effective investment of savings. The need for this policy accent on savings and on the most effective utilisation of savings is particularly great in underdeveloped economies which, because of their poverty, suffer from an acute scarcity of capital.

The rate of saving in India in 1950-51 was 6.7 per cent of the national income. In 1961-62 it was still 7.5 per cent as against a (gross) saving rate of 23 per cent in USA. The volume of savings in India is, currently, of an annual order of Rs 1,100 crore as against Rs 60,600 crore in the US.

The slow pace of increase in savings in India is the outcome of the slow pace of increase in the well-being of the masses of the people as evidenced by the semi-stagnant and sub-standard levels of consumption of food and cloth; the inroads of inflation on savings; the wastage of savings resulting from the steep rise in revenue collections; and the easy, unmerited and illicit incomes which the statist controls over economic activity have been yielding.

Revenues shift incomes from the pockets of the people into the coffers of the state. The steep increase in revenue collections, which have been almost wholly eaten up in the consumption expenditures of the state, have depressed national savings through converting the potential savings of the public into the consumption expenditures of the state.

To step up national savings (and to accelerate economic development, expansion of employment and a lifting up of the level of consumption of the masses of the people) we must pursue a monetary policy of zero inflation, resort to a drastic cut in revenue collections and adopt free market economic policies, which alone are capable of bringing about the most effective utilisation of savings.

It cannot be validly argued that a cut in the consumption expenditures of the state (to balance the cut in revenue collections) may reduce overall national income or overall national employment. To the extent of the cut in revenue collections, the incomes of the people would increase and, therefore, their disbursements from income. The cut in the consumption expenditures of the state would be, then, balanced by the increase in the disbursements from income by the public. Total national income does not shrink. Outlays from this income by the public will replace, to the extent of the revenue cuts, outlays by the state. Employment being a function of the level of national income, since the latter would not change with the cuts in revenue collections and state expenditures, employment would not suffer either from these two measures.

We must pursue a monetary policy of zero inflation, resort to a drastic cut in revenue collections and adopt free market economic policies, which alone are capable of bringing about the most effective utilisation of savings

The need for drastic cuts in revenue collections by the state arises, firstly, from the urgent need to step up national savings and, secondly, the human cruelty which any cuts in the consumption standards of the public (to step up savings) would involve, as masses of the people are already at the margin of subsistence. If revenue collections by the Centre and the states are held down to their 1955-56 level, and consumption expenditures of the state are limited to revenues, national savings would accelerate investment and economic growth, national income, employment and consumption by the masses of the people.

While almost all revenues need to be axed drastically, progressive taxation, being particularly pernicious in its effects, merits being abolished altogether. Its incidence is anti-social in that it virtually closes the route to vertical mobility in the acquisition of income and wealth distribution; deprives the community of the full production advantages of its ablest men as it penalises talent and efficiency; and thus debilitates a major force of dynamism and growth. Modern communities have been saved from the full impact of progressive taxation through tax avoidance and illegal tax evasion, though the moral and economic costs of this have been heavy.

Liberal economic thinkers advocate the replacement of progressive taxation by a flat rate income tax applicable to all incomes above a minimum, and are averse to the sadist theory of taxation. This confirms the two basic doctrines of the tax policy of the Indian tradition, namely, that taxation should be limited to one-sixth of income and should be levied as painlessly as the bee collects honey from the flower.

Program of tax reform

We have been saved from the full economic damage of progressive taxation in India through the extensive tax avoidance and illegal tax evasion which it has given rise to, though the price of this has been a weakening of our moral standards. Tax avoidance and tax evasion have been induced by the phenomenal gains they bring at the existing tax rates on the upper income slabs. When an individual with an earned income of Rs 3 lakh has to pay Rs 2.25 lakh in taxes, tax avoidance and tax evasion become well worth the effort. This would seem to explain the semi-stagnation of tax collections on personal incomes, despite the vast strides we have made in industrial development; in 1961-62, these collections were still at Rs 142 crore as against Rs 133 crore in 1950-51.

Current thinking among liberal economists is strongly in favor of abandoning progressive taxation. This will suit the needs of underdeveloped economies eminently well.

> Progressive taxation merits being abolished altogether. Its incidence is anti-social in that it virtually closes the route to vertical mobility in the acquisition of income and wealth distribution, penalising talent and efficiency

The problem of taxation in India must be viewed in the context of the overall economic problem confronting us, namely, the economic development of the country with a view to the abolition of poverty and the liquidation of unemployment, including the massive under-employment prevalent in the rural areas. The emphasis on the abolition of poverty in this definition of our objective is called for by the continuation of misery and squalor in certain countries, which in point of industrial development seem to stand very high indeed. Russia, for instance, appears to be ahead of virtually the whole of the rest of the world in marvels of engineering, in nuclear science, rocketry and space science.

Rapid industrialisation

Production statistics exhibit striking progress in industrialisation, the General Index of industrial production going up by 70 per cent, from 100 in 1951 to 169.9 in May 1961, or at an annual rate of 7.4 per cent. This has not lifted up the overall national product at a comparable rate because indus-

This has placed the domestic manufacturers of the substitute goods in monopoly or semi-monopoly positions. They are able to extort near-ransom prices from the consumers of these goods, which are generally shoddy in quality

tries account for the minor part, 16 to 19 per cent, of economic activity.

Though, as we have seen, progress was recorded in all categories of production, the output of capital goods (machinery, electrical motors, machine tools and automobiles) and intermediate goods (coal, iron and steel, other metals, cement, heavy chemicals, paints, tanned hides, rubber goods and electricity) showed outstanding progress. Among consumer goods, the output of cotton textiles and other consumer goods in common demand showed the least progress. The index of production of consumer goods used by the relatively better-to-do classes of the people, on the other hand, made rapid strides.

This record and pattern of industrial production reflects the unduly large diversion of resources into heavy industries to the neglect of consumer goods industries and agriculture; the pattern of production of consumer goods reflects the anti-social income shifts from the masses of the people to the upper-income groups – the output of goods entering into the consumption of the latter has increased at the expense of goods consumed by the masses.

Perhaps most of this industrial expansion has taken place in defiance of the doctrine of comparative costs. It is generally forced by official policy, this applying particularly to heavy engineering and heavy chemicals. Much of the expansion is also induced by rigorous import restrictions, exchange controls and drastic cuts in imports. Private imports were slashed by 38 per cent in two years, from Rs 812 crore in 1956-57 to Rs 505 crore in 1958-59. Import licenses are generally not issued where comparable domestic output is available in adequate quantities, regardless of the prices of the substitutes fabricated at home.

In the face of the paramount 'need' to 'save' foreign exchange, the price of the substitute domestic output is treated as a minor matter. This has placed the domestic manufacturers of the substitute goods in monopoly or semi-monopoly positions. They are able to extort near-ransom prices from the consumers of these goods which are – striking exceptions here and there apart – generally shoddy in quality; the community is compelled to forego the benefits of the use of the vastly superior quality import goods which could be had at lower prices than the home-made varieties.

EVIDENCE OF THE NEAR-RANSOM prices paid by consumers may be seen in the vast gaps between landed cost and market price of virtually the whole range of import goods. These gaps vary from 30 per cent to 500 per cent or more of the landed cost, depending upon commodities. These price gaps are a measure of the windfall gains which accrue to the privileged nominees of the state, the recipients of the import licenses. These licenses are thus documents of great value. Though not transferable in law, they are frequently transferred in fact through the fiction of the forward purchase of the commodities, which the licenses permit the import of and other legal blinds. The prices of the licenses are regularly quoted in a section of the press in Bombay. The prices which the import licenses fetch are naturally a reflection and a measure of the gaps between the landed costs and the market prices of import goods, less the normal profits of the *de facto* importer.

Market prices of import goods being a rough measure of the market prices of their home-made substitutes, the prices which the import licenses fetch provide a rough measure of the fleecing of the consumer by the importers and the domestic manufacturers, which the prevailing statist policies embody.

It is a commentary on our economic understanding to suppose that such policy measures can help to correct balance of payments deficits; or that forcing the pace of industrialisation – which, we describe as an 'exciting national pilgrimage' – at the expense of agriculture and other sectors, where output per unit of resources is very much higher, will push the economy forward. The striking pace of progress of industrialisation is, thus, not a matter to be enthused over. It is a pyrrhic victory. Obviously, the consumer does not stand to benefit from it.

During the First Plan and the first three years of the Second Plan, it has been estimated that the increase in output from agriculture was of the order of 57 to 69 per cent of the additional capital invested. The rate of additions to output from investments in industry, in particular, heavy industries, is of a very much lesser order. In 1946-1953, in five industries – cement, paper, iron and steel· cotton textiles and sugar – the additions to output varied from a low of 14 per cent in paper (iron and steel came close to paper with a percentage of 19) to a high of 45 per cent of investments in sugar. The corresponding percentage in the case of textiles in Ahmedabad was 36. In 1956, the average addition to the output in 29 industries was 32.6 per cent of the additional capital invested.

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THESE FIGURES PROVIDE a rough measure of the wastage involved in the policy of forced industrialisation. The national product might have gone up at a much higher rate than it did – probably at 8-10 per cent per year – if economically optimum investments had taken place in agriculture and the lighter industries. Among the latter, cotton textiles account for 36 per cent of industrial activity in India.

Forced industrialisation has also detracted from progress in the liquidation of unemployment. Employment being a function of the aggregate national product, measures that would detract from the national product would detract from the expansion of employment, too. Not only do agriculture and the lighter (consumer goods) industries add to the national

An inspiration for millions

product, for a given amount of capital investment, much more than investments in heavy industries, and thus add more than the latter to the overall employment potential, which would attend accelerated expansion of the national product; labor directly absorbed into employment in the production processes, representing a given amount of investment, is much more in agriculture and the lighter industries than in the heavy industries.

It has been estimated that an investment of Rs 1 crore would provide employment for 500 persons in large-scale industries producing investment goods, 1,150 persons in large-scale industries producing consumer goods and 4,000 persons in agriculture and small and household industries. Under these conditions, to press on with heavy industries in the Indian context of poverty and unemployment is not only uneconomic, but also inhuman. Abolition of poverty and expansion of employment must always command priority over sensational projects.

This conforms to historical experience. Revolution in agriculture has virtually always preceded industrial revolution in nearly all countries. And progress in lighter industries has nearly always preceded the development of heavy industries. Growth of agriculture provides a broad-based demand for the output of industries and the growth of lighter industries provides an assured demand for the output of heavy industries. The pattern of expectation of life of the Indian people was 24 years. This average rose to 42 years during the Second Plan period and now it is 47.5. This 'remarkable increase' represented, it is argued, is due to many factors – better health, better food and better living conditions.

The prime minister cites statistics of progress in the educational field. The number of students attending school and college has risen by 29 million to 46 million and the number of engineering colleges from 134 to 380.

The sudden increase in the expectation of life cannot be properly claimed to be the result of overall planning. Credit for this should go to the DDT campaign and other health measures financed by other bodies. Such campaigns, as universal experience has shown, reduce infant mortality and the general death rate, extending the expectation of life rather suddenly.

In British Guyana, which had no 'plans', the eradication of malaria, mainly through spraying of the insecticide DDT, led to a population burst, the rate of increase of Indian settlers in the colony rising to nearly 4 per cent and of the colony as a whole to 3 per cent; the suddenness of the change is currently reflected in 50 per cent of the population being below 20 years of age. To list among Plan achievements the improvements in the expectation of life is to take pride in feathers stolen from the crown of DDT.

Nor can a more than doubling of the number of students in school and college be adduced as evidence of plan success. Credit for part of this increase must go to private effort and the effort of municipalities and other semi-public agencies. Provision of education being a natural function of the state, any administration must spend part of its revenues on education. To claim special credit under this head the effort must be extraordinary. The expenditure on education in India – primary, secondary and higher education – during the Second Plan period (Rs 208 crore) represents 1.5 per cent of the budget outlay of the Centre and states (Rs 14,107 crore). This percentage in the First Plan was 1.9.

Over large parts of the enlightened world, the percentages are 4.5 to 8 times the Indian figure in the Second Plan. We are investing much more in steel than in man. During the same period we spent over 2.5 times as much (Rs 526 crore) on the three steel plants in the public sector. With literacy in 1951 at 16.6 per cent of the population and in 1961 still at 23.7 per cent, it is difficult to enthuse over a 10 per cent annual rate of increase in the number of school and college students.

8

Fallacies of plan finance

DECEMBER 1955

Many of the writer's views expressed in dissenting notes to the Planning Commission were vindicated when planners tried to scale down deficit financing. But many other changes in fiscal policy were urgently needed, as he explained in this lecture, part of a series of Sir William Meyer Lectures presented at the University of Madras

Some leading industrialists and businessmen would prefer inflation to be kept comfortably on the boil. Most hyper-inflation started that way. But the gain of the few would be at the expense of millions on the margin of subsistence. Post-war experience proves more conclusively than ever before that neither social nor economic progress can be made unless a proper monetary and fiscal policy is pursued. Economic prosperity as indexed by production, employment and income has a partiality for a background of sound money and conservative public finance.

The problems of dollar scarcity and payments difficulties generally resist solution when inflationary pressures prevail, but tend to disappear with the stabilisation of the domestic economy. In view of the all-pervasive character of money, it is important that our thinking should steer clear of the more obvious fallacies of plan finance.

The authors of the Bombay Plan had argued that since created money is only 'meant to increase the productive capacity of the nation', in the long run, it would be 'of a self-liquidating character.' Consistent with their belief that, when the larger output was ready for the market, it would cancel out the initial inflation, they provided for 34 per cent of a total finance of Rs 10,000 crore in created money. The problem of inflationary finance was believed to be, mainly, a problem of how 'to keep prices within limits' pending completion of investment projects.

This view had an extensive and also distinguished following in India. It embodied three main ideas: (i) that deficit financing added to the investable resources (ii) that the supposed increase in output would neutralise inflation, and (iii) that controls would minimise inflationary pressures.

At a given moment, the available real resources for capital formation (labor, capital, equipment and materials of production) are a fixed quantity. Their financial counterpart is money savings. According to the Taxation Enquiry Commission, savings in India amounted to about 7 per cent of the national income in 1953-54. The rest of the national income (93 per cent) was accounted for by current consumption and capital maintenance. The sum of domestic savings, withdrawals from the currency reserves, and foreign aid represented total investable funds. Deficit financing was only one of several devices of gaining access to current domestic savings and currency reserves. There are definite limits beyond which it was not possible to collect resources through deficit financing. Deficit financing did not add to the available real resources.

It is not as if inflationary funds would remain accumulated out somewhere in the economy to be absorbed by the expanded output. Money income would rise as an automatic reflex action of the increase in physical output

IT IS ILLUSORY TO suppose that the increased output would neutralise inflation, even if we assume that overall output might increase under inflation. There is always a time lag between investment, its completion, and the resulting increase in output. This time lag is the crux of the problem. As a result of the vertical and horizontal rise in prices, costs of production would rise. The new output, when it flowed into the market, being the progeny of a background of inflated costs, would bear higher price tags. It is not as if the inflationary funds would remain accumulated out somewhere in the economy to be absorbed by the expanded output. Money income would rise as an automatic reflex action of the increase in physical output. If prices did not fall, the process would be deflationary, and might call for anti-inflationary measures.

It is no answer to these difficulties to allot resources for increased production of consumer goods. This would involve diversion of resources from the investment to the consumer trades. The pace of progress of the Plan would be correspondingly decelerated.

The question of their success in an inflationary background apart, it was not as if price controls would enable deficit financing to achieve increased investment. Price controls and rationing of consumer goods did not create savings. Their prime function was egalitarian – to distribute equitably, at fair prices, supplies of scarce goods.

Controls and allocations are not a necessary adjunct to planning. As the distribution of resources over the several industries and trades, and the ratios in which they are used, depend on diverse and changing technological and price conditions, it is quite impossible to arrange anything like a satisfactory allocation of resources. There are great advantages in allowing freedom to the economy and to the pricing system in the matter of such distribution.

As long as inflationary demand for consumption prevails, import restrictions would not provide a lasting remedy to payments difficulties. Reduced imports would induce fabrication of home-made substitutes and diversion of export goods into home consumption. As a result, both exports and imports would decline.

Deficit financing is sometimes defended on the ground that unemployed resources exist in India. It is important to distinguish between the problems of unemployment in industrial economies and the problems of under-employment in underdeveloped economic. A mistaken analogy between the two has been responsible for much confusion of thought and erroneous policy in underdeveloped economies. The two problems, in essential respects, are poles apart. Unemployment in industrial economies is accompanied by unemployment of the complementary resources of production. The problem is one of reinstating labor, materials and equipment back again into employment. It is possible in such a context to increase production by loan financing of budget deficits.

The problem of underdeveloped economies, on the other hand, is scarcity of savings. It is not true to facts to suppose that abundant domestic resources exist in such economies and that development is merely a matter of providing finance. The only abundant factor of production is unskilled labor, and increased output is not possible by labor alone. Even the simplest form of construction such as earthwork for irrigation projects requires some capital. The Shramdan workers, who offer their services free, bring their own food with them, and sleep in the open, still have to be equipped with some implements, and engineers and foremen have to be found to plan, organise and supervise construction. Such personnel, equipment and materials have to be saved.

Importance of monetary stability

The effect of fundamental policy decisions in the sphere of money and finance would pervade the entire economy. All who use money, or have dealing with those who do – and this may exclude only the lions of the Gir forest – would be affected. From the resulting economic instability, even as there is no safe end on a sinking boat, virtually all would stand to lose.

It is not true to facts to suppose that abundant domestic resources exist in such economies and that development is merely a matter of providing finance

Some leading industrialists and businessmen, who are not without supporters in other walks of life, including the academic profession, would prefer inflation to be kept comfortably on the boil. Most hyper-inflation started this way. But the gain of the few, whether or not their effort to keep themselves warm leads to a forest fire, is at the expense of the many, the millions on the margin of subsistence. In the process, overall national output will suffer through uneconomic distortions in the pattern of production and wastage of savings, which inevitably attend inflation. All may gain, and keep gaining, when the cake (of national income) continually grows, and it is known to grow best under monetary and financial stability.

Post-war experience has proved more conclusively than ever before that neither social nor economic progress can be made unless a proper monetary and fiscal policy is pursued, especially in a world where the governor of the central bank – too rare exceptions apart – is of the official family of the minister of finance. The example of Belgium, of Switzerland, and during the past few years, of Germany in Europe, of Canada in North American, or Cuba and Mexico in South America, and nearer home, of Thailand, show that economic prosperity as indexed by the state of production, employment and income, has a partiality for a background of sound money and non-inflationary public finance. The wolf of dollar scarcity and payments difficulties has tended to be more menacing under inflationary pressures, but has generally kept away from the door when stabilisation of the domestic economy had materially progressed or had been achieved. The textbook dictum that playing with money is like playing with fire has proved to be too true in practice.

But there are certain fields of economics with a wide common applicability to both underdeveloped and industrial economies. The need for non-inflationary monetary and fiscal policies is among them

It has been argued that economics has been hitherto preoccupied with the problems of industrial economies, and that, in dealing with the comparatively unfamiliar issues of the economics of growth of underdeveloped economies, economists were apt to be influenced by the doctrines applicable to the models of industrial economies, with which the science had been more familiar. This counsel of caution merits attention and is particularly relevant to one of the fallacies of plan finance which we shall presently consider.

But there are certain fields of economics with a wide common applicability to both underdeveloped and industrial economies. The need for non-inflationary monetary and fiscal policies is among them. The broad economic processes of inflation would apply to all economies regardless of their stage of development. As the welfare of millions of families and individuals, already indigent, is involved, it is both a moral and economic obligation that the monetary and fiscal policies of the Second Plan should steer clear of the more obvious fallacies. We shall now consider some of them.

Deficit finance and investable resources

Professor D R Gadgil has compared deficit financing of development to inflationary war financing. The latter resulted in inflation because it did not yield 'an increase in production for consumption,' but '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 is inevitable. But this rise in prices 'may be held in check by a regulatory regime such as existed in the United Kingdom during the period 1940-46.' It is only in the absence of such 'regulation' that deficit financing might 'obstruct the working of the plan' through a transfer of resources from the poorer classes to entrepreneurs, a reduction in the consumption standards

D R Gadgil

of the former, and a general shortage of commodities.

Consistent with this view of deficit financing (as enabling investment to take place which would not be permissible in the absence of it), Professor Gadgil conceives it as an independent source of finance and not, as we have viewed it, an instrument, along with other devices such as taxes or loans, for mobilising the savings of the community. He argues that the 'receipts through taxation and borrowings...even when stretched to the utmost' and receipts under 'sterling balances and foreign aid of all kinds', will not 'enable undertaking a bold plan.' If we need a bold plan, continues Gadgil, 'this appears to leave only two sources' namely (1) extension of the sphere of the public sector and (2) deficit financing.

The foregoing view seems to have a rather extensive, and also distinguished following in India. It embodies three main concepts: (1) that deficit financing would add to the available investable resources and permit an overall increase in the national product, (2) that the increase in output, which may flow upon the completion of the program of investment, would absorb the initial inflationary pressures and (3) that price controls, together with certain safeguarding measures, such as buffer stocks of foodgrain, supported, if possible, by physical controls, may hold the price line pending completion of the investment. We shall examine these concepts separately.

TAKING THE FIRST OF THESE resources first, at a given moment the resources of production available in the economy, labor (skilled and unskilled), capital equipment, raw materials of production in various stages of processing, stocks of goods of all kinds, and natural resources, are a fixed quantity. Broadly speaking, some of the resources would be engaged in the consumption trades, producing investment goods. Of the latter, a part would be engaged in the activity of repair and replacement of capital and a part in augmenting the capital stock of the community. The rate of development of the economy (the growth of the national product) is a function of the latter, as the activity of maintenance of capital might only succeed in keeping undiminished the prevailing flow of output.

Some factors of production, as may happen even under 'full' employment, would be unemployed, partly or wholly. The resources of production employed in the production of investment goods are 'saved' or 'invested', while the resources employed in the consumption trades attend to the consumption needs of the community. Invested resources are properly described as 'saved', since they might be very well utilised to increase consumption.

The financial counterpart of the physical pattern of the economic process outlined above is, briefly, that the invested resources would be matched by total savings (current, past and imported) plus depreciation funds, the latter corresponding to that part of the investment activity which maintained undiminished the existing capital equipment of the economy, and the former corresponding to the investment activity which brought about an augmentation of the capital stock; the flow of consumer goods would be matched by consumption expenditure, and the unemployed resources by idle savings (hoards).

Underemployed rural labor, which is generally unskilled, may be claimed into employment only gradually as the complementary real resources (savings), which are scarce, became available

Potential savings may get converted into consumption expenditure of the unemployed workers through 'doles', or claims on social security funds. The task of a plan of economic development is, in essence, to increase the invested resources, with a view to expanding the flow of output, income and consumption in the future. To the extent unemployed resources exist, this may be achieved without encroaching upon current consumption. Through loan financing of budget deficits, idle savings may be activated, i.e., speaking in physical terms, unemployed resources may be drawn into the investment trades, consumption may continue undiminished to begin with and may eventually increase with the expansion of output.

LOAN FINANCING OF SUCH operations, which is non-inflationary, does not, however, constitute deficit financing of our definition. Nor is it this phenomenon which is in the minds of those who advocate development through deficit financing. Deficit financing of the latter category would cause inflationary pressures, and its advocates would seek to bottle it up by controls. Compensatory deficit spending by the government – even if financed by central bank borrowing – is not deficit financing, as long as its effects amount to salvaging idle savings.

Deficit financing proper begins when such compensatory deficit spending (financed by central bank borrowing) was continued beyond the point at which (employable) idle resources (the physical counterpart of idle savings) were all activated into employment. We come to grips with our problems when a plan of development attempts investments beyond the capacity of the currently accruing resources as measured by current savings, available currency reserves, foreign aid, and idle savings.

The concept of immediately employable resources must not be confused with massive underemployment of rural labor in India and other underdeveloped countries. Such labor was actually incapable of immediate absorption into employment. Like deposits of coal and iron underground, and electricity latent in the water running down the Nilgiri hills, they embody potential productive resources which would go waste if not tapped for augmenting production. Underemployed rural labor, which is generally unskilled, may be claimed into employment only gradually as the complementary real resources (savings), which are scarce, became available.

According to the Taxation Enquiry Commission, in 1953-54, net savings in India amounted to about 7 per cent of the national income. Placing the latter at Rs 10,600 crore, Rs 742 crore worth of resources were employed, during the year, towards net additions to the capital stock of the community and Rs 9,858 crore (93 per cent of the national income) towards current consumption and capital maintenance.

If savings continue at this rate, a plan of economic development will have available to it real resources of a value of 7 per cent of the national income. If the investment plan is limited to this amount plus the available foreign resources (sterling releases and foreign aid), consumption might continue undiminished.

THE CHIEF PROBLEM of the Planning Commission would be, then, collecting resources for the public sector, the private sector looking after itself in its own way with such assistance as the Commission might offer. Once the rate of savings, the magnitude of idle savings, if any, and the amount of the external finance were given, the resources available would be fixed.

As we have seen, the issue of loans, surpluses on the revenue side of the budget, deficit financing (of the non-inflationary category) and so on, are but several devices of appropriating resources for the public sector. The ploughing back of profits (self-financing), issue of share capital or debentures, raising loans, or bank borrowing are devices of appropriating resources for the private sector.

Deficit financing does not create real resources which are not already there. It is not as if, after receipts under taxes, public borrowings and other heads of finance referred to above have reached their limits, we could turn, as Professor Gadgil seems to think, to deficit financing to make a plan bigger and bolder than it is otherwise.

Deficit financing is no more than an instrument for gathering in the savings of the community. And, as in the case of other instruments (e.g. taxes and loans) for mobilising savings, there are very definite limits beyond which it is not possible to raise net resources through deficit financing. The limit is determined by available currency reserves and the increase in the real income of the public held in the form of cash, and any attempt to collect, under this head, larger amounts of real resources than may be available under stable prices would be self-defeating.

Thus, if investable resources are all being invested, there is little that deficit financing can do to add to them. Nor can it augment the national product in such a context. Deficit financing designed to attempt this would be inflationary, and the forced savings it might temporarily generate would not make a lasting addition to overall investable resources, as this phenomenon would soon be attended by a dissipation, and diversion away from investment, of a part of savings. The net result may be smaller overall output than if inflationary deficit financing had not been resorted to.

The hypothesis of the concept we are considering is, in other words, not quite valid. The only useful role that deficit financing could play would be to activate idle savings or mobilise the cash balances resources of the public. Deficit financing of this character is non-inflationary.

'Compensatory' increase in production

To pursue this matter further on the assumption of an overall increase in the national product would be to chase a mirage. The hypothesis of the second concept that the increased output, once it reached the market, would cancel out the initial inflationary pressures may be, however, examined in the context of the increased output of the deficit-financed projects concerned. Let us assume that there exists a considerable surplus labor force in agriculture, as is the case in India today, which is underemployed and whose contribution to agricultural output is so small that its removal from agriculture might not involve any noticeable diminution in output. Let us assume further that these marginal workers are transferred to the construction of wells, dams, roads or factories, in the public sector, the requisite finance being provided by budget deficits.

> The net result may be smaller overall output than if inflationary deficit financing had not been resorted to. The hypothesis of the concept we are considering is, in other words, not quite valid.

The transferred workers would have to be paid wages at least at the rate of their earnings in agriculture – probably a little more to induce them out of the surroundings for which they have a liking. As, by assumption, agricultural output has not fallen, the incomes of those left behind on the farms would not diminish. The total money income of the community would, therefore, rise by the wages paid to the transferred workers.

There is always a time lag between investment, whether in the construction of wells, roads, or factories, its completion, and the resulting increase in output. This time interval, during which much economic disturbance might occur, is the crux of the problem. As nothing would happen to increase the currently available supply of consumer goods, and as wages would be paid by the week or the month, prices of consumer goods would rise almost as soon as investment began. With the progress of investment, the rise in consumer prices would spread and in due course pervade the entire economy, even as water drawn from a canal would cover the entire farm under the force of gravitation.

At some stage in the horizontal progress of the rise in consumer prices, prices would begin to rise vertically too. Higher wages would be paid to workers, the more highly skilled among them (whose numbers might be relatively scarce) taking the lead, and 'specific' commodities, or the more specialised materials of production (e.g. the output of the engineering trades) would rise. The tempo of the inflationary rise in prices, horizontal and vertical, would depend on the magnitude of deficit financing.

We have seen that once deficit financing begins, it would tend to be self-perpetuating. The rise in prices would increase the cost of investment and to complete the projects taken in hand, more deficit financing would be resorted to. As prices rise, individuals would tend to hold a smaller proportion of their real incomes in cash. The velocity of circulation of money would rise and the price rise would gather momentum.

The new output, when it flowed into the market, being the progeny of a background of inflated costs, would bear higher price tags than the stocks long sold out. The higher costs of the output, the inevitable outcome of the horizontal and the vertical progress of inflation, are the logical justification for the common experience that prices, once driven up by inflation, tend to stick. It is a delusion, probably born of the classical quantity theory of money (misconceived in its operation), and a faulty visualisation of the realities of economic dynamics and the economic processes of inflation, to think that when the harvest of the new output becomes available, prices would fall.

PROFESSOR GADGIL'S CONCEPT of a 'compensatory' increase in output 'neutralising' the initial inflationary pressures is wholly untrue to the observed facts of life. Even supposing that after an interval of one or two years, the new investment added to production annually an amount equivalent to the investment financed by the budget deficits, no such 'cancellation' of inflation is tenable. It is not as if the inflationary funds would remain accumulated somewhere in the economy to be absorbed by the expanded output. As the output of the deficit-financed projects increase, there would ensue, so to speak, as an automatic financial reflex action of the increase in physical output, a corresponding increase in money incomes in the form of wages, rent, interest and profits.

If the flow of output, on the maturity of investment, is larger, money incomes and demand would be correspondingly larger too. Inflation would be absorbed by the economy. If we assume that deficit financing would cease with the completion of investment projects, the vertical and horizontal movements would be soon exhausted. Costs would be adjusted to the new prices. The manufacturer's profits, which would have been inflated in the early stages of the phenomenon, would revert to normal with the upward movement of costs, except for individual commodities where semi-monopolistic conditions might prevail. In such a background, if general prices did fall in any significant measure, the process would be deflationary and might call for anti-deflationary measures.

As prices rose, individuals would tend to hold a smaller proportion of their real incomes in cash. The velocity of circulation of money would rise and the price rise would gather momentum

It is no answer to the march of events outlined above to allot additional resources for an increased production of consumer goods or additional foreign exchange for an increased import of such goods. It is sometimes suggested that cottage industries and handicrafts, which permit increased output of consumer goods at a low capital outlay, could be used with 'advantage' for tackling such awkward by-products of deficit financing. To adopt these measures would be to work at cross purposes.

The starting point of deficit financing was a shortage of resources for investment. If deficit financing inflated the demand for consumer goods, to divert resources in short supply from the investment trades into the consumption trades, would not correct, but would accentuate, the basic problem of scarcity. The pace of progress of the plan would be correspondingly decelerated. Savings, instead of being applied to augment the capital stock of the community with a view to augmenting, ultimately, the flow of output, would be dissipated into increased current consumption. If deficit financing produces predicaments which call for such 'remedial' measures, it is evident that the 'remedy' of deficit financing is worse than the disease it seeks to cure. It creates new problems without solving the old ones.

THE ECONOMIC PROCESSES of inflationary finance reviewed above must be distinguished from the phenomenon of relative over-production and the effect of the latter on the prices of over-produced commodities. Relative over-production is a case of uneven development, the fall in the prices of commodities (the output of which is in excess of market demand) being a manifestation of it. The price decline is the market's device of inducing reduced investment in the industries concerned.

It is not this phenomenon that the advocates of deficit financing refer to when they speak of a compensatory increase in production. What they have in mind is a supposed increase in aggregate national output which they conceive of as being set against the increase in the aggregate money supply. General overproduction being an economic impossibility, what might happen in a particular trade from relative over-investment cannot happen over all trades in the economy at the same time.

Controls

We now turn to the third concept that price controls and certain safeguarding measures might hold in check the disruptive consequences of deficit financing pending completion of the projects. The expectation that price control of foodgrain and cloth would, so to speak, bottle up inflationary pressures insofar as they concern the masses of the people, that it is a matter of 'comparative unimportance' if the prices of other commodities rise, and that this makes room for further development through further deficit financing, is a mirage.

Relative over-production is a case of uneven development, the fall in the prices of commodities (the output of which is in excess of market demand) being a manifestation of it. The price decline is the market's device of inducing reduced investment

First, price controls may not work in an inflationary background. A people in want cannot be induced or coerced not to spend the money put into their pockets. To the extent price controls may be effective, the flow of money to the controlled sector of the market would be less than it might otherwise be, and its flow into other sectors might be correspondingly larger, even as flood water checked in one direction would flow with greater force in another direction.

Lower prices of the controlled commodities would be balanced by higher prices of uncontrolled commodities. The average of the two -- the General Index of prices – would reflect the state of inflation. This indicates the fallacy of thinking that price control of foodgrain and cloth might control the cost of living. Control of the prices of foodgrain may not control even the food bill of the people. A plate of food contains many more items than rice and *atta*. If the prices of vegetables, condiments, *dal* and firewood rise freely, the price of a plate of food would reflect the inflationary situation, notwithstanding foodgrain controls. This fact is not negated by reducing the number, and diluting the quality of items on the plate, though it may deepen the delusion regarding the effectiveness of controls.

The spread of controls in a vast country like India would raise stupendous administrative problems and would involve a diversion of personnel, greatly needed for implementing development, into administering the machinery of controls

Second, under the stress of reduced profits, the output of essential commodities, the prices of which are controlled, might suffer. Price control of foodgrain in India might cause honest farmers to shift to the production of uncontrolled commodities. This may widen the food deficit gap and the government may be compelled to import more foodgrain. The counterpart of this phenomenon is a diversion of resources to the socially less useful trades which offer higher profits.

Third, once introduced, controls would tend to breed more controls, and would cause corruption and black marketing. The spread of controls would be induced by the urge to render controls effective. Black marketing and corruption would be the natural outcome of the gap between controlled prices and competitive (black market) prices, which would emerge in an inflationary background.

The spread of controls (on the war-time UK model, which is often quoted in this respect) in a vast country like India would raise stupendous administrative problems and would involve a diversion of personnel, greatly needed for implementing development, into administering the machinery of controls.

Economic development in India is not a matter of one or two five-year plans. It may take a generation or two before our level of living rises to that of western Europe. It is not practical to expect 385 million people meekly to submit to the rigor of price controls and rationing for prolonged periods. The analogy of the conduct, for a few years, of a disciplined island community in the face of the dangers of a total war would not apply to the needs of peace-time economic development. Moreover, the problem of imposing a system of controls in an economy, such as the British, where production and distribution are highly organised, cannot be compared with the almost insuperable task of controlling the operations of millions of small units of production and distribution, such as prevail in India. Even assuming that total controls were attempted and were successful, they would leave behind them the legacy of latent inflation to the extent of their success. Controls would thus only postpone the evil, not remedy it.

Finally, price controls and rationing did not create savings. Their prime function was egalitarian – to distribute equitably, at fair prices, the scarce supplies of goods and thus help maintain peace on the home front. They came into the picture, so to speak, after investment took place and the quantum of the available consumer goods had been determined. They did not have influence either on investment or the flow of consumer goods. By themselves, price controls and rationing would not cause even two blades of grass to grow where one grew before.

It is, thus a delusion to suppose that the institution of controls on the lines of war-time controls on the prices of wage goods would provide a way out of shortage of resources. To meet the immediate requirement of a plan of development we need more savings, not controls.

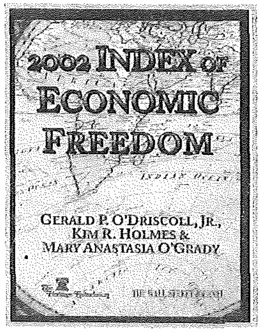
THE MAJORITY MEMORANDUM of the Panel of Economists of the Planning Commission would go beyond price controls (and rationing) of wage goods into the sphere of allocation of the resources of production. Referring to the importance of controls over allocations to its concept of planning, it observes:

In the context of this report, the most important of these (i.e. 'forms of regulation and control of economic activity') are capital issue control, the regulation of establishment, control over the imports of capital goods and consumer goods, control over the allocation of products like cement and steel, control over the export of selected commodities.

It is not quite clear whether the passage quoted above implied totalitarian techniques of planning. As we have stated earlier, it is no doubt possible to increase savings and investment by reducing resource allocation to the consumer trades. Such procedure, however, would require the right of acquisition and disposal over the physical resources of the community, including labor and managerial personnel, and would demand a 'firm legislative and administrative base' as indicated by the memorandum. It would involve regimentation of the entire economy, universal controls and allocations. Such planning is indistinguishable from communist planning. We presume that planning in India would be consistent with individual liberty and democratic institutions.

It is a delusion to suppose that the institution of controls on the lines of war-time controls on the prices of wage goods would provide the way out of resource shortage

The Second Plan has defined the socialist pattern of society, an objective of planning in India, as a 'social and economic order based upon the values of freedom and democracy, without caste, class and privilege, in which there will be a substantial rise in employment and production and the largest measure of social justice attainable.' Elucidating the concept further, we are told that the 'socialist pattern of society is not to be regarded as some fixed or rigid pattern. It is not rooted in any doctrine or dogma...Economic



An alternative worldview

and social policy has to be shaped from time to time in the light of historical circumstances. It is neither necessary nor desirable that the economy should become a monolithic type of organisation offering little play for experimentation either as to form or as to modes of functioning.'

The Second Plan would prefer to steer clear of price and allocation controls. As stated earlier, it would seek to influence the prices of foodgrain by building up buffer stocks and by mopping up the surplus purchasing power through the tax device.

Though 'physical controls including rationing and allocations, can be used to prevent consumption from increasing beyond a particular level and for economising scarce materials or scarce productive resources,' in view of the past experience of controls, they are not deemed to be a 'device that can be relied upon to function effectively' or equitably for any length of time.'

It is quite impossible to take into account these complex and changing considerations and arrange anything like a satisfactory allocation of resources. There are great advantages in allowing freedom to the economy, and to the pricing system in the use and distribution of the needs of production, in the several industries and trades.

Even in the matter of the availability of foreign exchange, it is not as if a plan of economic development rendered exchange and import controls inevitable. As we have observed earlier, if investment was adjusted to the total available resources, and if inflationary pressures did not exist, the requisite foreign exchange difficulties, and the need for exchange control, would arise (crop failures, sudden shifts in demand, and such other factors apart), not because of a plan of economic development but because of the plan attempting investments beyond permissible limits and thereby causing inflationary pressures.

Credit restrictions and increased taxation

As part of the policy of facilitating deficit financing of development by control over commodity prices, it is proposed to resort to drastic measures of credit control. The Reserve Bank has been endowed with powers of such control by a recent amendment to the Reserve Bank Act. The theory seems to be that a rise in commodity prices ensued from a speculative hoarding of stocks. As stocks are generally held on bank credit, denial of credit for speculative hoarding might prevent an undue rise in prices.

This reasoning is rather superficial. Hoarding is more a consequence than a cause of inflation, though it fans the flames of inflation. In a background of continuing inflation, dealers would hold stocks because of a continued rise in prices which inflationary finance might cause. We cannot remove the cause by tampering with one of its consequences, the stimulated demand for credit for holding stocks.

To accuse the business community, comprising vast numbers of competing dealers scattered all over the country, as though it were a monolithic monopoly organisation and the root cause of what were really the consequences of the fiscal and monetary policy of the government, is to exaggerate the part it plays in driving prices up.

To accuse the business community, comprising vast numbers of competing dealers scattered all over the country, as though it is a monolithic monopoly organisation and the root cause of what were really the consequences of the fiscal and monetary policy of the government, is to exaggerate the part it plays in driving prices up

In cases of monopoly or quasi-monopoly control, acquired by agreed action by a group of individuals, there might be justification for such accusation. But when inflationary conditions prevail and are expected to continue, hoarding tends to become an *en masse* operation of the entire body of traders, even non-traders temporarily joining their ranks. When commodity speculation tends to assume these dimensions, it is little use putting the blame on stockists for the rise in prices. Though restriction of credit to stockists would, doubtless, handicap their operations, the self-adjusting forces in the economy are apt to devise ways of overcoming the handicap.

First, the friends or agents of the stockists, or the indigenous bankers, may borrow from banks and pass on the funds, in cash, to the stockists. The statistical decline in bank credit advanced against stocks (of banned commodities) may then be accompanied by a reciprocal rise in bank credit, under permissible heads of borrowing, against other securities.

Second, induced by remunerative interest rates, lending and borrowing outside the (scheduled) banks may grow.

Third, trade and industry may use more and more cash, which was not subject to restrictions and less of credit. Monetary statistics reveal the emergence, in 1955-56, of a trend in favor of the use of cash. This is retrograde from the standpoint of monetary progress and is a warning that we cannot tamper with impunity with the functioning of the monetary mechanism. With drastic measures of credit control, this trend may grow to the detriment of banking development.

Fourth, if specialist stockists were handicapped by a non-availability of credit, as long as hoarding is a profitable undertaking, farmers and others might step into the breach. This may lead to credit from co-operative societies and other semi-official agencies being utilised for the finance of hoarding. Finally, the velocity of circulation of money may increase and counteract the effect of credit restrictions.

The combined effect of these developments, which are beyond the reach of the weapons of credit control, would be that speculative hoarding of stocks might continue whilst the root cause of it, inflationary deficit financing, remained operative. In the process, the scheduled banks would be penalised through requiring them to hold unnecessarily large reserves. This would increase banking costs and the banks, in self defense, might raise the charges for banking services or withdraw from their marginal business. In an economy so ill-equipped with bank facilities, this would be unfortunate.

The following observations of *The Economist*, which have a bearing on the relationship between controls and prosperity, may be read with interest:

For the most heartening feature of the past few months is that the Chancellor's assumption of a 5 or 6 per cent increase in production in 1955 has so far been justified by events; and the government must know that under a controlled economy a seven-week dock strike and a three-week railway strike would quite certainly have shot that assumption to ribbons.

This proved staying power of production in a free economy is so much the most important lesson of the last nine months that there need be no apology for constantly drawing attention to it. Under controls, the amount of raw materials and other resources that a factory was allowed to hold was the amount that some planner thought it could use – which meant in practice that each had a quota based on the amount that it had used before.

The result was that industries that were increasing production most readily were always knocking against the limit of the resources allowed to them; and whenever there was a temporary hold-up of supplies – a lightning strike or a snap of cold weather– production in these industries immediately slowed down.

The great and glad lesson of the dock and railway strikes of 1954 and 1955 is that a free economy can solve this problem. With stocks no higher in relation to total national output than they were in some of the earlier postwar years, the distribution of resources under the whip of monetary discipline has been efficient enough to allow production to go on increasing even while the docks and railways have been partially throttled.

It should now be a principle of bi-partisan economics that Britain is too vulnerable ever to be able to afford to maintain a controlled system of basic imports and to have prosperity too.

AMONG OTHER REPERCUSSIONS of inflationary deficit financing are investment in non-essential consumer goods to meet the inflationary demand for them, a misdirection of savings in low priority investments, in gold hoards and foreign exchange, and balance of payments deficits. Tax measures and import restrictions may not be able to prevent these repercussions. The Second Plan proposes to meet the phenomenon of an inflationary rise in the demand for non-essential consumer goods by tax measures for mopping up the inflated money incomes. It is difficult to see how such mopping up measures can correct the consequences of inflationary financing even partially.

If deficit financing amounts to 'x' crore of rupees, the resulting rise in the money incomes of the residual income groups is 'a' crore of rupees, and the mopping up operations of the government bring them 'b' crore of rupees, then the net effect is the same as a deficit financing (x – b) crore of rupees. The year would begin with a budgeted deficit of x crore of rupees, but would end up with an actual deficit of (x –b) crore of rupees.

> To derive full value from foreign aid, it must be utilised for capital formation. It would then, in due course, add to the stream of national output. If employed to combat inflation, it would get dissipated into consumption

Rather than speak of a budget deficit of x crore of rupees followed by mopping up operations of b crore of rupees as a 'corrective' to inflation, it is much simpler and more in keeping with facts to speak of budget deficits of (x–b) crore of rupees, the money incomes of the residual income groups being inflated by about (a–b) crore of rupees. In this operation it was not necessary that b crore of rupees be mopped up by tax measures.

As expenditure and tax receipts are continuous operations, it might as well be that, with the improvement in tax receipts, as the budget year progressed, deficit financing as at the close of the year would be (x - b) crore of rupees. In both cases, the difference between the two statements is the difference between 'budget' figures and 'accounts', the former representing budget proposals and the latter actuals.

MISDIRECTION OF SAVINGS, primarily into gold hoards and, to a minor extent in foreign exchange and capital exports, to the extent they may be due to a receding confidence in the stability of the currency, may be corrected only by restoring that confidence. For this it is necessary, first, to put a stop to further inflationary finance and, then, to adjust the exchange rate for over-valuation attributable to past inflation. Exchange control is no effective remedy for an export of savings; nor, as our experience of the past decade had shown, is a ban on gold imports a remedy for gold smuggling.

The pressure on the balance of payments cannot be corrected by restricting imports. As long as inflationary demand for consumption continues, any reduction in import of consumer goods would divert substitutable exports into domestic consumption, or would induce fabrication of substitutes at home, often involving a wasteful use of resources, at the expense of potential exports. As a result both exports and imports would decline.

Any balance that may be attained in the external payments would be at a low level of international trade. A low level of exports and a pressure for imports, held down artificially, is a characteristic of inflationary expansion of domestic consumption. This is well illustrated by Indian experience.

The foregoing discussion indicates that deficit financing is no substitute for saving. There is no device for dodging the economic consequences of inflation. There is no place for inflationary deficit financing, whether we adopt democratic or totalitarian planning. Inflationary finance is the antithesis of planning. Progress with inflation is a contradiction in terms.

We may also briefly refer to the prevailing views on the criteria of non-inflationary deficit financing. We have seen that the First Plan criteria of the magnitude of deficit financing were, firstly, withdrawals from the currency reserves and, secondly, the level of the cost of living. The Second Plan position was virtually the same. The first criterion makes no distinction between the use of currency reserves for the public and the private sectors. To be non-inflationary, deficit financing (of this category) must be limited to the amount of the former. We have also seen that price controls of 'strategic' goods would not add to the scope for deficit financing.

In the recent discussion on plan finance, it had been suggested that the large undrawn amounts of foreign loans offered scope for a large dose of non-inflationary deficit financing. The logic of this would seem to rest on the first criterion referred to above, namely, that since foreign aid added to the available resources, there arose scope for equivalent creation of money. But foreign aid, in the same way as increased domestic savings, helped the avoidance of inflationary finance. It was not an occasion for more deficit financing.

To derive full value from foreign aid, it must be utilised for capital formation. It would, then, in due course, add to the stream of national output. It would get dissipated into consumption if employed to combat inflation. The capital base of the economy not being augmented, on the one hand, the flow of future real income may not improve and, on the other, the amortisation payments on the foreign loans would have to be drawn from the unchanged flow of income. This may interfere with a rise in the level of living.

The criterion of non-inflationary deficit financing is the utilisation for the public sector of, firstly, the amount of the currency reserves and, secondly, the real resources behind an increase in the cash balances of the public which may attend an increase in real national income.

9

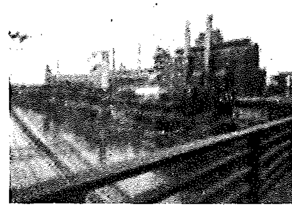
Heavy industries

22 FEBRUARY 1965

At the annual general meeting of the Associated Chambers of Commerce and Industry, Calcutta, the prime minister is reported to have lashed out at the critics of the government's policy of overemphasis on steel, power and heavy industries. One of these critics, B R Shenoy, had plenty more to say in defense of his viewpoint: particularly that the remedy does not lie in more steel and more power

Looking to the conditions in India today, the prime minister is reported to have observed in Calcutta, "The sky is the limit for power and steel." The output of both is speedily used up, and shortage of power in fact has become a big bottleneck. Demand for power will in fact become 'incalculable' when its use spreads to the cottage industries in the countryside. The prime minister entirely agreed with N Stenhouse, president of the Associated Chambers, on the urgent need for more power.

In the prevailing policy set-up, the fact of the scarcities of steel and power is no evidence that the criticism of the Plan over-emphasis on the production of steel, power and heavy industries is unfounded. The demand for power and steel is a derived demand. The prevailing abnormal demand for them is born of the enormous expansion of investment in industries, with an inordinate bias for heavy industries and mammoth, multi-purpose river-valley projects, which are heavy consumers of power and steel.



During the past decade, industrial production rose by about 73 per cent. Second Plan investments were over twice the investments in the First Plan and the Third Plan targets are over three times as much. Industries with iron and steel as the principal raw material – automobiles, bicycles, diesel engines, electric fans, enamel ware and sewing machines – have expanded during the same period by 2.5 times (automobiles) to 9 times (bicycles). In the meantime the output of iron and steel rose only 2.5 times and electricity, gas and steam 3.3 times.

It would thus seem that the scarcities of power and steel – like the shortages of cement and industrial raw materials – are a byproduct of Plan investment and production policies. These scarcities will remain as long as the policy of forced creation of fixed capital continues. Scarcity being the result of this policy, they cannot be adduced as justification of it.

THE REMEDY TO the problem of scarcity does not lie in producing more steel and more power. To do so would be to treat the symptom, forgetting the deep-rooted disease. It will accentuate the malady of the overemphasis on the production of fixed capital and intermediate products. The remedy lies in abandoning this policy, to put a stop to the heavy toll it has levied in terms of lost economic development and social progress. The scarcities will cease with the adoption of a more natural and more orderly program of development: such a program will also yield accelerated and stable progress on all fronts.

Evidence on the success of the Plan must be sought in the achievements in the field of social justice – the eradication of poverty, liquidation of unemployment and reduction of income disparities – not in the man-made scarcities of steel and power, the natural outcome of these policies. Measured by this yardstick, our policies would seem to have failed utterly.

> The remedy to the problem of scarcities does not lie in producing more steel and more power. The scarcities will cease with the adoption of a more natural and more orderly program of development

The prime minister thought that it is 'completely right' to say that there is a 'marked difference' in the 'way of living' of the people in the last decade or so. From his observation at public meetings and functions in rural areas, the people looked 'better fed, better clothed and to some extent better housed.' Statistics put out in official publications do not confirm this view. This *Economic Survey*, issued with the Union Budget, shows that the per capita availability of foodgrain, already below the nutritional norm, fluctuated downward with the intensification of planning, from 15.7 ounces per day in 1954 to 15.4 ounces in 1960. The *Monthly Statistical Bulletin*, issued by the Textile Commissioner, indicates that the per capita consumption of cloth (provisional), already sub-standard, was 14.63 metres in 1955 and 14.36 m in 1959.

Deaths – officially reported at about 400 in Bihar – from the recent cold wave in northern India lend support to the evidence of official statistics. People dying at railway stations, at bus stops and on roads, at temperatures above freezing point, bespeak malnutrition, empty stomachs and meagre clothing.

The slowing down of the expansion of agricultural production and the fall in agricultural incomes per capita are directly related to the policy of forced drafts of the largest bulk of plan resources – probably, well over two-thirds – into industries all into fixed capital formation. These forced drafts have been at the expense of the weakest sector of the economy, the 67 mil-

Soviet Russia is a classic example of high output of power, steel and capital goods and comparatively low levels of living of the people. China is moving along the same road

lion farm families, the organised private sector being mostly able to collect its needs of capital. Credit flow into agriculture has been hindered or repelled by restrictionist legislation, land ceilings, hurdles on land transfers, the only major asset of most farmers, and other plan measures. This has led to capital starvation of agriculture – interest rates even on secured farm loans are at 20-75 per cent – and to the retardation of agricultural production.

The prime minister approvingly quoted the view that the test of a country's economic growth was in its output and consumption of power and steel. Professor P T Bauer (in *Indian Economic Policy and Development*) and Dr Colin Clark (in *Growthmanship*) have conclusively demonstrated the fallacy of this concept. The US before World War I, the Scandinavian countries and New Zealand today are examples of high levels of economic growth and high incomes of dominantly agricultural communities.

THE TEST OF ECONOMIC GROWTH is in the level of living of the people and, therefore in the market supply of consumer goods, either produced at home or acquired through imports against exports. The right road to progress is via the maximisation of the national product from the available investment resources, not necessarily via the increased production of power, steel and capital goods. Soviet Russia is a classic example of high output of power, steel and capital goods and comparatively low levels of living of the people. China is moving along the same road. With the largest bulk of our population on the margin of subsistence, we can ill-afford this waste and its inevitable mass cruelty.

The Indian economy, as it has developed during the past decade of planning, presents a sad picture of misallocation of resources. Resources, which are acutely scarce, are being forcibly diverted away from agriculture and the consumer goods industries, where the yields and employment potentials are the highest, into the production of capital goods and intermediate products, where the yields and employment potentials are generally the lowest. The tragedy is that this is done with the best of intentions – to relieve with speed poverty and unemployment. The result is the exact opposite of the intentions. Mass poverty is on the increase and unemployment is growing. The only beneficiaries of this arrangement would seem to be a thin upper crust of traders, businessmen, industrialists and the corrupt among the functionaries of the state.

10

Communist planning and deficit finance

18 FEBRUARY 1956

This was the writer's reaction to an article 'Physical Planning and Financial Planning' which appeared in *Commerce*. Here he argues that the Mahalanobis Plan is indistinguishable from communist planning, where consumption is forced down by control over the allocation of resources

One readily agrees that what Professor Mahalanobis means by physical planning is something deeper than the physical counterpart of the financial magnitude of a program of investment in a democratic set-up. It is not just a case of evaluation in physical terms of the financial estimate of the investment program.

P C Mahalanobis

Physical planning of the Mahalanobis pattern would first determine the program of investment by reference to the 'men, materials, and resources' in the economy wherever they may be presently situated. Finance, in the sense of savings, is, to quote your correspondent, a 'sort of camp-follower of investment'. The volume of savings would be adjusted to the needs of investment.

This technique of planning is indistinguishable from communist planning, under which consumption may be forced down by reducing the output of consumption goods through control over the allocation of resources and, within limits, the blueprint of the communist plan can find the resources it required. But even in a communist economy, consumption cannot be forced down indefinitely.

In a democratic set-up, the position is different. Here the blueprint of the plan must necessarily adjust itself to the available resource, which must be determined first. Otherwise inflation, instability, and frustration would result. The availability of resources would be measured by the sum of current savings, past savings held in the form of currency services, and foreign aid. This sum would include non-inflationary deficit financing.

An increase in investment may take place simultaneously with increased consumption if production can expand sufficiently. This has happened in both democratic and communist countries

The difference in approach is fundamental. In a democratic society savings are the result of free choices of individuals with regard to spending and saving. It is, therefore, not capable of the same measure of variation as is attainable in a communist society. The success of democratic planning lies in the reliability of the estimates of the available resources. Under communist planning, within limits, adjustment between saving and investment may be brought about by running the steam-roller on the output of consumption goods.

Fellow-travelers in India, seeing that the term communist planning is not yet popular, find it convenient to take shelter behind the less offensive phrase 'physical planning'. But the two are identical in content and process and the choice between them boils down to a choice between the communist and the democratic patterns of society. In view of the presence of certain personalities close to authority in India, we should beware of communism being sold to us in the guise of physical planning.

Official statistics of the economic progress of iron curtain countries suggest that communist planning makes for more rapid capital formation than is permissible in a democracy. These statistics, however, have been challenged by some economists. It has been suggested that they have a considerable propagandist content.

In a background of vast employment and massive underemployment in the agricultural sector, promise of employment has a great propaganda appeal. Unemployment remedies have figured prominently in political salesmanship.

Your correspondent is of the view that financial (democratic) planning 'based on the theory of savings determining the rate of investment' is congenitally incapable of tackling the problem of unemployment and poverty in India. To support his thesis, he has produced a figure of 15.3 million as being the aggregate labor force seeking jobs; the employment potential of the draft plan, which is based on the democratic technique, is 8 million. The impact which the first two plans may make on the problem of Indian poverty would be negligible and 'the gap between the income of the people in India and other countries will go on widening.'

His remedy to both problems is to abandon 'the present basis of planning' and adopt physical (communist) planning. He quotes Maurice Dobb who 'derives his theory from the history of economic development in Russia', and refers to the 'leaping progress' made by the Soviet Union under 'the physical approach to planning'.

That the acquisition of investment resources does not always involve a reduction in consumption is not a communist revelation. An increase in investment may take place simultaneously with increased consumption if production can expand sufficiently. This has happened both in democratic and communist countries. Your correspondent is doubtless aware of the acute hardships suffered by Russia in the early days of its economic development. It is not as if communism is a passport which purchases immunity from the operation of economic laws. The pace of progress of Russia cannot be wholly attributed to the virtues of communism, even as the vastly more striking progress of USA cannot be wholly attributed to the virtues of free enterprise. Both countries have special advantages of vast unsettled areas. The environmental difficulties which confront us will remain a drag on development, whether we have a communist or individualist pattern of society.

THE MASSIVE UNDER-EMPLOYMENT in India is largely the legacy of 200 years of British rule when, owing to a combination of factors, the rate of investment fell short of the minimum necessary to absorb into employment the natural growth in the labor force. This legacy cannot be written off in a five-year period. A solution lies in investment exceeding the pace of increase in population. This has been achieved in the First Plan. The Second Plan may be expected to make more progress in the same direction and cause a larger dent in the volume of under-employment. Our performance under this head would not, therefore, justify crucifixion of the individualist order of society, and of the sovereignty of man over his private affairs and personal beliefs.

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Credit creation in Russia

It would be misleading to suggest that Russian economic development was made possible by inflationary credit creation. The market mechanism and the pricing system do not regulate the allocation of resources under communist planning. Here diversion of resources into investment is an arbitrary function of the planning authority. Finance steps in only after resource allocations have been made. The banking system creates credit in accordance with the need of investment, to meet the wage bill and other payments. Under such an arrangement there is little room for an expansionary issue of money. The pace of economic development is determined as soon as the decision to allot resources to the investment trades (at the expense of consumption trades) has been taken. Credit creation does not make this decision.

Let us not deceive ourselves into thinking that government and private enterprise, under a regime of the individualist market system, would 'create new money and spend it only if all the factors of production including labor, equipment and raw materials are available.' That may be so under the Russian arrangement indicated above. In a market economy, where the allocation of resources is effected by finance and the price device, money is created first and investment only follows. It is money that tries to bring the investment resources together; it is not the latter (as in Russia) that call the creation of the necessary money media. The shortage of resources is discovered as a result of the operation of market forces, the discovery being reflected in inflation. Let us not get mixed up and try to apply to the free market mechanism the logic which is valid only in relation to the authoritarian Russian mechanism.

Unlimited deficit financing

Your correspondent states that those who counsel limited use of deficit financing 'lose sight of the meagre scale economic development that is possible without it', adding that, 'even if the Second Plan is fulfilled 100 per cent and the entire investment program of Rs 6,100 crore, including Rs 1,200 crore of deficit finance, is put through, it will result in an increment of 10 *annas* in the average monthly earnings of the people.' From his standpoint, deficit financing of even Rs 1,200 crore is inadequate.

It is an illusion to suppose that unlimited deficit financing can permit economic development to take place, which would not be possible in the absence of it. The fact of the matter is the exact opposite. If deficit financing is pushed beyond the point at which inflation begins, the rate of economic development would be less, not more, because of the economic instability which would necessarily ensue from inflation.

Fellow-travelers in India, well supported by their professional comrades, would like to utilise the machinery of planning for imposing communism on the country. Failing this, they would much rather have uncontrolled inflation than steady progress with stability

The Second Plan aims at a 25 per cent increase in national income, as against an achievement of 18 per cent in the First Plan. This is no mean ambition. It represents a 20 per cent increase in per capita income, allowance being made for the increase in population. The quotation above mis-states the contemplated increase in the 'average monthly earning of the people.' The per capita increase in income from the Second Five-Year Plan would be, not 10 *annas* per month, as this statement might suggest, but Rs 4.12., the per capita monthly income rising from Rs 23.12. per month to Rs 28.80 per month. Whatever else we may do, let us not mislead an uncritical public by suggesting false facts.

Things in India appear to be coming to a stage which do not permit mincing words. Fellow-travelers in India, well supported by their professional comrades, would like to utilize the machinery of planning for imposing communism on the country. Failing this, they would much rather have uncontrolled inflation than steady progress with stability. It is apt to recall here the following statement of Lenin: 'Debauch the currency of capitalism and you destroy capitalism.' It is significant that the communist and fellow-

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traveler technicians, whether from overseas or from India, not only do not regard deficit financing of Rs 1,200 crore too high, but would recommend deficit financing of several times this amount.

Neither under communism nor under democratic planning can inflationary deficit financing lead to overall economic progress. It is incorrect to suggest that credit expansion is the secret of physical (communist) planning in the sense that it was the first link in the chain. The first link in the chain was the availability of real resources and their allocation by authority. Credit came only second. Under democratic planning savings (current, past, and imported) came first. When savings were available, credit would not act as a bottleneck. Thus, whether in India or in Russia, the size of a plan was limited by the amount of real resources, and this amount cannot be augmented by inflationary credit creation.

Pattern of consumption

Your correspondent argues that the bulk of consumer expenditure in India being on 'food articles', and, next, on cloth, if we could ensure adequate supplies of the two, 'no amount of inflation can affect' our standard of living. Since created money would bring about increased output, inflation would, on the other hand, ultimately raise the level of living! When theory fails to support our fancy, let us not try to take shelter behind imaginary models and a display of irrelevant facts. If, indeed, this hocus pocus would work, we have the philosopher's stone in Nasik, and it would be merely a question of time before all the underdeveloped countries of the world march to EI Dorado!

The combined weight of theoretical analysis and economic history has demonstrated that the influence of money is all-pervasive. It does not move, nor can it be made to move in compartments, whichever side of the iron curtain, or of economic well-being, we may be. The pattern of consumer expenditure is immaterial in this respect. It makes no difference whether food articles and cloth constitute the bulk of consumer expenditure, as it will in poorer economies, or only a minor part of such expenditure, as in richer economies. Under proper classification, most patterns of consumption expenditure should be capable of showing heavy weightages on the side of some articles.

THE INFLATIONARY PROCESS, which is ruthless, cannot be induced to operate with lesser severity on the poorer economies, than upon the richer. In actual fact, for a given amount of monetary expansion, inflationary pressures would appear earlier in a relatively poor economy. If prices of foodgrain and of cloth are held unduly (no matter by what device), and if money supply continued to expand, the prices of other commodities will rise unduly, and the general cost of living will reflect the inflationary situation. Let us not forget that during the miserable regime of price control in India, we were witness to queer facts of hay being costlier than grain, firewood being dearer than *atta*, and cattle being fed on pulses of which men went short. There is no device whereby inflation may be kept out of one (major) sector, and made to operate only on the other sectors.

IT IS UNFAIR OF YOUR correspondent to quote Maurice Dobb's observations relating to agricultural surpluses, to support his fallacious thesis regarding inflation. Inflationary finance of development is one thing, and the use of agricultural surpluses for the same purpose, is quite another. The latter constitutes savings, and those who have argued against inflationary deficit financing in India have not argued against the appropriate use of agricultural surpluses. If these surpluses could be conserved and mobilised into the 'savings fund', instead of being used up in increased consumption, as hitherto, to that extent economic development may be accelerated. This will, indeed, require an expansion of money, as will all investment of increased savings. But the expansion of money would be in proportion to the expansion of investment and output. It would be non-inflationary.

In India inflation is 'not inflationary'

Many have argued as if, in the Indian background, inflation is not inflationary. They base their case on, and draw their inspiration from, the Indian post-independence experience, when large deficit financing had failed to drive up prices. In fact money supply had been declining until 1952-53, and prices in the agricultural sector until May 1955. Your correspondent has drawn from the latter part of this experience support for his fallacy that inflation may be held in check by an increased output of food articles.

Recent price history in India has to be viewed, not with an eye on budget deficits in isolation, as many have done, nor with an eye on agricultural output in isolation, as your correspondent has done. Variations in money supply are the result of three forces: the state of the budget, the international payments position, and the public debt and the credit policy of the banking system. If money supply declined until 1952-53, it was because the monetary expansion of budget deficits was more than negated, first, by a contraction of credit by the banking system and, second, by the deflationary effect of payments deficits.

If prices declined until May 1955, broadly, it was because total output increased faster than money supply expanded, the index of industrial output rising to 140 and agricultural output to 114. The trick was not done by an increase in the output of foodgrain alone. If foodgrain prices were unduly deflated, this was the combined result of the low elasticity of demand for them and of the restrictions on exports.

In 1954-55 and thereafter, all the three factors influencing money supply which we have cited above, moved in the expansionary direction at record rates, money supply rose to new peaks and, since May 1955, prices have been moving up at an annual rate of over 11 per cent. In the interests of economic stability and progress, and of the supreme importance of not upsetting the (precarious) balance in the private budgets of tens of millions of the already indigent families in India, pray let us look at the elephant as a whole and not, like the blind men, only a part each, and recognise that inflation in India, too, is inflationary. Our recent price experience lends no support to your correspondent's fallacy.

Time lag between investment and output

Your correspondent quotes me as under in the matter of my views on the crucial importance of the time-lag between investment and output in an analysis of the inflationary process: 'It would be incorrect to suppose that inflation would be liquidated when the 'compensatory' increase in output becomes available.' Instead of coming to grips with this phenomenon, he begins by stating that in this argument, I have only echoed the views of the IMF mission to India as embodied in their report *Economic Development with Stability* published by the ministry of finance.

This report is a classic and merits close study by all students of the problems of Indian economic development. It may disillusion those who fondly believe in inflationary shortcuts to development, or fancy that Keynesian, or post-Keynesian, analysis supports such short-cuts.

The phenomenon of the time-lag between investment and output is simple enough. Though the Austrian school, in particular Professor Hayek, were among the first to make effective use of it in economic analysis, it is common property of current economic thinking. You can ignore the time-lag in a study of the process of inflation only at your own peril. To accuse an economist of echoing another's viewpoint in this respect is almost like accusing us of echoing the words of the Oxford dictionary! Your correspondent's opinion that in an economy dominated by agriculture, there is scope for vast deficit financing does not merit serious notice. In the face of the post-war experience of the world, so fresh in our minds, we need not also waste time on his assertion that inflation need have no repercussions on balance of payments.

The long and short of your correspondent's thesis is that India's economic salvation is best sought in physical (communist) planning, as planning in a democracy cannot make much impression on your standard of living. The long and short of my position is that we have done very well in the First Five-Year Plan. Our income had risen by 18 per cent in place of the anticipated 11 per cent, which is very much in excess of the rate of our population growth. On the same technique of planning we should do considerably better in the Second Plan. Our performance would not merit shoving into the gas chamber individual liberty and democratic institutions, which we value as dearly as life. We cannot exchange them for dubious promises of accelerated economic progress under communism.

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A decade of planning

1962

As early as the 1960s, the writer could foresee the damage and chaos which inflation and statism would produce, and he repeatedly warned of their ill effects. In this chapter from his book *Indian Planning and Economic Development*, he sounded a warning which was heeded only in 1992, when the wave of liberalisation and globalisation finally swept the country

Though the statistics of Indian national income show a rise of 42 per cent since planning began, this has not ameliorated mass poverty. Much of the increase in income has accrued to a thin upper crust of wealthy people; and a part has been locked up in inventory accumulations and idle production capacities. The little that has come the way of the masses of the people is reflected in the semi-stagnant level of consumption of food and cloth. The pattern of income distribution is more anti-social today than before Independence, and unemployment has risen with each Plan.

Striking progress has been achieved only in industrial production. But this is a pyrrhic victory, won at heavy real costs of production in violation of the law of comparative costs and at the expense of more lucrative investments in agriculture and consumer goods industries and, therefore, to the detriment of the national product. This, coupled with overemphasis on heavy industries, has caused employment, which is a function of the expansion of the national product, to lag behind the expansion of population. The net result is that the backlog of unemployment has kept growing with the progress of planning.

The past decade of planning in India has yielded a large portfolio of economic oddities, which reflect the damage potential of planning, though our planners often recount the 'benefits' of planning. We may recall some of these oddities. Abolition of poverty and liquidation of unemployment, which are among the prime objectives of planning, demand maximisation of the national product. This necessitates that the available resources should be put to uses where output is the highest. And yet, over two-thirds of plan resources are forcibly drafted into heavy industries, where the additions to the national product from the additions to investments are estimated at under 20 per cent of the invested resources, in preference to agriculture and the consumer goods industries, where the corresponding additions to the national product may be up to 70 per cent. The oddity of this project also extends into the sphere of employment. Employment opportunities in the former set of industries are one-half to one-eighth of the employment opportunities in the latter set.

The cotton textile industry, which produces 69 per cent of the domestic output of cotton cloth and accounts for over one-third of Indian industrial activity, is riddled with a perplexing complex of restrictionist directives

Abolition of poverty in the Indian context implies increased production of food and cloth, the consumption of both being deplorably sub-standard. But the cotton textile industry, which produces 69 per cent of the domestic output of cotton cloth and accounts for over one-third of Indian industrial activity, is riddled with a perplexing complex of restrictionist directives and regulations; the expansion of production and modernisation of the textile mills is constricted, the former rather drastically. This has led to the semi-stagnation of the production of cloth during the past four years. In the context of a rising population, the price of cloth has risen steeply, causing retrograde income shifts from consumers to producers, who get monopoly advantages through state action.

IN PURSUANCE OF the policy of rapid industrialisation, we force the establishment of industries – by banning or restricting imports and by offering inducements to the domestic manufacturers – though our production costs are uneconomic over a wide range of industries, relatively to the costs abroad. The result is that the output of the new industries generally is a business proposition only in the highly protected domestic market, fed by inflationary demand, and is unsaleable abroad, both because of price and quality.

When we find that exports are slow to move, we resort to all manner of artificial devices for boosting exports – export promotion, import licenses, state trading, bilateral agreements, concessions in taxation, freight and credit, coercion of producers to export and so on – which confound the position all the more. With the basic difficulties remaining unremedied, exports, however, have stagnated around Rs 625 crore during the past five years. Meanwhile, the establishment of uneconomic industries continues with unabated vigour.

We engage in unrestrained deficit financing of the public sector. When this drives prices up, we look around for the 'anti-social elements' responsible for it, throw the blame on banks and traders and seek relief in selective and overall credit curbs and in controls. Floods cannot be checked by restricting the flow of water down the canal, nor can controls gobble up the inflationary funds. Quite naturally, these measures have made no difference to the price rise. Since 1954-55, prices have gone up by 46 per cent. Notwithstanding this experience, deficit financing continues and, as we have seen, is contemplated on a larger scale than before.

Perhaps the oldest among the economic oddities are in the field of foreign trade and foreign payments. We have been harassed by acute foreign exchange scarcities for the past decade or so. And yet, we penalise the earners of foreign exchange – the exporters – and subsidise the consumers of foreign exchange – the importers. We do this by mulcting the exporters of a part of their legitimate dues when they covert their foreign exchange receipts into rupees and by charging the importers less than legitimate prices for the foreign exchange allotted to them.

These wholly perverse subsidies and penalties are effected through the state monopolising foreign exchange transactions and ruthlessly exercising this monopoly power to maintain an unconscionably high and artificial exchange rate for the rupee. The rupee is currently quoted in the free markets for foreign exchange overseas at discounts of about 32 per cent and internally has lost about 30 per cent of its value since the close of 1954-55 and as at the close of 1960-61, the General Price Index having risen in the interval by 42 per cent. The internal price of gold currently (Rs. 119.70 for ten grams) is nearly 2¼ times the external price (Rs. 53.58 for ten grams).

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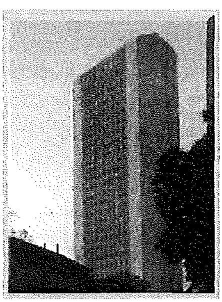
AND YET, WE FIRMLY believe that the Indian rupee is, in the words of the prime minister, as 'strong' as ever; that it is 'one of the best, being among the few sound, currencies in the world' and that, in the words of the Governor of the Reserve Bank of India, it may 'within 10 or 15 years, become a relatively hard currency.'

This faith in the solidity of the rupee rests, not on our own analysis of facts, but on the views of 'visiting experts' – 'hard-headed foreign businessmen,' whom the prime minister quoted, and one C Douglas Dillon, quoted by the Governor of the Reserve Bank, who seem to inspire the same confidence in us as perhaps the Rock of Gibraltar did in the Royal Navy in the defense of the Mediterranean seas; as witness the peremptory dismissal by the prime minister of all talk of an adjustment in the exchange value of the rupee as '*fantastic nonsense*;' witness, too, the bemoaning of the Governor of the Reserve Bank that, despite the optimistic forecast for the future of the rupee by a competent 'authority,' 'a few people in our country' should 'indulge in unwarranted pessimism' regarding the external value of the rupee.



RBI, Bombay

Meanwhile, it being immaterial whether imports come in by the Customs gate or by other routes, BoP deficits widened under the pressures of inflation and intensified statist controls

We ban or restrict imports to the 'austerity level' for correcting our balance of payments deficits and slash private imports by 38 per cent in two years – 1975-58 and 1958-59 – 'luxury goods' being shown, quite naturally, the least mercy. But this made little difference to the pressure of demand for import goods, which is continually fed by inflation and 'black' incomes born of controls.

The banned and restricted imports flowed in by the backdoor, the national exchequer being mulcted of the import duties in the bargain; the import duties now accrued as subsidy to the smugglers. Smuggled imports – not being free gifts – have to be paid for like open imports, though the techniques of acquiring foreign exchange to make the payments may differ in the two cases. The deterioration in the balance of payments, therefore, remained uncorrected, though open imports have been securely held at the 'austerity level.'

We proudly exhibit, as evidence of 'self-effort' for plan finance, the statistical 'fact' that consumer goods imports declined from 25 per cent of private imports in 1954-55 to 13 per cent in 1958-59. Meanwhile, it being immaterial whether imports come in by the Customs gate or by other routes, the balance of payments (BoP) deficits, under the pressures of inflation and intensified statist controls, widened from an annual average of Rs 21 crore in the four years ending 1955-56 to an annual average of Rs 264 crore in the four years ending 1959-60.

The rupee exchange has been kept at the highly unrealistic rate – the BoP gap resulting from inflation and statism has been covered – until 1958-59, mainly through foreign aid and partly drafts on currency reserves, and, thereafter, almost wholly by drafts on foreign aid. The penalties of the unrealistic exchange rate, of inflation and of statism impinge not only on Indian exports and the Indian national product. The penalties are partly borne also by the taxpayers in countries which extend 'developmental' aid to India as, short of an economic miracle – which policies of economic freedom alone can produce – the chances of our ability to repay foreign loans are extremely meagre.

The aid-givers, being wealthy, may write off the loans as part of the costs of the Cold War and of wooing and winning uncommitted nations. But this misfortune will be a lasting blemish on the good name of India.

We regulate imports by the issue of import licenses. Foreign exchange to pay for the imports is provided by the Reserve Bank to the holders of import licenses. The price charged for the exchange is based on the official price, which, as we have seen, is unconscionably lower than free-market prices. But the imported goods are sold at the domestic free-market prices, which are phenomenally higher than the landed costs of the imports. The difference – varying from 30 per cent to over 500 per cent or more, depending on commodities – which is a windfall, accrues to the participants in the import activity: the traffickers in import licenses and the dealers in import goods. This is a free gift of statism to the privileged recipients of the import licenses, disbursed twice a year; its magnitude may be of the order of Rs 460 crore annually. If the import licenses were sold by auction, like treasury bills and liquor licenses, the bulk or whole of this difference might have accrued to the Union revenues, converting budget deficits into budget surpluses.

To embark 'in a big way' on producing machinery and other heavy capital goods in India is to add to the error of inflationary and statist policies one more error – the extravagant use of resources for turning out low grade output at home to replace superior quality and cheaper import goods

It might have removed, too, a potent instrument of corruption and a source of heavy anti-social income shifts. Instead, we have preferred to cover budget deficits by inflation and distribute the licenses free to favorites among others, thus keeping alive corruption and undermining progress towards the national objective of a socialist pattern of society.

To the anti-social income transfers ensuing from import licenses must be added the analogous income transfers from the other instruments of statism – contracts, permits and concessions – and from inflation. In the discussion on this subject in the following pages we have estimated that this may raise the aggregate income shifts to an order of Rs 750 crore annually. This strange phenomenon has given rise to the no less strange phenomenon of the rich becoming richer, there coming into being a new class of the rich, the progeny of inflation and statism; in the process, the conventional middle class families have been impoverished further.

The easy-gotten money has caused squandermania in the industrial centres and in the seats of the Union and state governments. Forgetting our own role in producing this phenomenon, we complain of the 'flaunting of wealth and the display of opulence' and of the general 'atmosphere of extravagance in which certain classes lived.' With statism will co-exist social injustice, unemployment, poverty and conflict.

We pursue vigorously the policy of establishing heavy engineering, heavy chemical and other basic industries, and industries producing substitutes to import goods, 'even at the cost of slowing down the growth of small industries and agriculture,' with the twin objectives of 'saving' foreign exchange – for correcting balance of payments deficits – and of forcing the pace of economic development, as part of the 'grand adventure' of 'modernising' the country.

Now, India's balance of payments difficulties are not due to the importation of machinery or other capital goods. Ordinarily, such imports should cause no strain on BoP, if investments are wholly covered by domestic savings and foreign aid. Nor can BoP difficulties be corrected by fabricating at home machinery and other substitutes to imports. Our BoP difficulties are the direct result, principally, of inflation and of the distortions in the production structure which have ensued from statist policies. To embark 'in a big way' on producing machinery and other heavy capital goods in India is to add to the error of inflationary and statist policies one more error: the extravagant use of resources for turning out low grade output at home to replace superior quality and cheaper import goods. It is difficult to see how diversion of resources into heavy industries – which add to the national product under 20 per cent of the value of the investments – at the expense of industries, which add 30-70 per cent, can contribute to amelioration of the BoP problem. Such extravagance, through slowing down expansion of the national product, should accentuate the payments problem. But this false notion has extensive support in India and other parts of the underdeveloped world.

THE MALADY OF India's foreign exchange difficulty is a deep-rooted one, and cannot be remedied without stopping inflation and, as a practical matter, without abandoning statist policies, since it is these latter policies – through their built-in bias for the acceleration of expenditure and investments regardless of the availability of resources – that produce inflation by causing overinvestment and extravagant expenditures.

Second, the accumulated distortions in the structure of production which inflation and statism hitherto have given rise to must be corrected. Statist restrictions on imports, the statist basis for industrialisation, regardless of the economic viability of the industries induced into being, and the inflation-fed demands which nourish the home market, have led to large-scale diversion of resources from export production into production for the home market.

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These factors have also created vast and widening gaps between the domestic and international prices of import goods, a wide range of export goods and of gold. It is not possible to regain domestic economic stability and equilibrium in the balance of international payments without a shift-back of production for exports from production for the home market and without eliminating the price gaps. The achievements of these two decades of inflation and a decade of 'planning' have worked into the economy fundamental structural imbalances.

The shift-back will not materialise unless the load of inflationary demand is taken off the home market and the price gaps are eliminated; the price gaps cannot be eliminated without putting a stop to inflation, abandoning statist policies of inducing the establishment of industrial and other undertakings in defiance of the law of comparative costs and without an appropriate adjustment in the exchange value of the rupee in expiation of past inflation and statism. The faith which we evince in simpleton export-pro-

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motion measures is indicative of the fact that we have not as yet recognised the awesome complexity of the problem.

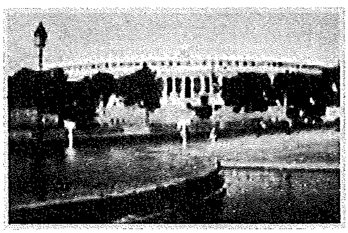
President Kennedy, in his message of 22 March 1961 to the US Congress asking for long-term foreign aid commitments, cautioned that the 'economic collapse' of the less developed nations which stand poised 'between sustained growth and economic chaos would be disastrous' to US national security. The tragedy of the situation is that India's policies of the past decade or more have been producing chaos, not growth, and foreign aid has been feeding the very policy measures responsible for it.

Quite aware of our strategic advantages in the Cold War, we are averse to changing these policies. If Indian economic collapse is, in fact, dangerous to US national security, it is vital that the US Administration recognise this most unhappy involvement as the forces of imbalance must, in due time, prove overwhelming; the topsy-turvy structure will topple over and no amount of foreign aid could then prevent chaos.

Notwithstanding the great damage which the prevailing policies have caused and are causing to the Indian economy at its roots, it is a forlorn hope that they will be replaced by sounder policies voluntarily – the 'plan barons' and other powerful vested interests would not abandon it except under overwhelming pressure.

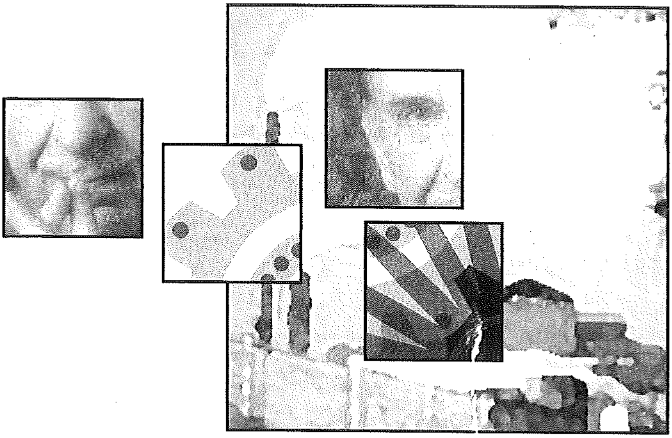
STATISM OPERATES THROUGH licenses, permits, contracts, quotas and concessions. The recipients of these documents obtain large and easy gains – including the unmerited gains from inflation, they amount to an order of Rs 750 crore annually – to which they have neither ethical nor economic title. Add to this the enormous patronage which statism provides to the Plan barons over senior executive positions and other employment in the public sector and, to a certain extent, also in the private sector. The bigger the Plan, the larger become the portfolios of these documents and of the executive positions and other employment for distribution.

Thus, there lurks behind statism some built-in accelerator of plan magnitudes akin to Parkinson's law. This powerful motivating force is responsible in no small measure for the jump in investments from Rs 3,760 crore in the First Plan to Rs 7,900 crore in the Second and to Rs 12,350 crore in the Third. The lack of domestic resources has not held the hand of the planners. They seek to fill the gap by foreign aid and inflation, and seem to pay little heed to the consequences of the latter and to the burden of the former.



The Parliament building

So, far from abandoning statist planning, a milch cow of their dreams come to life, its beneficiaries and their supporters would defend it to the last ditch. With a Parliament where a viable opposition is absent; an electorate of over 80 per cent illiterates; and a community where public opinion has never had the same compelling force which it commands in certain democratic countries of Europe and America; policy reform through education and political campaigning is a steep uphill task, though heroic efforts in this direction are widely in evidence. There seems little chance of statism being discarded without the plan barons being dislodged.



foreign aid

section

12

Is aid necessary for development?

21 JANUARY 1970

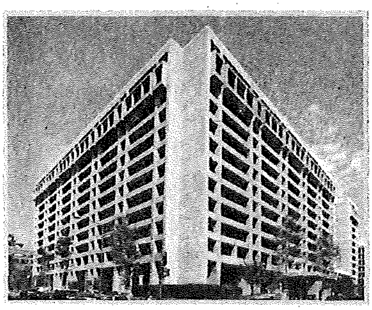
Going against the wisdom of the day that foreign aid would fuel growth, the writer predicted in this paper presented at a seminar that massive aid would be massively misdirected. He expressed surprise that the economists and statistical experts of the IMF and World Bank have not understood this

There is virtual unanimity of opinion that foreign aid is essential for accelerating economic growth. The argument generally advanced is that the resources available for investment in developing countries are inadequate to meet the needs of such acceleration, this inadequacy being the result of low income and, therefore, of the lower rate of saving. The rate of saving of underdeveloped countries generally is of the order of 5 to 7 per cent. In the developed countries, on the other hand, the rate of saving may range from 15 to 30 per cent – in Japan it has been 39 per cent. The quantum of saving in some of the developed countries may be larger than the entire Indian national income.

The meagre accumulation of domestic resources clearly needs to be supplemented, so the argument continues, by inflow of foreign savings. Historically, economic development even of the US and of countries in west Europe had been stepped up by foreign capital. In the absence of foreign capital, the pace of progress in these countries might have been slower.

Currently, foreign aid is about 65 per cent of India's own savings; and visiting experts from aid-giving countries, from the World Bank and from the UN have given moral support to our policies.

But economic development is not a matter of the volume of savings and investment alone. People's attitudes, institutional and other environmental factors and the direction of investment are no less important. Skills and other non-economic factors are slow to improve. Removal of illiteracy and the



IMF HQ

spread of education, general and technical, may impart considerable leverage to growth when compared with the results from a mere piling up of investments. But among the economic factors, the direction of investment may be vital to the pace of growth.

Basic industries are really those which yield the highest output for the given quantum of investment resources and bring maximum employment at current wage rates; not necessarily iron and steel, heavy engineering, heavy chemicals, mammoth river valley projects and the like

Capital formation may mount statistically, as has been the case in India during the past 15 years. The pace of investment during this period rose three times. Currently, it may have doubled again. Yet the economy is in a state of utter chaos; per capita income, both statistically and in terms of consumption of even the necessaries of life, is semi-stagnant, if not worse. This is so because much of the mounting investment has gone into the wrong channels.

India during the past 15 years, and some other developing countries in recent years, have resorted to two policy measures which have proved fatal to accelerated economic growth. First, basic industries have been wrongly identified. An overwhelming proportion of the available investment resources comprising domestic savings and foreign aid have been devoted to these 'basic' industries. Second, the private sector has used capital on a colossal scale for indiscriminate import substitution.

The same set of industries cannot be regarded as basic for all countries all the time. Agriculture was the basic industry in the US before World War II. By gradual changes, manufacturing industries and subsequently heavy industries became basic industries. Tomorrow's basic industry in America may be automation. The basic industries of Israel today may be citrus fruit and diamond polishing – the two together yield more than half of all foreign exchange receipts of the country.

BASIC INDUSTRIES ARE really those which yield the highest output for the given quantum of investment resources and bring maximum employment at current wage rates; not necessarily iron and steel, heavy engineering, chemicals, mammoth river valley projects and the like. Basic industries, therefore, change with country and with time in the same country.

The story is told of the prime minister of a country with a population equivalent to that of a suburb of Ahmedabad being advised by an Indian economist to establish a steel mill to save the country from economic stagnation. He was persuaded to abandon the idea by the timely intervention of a friendly socialist country.

This underlines the importance of correct domestic policies, which alone can ensure not only maximum economic development but also prevention of the misdirection of foreign aid. If domestic policies fail to make for harmonious balanced multi-sided progress but divert resources into the wrong channels, any amount of foreign aid cannot effectively contribute to economic development. Massive aid is apt to be massively misdirected.

Since our discussion centres round economic development, the definition of aid should relate, first, to the amount of foreign savings flowing into the national economy, not to the 'hard' or 'soft' terms of lending. External credit repayable in exports is not, however, aid in the real sense of the term, as such credit does not finance domestic capital formation. The inflated figure of aid from the USSR in certain official publications is the result of including such credit in aid. Secondly, the term aid should cover commodity aid as well as aid in currencies, and foreign savings injected into the national economy such as PL 480 imports. These imports too contribute to capital formation, employment opportunities and economic development.

It has been suggested that aid to India is vastly lower than aid to Israel, Jordan, South Vietnam and Pakistan. Such a comparison is based on per capita aid, hardly a correct criterion for comparison. On this basis, the quantum of aid to India may be about the lowest in the world.

A more correct measure of the quantum of aid may be to relate it to domestic savings. On this basis, aid to India in recent years may be about the highest in the world. While the US has been the last aid-giving country since long, India was, until quite recently, the largest recipient of aid.

The real worth of aid also gets unduly deflated when we convert, as we have been doing, foreign aid into Indian money at the official exchange rate. Aid should be valued at the Indian prices of the import goods purchased from aid funds. This would call for the valuation of foreign exchange at its true worth, which may be closer to the free-market rate than to the official exchange rate. Adjusting for these factors – a matter for close statistical study – foreign aid may be not one-fourth, but closer to one-half of total investment. If foreign aid is closer to one-half than one-fourth of total investment, it follows that this aid is also closer to 100 per cent of domestic savings, not 50 per cent of these savings. With perhaps an exception or two: no country received aid on so massive a scale as Europe under the Marshall Plan.

Leakage of foreign aid

Leakages of foreign aid also need to be pondered over. Despite foreign aid of the order of one-half of total investment (or 100 per cent of domestic savings), Indian national income rose, during the five years ending 1965-66, at an annual rate of about three per cent; and per capita income has remained semi-stagnant since about 1960-61, if we ignore the weather-based cyclical rises in agricultural production, as in 1964-65 and 1967-68. Does it follow that in the absence of this aid, the rate of increase might have been far slower – possibly of an order of 0.5 per cent per annum, or disastrously lower than the rate of increase in population? Does it really mean that, if the aid crutch had not come, and the pace of aid had not skyrocketed, the Indian economy might have gone to bits? *Prima facie*, there is something wrong somewhere. Apparently, aid has not had the effect expected of it. If aid has not visibly added to income, where has it gone?

Appreciable parts of aid are lost in the leakages that abound, both external and internal. About the external leakage of foreign aid, my argument, briefly, is that gold and consumer goods smuggled in, concealed exports of foreign capital, foreign travel expenses of residents in excess of the allotted quota of foreign exchange are all, necessarily, paid for in foreign currency, as no part of these foreign currencies can be a free gift. To finance these exports and remittances, foreign currency can come from one of three sources: (a) export receipts, including receipts on invisible exports (b) currency reserves or (c) foreign aid. There is no fourth source from which foreign exchange may be drawn.

Clearly, he who finances the official BoP deficits provides, though indirectly, the foreign exchange finance for smuggled imports and concealed remittances. It is a case of the cuckoo laying its eggs, unnoticed, in the nest of the crow

FOREIGN EXCHANGE TO finance this traffic cannot possibly come from export receipts, as open imports alone exceed open exports. Nor can any appreciable amount of exchange be provided from currency reserves, as these reserves are already at rock bottom. The only source of finance is foreign aid, and the question is not whether foreign aid should be tapped. The question really is: how is foreign aid tapped?

This is a most interesting inquiry. The widely acknowledged devices of tapping the foreign exchange accruing to a country are underinvoicing exports, overinvoicing imports and smuggling out exports. This tapping must necessarily widen the gap in the official balance of payments (BoP) by the amounts of foreign exchange that are, thus, surreptitiously diverted into free markets for foreign exchange. The official BoP deficit is then 'sold' to the World Bank and the Aid India Consortium as 'developmental' deficits; and these bodies make good these deficits.

Clearly, he who finances the official BoP deficits provides, though indirectly, the foreign exchange finance for smuggled imports and concealed remittances. It is a case of the cuckoo laying its eggs, unnoticed, in the nest of the crow. The crow has a reputation for cleverness, but apparently it can neither count nor identify its own eggs: it hatches both with the same care and affection. The Reserve Bank and the ministry of finance, notwithstanding their well-staffed research departments and policing arrangements, have not fared any better than the crow. For all their erudition in assembling and analysing statistics, they are unable to separate the part of BoP deficit representing the shift of foreign exchange to the black market from the part representing developmental finance. They have solved this difficulty by the make-believe that what they are 'selling' to the World Bank and to the Aid India Consortium are all developmental eggs and, apparently, the economical and statistical experts of these august bodies have had no difficulty in believing this.

Quite understandably, the Exchange Control Enforcement Directorate of the ministry of finance, the Reserve Bank of India and the Customs depart-

A meeting at the World Bank

ment wish to assert that the external leakages from foreign aid are not qualitatively significant in relation to total volume of transactions. The logical and factual basis of these assertions is not revealed. On the other hand, in private, dealers in foreign exchange and market gossip indicate that illicit transactions in foreign exchange are very large – that 'exchange control' leaks like a sieve.

Seeing that the gap between the official and black market rate for convertible currencies is so large – on 20 November 1969 the premium in terms of Indian rupees on the Swiss franc was 47.6 per cent in Zurich – it is unrealistic to assert that leakages of foreign aid are minor in nature. At a rough guess, the leakages may be of an annual order of Rs 425 crore in recent years. The annual average foreign exchange inflow into India from exports during the decade ending 1967-68 was Rs 1,300 crore. Foreign exchange flowing illicitly from the official to the black market may be, therefore, of an order of 54 per cent of India's exports during this period.

WE ARRIVE AT this guess of the order of magnitude of foreign exchange leakage from foreign aid by collating the statistics of seizures by the police of smuggled goods. The assumption is that illicit transactions in foreign exchange finance the traffic in smuggled goods. Seizures of smuggled goods amount to Rs 14.04 crore at the official exchange rate during the first eight months of 1968-69 and may be placed at Rs 21.06 crore for the 12-month period. Smuggled goods are insured against seizure and the insurance premium is stated to be around 15 per cent. If we assume the costs and profit of the insurance companies to be at about 10 per cent, seizures may be about 5 per cent of the total smuggled imports that are insured.

It is not smuggled imports alone that are financed by the black market for foreign exchange. These markets also provide foreign exchange for concealed capital exports and the expenditure of Indian travelers abroad above the official allotted rations of foreign exchange. The above exercise in conjecture, it will be noted, does not allow for these two categories of illicit dealings in foreign exchange.

Taking next leakages of foreign exchange internally, such leakages have taken place through overcapitalisation, by creation of excess production capacity, by overstaffing, in corrupt payments and practices, and in extravagant use of resources in fringe benefits, in social overheads etc. Foreign aid has been misdirected also in financing capital formation in uneconomic domestic goods industries at the expense of capital formation in the traditional export industries.

Such diversion of capital formation is among the ill-effects of currency overvaluation, which represses the rupee receipts from exports and reduces the relative attractiveness of investment in export industries, even as it artificially increases the attractiveness of investment in industries catering to the needs of the home market. It may be noted that this category of misdirection of capital applies not only to foreign aid but also to domestic savings.

When the public sector expands faster than the availability of personnel with the competence and character to man public sector enterprises with disposal over huge sums and employment benefits, there is danger of corruption

Causes of leakage

Leakage of foreign aid to finance non-plan imports and capital exports is induced by influences which stem from two factors: (i) Inflation and statist measures, including economic controls of all categories; and (ii) a too rapid expansion of the public sector.

Inflation, by driving prices up, eats into savings if held as cash or as fixed interest-bearing securities. To protect savings from erosion by rising prices, savers divert their savings into gold hoards, concealed exports of capital and less essential urban property. Rising prices also enhance speculative activity and part of the savings get drawn into inflated inventories. Under controls, some transactions become 'black' and give rise to 'black' incomes, savings from which cannot be invested openly. Such savings add to the demand for gold and other non-plan uses of capital.

When the public sector expands faster than the availability of personnel with the competence and character to man public sector enterprises with disposal over huge sums and employment benefits, there is danger of the spread of corruption. Part of public sector 'investments' may get lost through inefficiency, extravagance and neglect, and part of them are apt to be converted into corrupt payments. Thus when the public sector project is accounted to cost Rs 100 crore, the value of physical assets created may be less than this sum, the margin varying with projects and circumstances. To the extent of these margins – more expressly to the extent of the corrupt payments – domestic savings and foreign aid appropriated for the projects get transformed into 'black' incomes, and savings from them leak into non-plan uses.

We have conjectured that the magnitude of 'black' incomes may be of the order of Rs 650 crore annually, or more than the annual rates of increase in the national income. Since these accrue to people in the top income group, the savings from them may be at a higher rate. It is possible that the order of magnitude of savings from black income may be Rs 400 crore annually.

Not the whole of these accumulations of savings remain concealed permanently. If such were the case, the magnitudes being so considerable, its effects might be disastrous. Their owners continually attempt to convert them into open savings, through various ingenious devices. The more easily seen among these devices are understating household, travel and marriage expenses, and cost of building and equipment.

Black incomes are converted into white also through bullion dealers, with the collusion of the latter. An individual X, who wishes to convert black funds – say Rs 50,000 – into white may engage in a fictitious 'sale' of 'ancestral' jewelry worth Rs 50,000 to bullion dealer Y, who will enter the transaction in his books as though it were a genuine case of jewelry purchased by him and pay to X the value of the jewels in cash or by cheque.

This solves the problem of X. He will have converted Rs 50,000 of black funds into white: he can now use the funds openly as they are no longer black money. Legally, they are the proceeds of the sale of jewelry. Y will balance this transaction in his book by an order for melting the 'jewelry' at a refinery or goldsmith, the costs of this being duly entered in the books of Y as well as of the goldsmith or refinery. This will fortify the 'genuineness' of the fictitious deal. Y will charge extra commission of 8 to 10 per cent for services thus rendered, sharing a part of it with the refinery or the goldsmith for 'melting' the non-existent jewelry. The next task of Y, in order to straighten out the position in his books, would be to 'sell' the fictitious bullion 'received' from the refinery or the goldsmith; this he may do by book entries of numerous sales to *benami* parties (fictitious individuals).

We know that domestic inflation, too, gives rise to BoP deficits. Since these deficits, whatever may be their originating causes, are all covered by foreign aid, it follows that finance for extravagant living, gold hoards, luxury imports and capital exports is all scooped out from foreign aid

Such deals provide lucrative side business to bullion dealers. Apart from the damage to conscience, they involve next to no risk. Proof of fictitiousness is extremely difficult, if the amount of the jewelry is within reasonable magnitude, considering the status of X.

The conversion of black into white incomes is effected, too, through 'buying' business losses of individuals.

This is a rather complicated operation and needs clarification. An individual A, who has suffered a loss in business, 'sells' the loss to B who has 'black' savings for conversion into 'white' for a consideration; the consideration is believed to vary from 6 per cent to 8 per cent of the amount of the 'sale,' depending upon the market conditions for such transactions. The 'sale' of the loss is effected by A showing, through the necessary entries in his accounts, that the loss of A represents the balancing profits of B, A and B supposedly being parties to the transactions which had resulted in A's loss. The 'profits' of B emerging from this after-the-event fiction enables B to transform equivalent 'black' savings into 'white' savings.

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-betweens who have come into existence for precisely this purpose.

Correspondingly, an individual A may 'sell' his profits to an individual B, who may have made large profits and may wish to reduce them to reasonable proportions to avoid high income tax rates on the upper slabs of large incomes. In this case A will make appropriate entries in his books to show that his profits represented the balancing losses of B. This would enable B to convert white incomes into 'black'.

The 'sale' of profit for converting 'white' incomes into 'black', with a view to tax evasion cannot be applied universally. Income tax laws will not permit the setting-off of speculative losses on the stock exchange, or of speculative (forward) transactions on other exchanges against profits from ready transactions. This may restrict the use of this technique of tax evasion; it does not however, disable the technique altogether. The device of converting 'black' incomes into 'white', through 'sales' of losses, remains unaffected by this income tax restriction.

The conversion of 'black' into 'white' savings, however, takes time and, if the pace of increase of 'black' savings should be faster than its conversion into 'white' savings, large amounts of savings are to be accounted for. They may be invested in gold; they may finance inventory accumulations and working capital purchases against cash; they may be remitted abroad clandestinely; held abroad if the income itself accrued abroad in unaccountable form, e.g. as commission on purchase of machinery which appears as 'expense account' of selling firms abroad; or used to put up residential and other structures, not wholly essential.

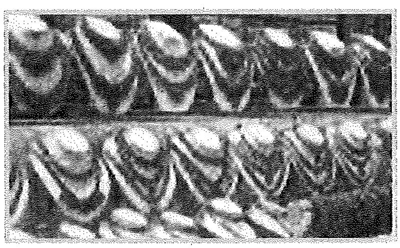
Excepting cash finance of the usual working capital needs of trade and industry – this is not a case of misuse of savings but a concealed use of it – all these cases of misdirection of savings are apt to worsen the BoP position of the country correspondingly – through reducing exports, concealing the receipts of foreign exchange or increasing imports.

DETERIORATION IN THE BOP is obvious in the case of gold and remittances of funds abroad. Both involve use of foreign exchange accruing to the country and, therefore, must get debited to BoP accounts. Such deterioration is obvious, too, in the case of expense account commission earned abroad and held abroad. These commissions form part of Indian national income. Their not figuring expressly as commissions paid to Indian buyers in the books of the overseas sellers and their not figuring at all in the books of Indian buyers have nothing to do with this fact. These routine practices are part of modern business ethics and strain the consciences of neither party. If these foreign exchange earnings were not held abroad but were brought home, they would figure as credit items in our BoP. To leave them abroad has a debit effect, instead.

The processes through which a worsening of the BoP position may take place when black savings are invested in speculative inventories, in the construction of less essential local property and in such other hedge-investments against inflation, or in excess production capacities, may be less obvious. But the link between this category of the misdirection of savings and the deterioration of the payments position is as real as in the case of the more obvious links between the two phenomena; this link becomes apparent when we see that in the absence of this misdirection, the national product which has gone into these operations might have been exported either in the same form or through appropriate fabrications to meet export needs; or, the savings thus misdirected might have been utilised to manufacture at home substitutes for import goods, in which event there will be correspondingly less demand for imports. In all cases, the country would have been spared a corresponding deterioration in the BoP.

THUS, ALL MISUSES OF DOMESTIC savings are likely to set in motion consequential economic events that would show up in the direct effect on the BoP. The larger the misuse, the larger may be the BoP debits. Black incomes, being often easy-gotten money, might induce extravagant living. This has been much in evidence in recent years in the business and industrial centres and in the Union and state capitals. To the extent of such extravagance, expenditure from 'black' income might also contribute to the deterioration in payments through consuming at home what should be exported, or by inducing larger imports.

We know that domestic inflation, too, gives rise to BoP deficits. Since these deficits, whatever may be their originating causes, are all covered by foreign aid, it follows that finance for extravagant living, gold hoards, luxury imports and capital exports is all scooped out from foreign aid. The mechanics of the process is a matter of unimportant detail. Thus, viewed under the economic X-ray, we are able to establish the financial link between, on the one hand, foreign aid, and on the other the galloping increase in the number of cars in the urban areas, of the luxury flats, of impressive residential constructions, of expensive hotels, of the accumulation of smuggled gold despite semi-stagnant per capita incomes, of the heavy holiday traffic, of the overcrowding of resorts, of the flaunting of wealth at marriages and other ceremonies, of the secret accounts in investments in Switzerland and elsewhere, and of the abandonment of frugal ways for extravagant living by the new rich among the beneficiaries of planning.



It is significant that these developments emerge with striking rapidity with the resurgence of inflation in 1955-56, accelerated plan investments as of the same year and the steep jump in foreign aid since 1956-57 – unutilised foreign aid rose from an annual average of Rs 39 crore in the First Plan to Rs 272 crore in the Second. Foreign aid put to such uses would add to the debt burden of the country without adding to our ability to repay the debt. It is time we appreciated the dangers of this phenomenon, which undermines Indian economic progress, our moral standards and also our international stature.

It is time, too, that taxpayers in the aid-giving countries recognise the truth regarding the uses to which foreign aid – drawn from tax funds – is really being put.

Plugging the leakages

In an arrangement under which the aid dollar is not watched or followed by the owner of that dollar, contrary to past practice, such leakages are unavoidable. Much aid has also been misdirected, together with matching domestic savings, in sub-marginal projects, which could very well wait for a later date. The net outcome of this policy has been that, while the aid has been flowing quite vigorously, we have little to show by way of worthwhile capital formation and economic development, as the result of this aid flow.

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AS OUR OWN EXPERIENCE of the past two decades has demonstrated, there is no human device to successfully prevent these leakages of foreign exchange, internal as well as external, though prosecutions may mount. We cannot carry water in a sieve, nor is it possible to prevent fish from drinking water, though some administrators may fancy that, given adequate powers, they may achieve both. So long as the system of two prices for foreign exchange – an official price and a black market price – continues, foreign exchange leakage must continue, too.

How can we hope to prevent exporters and others from wanting to sell part, if not the whole, of their exchange earnings in the black market, which offers a most tempting price? And how can we hope to prevent those who need foreign exchange from wanting to buy all their needs, and more, from the vastly cheaper official market? The natural tendency is apt to render the balance, in the official BoP, exceedingly difficult; reliance on foreign aid for the external viability of the country becomes unavoidable.

The only lasting solution to this malady is to abolish the system of dual pricing of foreign exchange. Physical restrictions on imports are no solution to the problem of BoP deficits. Nor is any rigorous program of import substitution a remedy, as most economic administrators seem to assume. These two measures – import restrictions and import substitution – are interrelated in that import restrictions necessarily cause pressures for import substitution. I have dealt on this subject in my book *Indian Economic Policy*. Import restrictions do not destroy the purchasing power that used to feed on the imported goods which are no longer allowed to come into the country. This purchasing power knocks about in the market, moving from counter to counter, and feeds on whatever substitute national product may be available.

If C stands for consumption, I for investment and E for exports, C + I + E would be equal to the national product (Y) + imports (M). Restriction of imports does not reduce the income devotion to consumption (C); nor the savings devoted to investments (I). It follows that purchasing power, delinked from import goods by import restrictions, cannot feed on C or I. It must, therefore, necessarily feed on E. In other words, every time imports are cut, there would result a corresponding fall in exports; so that the cut in imports would not correct the BoP deficit. This deficit would remain the same, despite the import cuts.

Import substitution has the same end-result. Import substitution will reduce or retard exports (E) by diverting resources of production from export industries into import substitution industries. Reduced or retarded exports ensue as a consequence of reduced or retarded export production.

If, in the meanwhile, inflation persists, the new moneys issued into circulation would make further dents in exports. Further drastic cuts in imports cannot correct the larger gap in the BoP position resulting from inflationary finance.

Reference must also be made to the popular concept that import substitution 'saves' foreign exchange for 'essential' imports, which cannot be produced at home; and that these measures help to speed up economic growth. Economic development is a function of the most effective investment of the available domestic savings and foreign aid – effective investment in the sense of producing goods marketable at reasonable profits. Exchange controls and import restrictions are not part of the investment process, nor are export receipts a fresh investment resource. They do not constitute currently generated national savings for current investment.

To treat foreign exchange receipts from exports as though they were a fresh resource, available for fresh investment, is a misconception, though the Planning Commission has been basing its calculations on it

LIKE THE SALE PROCEEDS of a trader, export receipts are circulating real capital, though transferred abroad. Calculating them in foreign currency does not alter their functional identity, namely, that like block capital, export receipts constitute the past savings of the community.

Circulating real capital adds to national income in proportion to the pace at which it keeps circulating in the course of the year, i.e. the number of times it is converted from goods into cash and back into goods over and over again. Exchange and import controls detract from the efficiency of circulating real capital, the national income ensuing from this trade, and the volume of international trade.

To treat foreign exchange receipts from exports as though they were a fresh resource, available for fresh investment, is a misconception, though the Planning Commission has been basing its calculations on it. In the interests of economic development, in fact, exchange control and import restrictions should be removed. Not only would national income for the international trade sector then increase; freer foreign trade would facilitate more efficient functioning of the national economy.

We may now pass on to the concept of the 'sacrifices' and 'burdens' of economic development. These 'sacrifices' and 'burdens', I wish to submit, may find a place in imaginary economic models. They do not generally form part of real life experience if aid is put to productive and profitable uses. Economic development, like the growth of an infant into manhood, is essentially a healthful and invigorating enterprise, not a series of negative hardships.

The model of a developing economy in real life – if what we are dealing with is a free society – is not one in which the community moves down an inclined plane of hardships,and more hardships, to begin with, then 'takes off'. The real-life model is essentially one of progress on three fronts

The family marching along the road to prosperity moves from more income to more income; more savings from the larger income; more investments from the larger savings; and so on. Both savings and investments keep rising. In a free society, which is a collection of independent individual families and firms, the picture of a growing economy is similar.

The model of a developing economy in real life – if what we are dealing with is a free society – is not one in which the community moves down an inclined plane of hardships, and more hardships, to begin with, then 'takes off'. The real-life model is essentially one of progress on all three fronts – progress in income, consumption and savings – though consumption may conceivably grow at a slower pace than income and savings.

Foreign aid, if fruitfully employed, need not necessarily give rise to BoP 'burdens' and 'difficulties'. A poor people are not necessarily an insolvent people. Insolvency is the result of mismanagement. Under continued mismanagement, insolvency comes whether people are rich or poor; or belong to a developed or developing economy.

A distinction must be made between BoP deficits and BoP difficulties. Developing countries, which draw investment finance from foreign aid, show deficits in the current account. But these deficits will be covered by the inflow of payments. And there will be no BoP difficulties, in the sense of any undue pressures on the external viability of the country or on the exchange value of its currency. Economic development does not necessarily involve a 'problem' deficit in the BoP.

BoP difficulties, on the other hand, are generally a symptom of economic ailment, if they are not the result of crop failures, damage by calamities such as earthquakes, floods, cyclones, or, much more rarely, sudden changes in demand for staple exports. Economic ailments causing BoP difficulties have, generally, their roots in inflationary finance; or in massive misdirection of savings.

The remedy for these ailments is not massive aid, exchange control or import restrictions. Massive aid in such a policy context may, in fact, turn out to be a disservice in disguise, through covering up the ill effects of wrong policy measures. The remedy lies in removing the root cause of the trouble.

Need for aid through capital markets

The ill-effects of misconceived domestic policies are often covered up under a regime of government-to-government aid. But the flow of aid through the world's capital markets would dry up under the influence of two factors: doubt in the continued stability and progress of the economy, and apprehension of inability to repatriate the capital at will or to transfer the earnings due to the possibility of impaired external viability of the economy.

It is significant that during the past two decades private capital has been, on balance, leaving the country. The net outflow of private capital amounted to Rs 92 crore since 1948-49 and Rs 43 crore during the first three-year plan periods. The finance minister has stated that foreign private capital invested in India has increased by Rs 625 crore during the first three Plans. This is a somewhat misleading statement, as it apparently includes reinvestment of rupee earnings from past foreign investments.

To quote Professor P T Bauer, prosperous countries were not entrusted by the Creator with the task of correcting his mistake in having created poor countries. The rich countries of today were poor at one time, and malnutrition was not the misfortune of Asian peoples alone. People in East and West Germany had abundant knowhow and belonged to the same racial stock. If economic development in West Germany accelerated to the dimension of a miracle, this would seem to be because of the difference in the policy measures adopted by the two parts: East Germany pursued policies of centralised planning, while West Germany pursued policies of economic freedom for the individual.

Individual freedom is worth having not only for its own sake; economic development is apt to be in proportion to the freedom which the individual has in the choice of his occupation, in the disposal of his income, and investment of his savings. If the individual is deprived of these economic freedoms – and we have been engaged in this nefarious business under the guise of planning – how different would such an individual be from a slave? Under the policy measures mis-called planning, we forgo both freedom and progress.

Given correct policies, the same quantum of domestic savings and foreign aid may take us strikingly fast on the road to prosperity. If, on the other hand, our policies are misconceived, no amount of foreign aid, as Indian experience has so conclusively demonstrated, can save us from economic chaos and social and political instabilities. The way out of this chaos is in our own hands. What we need most, today, is basic policy changes, not massive foreign aid.

13

Visiting experts rush in...

1962

Here the author points out that too many people, including the prime minister, seem to think that economists from the free part of the world would subscribe to liberal ideologies. But he says nearly all invitees of the government seem to be devotees of statism. He wishes they would realise that it is not true that vast, idle investment resources exist in India, only waiting to be tapped

Generous foreign aid – Rs 196 crore or 6 per cent of the outlay in the First Plan and Rs 1,467 crore or 19 per cent of the outlay in the Second Plan – seems to have more than compensated for the prodigalities of planning. Despite the dents of statism on savings, foreign aid has lifted investment from 7 per cent of national income at the end of the First Plan to 11 per cent at the end of the Second. The per capita income has, nevertheless, remained semi-stagnant, telling a story in shorthand of investment extravagance, waste and corruption. Our socialist policies are being boosted by savings from free societies overseas. Foreign aid helps to conceal from public view the full damage caused by wrong-headed policy measures – rather than correct such measures and restore economic stability, it helps sustain them.

The thinking behind statist policies, though much of it is fallacious and empirical evidence against it is growing, has received considerable moral support from visiting experts. Their chits carried great value with the Indian public. The experts may be no more than successful bankers, publicists, businessmen and administrators in their respective countries and may not themselves claim any mastery over the intricacies and subtleties of economics, much less over India's prevailing economic predicament, which during the past two decades has acquired a unique complexity; but they may be professional economists, philosophers or historians carrying with them the 'authority' of venerable Harvard or Oxford, in which case their views may receive special attention.

The essential point is that there must be foreigners with some claims to distinction. The tributes they often pay to India's 'achievements' are apt to make headlines and receive editorial approbation, all of which we read with much satisfaction.

> **It is hard at times to know what the current coin of neo-Keynesian economics, means specifically; but it is generally highly misleading. The surplus capacities in a number of industries are the creation of planners; and investment resources cannot be conjured up**

In answer to the critics of statist policies and of the undue bias of the plans towards heavy industries, prime minister Jawaharlal Nehru observed in his December 1959 press conference that 'more and more people of completely different ideologies, who had come to India and studied these matters, have come to identical conclusions on the importance of planning and building heavy industries'. As an exit from the rather difficult points made in the debate in Parliament on the draft outline of the Third Plan in August 1960, the prime minister quoted the World Bank mission as having endorsed the general feasibility of the Third Plan targets. The logical basis for accepting the possibility of a step up in savings – which the Third Plan required – from under 8 per cent to 11 per cent in five years, in the face of past performance, was neither stated nor sought for. In view of the expert assessment quoted, inquiries into such details were probably thought superfluous. Surely, World Bank experts will have looked into all that.

We have been assured by some other experts that inflation, born of a big plan, may be held at bay if an abundant flow of foodgrain – the main content of wage goods in the Indian economy – was provided for through PL 480. We seem to have followed this advice. We have also been told by Professor J K Galbraith that, though our socialist theories may be of the 'post office' category, there is no 'alternative to extensive public enterprise', which some have interpreted as expert blessing to our policy of unrestrained expansion of the public sector.

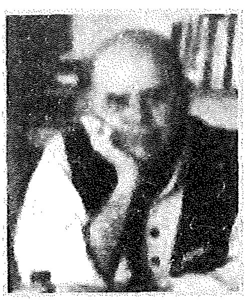
Not the least interesting appreciative pat came from Dr T Balogh, after a two-month sojourn with kindred souls in the monastery at Calcutta. He has commended Soviet planning for India and is confident that we might undertake this without damage to democracy 'thanks to the great authority which the prime minister wields'. It is reassuring to hear him say that our economic thinking is ahead of the rest of the world, though it is not clear whether this applies also to the unrepentant adherents of a free society.

In November 1959, Professor Max Millikan of the Massachusetts Institute of Technology, supporting the so-called theory of the 'Big Push', argued that since India had 'huge untapped reserves' of real resources, the country had a better chance of going over the hump into the modern age if it 'tried to do too much rather than too little'; that the resources themselves would get 'augmented' if the program of development was well 'synchronised'; and that the resulting 'momentum' may catapult the country into an impressive 'takeoff'. It is hard at times to know what this kind of familiar jargon, the current coin of neo-Keynesian economics, means specifically; but it is generally highly misleading.

It is not true to facts to suppose that vast, idle investment resources exist in India; the surplus capacities in a number of industries are the creation of planners themselves; nor can investment resources be conjured up by talk of 'synchronised' programs. The only factor of production in abundant supply is unskilled labor, and labor alone cannot increase output. Abundant natural resources also exist underground; but their exploitation for the social good is being hindered by the wet blanket effect of centralised planning on enterprise and initiative.

The inaptness of some of the views of our distinguished and doubtless well-meaning visitors from overseas is evidence of the pitfalls of prescribing on first reactions, though the Indian scene offers great temptation to do so. The difficulties confronting foreign analysts are not the peculiar social and institutional arrangements and practice alone, which take time to gain familiarity with – the main hurdle is one of diagnosis. The malady is rather complex and deeply involved. In several aspects, it is without illustrative parallels in recent experience of many west European countries or of North America. For a correct appraisal of Indian economic phenomena, it is often necessary to take a second look at the data or dive below the surface.

MANY AMERICAN SUPPORTERS of planning in India, notably Professors Galbraith, Rostow and Millikan, have stated that India is less socialist than even USA, as the ratio of taxation to national income in India is low and the public sector is relatively small. Such statements are productive of enormous mischief, though wholly unintended. "This line of reasoning," to quote Professor P T Bauer, "is erroneous." It misleads people both in India and abroad. First, it is the direction and speed of change that matter, not the statistical position at the particular moment. Second, taxes in India fall on the exchange sector, the large subsistence sector being generally beyond the reach of many tax instruments. If allowance is made for this factor, the ratio of taxes to income will be much higher than the less meaningful overall ratio.



P T Bauer

It may be noted, too, that the public sector has been appropriating in India nearly two-thirds of the total investment resources, including foreign aid, though it contributes about 4 per cent of the national income. This is without parallel in the free countries. Third, import controls, exchange restrictions, and price controls, allocation controls over certain essential raw materials and controls over the management of companies have resulted in the private sector being regimented much more closely than in most other countries, even underdeveloped countries, outside the communist orbit.

Professor T Balogh, in the lecture at New Delhi, countering this writer's view that the exchange rate of the Indian rupee is unrealistic, advanced the conventional argument, which may be applicable to conventional cases of currency depreciation below competitive equilibrium rates, that 'it is not possible to change the exchange rates in India without influencing most prices and most incomes at home'. Professor Balogh, like too many of our busy visitors, has apparently lost sight of the phenomenon of vast gaps between landed costs and market prices of virtually the whole range of import goods and of artificial shifts in production from the conventional and other potential exports into the production of substitutes for the banned or restricted imports.

During the past decade, as the logical result of currency overvaluation, severe restrictions on imports and inflationary finance of investments, an extravagant, uneconomic and highly vulnerable industrial structure has been erected in India. An appropriate adjustment in the exchange value of the rupee – together with the other measures which we have indicated in these pages, namely, abandonment of inflation, harassing economic controls and drastic policy shifts from statism to economic freedom – is part of essential reform, if we must, firstly, prevent this structure from toppling over and, secondly, build on sound foundations. The exchange rate adjustment will help to correct the gaps between internal and external prices and will induce a shift-back of production to its more economic and more natural pattern, with the attendant gains in stability and progress.

As the partial devaluation of 1949 has convincingly demonstrated, domestic prices and incomes will remain generally unaffected except, of course, for the parasitical earnings of those trafficking in import licensing, the recipients of these licenses and the black marketers in foreign exchange, who will find their windfall earnings disappearing like a dream, with the devaluation of the rupee at an appropriate degree and the adoption of the other measures of reform.

This is not to argue against foreign aid. The need for accelerated economic growth is obvious. But if the debt service burden is not to break our back, aid must go into the most fruitful among alternative investments – not from the standpoint of the spectacular so much, though this may be politically important, as in lifting up the national product. The first essential condition for this is to ensure that aid, like domestic savings, was not going down a sieve. There is no device of guaranteeing against this in the absence of fiscal and monetary stability.

> **It may be noted, too, that the public sector has been appropriating in India nearly two-thirds of the total investment resources, including foreign aid, though it contributes about 4 per cent of the national income. This is without parallel in the free countries**

Somehow, visiting economists to India, when not confirmed fellow-travelers, have been mostly of the *dirigiste* denomination, the visits being frequently financed from public funds. Professors Milton Friedman and P T Bauer were exceptions. There is great need for more frequent visits by liberal economic thinkers to correct the widespread impression that over-

We have developed a doctrinaire attachment to planning and are prone to explain away the shortfall in plan achievements as being due to inadequate efforts at planning rather than its limitations as a technique of economic growth

seas experts generally approve Indian economic policies.

Thirdly, we have developed a doctrinaire attachment to planning and are prone to explain away the shortfall in plan achievements as being due to inadequate efforts at planning rather than its limitations as a technique of economic growth. A considerable body of economists and publicists seem to take this view. Quite naturally, it has also the powerful support of the purveyors, the peddlers and the recipients of licenses, contracts, permits and concessions, for whom statism is a storehouse of economic power and easy income. The parasitical beneficiaries of statism in collaboration with its doctrinaire votaries are apt to be stubborn defenders of statism.

The ambivalence of Indian planners between democracy and communism cannot continue indefinitely, despite endless transfusion of foreign aid. Compulsions of plan finance or economic chaos must take us to the parting of the ways, sooner or later. Either we take the road of economic liberalism, which will ensure maximum economic development and also a free society; or we get lured or forced into communism, toiling along the soulless and fruitless part of regimentation, with the show windows exhibiting sensational sectoral achievements to keep us toiling endlessly, with little mass well-being and less freedom.

It is for the collective wisdom of the Indian people to make the choice. It is clear that statism must go. The sooner this happens, the better for the Indian people, as statism is tightening the stagnation. The longer it lasts, the more it will add to the stresses and strains and to the tensions between classes; and the greater may be the crash and the chaos which must come when statism can survive no longer. This will facilitate the communist build-up and load the dice in their favor. They will blame it all on the capitalists and on free enterprise, though the real villain is statism.

By financing and supporting statist policies, our friends from the free part of the world are really aiding the forces of unfreedom. If they truly mean well by the Indian people, they should exert their great influence for abandoning statism, before it is too late, in favor of policies of economic liberalism.

14

How foreign policy suffers

1962

Here the writer warns that aid-giving countries had acquired a stranglehold on the economy, particularly on the public sector. He writes that donors are understandably irritated whenever India makes purchases from the Soviet bloc countries

Undue reliance on foreign aid has been productive of national humiliation. The MiG (light combat aircraft) episode is a case in point. It is purely a domestic matter whether we purchase our defense needs from the Soviet Union or elsewhere: the explosion of USA and UK over this is evidence of their awareness that they have a stranglehold on the Indian economy. It is utterly unrealistic, on the one hand, to demand immunity from diplomatic pressures in domestic affairs and, on the other, to rely so heavily on foreign aid.

The stock exchange slump which followed the adjournment of the Aid-India Club meeting on 28 May 1962 without coming to a decision on the quantum of foreign aid to India is, so to speak, a laboratory demonstration of the dangerous extent of the dependence of the Indian economy on foreign aid. The slump indicated that any drastic cut in foreign aid is apt to slow down economic activity and, therefore, the returns on stock market investments. With dependence on foreign aid in so vital a measure, we must be prepared for diplomatic interference of the MiG type in our domestic affairs, especially at critical times in the state of the internal economy, when our ability to resist diplomatic pressures would be weak.

A MiG plane

The aid-giving countries are likely to get irritated whenever we make purchases from the Soviet bloc countries in excess of our exports to these countries. Our trade with Eastern Europe, including USSR, showed an overall deficit in 1961-62, though we had small trade surpluses with these countries in the earlier years. The irritation of the aid-giving countries would result from the fact that we would then be financing such surplus purchases from the general purpose foreign aid received from the democratic countries.

This would be the case with proposed MiG purchases. Foreign exchange to pay for the MiGs – about Rs 9 crore for two squadrons of a dozen planes each – cannot come from India's own earnings. Such imports, especially since planning has intensified, have remained well above exports; during the five years ending 1960-61, the excess of imports over exports amounted to Rs 2,240 crore. Being itself in need of foreign exchange to cover its deficits, our international trade can make no foreign exchange contribution to finance MiG purchases.

When we take money from the pockets of one block and transfer it to the other – which is what we do when we purchase MiGs with foreign aid funds – an underwater explosion is on the cards; in the present case, the explosion has become visible above the surface

This finance cannot be properly drawn from our currency reserves either. On 29 June 1962 these reserves amounted to Rs 215 crore, or close to the legal minimum of Rs 276 crore. During the decade ending 1960-61, the reserves are already well below the danger line.

It follows that the foreign exchange to pay for the MiGs must come from foreign aid – it cannot come from anywhere else. More significantly, it will be taken from foreign exchange that is not tied to projects, nor to be spent in the donor country. It will come from democracies. This broad position is patent in what we have said above; the mechanics of the process is a matter of unimportant detail.

THE COLD WAR HAS helped us put our hands in both power blocs. This causes strain enough in either camp. But when we take money from the pockets of one block and transfer it to the other – which is what we do when we purchase MiGs with foreign aid funds – an underwater explosion is well on the cards; in the present case, the explosion has become visible above the surface.

Prime minister Jawaharlal Nehru, speaking in the Rajya Sabha on 23rd June 1962, lashed out at the 'extraordinary approach' of UK and USA on the MiG issue. He stated that there had been hints – 'almost threats' – that economic aid would be lessened or would not come at all if India went ahead with the purchase. Earlier, press reports indicated the concern of the US administration that it might become helpless in resisting the adverse repercussions, on the issue of aid to India, of the Senate reactions to such a purchase.

Such interference by foreign powers in our domestic affairs is, indeed 'extraordinary'. But this extraordinariness is matched by our extraordinary dependence on foreign aid. There is no remedy to the situation other than self-reliance, through self-discipline, to finance Indian economic development. In this lies virtue. This will not only permit us to hold our heads high; it will also enable faster capital formation and economic growth than has materialised with foreign aid. In the prevailing policy setup, much of the latter has leaked into financing gold smuggling, other illicit imports, concealed export of capital, trips abroad without official allocations of exchange, and stockpiling of import goods, or has been utilised for the construction of idle production capacities or spectacular projects which are not immediately necessary and could very well wait until we built up some prosperity.

The capital stock needed for achieving this is an iron determination on the part of the government to replace the state's squander-mania, into which we have slipped under the delusion of 'planning', by a ruthless slashing of consumption expenditures to the not-so-low level of the pre-plan year 1950-51.

15

What's wrong with PL 480 aid

2 JUNE 1965

This is one of several papers B R Shenoy wrote on the subject after 1960, ultimately forcing the government in 1966 to appoint a commission to look into the monetary impact of PL 480 funds. He held that the expansion of money caused by these funds was wholly responsible for the inflationary rise in prices over the last decade

The story of PL 480 aid to India makes for a mixed narrative. Few have doubted the humanitarian and developmental motivations behind the disposal of US agricultural surpluses, in terms of the Food for Peace Act 1954; and fewer still have doubted the obvious need for the aid.

But wheat imports were allowed to grow beyond market deficits and caused price repression which, along with the production disincentive spread to other foodgrains. The government persisted with heavy wheat imports. Except for two years of weather-caused spurts in production, domestic output of wheat stagnated at about 9 m t from 1959-66; the output of foodgrain lagged far behind market needs; and, contrary to the self-reliance objectives of the Food for Peace Act, the Indian economy looked like becoming addicted to concessional imports. This damaging turn of events was arrested and reversed only when PL 480 imports tapered and wheat was released from price repression.

The impact of PL 480 finance on domestic monetary stability was no less unsettling. The method of finance chosen was out of the ordinary. PL 480 imports were paid for in created rupees, which were passed back to the Government of India as loans and grants. The expansion of money caused by the disbursement of these rupees was wholly responsible for the inflationary rise in prices during the nine years 1962-63 to 1970-71.

These destructive efforts on the food and monetary fronts could have been prevented if wheat imports had been regulated to match market deficits; and if PL 480 purchases were financed by a loan instead of created rupees such as the Wheat Loan 1951, or any other commodity aid loan.

In case of PL 480 finance, the imposition of wholly avoidable price inflation on the Indian economy was incidental; in the Rupee Settlement

Agreement of February 1974, it is completely inexcusable. It pulls out PL 480 loan documents from their resting place and uses them, for the second time, for an expansionary issue of money. The cognisance of this by officials and legislators in Washington fits in with the out-of-the-ordinary character of the total phenomenon.

An American farm

The Rupee Settlement Agreement may not be India's *adieu* to PL 480. The realities of this situation – the magnitude of food imports required, paucity of alternative sources of concessional food, our limited capacity for commercial imports even before the coming of the oil crisis and of soaring of food prices, ideological and other hurdles that obstruct the policy transformation necessary for expanding domestic food production, human suffering, and the political risks of leaving the market deficits uncovered – may compel resort to PL 480 aid. An early return to this aid may save us from avoidable distress. Due care, however, must be taken to ensure that PL 480 imports do not exceed market deficits.

NEVERTHELESS, food self-sufficiency has remained elusive since 1946, lesser or larger imports each year being the rule. The only exception: a market surplus of 0.56 million tons in 1971, when foodgrain production was at its all-time peak of 108.4 m t. This peak was fortuitous, being the outcome of propitious weather conditions rather than of planned achievement.

The nominal net exports (488,000 tons) of foodgrain in 1972 do not represent a market surplus, arising as they do from the special circumstance of emergency relief shipments to Bangladesh of 909,000 tons of foodgrain from official stocks. When adjustment is made for this extraordinary transaction, we find that in 1972 too we had to rely on imports (to supplement drafts on stocks) to cover market deficits.

Despite the continued dependence on imports, the government fancies that we have achieved a stage of self-sustaining growth on the food front by the target date visualised in the crash program of 17 January 1967. Accordingly, we stopped all PL 480 and other concessional imports of foodgrain in January 1972. We wrote to the US government that we do not propose lifting the balance of 438,000 tons of foodgrain to which we were entitled in terms of the PL 480 agreement of 1 April 1971, which had provided for total imports of 1.57 m t.

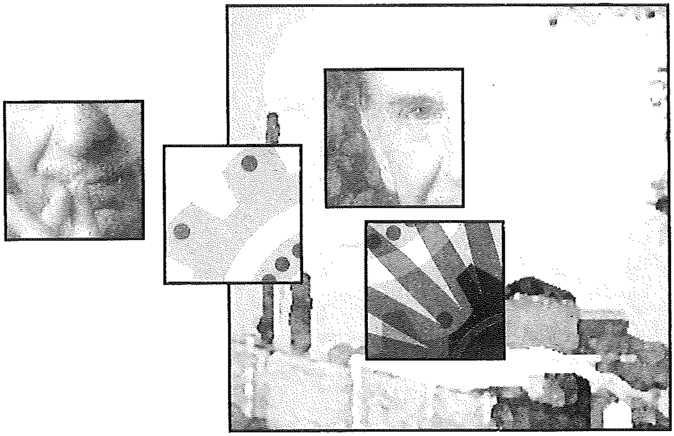
The reason given for this last step was the 'excellent *rabi* crop', which led us to stop even commercial imports, to presume that there was now no need to impose 'the general restriction on the export of cereals, which ceased to operate with the PL 480 Agreement having terminated on 30th June 1972', and, as though in token exercise of this freedom to export, 14,300 tons of superior *basmati* rice was exported through STC.

Four developments encouraged these decisions:

- First, between 1967, when the crash program for self-sufficiency was formulated, and January 1972, when concessional imports were stopped, we had a succession of good harvests, the result of favorable weather conditions and the coming of HYV seeds, especially in wheat. Consequently, the output of foodgrain continually increased, at an average annual rate of 7.2 million tons, from a low of 72.3 m t in 1965-66 to an all-time peak of 108.4 m t in 1970-71.
- Second, the expansion of domestic production in the context of high level of imports – which averaged 4.78 m t per year during the five year period 1967-71 – easily permitted additions to official stocks of foodgrain, and these stocks rose rapidly from 1.96 m t at the end of 1967 (at an average annual rate of 1.54 m t) to an all-time peak of 8.14 m t at the end of 1971, i.e. to about four times the average of the year-end stocks (2.05 m t) during the five years 1961-65. Stocks at the end of 1971 were 2.6 times the average market deficit of the preceding three years (3.14 m t).
- Third, following the self-reliance resolution of 1967, the use of HYV wheat seeds spread quite rapidly, the output of wheat rose without a break, at an average annual rate of 3.1 m t, and we soon achieved a break-through in wheat production. In 1970-71, the output of wheat (23.8 m t) was more than double that in 1966-67 – the second of the two years of drought, and in 1971-72 (26.4 m t) more than double that in 1964-65, the year of the bumper harvest which had preceded the drought years.
- Finally, for the first time since 1951, domestic procurement in 1971 (8.86 m t) more than covered the offtake of 7.83 m t from the PDS (public distribution system) and the excess procurement (1.03 m t) was added to reserves. There was no need during the year, unlike in the past, either to draw on stocks or to depend on imports for meeting the needs of rationing.

The food position, however, remained, as in the past, basically unsatisfactory throughout the period 1967-72. The ease with which we were able to meet the needs of PDS, the satisfactory reserve position, and the high foodgrain production for three years in succession rested on a combination of extraneous, cyclical, and temporary factors: large PL 480 imports for 15 years, a breakthrough in wheat and intensification of the procurement drive. They did not rest on any green revolution either in agriculture as a whole or in the foodgrain part of it.

The official belief that the Indian economy has reached the takeoff stage on the food front stems from uncritical assessment of data, and the decision to stop concessional imports was premature.



policy critiques

section D

16

Need for policies of freedom

21 DECEMBER 1961

In this critique of manifestoes of political parties released just before the elections, the writer points out that only the Jan Sangh is against statism, although it too suffers from lack of clarity on basic issues. The progress sought by the PSP and the Congress, he says, can only come about if cherished dogmas are jettisoned

Indian economic policies, says the Praja Socialist Party (PSP) manifesto, 'have sharpened economic inequalities'; they have added a class of new rich to the old body of powerful families; these 'spectacular beneficiaries' of planning are sharing the 'cream of wealth' and the production pattern is getting geared to meet their needs; the two plans, despite the heavy burdens on the people, 'have meagre achievements to show' both in welfare and employment; the 'erosion' in the living standards of the people has 'proved wanton' as the 'nation's strength has not grown much'. These charges are repeated, with minor variations of emphasis, in the manifestoes of the Communist, Jan Sangh and Swatantra parties.

The defense offered by the Congress manifesto shows both balance and vigor. It accepts that much poverty exists, that large numbers are unemployed and under-employed and that, despite 'our aim and desire', the disparities continue or are 'even more marked'. But, in spite of errors and mistakes, almost annual natural calamities and the Cold War, the 'march of the Indian people has continued towards the next stage of their great pilgrimage', as witness the growth of industries, heavy, medium and small; the 'marked' improvement in agricultural methods and in agricultural production; the advance in science and technology; and the progress in a variety of fields of human activity.

Though industrial development is striking – during the past nine years, industrial output increased at an annual rate (7.6 per cent), which is 1.5 to 2 times that in Canada, Norway, Sweden, UK and USA – this is a pyrrhic victory, achieved at heavy real costs. Both in quality and price the Indian output compares poorly with that of competing countries. Our products are generally unsaleable abroad except at heavy losses, which are recompensed through monopoly pricing at home and export promotion import licenses, the incidence of which, too, falls on the domestic consumer.

Any government must spend part of its revenue on education. To claim special credit under this head, the effort must be extraordinary. We are investing much more in steel than in man

The expansion of industry has materialised at the expense of agriculture. Agricultural production, since the intensification of planning in 1955-56, has been less than stagnant; it rose at an annual rate of 1.5 per cent, or slower than the population. The achievements in agricultural methods, science and technology are less meaningful than overall output and the consumption of food and cloth.

The Congress manifesto refers to three achievements, which it claims 'stand out' in a variegated background: first, the increase in the numbers at school and college from 24 million in 1950-51 to 46 million currently; second, the rise in the expectation of life from 32 in the forties to 47.5 now; and third, the Community Development program leading to Panchayati Raj, which has covered 72 per cent of the villages and 50 per cent of the population.

Credit for the whole of the increase in the school and college population cannot be claimed by the administration. Some of the increase is due to private effort, the effort of municipalities and other semi-public agencies. Any government must spend part of its revenue on education. To claim special credit under this head, the effort must be extraordinary. We are investing much more in steel than in man. In the Second Plan, the Centre and the states spent Rs 208 crore on education, while the public sector outlay on three plants was Rs 526 crore. The expenditure on education as a percentage of total outlay declined from 1.9 per cent in the First Plan to 1.5 per cent in the Second.

The lion's share of the credit for the sudden jump in the expectation of life properly belongs to the DDT campaign and other health measures; under these measures, similar jumps have taken place in other countries without statist planning. It does not reflect better food and better living conditions. Our consumption of food and cloth are both semi-stagnant and sub-standard.

Community Development and Panchayati Raj, like cooperation, have great potentialities; striking results in successful cases well illustrate this. When finance is not a limiting factor, success largely rests on personnel with competence, enthusiasm and character, which is acutely scarce. Multiplication of the number of units is no evidence of progress – in fact, sudden multiplication should provoke suspicion. Progress must be assessed by the increase in overall agricultural production: this is not in evidence yet.

Though the PSP manifesto recognises that 'as the plans become bigger and bolder, the gains become smaller'; links the deteriorating employment and price situations and income inequalities with past planning; is opposed to 'statising' man; sees virtues in 'competition' and cites the 'rapid dynamism of growth' of EEC; yet, it seeks India's economic and social salvation through 'much more integrated planning'. This basic inconsistency is hard to explain.

Statist planning operates through licenses, contracts, permits, quotas and concessions. They bring large and easy gains without ethical or economic title to them. The economic chaos and the moral decay of the past decade are largely traceable to them. Under more integrated planning their volume and sway will grow. The PSP will disburse them wider than hitherto. This cannot render ill-gotten gains any less unmerited; their ill-effects on the economy any different; nor is this any assurance against 'oligopolies' developing in certain fields through transfer of monopoly rights. There is no better guarantee of progress with human justice for all than free and orderly competition under the rule of law.

Statist planning operates through licenses, contracts, permits, quotas and concessions. They bring large and easy gains without ethical or economic title to them. The economic chaos and the moral decay of the past decade are largely traceable to them

The Jan Sangh manifesto lacks clarity, though its dominant note is against statism. It will 'basically' change the plan; will reconstitute the Planning Commission into an 'expert body' of advisers; will limit public sector enterprise to 'defense' and certain 'basic' industries without monopoly rights; will reduce government expenditures and provide some relief from the 'groaning' burden of taxation. Though the pricing system will be generally free, agricultural produce will be price-supported. There is no evidence of recognition that in our context this might cause inflation.

Despite the opposition to statism, the hand of the state becomes evident at many points. The 'ceiling on land' will remain; there will be a ceiling of Rs 2,000 per month on 'expendable' individual incomes and a 'salary' floor of Rs 125 per month; imports, in particular, of 'toiletry and luxury goods', will be 'drastically cut'; and there shall be no retrenchment without alternative employment. Promises of 'guaranteed' minimum standard of living for every citizen, free medical aid for all, and guaranteed employment are immediately impractical.

THE SWATANTRA MANIFESTO is built around the concepts of the Gandhian minimum state, 'maximum possible' competition and the 'minimum necessary' regulation. The party will 'end' growing statism, all monopolies, including those in the public sector, and wasteful expansions of bureaucracy and government expenditures; will abolish the Planning Commission and will release enterprise from 'tyrannical' regulations; is opposed to nationalisation, though it accepts the mixed economy set-up; and rejects the lopsided and Soviet-type priority to heavy industries to the neglect of agriculture and the consumer goods industries.

The minimum state philosophy might permit the promised drastic cuts in direct and indirect taxation and the virtual abolition of land revenues; it might enable, too, price stability and an honest rupee, if the inflation trap of the price-support of agriculture is not toyed with. With the removal of import restrictions – an easy step from zero inflation – Customs revenues might boom, through goods, smuggled hitherto, paying import duties; the abolition of controls will terminate 'black' incomes and tax evasion under duress. This, together with the normal budgetary resources, might provide ample finance for the more natural state activity.

We have to choose between welfare measures and welfare. Prosperity through legislation is a delusion and a snare. In UK during the past eight years real wages rose by about 17 per cent; the slow pace applied, too, to Australia, New Zealand, Sweden and other 'welfare' states. During the same period, both wages and national income galloped ahead in EEC countries, Israel and Japan under economic freedom, wages in Israel more than doubling and in the other countries rising well above 60 per cent.

It is not practical to transform the Congress and PSP economic programs by reforms here and reforms there to achieve accelerated progress on all fronts. This will demand a major operation on cherished dogmas and ideologies. Such treatment is perhaps feasible with the Jan Sangh program. The Swatantra program comes close to the policies which are currently yielding the heaviest social and economic dividends, wherever they have been adopted. Contrary to popular belief, these policies are also gaining increasing academic acceptance in the free world.

17

Bogey of overpopulation

JANUARY 1974

A year before the forcible sterilisations and other excesses of the Emergency, the writer had raised his voice against the population control measures of the government, ridiculing the idea that there are too many Indians, who are 'getting in each other's way'

Population pressures are frequently deemed to be among the most potent factors responsible for the poverty of the Indian people. The government having accepted the validity of this proposition, population 'planning' and population control are part of accepted official policy.

The link between population and poverty is supposed to be two-fold: the impact of population, first, on per capital income and, second, 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 net 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 labor force – ensuing from an expansion of population – matches the per capita income of the pre-existing labor 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 define a developing economy as one in which per capita income is on the uptrend, an economy in which NNI increases but per capita income is constant may be designated a stationary economy.

It is most unfortunate that popular writers and demographers should formulate prescriptions for population control as a remedy to Indian poverty, taking it for granted that population has produced poverty

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 labor 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 labor 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 two problems 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 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 that labor is not an essential factor of production and that it would make no difference to the national product if the labor force were cut down.

As Professor Colin Clark and other critical analysts have pointed out, this presumption does not hold true of live economic models. In most economies – the developed as also the underdeveloped – both numerator and denominator move upward under dynamic conditions. In a truly developing economy, the numerator keeps pace with population and per capita income remains constant.

The government's birth control program not only conflicts with the traditional ethics of this land, it merits being scrapped because it is altogether bad economics. The moneys wasted on it should be put to better uses.

The untenability of the argument of Indian poverty being related to population pressures gets reinforced when we examine the second aspect

The government's birth control program not only conflicts with the traditional ethics of this land, it merits being scrapped because it is bad economics

of population pressures, the impact of population on per capita output. Some theorists have tried to maintain that, in underdeveloped 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 overpopulation, people actually 'get in each other's way' and that, consequently, the marginal productivity of labor over a wide range is zero, or maybe even 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 labor 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 labor force on Indian farms is a case of labor substituting acutely scarce capital. It is by no means evidence of the marginal productivity being near-zero or negative, though this productivity may, indeed, contrast with the marginal productivity under mechanisation.

Otherwise why should all of them work from dawn to dusk? Why should a cultivator at all hire labor? If the marginal worker-productivity is nil or negative, how could any cultivator pay wages to hired workers and still remain in business? Quite obviously, the concept of workers getting in each other's way has received more serious attention than it deserves.

THAT POPULATION IS not a factor hindering economic growth is proved by comparing statistics of the growth of population and of the expansions of per capital national product in a number of countries. Taking a selection of 13 under-developed countries round the globe, we find that during 1960-69, population rose in India by 22.1 per cent and GDP at constant prices by 19.1 per cent. In 12 other countries, though population rose much higher, GDP rose faster than in India.

- In Korea, population rose by 26.1 per cent while per capita GDP rose by 121.8 per cent.
- In Taiwan, population rose by 30.1 per cent while per capita GDP rose by 99.6 per cent.
- In Iran, population rose by 29.6 per cent, per capita GDP by 61.5 per cent.
- In South Africa, population rose by 34 per cent, GDP per capita by 45.2 per cent.
- In Malaysia, population rose by 35.1 per cent and GDP 26.3 per cent.

If population had been a potent factor hindering growth, then countries where population grew faster should have had a slower pace of growth than India.

18

Exchange control

1962

The postulation that exchange control and import restrictions will not accelerate economic development was a recurring theme in B R Shenoy's writings. Contrary to widespread belief, he says, the foreign exchange 'earnings' of a country do not represent fresh resources for capital formation

Indian planners, in common with their counterparts in other countries, have taken the stand that exchange control and import restrictions are an essential part of the instrumentation for economic growth. We shall examine here the logical basis of this assumption.

Given the necessary policy measures, designed to provide the most favorable administrative and socio-economic background, economic development is a function of the magnitude of national savings and the most effective investment of these savings. To lay this stress on savings and capital formation is not to under-rate the vital importance of favorable 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 favorable 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 differences 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, the care bestowed on, and effectiveness, of capital formation.

If so, it is difficult to see how exchange control and import restrictions accelerate economic development. The exports of a country do not represent its savings. They are comparable to the sales of an individual trader. Like the sale proceeds of an individual trader, they represent the working capital of traders engaged in international trade; and are indistinguishable from the working capital of domestic traders, except that the working capital of exporters gets transferred abroad, being transformed into foreign currencies; while, in the case of domestic traders, their sale proceeds retain the garb of the national currency. This change of clothes does not alter the character of the inner entity which, in both cases, is circulating real capital.

Even so, those engaged in international trade will attempt to convert export proceeds, as rapidly as possible, into import goods, for sale in the home market; and to use the proceeds to purchase again home goods for export

In the case of the domestic trader, the sale proceeds are converted, as rapidly as possible, into fresh purchases, to repeat the sale transactions and, thus, to maximise turnover and income. Even so, those engaged in international trade will attempt to convert export proceeds, as rapidly as possible, into import goods, for sale in the home market; and to use the proceeds to purchase again home goods for export. The repeated turnaround of working capital of export-import traders adds to the incomes of these traders and of the national economy.

That firms engaging in imports may not be the same as those engaging in exports is a feature of specialisation of economic activity; it 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; even as factory buildings and installed machinery and capital equipment are part of the currently existing fixed real capital of the national economy.

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) and imports (M). Export proceeds are not reckoned as constituting part of the national product, as import goods include, in this system of accounting, 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.

Thus, contrary to widespread belief, the foreign exchange 'earnings' of a country do not represent fresh resources for capital formation. They constitute part of already existing capital stock. The dissection and 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 to aggregate capital formation. Indeed, it is more than likely that the restrictions on imports, like the restrictions on the purchases of a trader, may detract from the maximisation of income and savings, through keeping the volume and turnover of business at below their possible maxima. Even as the 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.

During the past decade, as a result of the rigorous restrictions of imports, Indian exports as a percentage of national income have declined from 6.4 per cent in 1955 to 4 per cent in 1964. Domestic capital employed in international trade and the volume of international trade (in real terms) declined too. Indian exports at 1958 prices fell from Rs 7,800 million in 1955 to Rs 6,120 million in 1964. The hurdles on exports caused a retardation of the turnover of the circulating real capital as well. This correspondingly reduced India's income from international trade with an equal debit effect on her GNP.

Nor was this loss of income made good by any equivalent and compensatory increase in income from the expanded domestic production for the home market. As we have seen elsewhere, the expansion of production for the home market, in replacement of the expansion of production for the overseas markets, may amount to shifts of production from sectors where factor costs of production are lower to sectors where such production costs are higher, with a corresponding debit incidence on GNP. Aggregate national income, therefore, would be lower as a result of artificially induced shifts in production and trade than if these shifts had not been induced.

Nor can dissection and restriction of imports assist in the most effective deployment of the available investment resources, to achieve the most fruitful capital formation. We have seen that maximisation of the national product from the given investment resources involves, first, full entrepreneurial freedom over their disposal; and, secondly, no less freedom to individuals to invest their savings in accordance with their own schedule of choices and priorities. In the absence of these two freedoms, there is apt to be mal-investment of resources, detracting from the maximum possible aggregate national product. As every investment and economic activity generally involves the use of import goods in lesser or larger measure, exchange control and import restrictions militate against the most fruitful exercise of these two freedoms.

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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 prerequisite for speeding up economic growth. We have seen elsewhere that the removal of import restrictions and exchange control are essential also in the interest of social justice. Import restrictions and exchange control, through creating vast gaps between landed costs and market prices, shift colossal sums from the masses to people in the upper income groups, such income shifts being of the order of Rs 500 crore annually.

There is no lasting solution to this problem other than to reduce to zero the values of the import licenses. This may happen only if we abolish altogether the system of import licensing. Monopolistic control of export receipts and a dissection and restriction of imports may be good 'siege' or 'blockade' economics in times of war, when the needs of national defense call for the mobilisation of all resources past and current including circulating real capital, depreciation funds and the currently accruing savings to subserve the war effort. Shifts in the pattern and direction of production, the 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 defense from external aggression and national survival.

This 'siege' economics, which may be appropriate in the context of a war, cannot apply to the needs of developing economies. Acceleration in economic growth cannot be achieved by restricting freedom of disposal over a part of the existing quantum of circulating real capital – the part represented by export proceeds. Abolition of exchange control and of physical restrictions on imports are, therefore, essential pre-conditions for rapid economic progress. But planners in most underdeveloped countries and their advisers, including visiting experts, advocate drastic import scrutiny and import restrictions, the axe falling heavily on luxury goods in particular, and consumer goods in general.

There is great need for the thinking in underdeveloped countries to grow out of the deceptive fallacy that exchange control and import restrictions constitute essential pre-requisites for achieving economic and social progress.

19

Auctioning of import licenses

20 NOVEMBER 1958

In this release to the press, the writer expanded on the views he expressed in an interview to a newspaper in Bombay, in view of 'the importance and the technical character of the subject'. The premiums being realised on import licenses, he wrote, are nothing but ill-merited earnings of anti-social elements among the public and in the administration

The auctioning of import licenses may bring to the national exchequer all the additional revenues we are looking for and much more; it may fetch sums of the order of Rs 300 to 400 crore per year. These sums are being dissipated, today, into the hands of anti-social elements, or are distributed as concealed subsidies among industrialists.

To begin with we may appropriate, through auctioning, the first category of this phenomenal figure – the amounts now realised by private parties on the importation and sales of import goods which are sold in the open market; the returns on this may amount to an order of Rs 200 crore per year. From the experience gained, we may extend the device of auctioning to import licenses, which are, today, issued to actual users of import goods (mainly industrialists); industries which are truly in need of subsidies may be, then, directly subsidised to compensate for the loss of benefits they now derive from the issue to them of import licenses, the necessary funds being drawn from the auction proceeds.

Import licenses are issued to established importers, actual users, and the government or governmental establishments. Apart from illegal payments made to corrupt officials, the licenses are issued free of charge even to private parties. But because of the wide disparities which exist between the internal prices of import goods and their landed costs (i.e. the external prices multiplied by the rate of exchange), import licenses fetch phenomenal prices in the market; these prices may vary from 50 per cent to 500 per cent or more of the face value of the licenses, depending upon commodities.

The recent cut in imports has driven these prices up. You cannot get rich quicker today than by getting import licenses issued in your favor. An appropriate license may bring lakhs of rupees overnight. This operation, which is remarkably simple if you have the right men in the right places in the right ministries, is even more profitable than gold smuggling (which yields a gross profit of 73 per cent on each act of smuggling), involves much less work, and carries next to no risk.

Import licenses fetch phenomenal prices in the market; these prices may vary from 50 to 500 per cent or more of the face value of the licenses, depending upon commodities

Indian imports on private account averaged during the past two years Rs 743 crore per year. Open General Licenses being restricted to a few items imported from Pakistan, virtually all these imports came under specific import licenses. If the auction were to fetch an average price of 45 to 55 per cent of the face value of the licenses, it may bring in revenue of Rs 300 to 400 crore. But perhaps, rather than upset all vested interests at once, it may be expedient to invite tenders, in the first instance, for the licenses which are now issued to established importers. The market prices of these licenses are among the highest and the returns on them may amount to Rs 200 crore per year. The amount may be even larger considering the accounts of the prices offered for the licenses for certain commodities. From the experience gained, the area of auctioning may be extended to cover all private imports.

This device is vastly better than the extension of state trading to imports, which has been suggested by some. State trading here would involve a great deal of organisational difficulties, which had better be avoided considering the scarcity of personnel with the necessary talent, knowledge, experience, and, above all, integrity. Auctioning will bring to the national exchequer the cream of profits, while leaving undisturbed the existing private enterprise machinery of import trade.

Premiums on certain import licenses

	Commodity	'Premium'	Notes
1.	Acrylic sheets	110 %	The prices of import licenses are referred to in the market as 'premiums', the premium being expressed as per cent of the amount of the import goods which the license is authorised to import. Thus, the premium for the import license relating to menthol (item 11 in the table) is quoted at 200 per cent. This means that, if the licence authorises the import of, say, Rs 10 lakh, the market value of the licence is Rs 20 lakh.
2	Aromatic chemicals	80 %	
3	Camp shaft (1)	150-200 %	
4	(Laboratory) chemicals	130-135 %	
5	Crank shaft (1)	150-200 %	
6	Dyes & chemicals	110-115 %	
7	Drugs & medicines	120 %	
8	Drums/barrel CR/CA sheets	150-200 %	
9	Dry fruits	190 %	Import licenses being non-transferable legally, the market for them is not open and it is not easy for 'outsiders' to get to know the 'premiums' in the same way as we may get to know the prevailing price of a stock exchange scrip. But a section of the financial press frequently quotes some of these prices.
10	(Surgical) instruments	110 %	
11	Menthol	200 %	
12	Mutton tallow	100-250 %	
13	(Essential) oils	75 %	
14	Plastic raw materials	45-65 %	
15	Polythene low-density powder	125 %	The 'premiums' quoted in the table relate to the second half of May 1969 and were privately obtained from dealers
16	Wool tops (2)	125-150 %	

(1) Diesel engine parts
(2) Before the import of this commodity was taken over by the State Trading Corporation.

These windfall receipts would represent 60 to 80 per cent of the annual average of the tax revenue of the Centre for the past two years; they may not cause any undue strain on the national economy. Insofar as the proceeds of the sales of the first category of licenses is concerned, it would amount to no more than a transfer to the national exchequer of the ill-merited earnings of anti-social elements among the public and in the administration. If care is taken to ensure that monopolist purchases of the licenses do not take place – this may be done by inviting tenders for the licenses and wide distribution of the accepted tenders – it may not amount to any new burden on the consumers and users of import goods, as the auction of the licenses would affect neither the effective demand nor the market supply of import goods.

It would, however, put a stop to the concealed subsidies of the industrialists, as the cost of the import goods would now amount to not merely landed costs, as formerly, but landed costs plus the prices paid for the import licenses. But subsidisation of industries should be done on a more rational basis than through the issue of import licenses; it should not be mixed up with the adoption of corrective measures for the balance of payments difficulties of the country.

THE CRUX OF INDIA'S balance of payments problem is, on the one hand, to bring about a shift-back to production for exports, from production for the home market and, on the other, to eliminate the vast gaps between the landed costs and market prices of import goods and between the internal and the external prices of gold. Stabilisation of the economy is just not possible without this two-dimensional desideratum. The auction of the import licenses would equate domestic prices of import goods to their external prices; the shift-back in production, which is necessary on a considerable scale, may be achieved by drawing on the auction proceeds of import licenses to subsidise exports. This would serve the ends of economic justice as the ill-merited gains of the import trade are acquired mainly at the expense of the export industries.

> Subsidisation of industries should be done on a more rational basis than through the issue of import licenses; it should not be mixed up with the adoption of corrective measures for balance of payments difficulties of the country

The export promotion measures we have so far adopted, or have under active consideration, include relief from export duties, 'drawbacks', rebates on customs and excise duties, and remission of sales tax on exports, rediscount of export bills at preferential rates, freight concession on railways, supply of steel at concession rates for export production, wider coverage of insurance risks than hitherto, provision of certain administrative facilities to exports, and so on.

The money value of these measures to the export industry being moderate, they may not achieve noteworthy results. They involve, moreover, a sacrifice of national revenues. Subsidies in the form of issue of import licenses to exporters (e.g. issue of import licenses for art silk yarn to exporters of art silk fabrics) has resulted in the sales of export goods abroad at below cost of production to the detriment of the national economy: the import licenses are issued on f.o.b. valuation of the exports and their sales abroad take place at fancy low prices as exporters are able to more than cover the difference by the sale of the import licenses.

This is, in effect, a queer case of a poor economy, struggling for developmental finance, subsidising its not-so-poor customers (of art silk fabrics) abroad under pressure of scarcity of (foreign exchange) finance for the Plan. It illustrates that deep-seated economic maladies cannot be corrected by patchwork remedies.

Any attempt to implement the suggestion for auctioning import licenses is likely to be opposed by the powerful vested interests which have grown around the existing arrangement of currency over-valuation and import licensing. But there is no justification for dissipating such large sums into (unmerited) private hands in face of acute shortages of rupee finance for the Second Plan.

20

Export promotion

27 MAY 1975

In reaction to a public statement by then prime minister Indira Gandhi, the writer pointed out that for exports to expand, imports must be liberalised. India's foreign exchange crisis is due, primarily, to our exports being too low – it is not a case of excessive imports

We shall examine the problem of export promotion under three heads: the need for export promotion, the effectiveness of the export promotion measures we have adopted, and the necessity for additional measures which an analysis of the situation may indicate.

The need for export promotion arises from the acute scarcity of foreign exchange: the quantities of foreign currencies (principally, the proceeds of exports) flowing into the Indian market for foreign exchange are far short of the demand for foreign currencies (principally, to pay for imports). The excess of demand over supply has been the more general rule since the close of World War II. We have tackled the situation by restricting imports (a case of arbitrary curtailment of demand) and, when the pressure of demand for essential imports (like foodgrain and Plan investment goods) was strong, by drawing on the currency reserves.

During three of the five years (1951-52 to 1955-56) of the First Plan, we were able, through import restrictions, to reduce the demand for foreign exchange to well within the market supply during the remaining two years (1951-52 and 1954-55), the currency reserves of the country had to be drawn upon (Rs 161 crore in 1951-52 and Rs 23 crore in 1954-55), to make good the shortages in market supply, the heavy withdrawals in 1951-52 being mainly due to the record imports of Rs 228 crore of food articles. Looking to the First Plan period as a whole, the net drafts on currency reserves amounted to Rs 138 crore (annual average Rs 28 crore).

The situation began to deteriorate in April 1956, the first month of the Second Plan, with the grip on imports being relaxed and the demand for foodgrain imports again rising. The gap between demand and supply of foreign exchange was covered by drafts on the currency reserves (including loans from the IMF) of Rs 281 crore in 1956-57, Rs 294 crore in 1957-58 and Rs 59 crore in 1958-59, or a total of Rs 634 crore in the first three years of the Plan. The Second Plan document had contemplated a draft of Rs 200 crore during the entire Plan period.

The surplus reserves remaining as of 12 June 1959 amount to Rs 114 crore (over the legal minimum reserves of Rs 200 crore). This contrasts with total currency reserves of Rs 1,769 crore in April 1946. It is open to us to amend the law regarding minimum reserves, as we had done twice (in September 1956 and October 1957) in the past, reduce the legal minimum reserves to zero (following the example of certain countries) and avail of the whole of the remaining reserves to meet the persisting foreign exchange crisis.

This suggests that India's foreign exchange crisis is due, primarily, to our exports being too low. It is not a case of excessive imports. Two decades of exchange restrictions and recurring foreign exchange crises led to progressive curtailment of non-essential imports

THOUGH THIS MAY enable us to carry on our precarious subsistence on the foreign exchange front for a further 12-month period or more, it would not be wise to do so, as the level of our (total) reserves today roughly corresponds to the emergency drafts on reserves in recent years.

It is, therefore, imperative that we rely on other ways of correcting the imbalance between the demand and supply of foreign exchange.

An imbalance in the supply and demand of foreign exchange may ensue from unduly low exports or unduly high imports. Despite an increase of about 85 per cent in industrial production and about 30 per cent in agricultural production, the volume of Indian exports during the five years ending 1955-56 was about 72 per cent. Since then, exports have moved up somewhat, but imports having risen by a larger margin, there has not resulted any relief to the foreign exchange scarcity.

In this respect we are almost alone in the world, another country in a similar situation being probably Japan. With an increase of 51 per cent in industrial production, UK's exports in 1956 were 73 per cent higher than before the war. The world total of exports in 1956, at constant prices, was 71 per cent, above that in 1937.

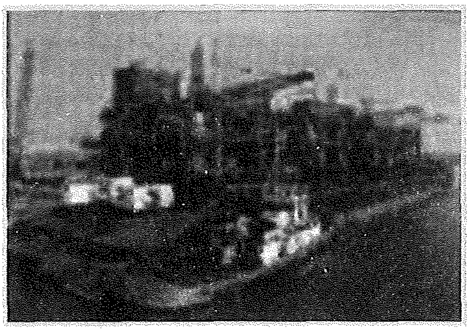
Though our imports have generally remained higher than our exports, relatively to pre-war and the rest of the world, they have been at low level. The annual average of the volume of Indian imports during five years ending 1955-56 was 85 per cent of that in 1937-38. With the liberalisation in imports in 1956-57, imports rose to somewhat above the pre-war level, their index in 1956-57 being 137 and in the first three quarters of 1957-58, 133, as against 116 in 1955-56 and 130 in 1937-38 (1952-53 = 100).

This suggests that India's foreign exchange crisis is due, primarily, to our exports being too low: it is not a case of excessive imports. Two decades of exchange restrictions and recurring foreign exchange crises led to progressive curtailment of non-essential imports. Imports of consumer goods (excluding food) represent about 10 per cent of our total imports (including food) during the two years ending 1956-57. Most of them are essential consumer goods. The largest bulk of our imports represented raw materials, factory accessories and capital goods. The recent import cuts (to correct the foreign exchange crisis) having fallen on essential imports, production, employment and income have been adversely affected.

To tackle the problem of our chronic balance of payments difficulties, rendered worse by a quadrupling of the prices of petroleum and the need for heavy imports of food, government recently constituted the Cabinet Committee on Exports with finance minister C Subramaniam as chairman; and revised the targets for growth of exports from an annual rate of 7.6 per cent envisaged in that draft Fifth Plan, to 10 to 12 per cent.

The government has accorded top priority to the committee's work and, at its first meeting held on 21 May, the committee decided to work out a crash program for boosting exports.

Though during 1973 the volume of Indian exports rose to an annual rate of 4 per cent (compound) and the value, expressed in US dollars, at 6.3 per cent, a more meaningful criterion of the adequacy of our exports for balance of payments stability, lies in the percentages of exports, first, to the Indian National Product and, secondly, to the world exports. Under conditions of normal economic good health (which implies viability of the external accounts), exports should keep pace with both the expansion of the national product and of world trade.



But Indian exports have tended downwards continually, from 7.6 per cent of the national product in 1960-61 to 4.4 per cent in 1971-72; and, recovering thereafter, were at 5 per cent in 1973-74. In relation to world exports, Indian exports fell continually from 1.2 per cent in 1960 – they were at 2.4 per cent in 1984 – to 0.51 per cent in the first three quarters of 1974.

These statistics reveal the basic debility of our export position; and explain our chronic inability to balance the internal accounts without external assistance. This is evidenced by our continued indebtedness to IMF from 1948, except for a break in 1956, and by our dependence on massive foreign aid for covering our current-account deficits, which have persisted without a break from 1956-57.

India is listed among 33 MSA countries – i.e., low-income countries which are 'most seriously affected' by recent world economic developments – which are eligible for emergency relief by UNEO (the United Nations Emergency Operation), set up by the UN General assembly in May 1974. It does not enhance the prestige of a potential global power, the second most populous nation in the world, which claims membership of the nuclear and space science clubs, to queue up for UNEO doles.

Our international role as a beggar of foreign exchange, as of food, is not only unbecoming – if there were a restructuring of economic policies, there would be no need whatever for it. Like most other economic ailments, India's balance of payments difficulties are our own creation and the remedy rests in our own hands, and not on massive aid and emergency relief.

It may be argued that, as poor economies have necessarily to rely on imported savings to accelerate growth, our heavy balance of payments deficits – they averaged, from 1956-57 to 1972-73, Rs 438 crore per year, and represented 30 per cent of the imports of the period – are but developmental deficits. But developmental deficits cannot be chronic deficits. They must diminish and eventually vanish as development progresses and the capacity for self-reliance grows.

Thus, with the progress of post-war reconstruction, the balance of payments deficits of West Germany declined from 73 per cent of its imports in 1948 to 24 per cent in 1950, the deficits became surplus from 1951 and national income galloped ahead at a 'miracle' pace. Similar was the experience of other OECD countries and Japan.

India's balance of payments deficits, however, do not have for their counterpart accelerated economic growth; nor are these deficits shortlived. Per capita real income in 1974-75 (Rs 339) was back again to its level in 1964-65 (Rs 338), both at 1960-61 prices; and balance of payments deficits which have lasted for 18 years already, seem to continue endlessly. These deficits cannot, therefore, be properly described as the developmental deficits.

Our international role as a beggar of foreign exchange, as of food, is not only unbecoming – if there were a restructuring of economic policies, there would be no need whatever for it

Our foreign exchange difficulties are largely the outcome of three major hindrances to the expansion of exports...First, imports and exports are functionally interrelated. If we cut imports, exports will fall commensurately. The logical link between the two is simple. Moneys hitherto expended on imported articles – these articles being now no longer available – would move from counter to counter and pick up comparable home-made goods from the market. These will correspondingly reduce the goods available for export, and exports will suffer. The experience of country after country confirms the dependence of exports on imports. For exports to expand efficiently, we must, therefore, liberalise imports. Our thinking being clouded by false theories, we may find it hard to accept this basic doctrine.

Secondly, when overall budget deficits are covered by printed money, these moneys claim for home use equivalent domestic output and the goods available for exports become correspondingly less. Except for a break in 1960-61, when there was a nominal budget surplus, we have had heavy budget deficits from 1956-57 onwards, the average annual deficit being Rs

386 crore. It follows that, if exports must rise, we must eliminate inflationary deficit financing.

Thirdly, throughout the post-war period, production for exports has been subject to an exchange penalty. Thus, in May 1956, exports worth $100 to the US fetched Rs 476. Ten years later, on the eve of devaluation, the rupee receipts for the same amount of exports remained unchanged at Rs 467, though Indian costs in the wake of inflation had risen by about 77 per cent. Currently (mid-May), as a result of devaluation of the rupee in June 1966, and the float, in July 1972, of sterling – to which the rupee had been linked traditionally – $100 of exports fetch Rs 813.45, a rise of 71 per cent over the receipts immediately before devaluation.

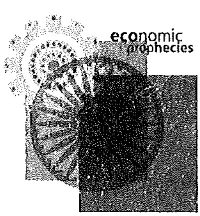
MEANWHILE, HOWEVER, Indian production costs went up by 118 per cent; so that the export advantages of devaluation and the float of the sterling were more than wiped out by the rise in production costs. On the other hand as, due to inflation, wages and other costs generally lag behind prices, the profitability of the domestic market increased with the progress of inflation.

Exports, therefore, yielded less and less profits, if not losses; and production for the home market yielded more and more profits. This led to a continued shift in production away from export and in favor of the home market; and export production and exports failed to keep pace with the expansion of the national product.

The only practical way of removing this penalty on exporters, and of shifting back production for export, is to float the rupee. The floating rupee will ensure to exporters rising rupee receipts to match the rising inflationary costs, and export production and exports will not suffer.

Global evidence shows that intractable balance of payments difficulties hound all countries where these export hurdles – import restrictions, deficit financing and currency overvaluation – remain formidable, as witness our own experience and that of Burma, Ceylon, Pakistan and Bangladesh; and countries which are singularly free from these hurdles have booming exports: witness the experience, in 1960, of Japan, West Germany and Hong Kong, whose exports multiplied from six to nine times. It is significant too that the exports of the tiny city states of Hong Kong and Singapore was ahead of India's exports, the former in 1969 and the latter in 1973.

Rather than learn from past failures, the government continues to tinker with the problem, its latest 'four-point package' being still on the plane of incentives and subsidies. If the basic hurdles in the way of exports are not removed, it is easy to see that the crash program of the Cabinet Committee would be stillborn.



21

Urban rationing

27 MAY 1975

Foodgrain rationing in the urban areas was suggested by Union food and agriculture minister C Subramanium as part of the measures to tackle the food crisis during 1964-65. Professor Shenoy's critique of the move mentioned, among other things, that open market prices for foodgrain could be a solution to the problem

Urban rationing may be in many ways worse than no rationing at all. It violates the concept of social justice, as the population outside the rationed areas may be then without assured supplies. Urban rationing does not reduce aggregate food consumption – aggregate consumption is necessarily equal to aggregate availabilities of foodgrain. It does not reduce consumption even in the rationed areas; the short rations, if any, are likely to be made good through the black markets by those who are able and willing to pay the higher prices, these markets are being supplied through smuggling from the neighboring non-rationed areas. In the non-rationed areas, the consumption of the better-to-do sections of the populations may be unaffected by scarcity and price rise, though some may substitute the relatively lower priced coarse grains for wheat and rice, as a consequence of the price rise.

The impact of the physical shortages would always be the heaviest on the poorer sections of the population. Their counterparts in the urban areas being shielded from its blast by rationing, the entire impact would not fall on the poorest sections of the population in the non-rationed areas. In the absence of urban rationing, the poorest in the urban areas, too, would have shared their misery to reduce its voltage.

Once physical shortages develop, urban rationing can only shift suffering; it cannot reduce or eliminate it. If the blanket is too short, to cover the head would be to lay the feet bare; and vice versa. This underlines the importance of remedying the crisis through sufficient imports of foodgrain and through putting a stop to inflation.

It is also a delusion to suppose that rationing, whether sectoral or nationwide, may provide protection against the inflationary rise in living costs. Rationing of foodgrain at controlled prices would keep the money expenditures of the community on foodgrain at below their level in the absence of rationing; and their expenditure on the non-rationed commodities might be correspondingly larger even as, if the flow of flood waters is checked in one direction, it flows with greater force in another direction. Lower prices of the rationed foodgrain may be balanced by the higher prices of the non-rationed commodities. The average of the two – the General Price Index – would reflect the state of inflation. The rationing of foodgrain may not control even the food bill of the people, let alone the cost of living. *A thali* of food contains more than rice and *atta*. If the prices of vegetables, condiment, *dal* and firewood rose freely, the price of a *thali* of food would reflect the inflationary situation, notwithstanding the rationing of cereals.

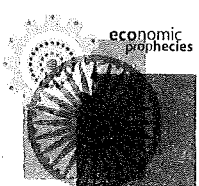
The General Price Index would reflect the state of inflation. The rationing of foodgrain may not control even the food bill of the people, let alone the cost of living

IT IS ALSO FALLACIOUS to argue that open market prices for foodgrain would drive up the cost of living. Open market prices logically imply the absence of food zones – which today exist in the case of wheat, paddy and rice – and an integrated national market. With the fall in foodgrain prices in the urban sector, which is most likely to attend the abolition of zones, the urban cost of living may fall as well. This benefit would accrue to that part of the urban population which, ordinarily, purchases a part or the whole of its cereal requirements from the open market, depending on fair price shops mainly for non-cereal items. In the longer run, too, this part of the urban population, like everybody else, should benefit when the new price policy expands the overall output of foodgrain.

In respect of those who depend on rationed supplies, the cost of living impact of free market prices for foodgrain would be neutral, as the issue prices would remain unchanged. This would apply to those under statutory rationing (17 to 20 million) plus an unascertained number of regular customers of fair price shops. Judging from the percentage offtake of foodgrain from the distribution system to net available supplies, beneficiaries of food subsidies during the past 10 years were 8.3 to 12.3 per cent of the total population, virtually all in the urban sector.

As, under open market prices, the whole of the food subsidy has to be borne by the government, the budget burden of this subsidy may be immediately larger than under procurement prices. But, as the subsidised distribution of foodgrain is a national policy, there is no justification whatever for extorting any part of the subsidy from producers. One way of moderating the subsidy is to raise issue prices moderately.

The greatest single problem confronting us today is the continued decline in the per capita production and income of the agricultural population. If this decline is to be reversed, agricultural production must accelerate to its economic limits. As foodgrain accounts for 58 per cent of agricultural production, this calls for nothing less than open market prices for foodgrain.



22

Operation Dehoarding

1974

Hoarding does not lead to price rise, rather it is the other way around, Shenoy wrote when the government cracked down on foodgrain traders. He stressed that any police action against hoarding would neither reduce the amounts hoarded nor add to market supplies

It is extensively believed that hoarding, which almost invariably accompanies inflation, causes prices to rice; and that a price rise may be corrected by anti-hoarding measures. We may define hoarding as the holding of stocks in excess of the normal supplies in the pipeline, i.e. in the yard, in transit, in the godown (warehouse) or in the family storeroom. Pipeline stocks are a functional necessity. To the trader, they enable a continued flow of supplies and are integral to efficient stock management; to the consumer, they save frequent visits to the grocer; and to the farmer, they are incidental to the production process. Hoarding, on the other hand, is part of the phenomenon of speculation. It is resorted to when prices are not only on the uptrend but are also expected to continue to rise at a rate that will at least cover the cost of hoarding: interest, storage charges, depreciation, and wastage.

If the price rise more than covers costs, hoarding brings profits; in the opposite case, it involves losses. When scarcities and the price rise are excessive, hoarding may be resorted to not only by farmers and traders but also by householders. Withholding the harvest for a better price is a variant of hoarding. By definition, normal pipeline stocks do not constitute hoarding. Hoarding implies stocks in excess of supplies in the pipeline, though the distinction may sometimes be a matter of judgement.

Thus, sequentially, the price rise manifests itself first, and hoarding, a logical consequence of the price rise, comes thereafter. A rise in prices is the cause of hoarding. In the absence of the rise in prices, hoarding will involve losses, the amount of the loss being the cost of hoarding.

We have seen that foodgrain prices may rise from one or both of two causes, an uncovered market deficit (i.e. an overall shortage of supplies in relation to the market demand at the prevailing prices) or an inflationary expansion of money. If either or both of these factors prevail, prices will rise, regardless of whether or not hoarding manifests itself. Hoarding will begin only if the anticipated price rise meets at least the cost of hoarding. That is to say, the presence or absence of hoarding has nothing to do with the coming or the continuation of the price rise.

Prices, hoarding and dehoarding react on one another. It is, however, important to note that the first link in the chain of events is a rise in prices, in the one case, and a fall in prices, in the other; the first link is not hoarding or dehoarding

This does not mean that hoarding does not react on prices. The definition of hoarding implies expansion of stocks beyond their pipeline norms. This correspondingly withholds supplies from the market and impinges adversely on the market deficit. The widening of the market deficit, in turn, affects the price rise: it gets a consequential forward push.

The opposite happens when rising prices decelerate and are reversed: the expanding pipeline stocks no longer accumulate, market supplies increase, the market deficit shrinks, and the receding prices, which produced these effects, receive a consequential downward push. Thus prices, hoarding, and dehoarding react on one another. It is, however, important to note that the first link in the chain of events is a rise in prices, in the one case, and a fall in prices, in the other; the first link is not hoarding or dehoarding.

AS HOARDING IS but an automatic reaction to the price rice, there is nothing that anyone can do to put an end to hoarding so long as the factors of uncovered market deficits and inflation remain operative and prices rise. If hoarding by the trade and by farmers should cease as a result of surprise raids or other anti-hoarding action – the immediate and shortlived effects of panic sales apart – prices cannot and will not fall, nor will hoarding cease. Apprehensions of a drying-up of the normal sources of supply – stocks with producers and traders – may stimulate hoarding by the third interested party, the householders. The stocks formerly with traders and farmers would now get scattered into innumerable household stocks and the phenomenon of hoarding continues.

Therefore, any police action against hoarding would neither reduce the amounts hoarded nor add to market supplies. It can do little else than shift the place of location of the stocks from farmers to traders, or vice versa, or from the two to householders. As these shifts leave unaffected the root causes of the price rise – the uncovered market deficit and the inflationary pressures in the economy – the anti-hoarding measures would have no lasting impact on prices. If these measures should cause panic sales of stocks, the price impact of such sales would be not only short-lived but also limited to the *mandis* (wholesale markets) subjected to the police action; and prices would soon recover to reflect the state of the uncovered national market deficit and of the inflationary pressures.

A rise in prices and hoarding is like a moving horse-cart, the horse being the prices, and the cart hoarding. When the horse moves, the cart moves, too; when the horse (the price rise) stops, the cart (hoarding) stops as well. One cannot think of a cart in motion without the horse; one cannot think of hoarding without rising prices. Whether the cart is on its onward or return journey, it is the horse that pulls the cart, not the cart that pushes the horse. It is the rising or falling prices that cause hoarding or dehoarding, not the reverse.

IT SHOULD ALSO BE NOTED that action against hoarding will only redistribute the hoarded stocks. It would not reduce the social aggregate amount of the stocks. It does not – leaving aside the short-lived panic sales – increase market supplies. Hence, it can have no lasting price impact. In keeping with the belief that the price problem can be corrected by dehoarding, the government of Uttar Pradesh (UP) started Operation Dehoarding against wheat farmers and smugglers on 2 June 1974 in Bulandshahr district, the 'granary of the state'. From Bulandshahr, the drive against hoarding and smuggling was soon extended to other parts.

Operation Dehoarding was not a haphazard undertaking. As a first step, 'surplus districts' were 'completely sealed off' and police officers and magistrates were posted for round-the-clock supervision of the check-posts on the border with Delhi. Screening was done of not only the road vehicles but also the trains and the Yamuna river craft. Women teachers of a degree college in Sikandrabad were drafted 'as special police officers for searching women travellers'. To prevent smuggling, the transport of grain by truck was banned and 'mobile squads' intercepted vehicles suspected of carrying smuggled grain. Surplus stocks with farmers, and grain that was being smuggled, were seized. The raiding parties, which were equipped with wireless-fitted jeeps and accompanied by a police force, took 'most of the rich farmers by surprise'. As of 12 June 1974, the number of raids in the 39 districts of UP is reported to have totalled 6,224.

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Operation Dehoarding has been hailed a 'success'. In Bulandshahr, wheat quoted (for unofficial transactions) at Rs 148 per quintal on 31 May 1974, was available at Rs 125 when the markets reopened on Monday, 3 June 1974, the day following the surprise raids; in Hapur, the golden grain crashed to Rs 140 from Rs 175; and in Meerut to Rs 165 from Rs 185.

This success story provoked the food ministers of Madhya Pradesh (MP) and Rajasthan to announce that they would follow the lead of UP in launching an anti-hoarding campaign. Similar action was probably being contemplated by policymakers in the Punjab government, who had decided earlier to issue a notification requiring individuals to declare, on pain of

The drive against hoarding is a poor corrective to the adverse impingement on procurement of the lag in production and of the unattractive procurement prices

stated penalties, their wheat stocks exceeding 40 quintals. This was designed to assess the amounts that a dehoarding drive may yield.

The UP government's drive against hoarders is reported to have had the full approval and support of the Centre. It is also reported that the Centre has urged the governments of UP, MP and Rajasthan 'to be relentless against hoarding at any level'. On 22 June 1974, the President promulgated an ordinance amending the Essential Commodities Act 1955 to provide for heavier punishment for hoarding, black-marketing, and profiteering: the ordinance has raised the maximum jail sentence from five years to seven years, provides for a jail sentence of not less than three years even for the first offense, and empowers the administration to confiscate not only the commodities, but also their containers and the means of transport.

The fall in prices in Bulandshahr and elsewhere is deemed to confirm the administration's theory that effective action against hoarding can push prices down. This conclusion is hasty. The fall in prices is artificial and is destined to be short-lived. The raids and seizures spread panic, with the result that arrivals in *mandis* dropped to negligible amounts. Many traders pulled down their shutters in Bulandshahr, Hapur, Jahangirabad and Meerut, the principal *mandis* in UP. Those with stocks hurried to sell in the unofficial markets, where prices were higher than in the markets for recorded transactions; and buyers were unwilling to add to stocks. This explains the immediate crash in prices.

The objective of the anti-hoarding program was twofold: first and foremost, procurement of wheat and, second, a reversal of the price rise. But Operation Dehoarding has not been a success in respect of procurement. As of 15 June 1974, the total procurement of wheat in UP amounted to 1.25 lakh tons, or a mere 16.8 per cent of the target (7.44 million tons). The all-India total procurement of wheat was 'around a million tons' on 8 June 1974, 'the corresponding figure last year' about 'this time' being 3 million tons.

Rice procurement, as of 6 June 1974, is placed at 3.8 million tons; and, before the rice year (generally November to October) is out, it is expected to go up by another 2 million tons. Even so, because of the low procurement of wheat, it is unlikely that total foodgrain procurement in 1974 would approximate to the procurement in 1973 (8.4 million tons). The low level of procurement in 1974 may be due to the unduly poor procurement prices in relation to open-market prices; and possibly to the reduced output of wheat, the result of the apprehended shift of land, during the *rabi* sowing season of 1973, away from wheat to other crops.

The drive against hoarding is a poor corrective to the adverse impingement on procurement of the lag in production and of the unattractive procurement prices.

Operation Dehoarding is destined to fail in its second objective of reversing the price rise. When a panic-unloading of stocks dominates the market, prices will fall regardless of the causes of the panic. In 1973, wheat prices fell sharply in March and plummeted further in April. This was the result of the panic-selling of wheat by wholesalers, which was caused by the takeover of the wholesale trade in wheat in March-April 1973. The takeover meant that wholesalers had to close down their business by selling stocks.

APPREHENDING A COLLAPSE in prices as a result, panic sales took place when a pronouncement of the prime minister, on 26 March 1973, made it clear that there would be no going back on the decision to take over the wheat trade from 1 April 1973. But the price fall was temporary. Wheat prices soon resumed their uptrend as reflecting the uncovered market deficits and inflation though, for a time, this uptrend remained suppressed because of price controls.

The crash in wheat prices in the wheat-producing states in March-April 1973, and in the UP *mandis* in June 1974, is but the latest evidence – in a long and endless series of such experience – that anti-hoarding measures are no corrective to rising prices. Once markets recover from the panic, prices continue to reflect the prevailing state of the uncovered market deficits and inflation, however drastic the nature of the police action against hoarding. If we dislike the steep rise in food prices, the only practicable corrective to it is to stop inflation and to cover the market deficits by imports. Anti-hoarding measures can achieve little else than destroy the civil liberties of traders, farmers, and householders; and, in the process, undermine the moral standards of the people, the police, and the administrative officials.

23

Stagnation begets social injustice

28 APRIL 1969

In this sharp reaction to statements by the prime minster and the Congress party chief at Faridabad, the writer tries to analyse the factors behind the political crisis and the public discontent in early 1969. He contrasts the raw deal for the masses to the riches of the privileged

The Indian situation presents an awful contrast with that of Japan and other countries. This contrast is not due to any lack of developmental design or effort – the Planning Commission was set up expressly for this purpose, and it has the prime minister as chairman and the minister of finance as a member. The other members of the Commission are distinguished technicians or administrators, in addition to being dedicated advocates of the government's policy in these matters.

Nor is the contrast due to any awful shortage of finance. Indian investments rose from Rs 3,360 crore in the First Plan (1951-52 to 1955-56) to Rs 10,400 crore in the Third Plan (1961-62 to 1965-66), or a rise of over three times; and to an estimated amount of Rs 21,350 crore in the Fourth Plan, or a rise of over six times in relation to the investments in the First Plan. And foreign aid, including inflows of private capital and banking funds, rose from Rs 452 crore in 1960-61 to Rs 1,291 crore in 1967-68. Foreign aid currently (due adjustments being made for the market worth of import goods, acquired against aid) represents 75 per cent of India's own savings.

In 1967-68, the budgetary resources of the Centre – Rs 240 crore – represented but 19 per cent of the net Plan outlay of the Centre (Rs 1,236 crore). The rest of this outlay (Rs 996 crore), 81 per cent of the total, was financed from foreign aid. In 1968-69, the Centre's own resources (Rs 509 crore) and foreign aid found the balance of 63 per cent (Rs 876 crore). The position in 1969-70 may be of a similar order. One or two exceptions apart, no country received foreign aid on so massive a scale.

And yet, there is little to show by way of expanded production or social progress. During the decade ending 1961-62, per capita income rose at an annual average rate of but 1.8 per cent. Thereafter, 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, reaching a low of Rs 302 in 1966-67. In 1967-68, it spurted up to Rs 321, again as a result of weather-based good harvests.

The prime minister's observations are a re-statement of government policies of the past 15 years which, until recently, had extensive public support. But, under the pressure of logic and disappointing experience, this support seems to be on the decline

The prime minister is reported to have emphasised that, in face of the grim poverty of the people, any further accumulation of income and wealth in a few hands cannot be tolerated; and that corrective action for reducing the present economic disparity among the people is a matter of the utmost urgency.

Referring to public sector undertakings, the prime minister observed that the justification for the heavy outlay in these undertakings is the importance of maximum self-sufficiency in vital sectors, including defense industries, and the key role of heavy industries in an economic breakthrough. Heavy industries have necessarily to be in the public sector to avoid undue concentrations of economic power in private hands, he said – the defects of public sector undertakings got highlighted because of the system of their accountability to the public and Parliament. A probe into the affairs of private sector undertakings, which enjoyed immunity from such accountability, may not yield flattering conclusions.

The prime minister's observations are a re-statement of government policies of the past 15 years which, until recently, had extensive public support. But, under the pressure of logic and disappointing experience, this support seems to be on the decline even within the Congress.

S Nijalingappa, in his presidential address to the Indian National Congress, observed that 'simply because an industry is in the public sector it does not mean that we should be saddled with losses and be content with whatever is produced' that if production 'in the private sector can be achieved more economically, we can even encourage the private sector'; that some industries in the public sector are 'badly managed', being 'run on very unscientific methods'; and 'we must see that big industries are not established in the public sector without due regard to demand and the capacity to produce.'

The Congress president also spoke in similar terms of economic controls and licensing. 'Where there are controls and licensing', he stated, 'there is always corruption and the sooner we do away with licensing and controls the better it would be unless there is compelling necessity' for the continuation of these measures. Though economic controls and licensing rank very high in our conception of socialism, the Prime Minister did not comment on this part of the presidential address.

Referring to the present state of national affairs, Nijalingappa remarked: 'A view of the present situation in the country cannot fill one with hope and satisfaction.' He felt concerned that 'a grave crisis is facing the party and the country today.' He referred to the deterioration in the 'law and order situation' in Kerala and Bengal; to the 'widespread feeling' of insecurity to life and property in 'those states'; to the spread of regionalism as manifested in the 'recent atrocities committed by the Shiva Sena in Bombay' and the 'agitation in Telangana'; to the policy of the 'non-democratic parties' to 'promote disruption, making use of the Constitution'; and to the theory of the Naxalites that 'violence with impunity alone' can further their cause, did not accrue to the workers viewed as a whole.

FROM THE CENSUS of Manufacturers in India and the Annual Survey of Industries (both issued by the Central Statistical Organisation, Calcutta), we find that from 1951-52 to 1964-65, industrial production rose by about 138 per cent. But industrial employment rose only by 35 per cent. This, apparently, reflects an undue use of labor-saving devices, the employers' defense against excess trade union activity. Mechanisation added to the ratio of capital per worker and, therefore, to his productivity. The output per worker, accruing to the employer after the payment of wages was, in 1964-65, about 2.3 times the output in 1951-52. But wages rose by only about 76 per cent; and much of this improvement in wages was largely wiped out by a rise of about 57 per cent in the cost of living.

This added enormously to the output left in the hands of factory management. Some of it was shared with the salaried staff, mainly executives and top technical personnel. Both have gained noticeably in employment and emoluments. The shareholders received less than their due share, especially since 1952-63. The bulk of the windfall remained behind with the management. Not the whole of this is visible in the published balance sheets: a part is concealed. We have here a real life case of the wonderland story where some people run breathlessly and yet remain where they are; and, what is worse, lag far behind those who rest in comfort and luxury. This would seem to be the main factor behind the general bitterness of workers against employers.

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Simultaneously, unemployment increased. Unemployment at the close (1955-56) of the First Plan was 5.3 million. It rose to about 7 million at the close (1960-61) of the Second Plan. The Third Plan (1961-62 to 1965-66) added to this figure 2.5 million. By 1966-67, it was 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.

Coeval with this raw deal to the workers and the masses, the affluence of the few continued apace, throughout the 1950's and 1960's; so that the situation presented all the major elements of social injustice in place of social progress – wages lagged far behind the increased output per worker, unemployment increased and the gap between the rich and the poor widened.

> We have here a real life case of some people running breathlessly and yet remaining where they are; and, what is worse, lagging far behind those who rest in comfort and luxury. This would seem to be the main factor behind the general bitterness of workers against employers

The deterioration in welfare applied to virtually all sectors of the people – not excluding salaried personnel – outside a privileged minority. The widening of the gap between the rich and the poor is visible to the naked eye as well as in statistics. C D Deshmukh was speaking for an overwhelming proportion of the salaried people and pensioners when he observed at Madras, on 15 July 1969 that, thanks to rising prices and heavy taxation – to both of which his own contribution, as finance minister, was of no mean an order – he was now among the ranks of the 'new poor'.

24

Ceiling on urban incomes

21 JANUARY 1962

The 64th session of the Congress held in Nagpur in January 1959 resolved that 'ceilings should be fixed on existing and future holdings' of agricultural land. Shenoy wrote this article in the press apprehending that a ceiling on urban income was in the offing. He dubbed 'a simpleton's logic' any presumption that such measures could boost plan finance

State legislatures have been passing laws fixing ceilings on agricultural land. The limit is generally 50 acres per family, depending on the quality of the soil and the rough criterion of an income limit from land of Rs 300 per month per family. Though the Nagpur resolution did not – to quote its wording – 'mean a ceiling on income' because of the vast variations in the income potentials of land, the prescription of land ceilings involved the adoption of a yardstick of income limitation for general applicability.

The 67th annual session of the Congress held at Patna early this month has resolved on 'some limitations' on high urban incomes, so as to 'lessen' the great income disparities that exist today. This forms part of the election manifesto which the Patna Congress adopted.

A ceiling on urban income is a natural second step which the farsighted had foreseen from the ceilings on land. The latter applied to 61 million farm families, the largest bulk of the population. It is iniquitous and, under adult franchise, intolerable that a minority of 15 million urban families should continue in freedom to amass and enjoy unlimited wealth and income.

It may be utter folly to treat this merely as a tactical threat for election gains. Reduction of income disparities is part of the ideology of the socialist pattern of society, which the Parliament accepted in December 1954 as the national objective of social and economic policy. N Sanjiva Reddy, Congress president, in his welcome address to the Patna Congress, referred to the inconsistency of a 'ceiling for landed property alone, and not for urban wealth also' especially as many people in the urban areas 'had amassed enormous amounts of money.' This militated against the 'basic objective' of the Congress that the 'increased wealth' of the nation should be 'shared by all sections of the people.'

Earlier, the prime minister had warned that anything that came in the way of socialist 'progress' would be 'swept aside with a broom'. Though unlike the earlier resolution on land ceilings, the decision on urban incomes does not specify a time limit for the completion of the necessary legislation, the sincerity and seriousness of the Congress leadership on this issue seem indubitable.

The Congress election manifesto would achieve the income limitation through 'taxation and other means' – Mr Reddy expressly invited attention to the 'significant' phrase 'other means', which, he said, was used 'with a real purpose and meaning'. It is not clarified what these 'other' means of leveling down urban incomes are. It is also not clear whether the limit will be on income, wealth, or both. Mr Reddy refers, at one time, to wealth limitation and, at another, to income limitation. The manifesto refers to income limitation alone.

Neither is there any indication of the precise limits beyond which all incomes and wealth will be axed. The rural analogy of an express ceiling on land, instead of on income, suggests a limit on urban wealth. In prescribing the wealth limit, the criterion of income may not be out of all proportion to the accepted rural standard. The maximum salary of Rs 3,500 per month permissible to the top executives of public sector enterprises, which a successful civil servant may aspire for, is another standard to go by.

A NATURAL COROLLARY TO URBAN wealth limitation is a curb on private sector salaries. Before the war, salaries of top government officials compared very well, if they did not contrast, with the salaries of top executives in the private sector. This order has since been reversed partly through some scaling down of top government salaries, but mainly as a result of inflation, which has reduced the value of money to nearly one-fifth its prewar value.

While inflation has drastically cut the real worth of the salaries of officials, private sector salaries have kept pace with, or risen faster than, inflation. The annual emoluments of top executives – general managers or managing directors and their deputies – including allowances and perquisites are frequently of the order of Rs 1-2 lakh or more. Due adjustments being made for the debasement of the rupee, and considering the enormous jump in the demand for executives, this may not seem fantastic remuneration. But the contrast between it and the remuneration permissible to the secretaries to the Union Government and to the public sector executives render them highly vulnerable.

The ceiling on urban wealth is a major retrograde step, socially, economically and also in terms of progress towards a free society. It violates the philosophy of ethical socialism, though it is true to the pattern of political socialism. We are aiming at the latter, Gandhi meant the former. We find it of tactical advantage to confuse the two.

Some persist in arguing that income limitation will help to solve the problem of plan finance, the surpluses above the limit being assumed to be

Income limitation will further retard economic growth, which is already semi-stagnant under the wet blanket of statism; it will further slow down relief from poverty and unemployment, if it does not aggravate both

available for plan investment, and that it is a major forward step towards an egalitarian society. This is a simpleton's logic. In reality, the opposite would be the case. Income limitation will further retard economic growth, which is already semi-stagnant under the wet blanket of statism; it will further slow down relief from poverty and unemployment, if it does not aggravate both, and therefore add to social conflict.

True to Parkinson's law, expenditures will rise to meet income from revenues. During the Second Plan, actual revenue receipts amounted to Rs 1,052 crore as against the initial target of Rs 450 crore. No part of the larger receipts accrued to plan finance – it was all eaten up by consumption expenditure. The jump in revenues from expropriated incomes, potential savings, is likewise apt to be burnt up in consumption. Income limitation will deprive the private sector of some of its supply of savings and there may not be any compensating increase in supply of savings to the public sector. Volume of aggregate national savings and investment will suffer.

Income limitation will add significantly to the prevailing compulsions and inducements for income concealment. This will further aggravate, on the one hand, tax evasion and, on the other, misdirection of the relative savings, which have now to be invested stealthily. Some may go into gold hoards, some in socially less essential assets and some may be exported for concealed investment abroad. Where income concealment is not practical, it may add to extravagant lifestyle, with their debit effects on savings.

The retardation of savings and their misuse will detract from effective capital formation and economic development. The diversion of savings into gold and capital exports will worsen the balance of payments position, adding to the already heavy reliance on foreign aid for economic stability and growth. Income limitation will also largely put out of action the better quality entrepreneurs, in acute short supply in underdeveloped countries; this will weaken the mainsprings of the dynamism of economic expansion.

In underdeveloped economies, the primary concern of policy should be maximisation of output. It is the responsibility of economic statesmanship to ensure that no measures should interfere with the flow of savings, enterprise and much-needed investments, whatever may be the political urge for such measures. With masses of the people underfed and ill-clad, all energies and attention must be bent to the production of food, cloth and other necessaries of life as speedily as possible, in order to lessen conflict and increase welfare. Supposedly egalitarian legislation, by hampering production, can only add to tension and conflicts.

Income limitation is not merely a drag on the economic well-being of the community – it deals a knockout blow to a free society. Private property, legitimately acquired, is not a crime. What may be deemed criminal is the unmerited acquisition of property, as its inevitable counterpart is illegitimate expropriation. Accumulation of wealth through such robbery is not practical under policies of economic freedom, which imply full and free competition, rendered orderly and humane through the sovereignty of the rule of law.

Under such a system, the building up of private property is feasible only in proportion to effective services rendered to the community, the valuation of such services being assessed by the twin – impersonal and almost infallibly just -- tribunals of the pricing system and the consumer referendum. And property so built up cannot be held indefinitely unless it is used for the benefit of the community, such benefit too being subject to the adjudication of the twin tribunals.

In a free society, governed by the rule of law, wealth accumulation and the retention of wealth are indices of the effective services rendered to the community. It is not by any means a measure of anti-social activity, to merit its expropriation by the state. Unmerited acquisitions of income and wealth are progenies of statism, or of a society without the rule of law. They cannot properly be fathered on a free-market system. The latter 'never yet had a full chance' (Lionel Robbins) though the British system, under the influence of Adam Smith, approximated to it – as perhaps the EEC system does today – from the 1840s to 1870s, and well proved its merit both socially and economically. In a free society, to limit private property is to limit below capacity the contribution of the most competent body of individuals to the well-being of the community.

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Private property and the rule of law are the two principal pillars of a free society. The rule of law is being blasted by degrees. The Nagpur resolution dealt a death-blow to private property in agricultural land: the 64th session of the Congress resolved that 'ceilings should be fixed on the existing and future holdings' of agricultural land. Urban private property is promised its turn by the Patna Congress. The propertied among the urban community are under notice that they should begin counting their sunny days. In these two measures we have taken a leap towards communism.

If we are truly looking for continued and maximum well-being of the masses of the people, what we need is a major policy shift from political socialism to the Gandhian ethical socialism. The latter implies maximum possible economic freedom for the citizen, the rule of law and minimum state. Heavy penalties, economic, social and ethical, attend the adoption of measures which violate the philosophy of ethical socialism. This policy shift will demand a major surgical operation on our pet dogmas and ideologies.

25

Industrial wages

21 JANUARY 1962

This chapter, which originally appeared in the book *Indian Economic Policy*, highlights the fact that a decade of hectic industrialisation did not lead to any appreciable benefit to industrial workers. Instead, entrepreneurs have generally taken care to protect themselves against the ill incidence of labor legislation

An outstanding feature of Indian economic development since 1950-51 has been the vast strides in industrial production. The net output of industries has risen several times faster than the net output of other categories of production. From 1950-51 to 1961-62, the output of factory establishments rose by 165 per cent; during the same interval agricultural output rose by 39 per cent; commerce, transport and communications by 46 per cent; and 'other services' by 79 per cent.

The declared policy objective of the government being the establishment of a socialist pattern of society, its policy measures have been generally pro-labor. The Industrial Policy Resolution of the government has prescribed (i) the statutory fixation of minimum wages in sweated industries and (ii) the promotion of fair wage agreements in the more organised industries. In pursuance of the first requirement, the Minimum Wages Act was passed in 1948, covering agriculture and 12 other industries; in pursuance of the second, the government appointed a Committee on Fair Wages, a tripartite body representing labor, employees and the government, to formulate principles for the determination of fair wages.

This leap forward of the industrial sector and the policy bias of the government raises the presumption that labor is well placed to appropriate to itself an even larger share of the national income than its due. The available evidence does not seem to confirm this presumption, looking to the community of workers as a whole, though in certain important industries, notably cotton and jute textiles, cement and sugar, real wages show considerable improvement.

Analysis of 29 manufacturing industries shows that the value of ex-factory output – less the cost of raw materials, including fuel, and other payments and less depreciation at income-tax rates -- rose steeply, though with

minor breaks, during the years 1949-58. This jump in receipts is largely the result of modernisation and increase in the capital equipment of industries, as reflected in a rise in the ratio of capital per worker from 100 in 1949 to 227 in 1958.

Receipts of manufacturers continued to rise much slower than the capital equipment per employee. This queer phenomenon of output lagging behind capital equipment seems to reflect, principally, the construction of idle production capacities, to which we have referred elsewhere, an outcome of forced industrialisation; and corrupt practices.

WORKERS IN THE manufacturing industries viewed as a whole do not seem to have gained any appreciable benefit from the expansion of industrial output. At the end of a decade of hectic industrialisation, employment in the manufacturing industries under review rose by only 5 per cent. Apparently, the additions to capital have replaced labor. The restrictions on rationalisation apply to the existing enterprises. In establishing new industries and new production units, entrepreneurs have generally taken care to protect themselves against the ill incidence of labor legislation.

Though money wages per worker generally tended upward, the rate of increase in wages was, firstly, a fraction of the rise in output per employee; at the close of the decade, the latter had more than doubled from 100 in 1949 to 244 in 1958, while wages had risen by but 28 per cent.

Secondly, part of the rise in money wages – in 1958, the whole of the higher money wages – was cancelled by the rise in the cost of living. In the context of sluggish aggregate employment – as this would add to the burden of unemployed dependents – any net improvement in the economic condition of workers in the manufacturing industries, viewed as one sector, may not be very significant.

The shareholders do not seem to have had their due share of the benefits of industrial expansion either. When the transfer of these benefits to shareholders is automatic, as under a competitive system, and the expansion is expected to continue apace, share prices are apt to rise even faster than production. This is well illustrated by the post-war experience of certain West European countries. In 1961, share prices in West Germany were 7.5 times their level in 1953, rising several times faster than production. In France, Italy and the Netherlands, too, the boom in production, which began about 1957, led to share prices far outpacing output. In India, by contrast, share prices have lagged behind industrial

Apparently, the additions to capital have replaced labor. The restrictions on rationalisation apply to the existing enterprises. Rise in money wages was cancelled by the cost of living

Wages and factory output (1949 = 100)

1 S.No.	2 Number Of Workers	3 Salaried em-ployees	4 Employees Indices	5 Wages per worker	6 Salary per person (i)	7 Remun-eration per em-ployee	8 Cost of living	9 Value accruing to em-ployers	10 Capital per worker	11 Output to the employer *(after wages and benefits)*	12 Industrial equity prices (ii) (1949-50 =100)
1.	96.5	100.8	96.9	97.4	110.1	99.8	101	104.1	125.0	125.0	108.8
2.	97.1	94.6	96.9	108.7	117.3	109.9	104	127.3	144.0	178.3	112.0
3.	98.3	93.7	97.8	113.9	124.8	115.3	104	115.5	145.9	123.7	94.0
4.	96.6	96.4	966	117.3	127.2	118.9	106	122.6	147.9	144.4	95.6
5.	100.8	111.1	101.8	117.4	127.8	119.7	99	136.8	153.4	168.2	112.9
6.	104.4	119.4	105.8	115.5	129.3	119.2	96	153.8	162.0	205.6	124.6
7.	110.2	127.4	111.9	120.2	136.1	124.4	107	171.9	18.8	221.0	109.2
8.	110.1	134.5	112.5	124.5	141.1	129.7	112	171.6	203.8	207.1	97.9
9.	105.1	135.4	168.0	127.7	145.1	133.8	118	179.6	226.8	244.5	138.0
	164.8	221.6	170.3	125.4	158.1	135.4	123	278.3	206.8	232.8	-
	-	-	172.3	-	-	135.1	124	282.3	-	-	-

Includes D.A. but excludes other benefits.
Year beginning with 1 April
Annual Survey of Industries, and Reserve Bank of India Bulletin.

production; share prices even fell, when production forged ahead, as in 1956 and 1957. If the West Europe experience be any guide, shareholders in India would seem to have been mulcted of much of their legitimate gains.

Income-tax statistics show that only a minor part of the increase in output flowed into the national exchequer. During the eight years ending 1958-59, while the net output of factory establishments rose by Rs 540 crore or nearly doubled; the net output of mining and industries in general rose by 41 per cent, personal income-tax and corporation tax rose by only 31 per cent (Rs 53 crore).

If little of the expanded output has come the way of the workers, and has accrued only partially to shareholders and the state, where has the bulk gone? Some of it has accrued to salaried employees. Their employment grew rapidly and their salaries rose much faster than wages, the principal beneficiaries being perhaps the executives.

A fair part of the net expanded output has doubtless remained with the manufacturers. These perverse developments are perhaps inevitable in a set-up of monopolies and semi-monopolies, which statist economic policies have created, in particular, through control over capital issues, import licensing and essential resource allocations by permits.

THESE MEASURES, ON the one hand, induce management extravagance or enable the unscrupulous to pilfer output for private gain. In rapidly developing economies, wage rates are apt to lag behind the national product, the difference between wages and output representing accelerated national savings and capital formation and this being reflected in booming share values. In India what has been denied to the workers, the shareholders and the state would seem to have been shifted into the pockets of entrepreneurs. These developments have been reinforced by the super profits tax levied in the 1963-64 budgets.

The poor gains accruing to industrial workers perhaps illustrate the doctrine that the expansion of employment is a function of the expansion of the national product, and that wages being the workers' share of the national income, wages cannot rise with impunity faster than the latter. The forced bulge in industrial output cannot negate this basic doctrine. Where trade unions have been strong, there has been sectoral improvement in wage rates. The cost to the body of workers of this pressurised improvement has been heavy. It has doubtless been a factor responsible for poor achievement on the employment front, despite the vast strides in industrial investment.

For labor as a whole to benefit, the cake of the national product must grow. Trade union action and legislative measures cannot succeed in improving the condition of the workers if the cake fails to grow fast enough.

26

State trading and cooperative farming

28 APRIL 1959

This is the summary of a lecture presented at the Central Institute of Study & Research in Community Development, Mussoorie. In this the writer points out the folly of imagining that the savings gap can be covered by government-run systems, saying that it is as illusory as an Alladin's lamp

The official thinking seems to be that the savings gap can be covered and finance raised for the future through institutional changes, the chief among them being extension of state trading and cooperative farming. Extension of state trading, it is believed, might produce more or less immediate results, while cooperative farming may take some time.

Overall, national savings cannot be expected to rise significantly by merely shifting profits from private trade to the coffers of the state through the State Trading Corporation. First, the possibility of savings increasing from this procedure depends upon non-investment expenditure of the government remaining unchanged, so that the additional revenues augment revenue surpluses for ploughing into plan investment. Past experience, however, has shown that revenue receipts, instead of benefiting the plan in this manner, are apt to be balanced by rising non-investment expenditure. This is probably inevitable in a democratic set-up based on adult franchise.

Second, the savings habits of a people do not change because they now draw their incomes from a state agency instead from private firms, either as proprietors or as employees. Under extended state trading, there is in fact the danger of national consumption increasing with unaffected national income (so that overall savings diminish) as wage rates and welfare services might be on a more liberal scale in a state agency than in private firms. Looking to the economy as a whole, common experience is that savings are a steady percentage of national income. The increase in national income is a slow process, though there may be compensating sector-wise variations in savings.

In the prevailing economic context of controls and inflation, the trading part of private enterprise has been making unduly large profits. Exchange control and import restrictions, by creating fiscal scarcities, have placed the owner of imported goods and manufacturers of domestic substitutes in a number of commodities in an undue position of bargaining advantage. This they have not been slow to exploit to make large profits. This is a temporary phenomenon. Once state trading has been extended, it is not practical to wind it up in a hurry. When normal conditions are restored, profits of trade would return to normal. In such a context, the net benefits of state trading would be doubtful as profits may be less than under private enterprise. State trading may be then instrumental in reducing national savings.

Once state trading has been extended, it is not practical to wind it up in a hurry. In such a context, the net benefits of state trading would be doubtful as profits may be less than under private enterprise

Cooperative farming is of value for plan finance only to the extent it may augment the output of farms without augmenting equally the consumption per worker on the farm. The former is expected to result from the application of modern methods of cultivation which the integration into optimum farms of the fragmented units might permit.

COOPERATIVE FARMING PRESENTS three problems. The first is organisation of fragmented units into large enough farms for the adoption of modern methods of cultivation. This is a formidable task in itself and may take a good deal of time and attention for an extended period, especially if the voluntary principle is duly respected. Second, it would require considerable amounts of capital for mechanisation, better implements, manure and irrigation. The amount runs into a colossal figure if the average capital requirement is placed at Rs 100 per acre. Third, modern farming is no less a mode of technical knowhow than factory production. Peasants and workers generally do not possess this knowhow today. They need some training before they may be capable of manning cooperativised farms.

These factors are but another way of describing underdeveloped economies. The difficulties they present merely amount to saying that economic development is a slow process. Cooperative farming indicates the principle along which Indian agriculture may achieve rapid progress. To state the principle is different from fulfilling it. The difficulties we have indicated will prevent anything like a universal extension of cooperative farming immediately. It is a program that may take several decades to complete. The Second and the Third Plans, at any rate, cannot reasonably hope to raise significant funds from this source.

We first fancied deficit financing to be an Alladin's lamp, within limits; after two-and-a-half years of discussion and a rise in the General Index by 91 points (27 per cent), we were convinced of the futility of relying on it for capital formation (see the budget speech of November 1956). Our attention, then, shifted to the tax instrument and two years' experience has demonstrated its limitations. We earnestly hope (and pray!) that the contrivance now in favor – institutional changes – will be abandoned, in its turn, before too great damage results.

Measures for covering the savings gap

Scope for raising larger plan finance exists. However, we must be prepared for stern measures: on the one hand stepping up revenues and, on the other, freezing non-investment expenditure at the prevailing, if not lower level so that the benefit of the increased revenue receipts accrue to the plan. These measures are seven-fold.

(i) Prevention of tax evasion, which is competently estimated at Rs 200 to Rs 300 crore per year, may add to revenues materially at existing tax rates. The stagnation of the taxes on individual income at about Rs 145 crore since 1951-52, notwithstanding a 20 per cent rise in the nation al income since then, would seem to suggest that tax evasion is a currently active phenomenon.

Modern farming is no less a mode of technical knowhow than modern factory production. Peasants and workers need some training before they become capable of manning cooperativised farms

(ii) Sale of import licenses, some of which fetch fabulous prices, but which are issued free of charge today might bring Rs 300 to Rs 400 crore per year, and, therefore, might alone wipe out the savings gap.

(iii) A cut of 10-15 per cent in the defense budget, which some deem to be unduly large, may yield Rs 25-38 crore in 1959-60.

(iv) The long overdue adjustment in the exchange value of the rupee, would remove the fiscal burden of the relief on export duties and of export subsidies, and would, at the same time, permit enhanced export duties on certain exports. This will simultaneously enable liberalisation of imports, increase the revenue from import duties, and eliminate the large anti-social shifts in the national income which have attended import restrictions and currency overvaluation.

(v) Labor in the organised sector (as well as in agriculture) may be induced (among other devices by piece rates) and exhorted to work harder and for longer hours, and the shifts in factories may be increased (for both of which there is room) so that the production – and savings, on which everything hangs, may rise.

(vi) Importation and sales of gold by the government may bring in, at current market prices, about Rs 18 to 20 crore per year.

(vii) Finally, there is scope for stepping up the national product, and, therefore, of savings by fuller use of Shramdan (labor offered as a form of worship) efforts, in particular by dependents, the idle rich and students during their vacations.

Conclusions

The conclusions emerging from the foregoing discussion may be stated briefly:

- Economic development being a function of invested savings, the rate of economic development is necessarily conditioned by the non-availability of savings, the bulk of which must be domestically generated.
- In a communist economy it is possible, within limits, to make a plan and then proceed to find the funds for it. The latter is capable of variation through the control which planners in a totalitarian economy have over the production of consumer goods. In a democratic society a plan of investment must be adjusted to the amounts which the community is willing and able to save.
- With our currency reserves nearly gone, plan investment from now on is to rely wholly on current domestic savings and foreign aid. Due account being taken of receipt under both heads, the savings gap in 1959-60 is Rs 300 crore.
- This savings gap cannot be covered by an extension of state trading as the overall savings in the economy would not increase merely by the device of shifting private profits in the national exchequer. If public savings should increase thereby, private savings would decline, so that overall savings may not increase.
- Cooperative farming is an obvious device of increasing agricultural pro duction and surpluses through modern methods of cultivation. But this presents formidable problems of organisation, scarcity of capital equipment and technical knowhow. This merely states the problem; a solution would involve a long-term program. Cooperative farming is of little avail for covering the saving gap of the Second and Third Plans.
- It is, however, possible to cover the savings gap of the Second Plan if we are prepared for stern measures, including the prevention of tax evasion, sale of import licenses, cut of 10 to 15 per cent in the defense budget, devaluation of the rupee, harder and longer hours of work by labor, additional shifts in factories, importation and sales of gold by the government and fuller use of Shramdan.

27

Economic injustice

MARCH 1977

When the Janata Party won the March 1977 elections after 30 years of Congress rule, Shenoy wrote this letter (among others) to the new government urging it to jettison socialist planning, as it had not led to a reduction in concentration of wealth

The thinking of our policymakers has been dominated, since before independence, by the Marxist theory of conflict between 'private profit' and 'social gain'. Indian planners were apprehensive that capitalist classes might appropriate the lion's share of the rewards of economic growth by exploiting the helpless proletariat and other weaker sections of society. In order to prevent this, it was deemed to be of the utmost importance that the responsibility of the decision regarding 'distribution' – in fact, regarding 'all the significant social economic relationships' – was vested in the hands of the state, as the state alone could be trusted in these matters.

In accordance with this doctrine, the validity of which the planners never doubted, the five-year plans subjected the acceleration of economic growth to the basically most sound corollary and overriding consideration that development serves a 'social purpose' – that the 'benefits of development accrue more and more to the relatively less privileged classes of society', such that there is 'a progressive reduction of the concentration of incomes, wealth and economic power.' This was spelt out in the Second Five-Year Plan (1956-61).

Motivated by the same welcome consideration of eliminating social injustice before it strikes root, the First Five-Year Plan (1951-56) enjoined 'a steady advance' towards 'full employment'. As actual achievement turned out to be negative, the Second Plan urged that 'at least a deterioration in the unemployment situation should be arrested'.

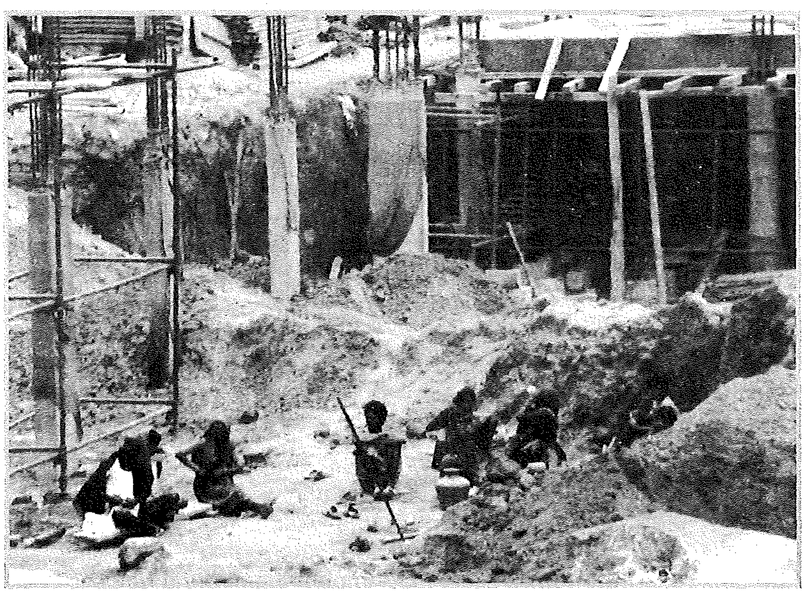
The implementation of these socialist policies has been the central principle of the high-powered planning activity of the past 25 years. To avoid pitfalls and to formulate correct and fruitful policy measures, the new government may find it eminently worthwhile to ponder over the achievements of these efforts.

To let statistics and other facts tell the story, studies tell us that the number of people below the poverty line – which is defined as earnings of Rs 40.60 per month at 1972-73 rates – has risen by 53 per cent from 172 million in 1960-61 to 264 million in 1973-74. As a percentage of the total population, those below the poverty line have risen from 39 per cent in 1960-61 to 46 per cent in 1973-74. There is no indication that the basic position has, since the latter year, improved.

Other data endorses this eloquent and conclusive enough overall evidence of the indigence of the masses. Thus, the per capita income of the agricultural population, which is 72 per cent of the total population, has shown a downtrend from 1960-61 and was Rs 195.50 in 1976-77, a little below its level two-and-a-half decades ago (it was Rs 197.80 in 1950-51). Simultaneously, the per capita income of the rest of the population – Rs 399.40 in 1950-51, the bulk of which is urban income – more than doubled to Rs 813.20.

The growing economic pressures emerging from this downtrend in rural incomes have been pushing the marginal cultivators into the lowest rung of the socio-economic ladder: agricultural laborers. During the decade 1961-71, the number of cultivators declined by 16 per cent and the number of agricultural laborers rose by 75 per cent.

Nutrition being poor and protection deficient, every winter brings stories of deaths from cold in Bihar, which is among the poorest states in a poor country. On 31 December 1977, when the temperature was still 20 degrees above freezing point, Bihar reported 21 such deaths. With the cold wave, the toll rose to 82 by 7 January. It is significant that deaths from cold



Precisely because of these policy measures, the real incomes received by the proletariat and the other weaker sections of society have been less than their respective contributions to the stream of the national product

are not reported from the Punjab, which is generally colder than Bihar.

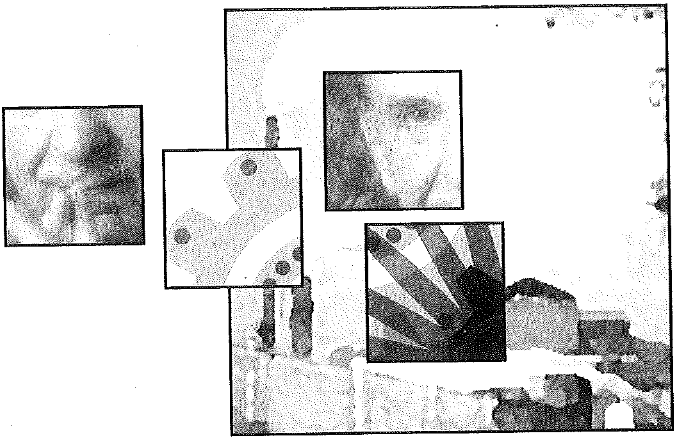
The lifestyles of the urban elite and the rural masses now belong to two different worlds, though in the countryside too there are floating particles of prosperity. This contrast in well-being explains the exodus of landless labor, mostly Harijans, to urban areas, and the problem of slums in the cities.

How has this disaster of development come about despite the severely socialist policy measures of the Congress? Briefly, the answer is that precisely because of these policy measures, the real incomes received by the proletariat and the other weaker sections of society have been less than their respective contributions to the stream of the national product. On the other hand, the income accruing to the upper crust of society, the profit-earning minority and the bribe-taking fraternity, have been larger than their respective contributions to this production stream. The incomes which the proletariat and others are deprived of fall into the pockets of the latter group which, consequently, has become more affluent than ever – perhaps even beyond its dreams.

IN A FREE ECONOMY, as a rule, there is no room for monopolies, whether in corruption, distribution, imports or exports; and the incomes of all individuals – whether as wages, interest, dividends, rent and/or profits – tend to correspond to their representative contributions to the national product. Windfalls being absent or rare, economic injustice would be absent or rare too. Moreover, as the economy grows, and as a consequence of this growth, national saving, investments and capital formation increase, income distribution will tend to move in the socially desirable direction. On the one hand, output per worker and hence wages will go up. On the other hand, interest, rent, and profits, the main incomes of the capitalist classes, will move downwards.

Income contrast between the masses (workers) and the capitalist classes would, therefore, tend to shrink as the economy progresses. We find this visibly manifest in the phenomenon that the rich and the poor consume the same brands in respect to the necessaries of life, notably food articles and conventional comforts. Both, not the rich alone, have their needs fully met.

The statistical counterpart of this lies in the uptrend of wages and salaries. In Japan, salaries rose continually from 41 per cent of GDP in 1960 to 51 per cent in 1974; in West Germany from 47 to 55 per cent; and in Belgium from 45 to 55 per cent. Similar uptrends hold true for a number of other free economies. By contrast, in socialist India, this percentage remained within a narrow range and was in 1974-75 lower (28) than in 1960-61 (30). Welfare measures failed to correct income contrasts.



agriculture

section E

28

Nation of farmers

15 DECEMBER 1974

Inaugurating the third national convention of the Farmer's Federation of India in Pathankot, the writer spoke about the importance of agriculture in the economy. This speech was also brought out in booklet form

We are a nation of farmers, like the US before World War II. About 70 per cent of the people of India draw their living from agriculture, and nearly 50 per cent of the national product constitutes agricultural output. America grew to be the greatest economic superpower of the world 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, the US simultaneously grew to be a political superpower.

We too can make the transition, perhaps faster than the US, as we constitute about one-fifth of mankind, but only if we first build a secure, sound and vigorous agricultural base, on which the whole economy rests. We cannot achieve internal and external economic viability if we neglect agriculture. This viability is linked not only to domestic political stability but also our international political stature. It is no exaggeration to say that the *Garibi hatao* (Remove poverty) program of the Congress has miserably failed 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 adds to output annually Rs 57-69 lakh in agriculture, Rs 36 lakh in textiles, and Rs 19 lakh in iron and steel. The inference is that Indian economic development would take place several times faster than has been the case if we reverse the order of priorities in our investment policies i.e. give higher preference to agriculture in place of a wholly uneconomic accent on industry.

It is not 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.

Agriculture would liquidate unemployment at a much faster pace than the same investment anywhere else in the economy. Indian national interests would be best served if we gave priority attention to 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 gave priority attention to agriculture.

And yet, since Independence, the accent has been excessively on development of industry, which has *ipso facto* involved stepmotherly treatment of agriculture. We appropriate over 65 per cent of the total investment resources for the public sector, though this sector accounts for but 3.5 to 6.3 per cent of the national product. The private sector, i.e., the rest of the economy, accounts for about 87 to 92 per cent. As the industrial part of the private sector gets preferential resource allocations, agriculture has somehow to manage with the leftovers.

This seems incredible. But we have been pursuing this strange investment policy for over two decades. Most of our major economic ailments have their roots in this mis-allocation of resources.

Obstacles to agricultural development

As foodgrain covers nearly three-fourths of the gross sown area, the reasons advanced for the general backwardness of Indian agriculture may explain also India's failure to achieve food self-sufficiency. The list of factors variously considered to be responsible for the backwardness of Indian agriculture is quite long. It includes:

a) Technological limitations or deficiencies in respect of seeds, fertilisers, soil culture, and management (including conservation measures to prevent soil erosion and preventives to water-logging), irrigation, weeding, crop rotation, and pest control
b) Shortage 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 communications
e) Inefficient or inadequate storage and marketing facilities
f) Unduly high interest rates on farm loans
g) Exploitation by middle-men and foodgrain traders
h) Wide price fluctuations, regional and seasonal
i) Fragmentation of land
j) Population pressure

k) The human factor, including illiteracy, fatalism, inertia, belief in sanctity of cattle, and other subjective attributes of Indian agricultural entrepreneurs (farmers and peasants) and farm laborers.

The argument is, briefly, that handicaps a) to k) have sapped the vitality of Indian agriculture and that, as a consequence, agricultural output, including foodgrain output, is still largely at the mercy of the vagaries of the weather, and the country is unable to achieve assured food self-sufficiency.

Till as late as 1965, some visiting experts from overseas were so overwhelmed by this array of basic handicaps confronting Indian agriculture that they saw little hope of lasting progress on the food front or in respect of the well-being of the agricultural population in general.

Pessimism, however, has waned with the remarkable leap forward of wheat production since 1967-68. This has considerably weakened the explanation for the backwardness of Indian agriculture and for India's failure to wipe out its food deficit. The output of wheat in 1971-72 (26.5 million tons) was about 2.3 times the output of 1966-67, the year immediately preceding the commencement of the green revolution. The national average per hectare yield of wheat rose continually with the progress of the wheat revolution. For the five-year period 1967-68 to 1971-72, the average yield was 12.4 quintals per hectare, as against the average of 8.3 quintals in the immediate pre-revolution half-decade 1962-67, i.e. a rise of 49.8 per cent

If the national average yield per hectare of wheat in 1971 (13.1 quintal) was still much lower than that of Canada (18.3 quintals), Mexico (26.8), or UK (44), this was largely because the progress of the new agricultural technology (the main plank of which is HYVP or High Yielding Varieties Program) had, by that year, extended over only 35.5 per cent of the total area under wheat. The pre-existing techniques could not make any large impact on the national average yield of wheat.

IN THOSE PARTS OF the country where the new technique – of which the HYVP is the crucial component – had been extensively in use, the average yield has increased phenomenally. In Ludhiana, in the fifth year of HYVP, as much as 95.9 per cent of the total wheat area in the district was covered by this program; and the per hectare yield was 32.8 quintals, higher than the average for Europe (28.5) during the same year. In 1965-66, the average yield of wheat in Ludhiana was 18.75 quintals per hectare. The HYVP pushed up the yield in the district by 75 per cent in five years.

The area covered by HYVP up to 1971-72 is over 11 times the total agricultural land in Belgium (1.6 million hectares), and just short of three times that in Japan (6.5 m ha). Of the total agricultural land elsewhere, it is well over one-half France's (33.2 m ha), nine-tenths Italy's (20.2 m ha), and more than nine-tenths UK's (19.4 m ha); and the population affected by the program is more than twice Japan's agricultural population (21.3 million), nearly five times Italy's (9.74 m), nearly seven times France's (7.3 m), 104 times Belgium's (0.47 m), and about 32 times UK's (1.54 m).

Thus, the new agricultural technology is no longer at an experimental stage. It has covered an impressively large area in the aggregate. It is in operation in all parts of the country and among all language groups. It is applicable to all major cereals – rice, wheat, *jwar, bajra,* and maize – which, as of 1971-72, accounted for 93.3 per cent of the total cereal production. And the food imports of the country have been mainly wheat, partly rice, and, in negligible measure, *jwar* and maize. Nevertheless, we continue to be confronted by the strange and inexplicable fact that the spread of HYVP remains tantalisingly short of the marginal increase needed to cover India's food deficit.

It is not as if farmers and peasants operating HYVP are hand-picked for special gifts of dynamism, enterprise, and freedom from belief in superstitions, and that those left out of the Program are victims of beliefs that keep their farms in economic stagnation

A close look at handicaps (a) to (k), which hinder Indian agricultural progress, may help to explain this puzzle. These handicaps may be divided into two broad categories: (A) human and traditional factors (j) and (k), and (B) material and institutional factors (a) to (i). Both categories are of general applicability to the Indian agricultural economy as a whole. Neither of them is regional or communal in its operation, nor restricted to any particular crop or crops.

The farmers and peasants involved in implementing HYVP with remarkable success are no different from the farmers and peasants who happen to be at present outside the pale of the program. It is not as if farmers and peasants operating HYVP are handpicked for special gifts of dynamism, enterprise, and – what is indeed no less important if we are to accept the wisdom and acumen of visiting experts and specialists – freedom from belief in superstitions, and that those left out of the Program are victims of fatalism or beliefs that keep them and their farms in economic stagnation.

The backwardness of Indian agriculture cannot reasonably be attributed to the subjective qualities of the Indian farming community, any more than the church-going habits of farmers in the wheat belt of the USA or the belief in Shintoism of farmers in Japan can be advanced as explanation for the high average yields of foodgrain in these two countries. It is not the religious faith and superstitious beliefs of the Indian peasants and farmers and of the Indian people which affect agricultural production.

Clearly, Indian farmers and peasants are no less interested in raising two blades of cereals where only one grew before – thereby increasing their incomes – 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 more 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 HYVP to grow out of the supposed influence of their traditional beliefs and subjective qualities which are, according to visiting experts, 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, Thanjavur farmers were not behind Ludhiana farmers in plumping for high-yielding varieties of seeds. They did this in double-quick time. There was a mass conversion of land under rice in Thanjavur from one crop to two crops, at lightning speed; with the coming of the HYVP rice strain ADT 27, the double-cropped area rose from one-fourth to three-fourths of the total area of 1.2 million acres under rice in the district.

29

Capital starvation of agriculture

24 FEBRUARY 1977

In this, one of many articles on India's food problems, the writer points out that moves to protect farmers from usury had only resulted in breaking the links between national money markets and markets for farm credit. In fact, commercial bank deposits from the rural sector tended to far exceed advances to agriculture

Material and institutional factors have been responsible for insufficient flow of capital into agriculture. The adoption of the new agricultural technology calls for much more capital. High interest rates on farm loans, which reflect insufficient flow of credit, prevent an extensive use of new technology. Poor transport and communication and poor marketing and storage facilities, which cause undue regional and seasonal price variations and unduly depress returns from agriculture, represent insufficient overhead capital investment in agriculture.

Legislation (much of which came in the 1950s) narrowly limiting the activities of moneylenders and restricting the transfer of land, though intended to 'protect' the farmer against usury and dispossession of land, his main source of livelihood, has added to the risks of – and returns from – the business of moneylending. The elite among the professional moneylenders, as a result, migrated with their funds to other trades. In the past, they were the main link between the national money markets and the markets for farm credits. This migration has reduced the flow of national savings into farm finance.

In 1951-52, professional moneylenders accounted for about 45 per cent of farm credit. In 1961-62, their share fell to about 13 per cent. The business vacated by elite moneylenders was taken up mainly by cooperatives, agriculturist moneylenders, traders and commission agents. The shift from professional moneylenders to cooperatives was an improvement, but the shift to agriculturist moneylenders and to traders and commission agents was not. Agriculturist moneylenders stepped in because the exit of professional moneylenders drove up interest rates and thereby rendered the business of farm finance attractive enough to them. They are not in the direct line of access to the national money markets and are not a channel for the flow of funds into the rural sector from these markets.

WITH THE EXIT OF PROFESSIONAL moneylenders, agriculturist moneylenders became the most important suppliers of farm finance, their share rising to 36 per cent of the total farm credit in 1961-62. Cooperatives came next with 15.5 per cent of the total.

The change to traders and commission agents could be, possibly, worse than the change to agriculturist moneylenders. The credit granted by traders and commission agents includes, first, advances against sales contracts of crops, a system known as *dadan* in some parts of the country; and, second, purchases of supplies and consumer needs on credit. Though both types of credit are, technically, free of interest, the prices charged for supplies and the prices paid for the crops include ample margins on account of interest; and the effective interest rates may be higher than those charged by professional moneylenders.

Loans classified as interest-free loans possibly belong to these two categories of loans. Interest-free loans amounted to 25 per cent of the total farm credit in 1961-62 and loans from traders and commission agents 22.7 per cent.

Simultaneous with these unhelpful developments, the Government of India appropriated, under the policy of centralised planning, 60 to 65 per cent of the total investment resources i.e. domestic savings, foreign aid, and currency reserves for the benefit of public sector projects and undertakings.

> Agriculturist moneylenders stepped in because the exit of professional moneylenders drove up interest rates and thereby rendered the business of farm finance attractive enough to them

The contribution of public sector undertakings – excluding the cost of government administration – to the Indian national product varied from 3.5 to 6.3 per cent, and the contribution of the private sector 87 to 92 per cent. The explanation of official apologists for the disproportionately heavy investments in the public sector does not bear scrutiny. They tell the story of large-scale wastage of resources in corrupt payments, idle production capacities and inefficient production.

This phenomenon produced two damaging consequences. First, from the private sector's share of 35-40 per cent of the total investment resources, the industrial and tertiary parts of this sector received weighted allocations. Agriculture suffered the most. Second, resource wastages impinged adversely on NDP and hence on income, employment, and saving.

Legislative hurdles to the flow of credit and capital into the farm sector have led to capital starvation of agriculture. Neglect of agriculture and uncertain overall economic growth are inevitable under the prevailing conjuncture of policy measures and resource allocations

During the three years ending 1968-69, 35 to 55 per cent of the plant and equipment of 20 central government undertakings remained idle. This part of investment made no contribution to the national product; the provision for depreciation and obsolescence on this account was drawn from the net savings of the rest of the economy, with a corresponding debit on current national savings.

The working of the plant and equipment that remained in use showed overall net losses, so that this investment, too, made no contribution to net national savings. The losses were covered from the savings of the rest of the economy, thereby reducing national savings by an equal amount.

Unduly heavy resource drafts into the public sector, the weighted emphasis on industrialisation, and legislative hurdles to the flow of credit and capital into the farm sector have led to capital starvation of agriculture. Neglect of agriculture and uncertain overall economic growth are inevitable under the prevailing conjuncture of policy measures and resource allocations.

We have evidence of the capital starvation of agriculture in the two surveys conducted by the Reserve Bank of India, one in 1951-52 and the second in 1961-62. In the intervening decade, capital formation in the farm sector failed to keep pace with the expansion of agricultural population, which went up by 21 per cent. Non-farm business, on the other hand, made noticeable progress.

Available evidence shows that, since 1961-62, the date of the second survey, capital starvation of agriculture has continued, though this may not apply to certain crops, notably wheat and to certain districts, notably, in Punjab and Tamil Nadu.

First, interest rates in the market for *hundis* and bazaar bills, the instruments which channelise credit from the national money markets into the farm sector, have risen noticeably since 1960-61. The State Bank of India *hundi* rate, which was 4.5-5 per cent in the 1950s, rose continually in the 1960s, moving to a peak of 10.5 per cent in 1971-72, where it has remained since. The gradient of the rise in the bazaar bill rate was even higher. It rose from about 9 per cent in the 1950s to 15 per cent in the 1960s in Bombay and Calcutta, and to a peak of 24 per cent in Madras in 1971-72.

Second, though commercial bank advances to agriculture – which were less than 1 per cent of the total in the 1950s – rose steeply from Rs 45 crore in June 1968 to Rs 439 crore in June 1972, commercial bank deposits from the rural sector far exceeded their agricultural advances; so that they have been, on balance, instrumental in draining away funds from the rural sector for financing urban activity, and adding to overall rural credit scarcity.

Third, the increase in cooperative credit, from Rs 240 crore in 1961-62 to Rs 578 crore in 1970-71, must be adjusted, first, for the migration of the elite among professional moneylenders; second, for the net drain of funds from the rural sector by commercial banks; third, for the re-issue of institutional credit by its first borrowers to other cultivators and the consequent double counting of farm credit; and finally, for the diversion of credit and capital into current consumption through corrupt practices and for their going astray through bad and doubtful debts. With these adjustments, the balance of the institutional credit to the farm loans market may not be considerable.

Fourth, agriculturist moneylenders, whose share of total farm finance has increased noticeably, do not bring any appreciable net amounts of credit into the rural sector, as they are not in the main line of contact with the national money markets. Their resources comprise mainly profits from agriculture and loans they raise from institutional credit agencies.

Finally, we have perhaps the most conclusive evidence of the capital starvation of agriculture in the 1960s and later in the statistics of per capita agricultural production. During the decade ending 1961, the annual average increase in per capita output of the rural population was 1.7 per cent. During the subsequent period 1961-72, this rate of increase dwindled to 0.34 per cent. Since, ordinarily, output varies directly with resource inputs, these data suggest that, viewing agricultural activity as a whole, per capita agricultural inputs fell sharply in the second period as compared with the first. This contrast in inputs is greater in respect to all crop groups other than wheat.

This is the crux of the problem. If this misallocation of resources is not rectified, there is little hope of our being able to wipe out the food deficit and to achieve substantial progress for the well-being of the rural masses

In the case of wheat, the inputs in the second period were larger than in the first. The increase in inputs in wheat, against a backdrop of capital starvation of agriculture, reflects the high profitability of HYV, which reduced the cost of production sufficiently to render it worthwhile to raise credit at the current interest rates for investment in wheat cultivation.

With the pampering of the public sector and industry, agriculture has been getting less than its due share of credit and capital. This is the crux of the problem. If this misallocation of resources is not rectified, there is little hope of our being able to wipe out the food deficit and to achieve substantial progress for the well-being of the rural masses. The needs of the situation cannot be met by an amendment, but call for a basic transformation of the prevailing policy structure.

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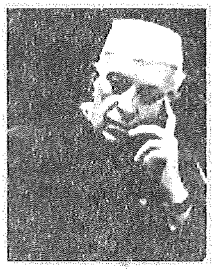
Chaos on the food front

DECEMBER 1974

Holding forth on what he calls the folly of the political goal of food self-sufficiency, the writer says that there is nothing wrong with importing foodgrain whenever necessary. But thanks to Jawaharlal Nehru's emotive appeal, planners had pursued this elusive goal without achieving any spectacular success

The *Washington Post* carries a story that the Government of India had warned newspaper editors in India not to give front-page prominence to starvation reports and photographs. Latterly, we read less of these reports in the Indian press. Recently, the issue figured in both Houses of Parliament. A Lok Sabha member invited attention to the famine-like conditions in Assam, Bihar, Orissa and West Bengal and alleged that starvation deaths in these states, during the current lean season, were of the order of 25,000. Though this figure was promptly denied by the food minister, the prevalence of misery and distress was admitted. The minister announced that the government was doing its best to relieve the distress and the misery. The BBC has been putting out reports that Cooch Bihar and certain other parts of West Bengal are in the grip of a 1943-like famine.



Jawaharlal Nehru

Sensitive to the absurdity of a nation of farmers living on imported food, prime minister Jawaharlal Nehru had exhorted the country in 1948 to strive for food self-sufficiency by 1951. Nothing positive ensued from it. On the contrary, we had to borrow $ 190 million from the US to import 2 million tons of wheat in 1951, the target year, to tide over a crisis. Two decades after this infructuous exhortation, prime minister Indira Gandhi announced to a mammoth audience on 30 January 1967 that the government had adopted, earlier in the month, a crash program for food self-sufficiency by 1971.

Though crash programs in India have a habit of crashing before take-off, this announcement seemed different. The output of wheat galloped at over 30 per cent annually; and of foodgrain at 10 per cent, to a peak of 108.4 million tons in 1971. Simultaneously, government stocks piled up to a record 8.14 million tons; and, for the first time in two decades, domestic output exceeded market needs in 1971, though only nominally.

Because of the acute shortage of foreign exchange and the unfortunate termination of food aid, we have not been able to import the quantities required. The deficit of the year has been left uncovered in a much larger measure than in 1973

The basic weakness of the food situation, however, surfaced in a matter of months. Food production declined, and export of 909,000 tons food to Bangladesh, drove up our food deficit. No other way being now open, this deficit was covered by drawing down reserves, which as a result fell during the year by 4.7 million tons. Seeing these reserves disappear rapidly, the administration apprehended, to quote to Annual Report for 1972-73 of the Union Department of Food, the 'possibility of breakdown of the public distribution system'. To avert this bizarre predicament, so soon after the announcement of self-sufficiency, the decision to stop commercial imports was abandoned and orders were placed for two million tons of foodgrains 'to replenish the buffer stock'.

IN 1973, PRODUCTION slumped by another 8 million tons. This meant a heavier deficit, when the capacity to cover it was vastly less than in 1972. The government was caught in a cleft stick. Unable to meet the deficit, it took the drastic step or reducing the deficit by reducing rations, by 36 per cent in Bombay, by 26 per cent in Calcutta and by varying percentages in other areas. This kept the deficit down to 4.08 million tons, as against a deficit of 5.12 m t in 1972. It was met, mainly, by commercial imports (3.6 m t) and partly by drafts on reserves (480,000 tons).

The recovery in food production during 1974 has been less than adequate and imports have fallen far short of needs. It has been estimated that, to avoid distress, the import needs of the current year are of an order of 6-8 million tons. Because of the acute shortage of foreign exchange and the unfortunate termination of food aid, we have not been able to import the quantities required; and reserves being already low, the deficit of the year has been left uncovered in a much larger measure than in 1973.

This is the story which price trends convey. The reported statement of the food minister in the Rajya Sabha, on 26 November 1974 that, "Government would maintain the public distribution system through stepped up internal procurement and purchase of grains anywhere," seems to be little more than wishful thinking.

Evidence of uncovered food deficit is in the press reports of the frequently empty ration shops – except in the politically articulate urban sectors – people supplementing rations by roots and rats, the spread of 'lathyrism' from a prolonged consumption of *kesari dal* in place of normal food in UP and MP; rural folk fleeing to towns for food and employment; subsidised *chapati* and *dal* camps, run by Chambers of Commerce, where even office clerks join the queue; official gruel kitchens or 'dry doles' of wheat (which are 'just enough for three or four meals' in a fortnight); acute scarcity, reminiscent of the 1943 famine, in Cooch Bihar, Alipur Duar and elsewhere in Bengal; famine-like conditions in Assam, Bihar, Gujarat, Maharashtra, Orissa and Rajasthan; and the unconscionably high prices of foodgrain in the deficit states.

Some developments misled the government into thinking that we have achieved the takeoff stage – the stage of self-reliance – in respect of food. So convinced were we of this that we stopped, in January 1972, all PL 480 and other concessional imports; surrendered to the US Government the balance of 438,000 tons of PL 480 foodgrain to which we were entitled; decided to forego even commercial imports; and permitted the export of 14,300 tons of *basmati* rice.

But none of the developments which had led to this fateful decision to forego concessional imports were any indication of a fundamental improvement in the food economy of the country. First, virtually all government stocks represented imports, not domestic production. The government had only piled up American wheat. These stocks were no more than a case of PL 480 foodgrain being transferred from US elevators to the Indian officials godowns, which is no evidence of an improvement in India's food economy.

Second, the acceleration of the output was highly vulnerable, as it rested on the breakthrough in but one crop, wheat – the minor of the two major cereals – and on an unusual (and hence undependable) succession of favorable weather conditions. The increase in the production of wheat, moreover, was made possible not by any net increase in agricultural investments but by a shift of capital from other crops into wheat.

31

Unshackling agricultural prices

9 MAY 1977

In this article which appeared under the title 'Agricultural Price Commission's Fallacy,' Shenoy demolishes the theory that a rise in foodgrain prices, through an upthrust on wages, would inflame price inflation. Instead, what we have is a simple case of money shifts, from the pockets of peasants via the distribution system into the pockets of the urban population

Under the new wheat price policy announced on 12 April 1977, farmers will receive open market prices for wheat. Wheat zones stand abolished, there will be no levies on farmers and traders, and hence no procurement prices. The announced price of Rs 110 per quintal is a floor price, to be effective when the market does not offer a better deal. This is the most welcome departure from penalty procurement prices which, by inhibiting the expansion of production, had contributed to our continued dependence on food imports.

The almost universal objection to farmers being offered a better price than Rs 105 per quintal – the price recommended for the fourth year in succession by the Agricultural Prices Commission (APC) – was that, through an upthrust on wages, and hence on prices in general, this may aggravate price inflation.

This theory should gain force under the new price policy, as wheat might fetch, in the open market, vastly higher prices than Rs 105 when the zones are abolished. But the theory is a fallacy and does not bear careful scrutiny. Currently, wheat accounts for but 3.4 per cent of the wholesale trade of the country, wheat and rice 8.5 per cent, and all cereals 10.7 per cent. A rise in the prices of wheat and rice, or even of all cereals put together, may not drive up the General Price Index (GPI), an indicator and measure of inflation.

A rise in this index would depend on what happens to the price of the commodities which account for the remaining 89.3 per cent or more of the wholesale trade. Apparently, the APC and its cohorts have not paused to see, before making a dangerous generalisation, that there is no logical or empirical evidence whatsoever to suggest that the prices of these other commodities are, in any way, linked with the prices of wheat, rice or other foodgrain. Apart from commodities whose production is interlinked, like cotton and cotton cloth, individual price movements are generally determined by their respective causal factors. It is not as if foodgrain prices drive all other prices up. Inflation is not generated by individual price change, whether arbitrary or functional.

So accustomed have we become to foodgrain procurement prices that we may be taken aback when reminded that free market prices for foodgrain and other agricultural products are, so to speak, a birthright of peasants and farmers

Inflation is severely a monetary phenomenon. It is an act of the state, not of foodgrain farmers or of the people in general. An expansion of money results when aggregate government expenditure exceeds its aggregate receipts, both on revenue and capital accounts, and the ensuing budget deficit is covered by resorting to the printing press or, which is the same thing, by borrowing from the Reserve Bank of India. This expansion of money becomes inflationary when it pushes up money supply per physical unit of the national product. As this process continues, commodity prices in general and, hence, the GPI, keep moving up. Thus, money supply per physical unit of the national product multiplied 3.10 times, from Rs 1,865 in 1954-55, the zero year for the current phase of inflation, to Rs 5,777 in 1975-76; and the GPI multiplied 3.86 times. It will be noted that procurement prices of foodgrain have no place whatever in this mechanics of inflation.

SO ACCUSTOMED HAVE WE become to foodgrain procurement prices that we may be taken aback when reminded that free market prices of foodgrain and other agricultural products are, so to speak, a birthright of peasants and farmers, even as wages equivalent to the net market worth of their output are a birthright of workers; and that procurement prices, therefore, involve confiscation of part of the most legitimate earnings of the peasants and farmers producing foodgrain. The social accounting of the phenomenon of procurement prices and the subsidised distribution of foodgrain is broadly that we supplement these confiscated amounts from the Union and state budgets and utilise the total sum to issue rations to urban people at low market prices.

The subsidy to the Food Corporation of India on account of stocks issued during 1976-77 is estimated at Rs 175 crore. The subsidy extorted from peasants and farmers is unclear as, the national market being cut up into zones, the zonal prices (which alone are available) are artificially low. Even these prices, however, suggest that the subsidy from the producers may be larger than the Union budget subsidy.

From the standpoint of monetary effects, we have here a simple case of money shifts, from the pockets of peasants and farmers via the distribution system, into the pockets of the urban population. This process of money shift leaves unchanged the overall money flows, and hence can have no inflation control effect. Overall money flows, on which inflation depends, originate with the printing press finance of budgetary disbursements. The money flows and inflation can be controlled only by a restraint on these disbursements. The APC process of income shifts, from food producers to the recipients of rations, has nothing to do with the inflation process. No price action that APC recommends can either cause or control inflation.

Empirical evidence confirms this analysis. The coming of procurement prices from the crop year 1964-65 did not arrest a rise in money flows per physical unit of the national product, and consequent rise in the GPI. Since then, to the close of 1975-76, money supply per physical unit of the national product rose 2.2 times and GPI 2.3 times. The inflationary price rise was unaffected, too, by the procurement price of wheat remaining unchanged at Rs 105 per quintal, and that for paddy at Rs 75 per quintal from crop year 1973-74. The GPI moved up, in response to continuing deficit financing, from 283.6, as at the close of 1973-74, to 326 (1961-62=100), on 26th March 1977, in total defense of the APC theory of inflation.

We have here a simple case of money shifts, from the pockets of peasants and farmers via the distribution system, into the pockets of the urban population. This leaves unchanged the overall money flows, and hence can have no inflation control effect

If we must control the prices of wheat and other foodgrain, the right way of doing so is to control inflation, to expand domestic production and to import sufficient quantities from abroad. The validity of this approach is supported by the fact that breaks in the continued uptrend of foodgrain prices occurred in 1970-71 and 1975-76, when domestic production alone exceeded market needs. There is every danger of production trailing behind needs and of prices shooting up when procurement prices are below market price.

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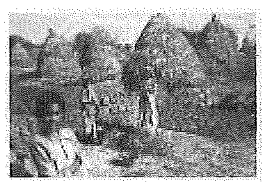
Production potential of foodgrain

1972

Here the writer presents evidence of scope for a dramatic expansion of food production in India, to the extent that exports are possible. A more extensive scientific management of the soil and the use of manure, fertiliser, and water should enable export of foodgrain in place of imports

Agriculture, the largest single sector of the Indian economy, accounts for about half of the Indian national product. At the same time, the national average per hectare production of food-grain in India compares very poorly with the average in the agriculturally advanced countries. In respect of both wheat and paddy, we find the world average yield has remained, throughout the post-war period, well above the Indian national average. In 1971, the latest year for which comprehensive data is available, India accounted for 8.5 per cent of the world total area under wheat, but the total output of wheat in India represented but 6.9 per cent of world output during the year. This reflects the low Indian yield, 13.1 quintals per hectare, which was 82.9 per cent of the world average or 15.8 quintals per hectare.



In respect of paddy, India accounted for 27.7 per cent of the world total area under rice in 1971, but the total output of paddy in India represented only 20.9 per cent of the total world output in that year. This reflects the fact that the Indian average yield of paddy during the year (17.2 quintals per hectare) was 75.4 per cent of the world average (22.8 quintals per hectare).

The contrast between the Indian yields and those of certain individual countries is enormous, as is evident from global data on the yields of wheat, and paddy (rice) respectively. We find that apart from Sarawak in Malaysia, the Indian paddy yield (11.1 quintals per hectare) was the lowest in the world during the half-decade ending 1952. Since then, though the Indian yield has risen faster than in many underdeveloped countries, the contrast between the Indian yield and the yields in the agriculturally developed countries continued. The Australian average yields are easily the world's highest: the all-time peak, reached in 1969, was 75.9 quintals per hectare, i.e. 4.7 times the Indian yield (16.1 quintals) during the same year.

Though the Indian yield was higher than the average for South America, the yield of most individual countries in South America was vastly higher than that of India. In Asia, the Indian yield in 1971 was higher than that of Afghanistan and the Syrian Arab Republic

In 1971, the average (paddy) yield in North and Central America (37.3 quintals) was 2.2 times India's yield. The Indian yield was also lower than the average for Asia (19.8 quintals) and for Africa (20 quintals). The Indian yield in 1971 was higher only than the average for South America (16.3 quintals). Among individual countries, India's yield in 1971 was lower than that of all countries in Europe and in North and Central America. Though the Indian yield was higher than the average for South America, the yield of most individual countries in South America was vastly higher than that of India.

The South American average is low mainly because of the low yield of Brazil (14 quintals). Excluding Brazil, the South American yield in 1971 was 27.7 quintals, or 1.6 times the Indian yield. In Asia, the Indian yield in 1971 was higher than that of Afghanistan (15 quintals), and the Syrian Arab Republic (12.9 quintals).

THE POSITION IN RESPECT of wheat is more favorable than that of rice. During 1948-52, India's wheat yield (6.6 quintals per hectare) was the lowest in the world, except for Algeria (6.2 quintals). Since then, the wheat yield, rising faster than the paddy yield, nearly doubled to 13.1 quintals in 1971. India had by now forged ahead of the average for Asia (11.7 quintals), Africa (10.1 quintals), and Oceania (12.1 quintals), and had come abreast of the average yield in South America (13.1 quintals). Meanwhile, agricultural development had further advanced in Europe and North and Central America, so that their yields continued to contrast with India's yield. But the gap in yields was less than in the early post-war period.

In 1971, the wheat yield in UK (44 quintals) was 3.4 times India's yield. During the five-year period ending 1952, UK's yield (27.2 quintals) was 4.1 times that of India. In 1971, the average yields for Europe (28.5 quintals) and for North and Central America (21.6 quintals) were 2.2 times and 1.6 times respectively the Indian yield. As comparative poverty of agricultural technology is among the major factors responsible for the low yields in India, these yield contrasts indicate the prevalence of ample scope for stepping up food production in India.

Third, there is a vast gap between the immediately available agricultural knowhow and that actually in use on Indian farms. This is evident from the contrasts in yields realized from different farm units in the same agricultural tract – the result of a corresponding gap in the knowhow actually in use in different farm units. As we shall presently see, in districts that are highly advanced agriculturally and where the knowhow gap is not considerable, the district average yields may exceed the average for Europe and for North America. This applies mainly in respect of wheat.

No one doubts that the Indian yields are capable of being easily and substantially stepped up in proportion as we bridge the knowhow gap. Given the timely availability of capital and other inputs at controlled rates, profits from extended production – the marginal output input ratios – may be more than competitively attractive. They may even bring windfalls. The results on government demonstration farms, the yield achievements of prize-winning farmers in all-India competitions and the yields realised by progressive farmers are constant reminders of the impressive possibilities, in respect of both output and returns and improved techniques of foodgrain farming.

In the cases of both paddy and wheat, the highest yields on demonstration farms and in all-India crop competitions have been several times the national average yield. This is sufficient evidence of the scope for a dramatic expansion of food production in India. What applies to wheat and paddy applies also to other cereals, pulses, and other food crops; and a realisation of even a fraction of this potential may easily usher in an era of food self-sufficiency.

Even simple innovations are known to bring ample returns. A survey in Mysore, conducted a decade ago, showed that better quality seeds alone added 7-15 per cent to the output of rice; transplanting, in place of broadcasting, 20-50 per cent; rotating paddy with gram, 15.5 per cent; and pest and disease control 10 per cent. Improved ploughing, more fertiliser, and better irrigation – for all of which there is considerable scope – could raise the yields still higher. In all cases ampler returns should begin to appear in the first crop year. Subsequent studies of a similar kind have repeatedly restated the same story – abundant scope for stepping up yields.

No one doubts that the Indian yields are capable of being easily and substantially stepped up in proportion as we bridge the knowhow gap. They may even bring windfalls

State-wise data on yields from irrigated and unirrigated land, collected by the National Sample Survey Organisation (NSSO) and made available in print for the first time recently, show the remarkable difference in output from wet cultivation as against dry cultivation. This difference, however, cannot be attributed to irrigation alone, as other inputs necessarily change in quantum and quality when wet cultivation is adopted in place of dry cultivation.

The difference in yield is the outcome of a complex of inputs, not merely irrigation. In the case of wheat (in 1968-69), the yield from irrigated land was higher than that from unirrigated land by a minimum of 22 per cent (Bihar) to a maximum of 121.6 per cent (Delhi). In the subsequent year

(1969-70), this increase varied from a low of 20.4 per cent (Himachal Pradesh) to a peak of 101.9 per cent (Mysore).

In the case of paddy, the larger increase from irrigated cultivation in 1968-69 (taking autumn figures where applicable), ranged from a low of 40.4 per cent (Kerala) to a high of 307.3 per cent (Jammu & Kashmir). In the following year (1969-70), the corresponding range was a low of 2.4 per cent (Kerala, autumn rice) and a high of 126.8 per cent (Bihar).

An increase of 6 per cent in production – which should present little or no agronomic, social, administrative, or technological problems – should bring 5.33 million tons of cereals on the basis of the average annual production of cereals during the five years ending 1971-72 (88.9 mt). This should yield a more than 6 per cent increase in production and altogether cancel the market deficit in food supply. A more extensive scientific management of the soil and the use of manure, fertiliser and water should enable export of foodgrain in place of imports.

33

Monopoly procurement of rice

6 JANUARY 1968

The writer was a strong opponent of the practice of building up buffer stocks by imposing a financial burden on rice farmers, some of whom are the poorest in the world. Moreover, he held, these stocks cannot mitigate or remove the shortages that plague this sector

Among the virtual certainties of the current economic situation in India would seem to be that, if the prevailing economic policies continue, the depressing trend in capital formation, employment opportunities, production, national income and well-being may deteriorate further. If corrective steps are not taken soon enough, the aggravating social and political instabilities might involve serious risks of even a demise of democracy and the corrective steps, which the situation calls for, must necessary include basic policy changes. Policies of drift and of ad-hoc tinkering with symptoms must be abandoned

Our food policies measures provide a good illustration of the inept manner in which we have been tackling vital problems of national concern. Our prescription for the rise in foodgrain prices is monopoly procurement of foodgrain and their rationing at prices well below market price. As we shall see, these measures have basically worsened the food situation.

Monopoly procurement of rice was introduced in 1965-66. The case for this measure briefly is that in the absence of this monopoly the farmer may not surrender his surplus of rice at controlled prices to the government and price control operations to combat scarcities are not possible without stocks. Experience has shown, so the argument runs, that the grower prefers to dispose of the surpluses in the free market at the vastly higher prices which rule in it. Stocks were cornered by farmers and traders who conspired to dodge the procurement efforts of the government. And this hoarding drove price still higher. The only way out of this difficult situation, it was maintained, was to put an end to free trade in rice and to compel farmers to surrender their output to the government or its nominees.

Now, rising prices of rice are the result of relative shortage of output and supplies, and of inflation – whether procurement is competitive or monopoly. And output may not accelerate as long as price control measures continue. Price control would retard rice production through the income penalty which it inflicts on rice growers; it would induce them to shift land, resources and efforts to other lines of production, to the detriment of the output of rice.

MONOPOLY PROCUREMENT, WHICH would be at controlled price, is apt to enforce the price penalty on farmers with ruthless efficiency, much more so than under competitive procurement. Monopoly procurement, therefore might decelerate output and thereby add to the upward price pressures.

Nor is compulsory procurement a remedy to hoarding. Hoarding is a direct and automatic outcome of rising price. Ruthless measures against traders and farmers can only drive stock underground and increase the black market cost of distribution and, therefore, of the price charged to the consumers, who do not get rationed rice. It is not farmers and traders alone who resort to hoarding in times of continuous rise in price, millions of prudent householders do the same, and hoarding by the latter may be enormous, in the aggregate. Even if hoarding by one category of hoarders is restrained or remedied, the phenomenon of hoarding will continue, so long as the general expectation of price rise remained.

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Any building up of stocks by government can have little price control effect in a background of scarcities and continuing inflation. Government stocks may only replace the stocks of traders, farmers or the well-to-do amongst householders. These stocks cannot mitigate or remove the shortages. To quote an analogy made famous by Rajaji, sales from buffer stock, acquired from domestic production, are like blood transfusion from one arm of the patient to another. The quantum of blood in the body cannot increase by such transfusion, and the condition of the patient cannot improve. Even so, the buffer stocks of the states built by domestic procurement do not add to aggregate food supplies and cannot therefore restrain rising prices. The intervention of the state because of its bottomless purse may in fact aggravate market shortages.

Rather than resort to these demonstrably doubtful devices of price control, it is time that we resorted to measures designed to increase output continually. In the name of price control we have been hindering accelerated production, thereby undermining the food position basically, and have not achieved any price control either.

Worse still, our policies of price control and monopoly procurement have inflicted gross injustice on rice farmers. A ban on the movement of rice

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outside the producing districts or states, except under license, has unduly depressed the price of rice in the producing areas. In March 1967, the average retail price of rice in Orissa was Rs 88 per quintal and in Andhra about Rs 104. In the neighboring state of West Bengal the average price was about Rs 121 per quintal, a difference of more than 30 per cent over the Andhra price. Rice farmers, however, received the procurement price only, which contrasted with the retail price.

In 1966-67, the Orissa government exported 75,000 tons of rice to the central pool at Rs 760 per ton, the export price in Orissa. The farmers got for this rice Rs 4.37 crore at Rs 300 per ton, the procurement price of rice in Orissa. If this rice had been disposed of at the average price ruling in West Bengal during the year, namely, at Rs 1,210 per ton, Orissa farmers would have received for this rice Rs 9.07 crore, less traders' commission, of their well-merited income during the year from this transaction alone.

Rice growers in Andhra suffer similar income penalties, though on a lesser scale. It is not a welcome thought that these income penalties are inflicted on rice farmers through the instrumentality of their own state governments, under pressure from the Centre. The counterpart of these income penalties are the income subsidies which accrue to the consumers of rice; and the windfall profits which accrue to the black market dealers.

Under compulsory procurement, the rice farmer is confronted with the official procurement agent, a much more powerful individual – because he is a government-nominated monopolist – than black market dealers. Competition among the latter might afford him some protection against the low prices of rice ensuing from the ban of open exports of rice. Under monopoly procurement, he has to deal with one sole buyer.

Though procurement prices are fixed, there are quality variations of rice within the fixed grades, and differences may arise between the buyer and seller on the legitimate prices payable for the rice concerned. Rendered helpless because he cannot go to an alternative purchaser with ease and freedom, the farmer may have no choice but to accept the price rating of his rice by the monopolist; especially so when he faces pressures for funds, both to meet deferred wants and to repay his creditors.

How can a monopolist be prevented from a price assessment of the paddy placed before him, a shade in his own favor than in favor of the seller, when there is no competing buyer to whom the seller may readily turn? This applies with great force in remote parts where the number of monopoly procurement agents must be restricted, and farmers may not have the means to transport their produce to bigger *mandis* where the number of agents is larger.

When a monopolist purchaser armed with the implied authority of the state confronts peasant farmers, each closeted separately with him for the sale of his paddy, it is naïve to expect that the farmer may get a fair or humane deal. Administrators assure us that compulsory procurement does not compel the farmer to sell his produce, if he should decide to retain it; and that any sales he may engage in would be 'on a voluntary contract basis'.

This may be so, in point of law. But the reality of the farmer's position is that he is more generally without adequate finance to hold his stocks, and also illiterate. Such a set-up involves great risks of a bilaterally 'agreed' body of prices, as between the farmer and the monopoly procurement agent, which may be lower than the officially fixed prices, and which the outside world may never know. There is no device to prevent such bilateral pricing to the detriment of rice farmers, though it may be true that procurement prices are given wide publicity.

But the reality of the farmer's position is that he is more generally without adequate finance to hold his stocks, and also illiterate. Such a set-up involves great risks of a bilaterally 'agreed' body of prices

IT IS A POOR DEFENSE of this arrangement to argue, as administrators generally do, that in the larger market centres several monopoly agents have been appointed. Some of these centres are too large for the operations in them to be handled by one or a severely restricted number of these dealers. Plurality of monopoly agents is a result of the compulsion of the situation, not necessarily of any consideration to sellers.The number of monopoly agents, however, is much smaller than the normal number of rice dealers before the coming of monopoly procurement.

If not a monopoly, the state may be, therefore, installing an oligopoly. To the extent that the monopoly agents may combine and have an agreed purchase policy, the farmers may not get the full amount of even procurement prices. The position may be worse in the remote areas. In all cases, the farmer is denied his fundamental right to sell his produce for the best price which the market may voluntarily offer. Instead of being rewarded, he is left to think that he is perhaps a social criminal, because he has had the misfortune of producing rice; he would gain freedom if he could grow, instead, jute or tobacco. Indeed, every honest rice farmer may look for alternative crops.

The answer to the problems of feeding the central pool with rice, and of the state building up stocks of its own is, appropriately, open market purchases at competitive prices. The need for such stocks arises from the responsibilities assumed by the state governments and by the Centre; and the cost of this responsibility should fall on state budgets and the Central budget. This cost cannot, with equity and justice, be passed on to rice growers, partly or wholly. It is beside the point whether rice growers are rich or poor. What is much more relevant is that the financial burden of building up buffer stocks cannot justifiably be foisted on rice farmers, most of whom, especially in Orissa, are among the poorest people in India and, therefore, in the world.

Continuation of these policies would defer the expansion of domestic production of foodgrain; and we may be condemned indefinitely to PL 480 food supplies on a massive scale. This is politically undesirable; and seems economically odd, as foodgrain accounts for about 70 per cent of India's agricultural production. About one-half of our labor force is engaged in food production, and the yield of food per acre is about the lowest in the world, being higher than only some African communities.

34

Discrimination against wheat farmers

1974

The writer fulminates against the policy of making ordinary trading and stock management activities of wheat farmers appear like criminal acts.
He also points out that zonal restrictions depress the prices of wheat in surplus states and push up prices in deficit states

In respect of the production and sales of wheat, we seem determined to violate all known market laws. The agriculture minister announced, on 25 May 1974, an overall ceiling price of Rs 150 per quintal in terms of the new wheat policy, for the export of wheat from the surplus to the deficit states. The price of Hapur 'average' on that day was Rs 140 to145 per quintal and of Hapur 'white farm' Rs 150 to 155 per quintal.

We have seen that wheat prices have since moved up much higher. How can traders remain in business with such wide disparities between open market prices in the *mandis* of surplus states – at which traders have to buy wheat – and the overall ceiling price, which must apply to all open exports to deficit states? They can survive only if the sales are recorded in their accounts at prices consistent with the ceiling, and their actual receipts – the part representing the difference between the ceiling and the actual sale price being paid in cash – are at prices consistent with those prevailing in the *mandis* where they purchased wheat. This problem cannot be solved by applying the price ceiling to the *mandis* as well. To do so would be to punish the wheat farmers or to invite unrecorded transactions in the *mandis*. We have here yet another case of ill-conceived official policies adding, under duress, to black-market transactions and black incomes.

Wheat farmers are discriminated against, in relation to farmers producing other crops, also in respect of access to markets that bring the highest prices. On 6 March 1974, 'in order to improve the availability of coarse grains', the government removed all the restrictions on the movement of coarse grains throughout the country. The same consideration has not weighed in the case of wheat. The new wheat policy of 28 March 1974 has not scrapped the one-state, one-zone provision of the wheat trade nationalisation of March-April 1973. The result is that whereas in the case of coarse grains inter-regional price variations may be small, being limited by the cost of transport and incidental charges, wheat prices contrast even among the wheat-producing states.

THIS CONTRAST IS MUCH larger between the surplus and deficit states. On 2 July 1974, superior qualities of wheat were quoted at Rs 133.60 per quintal in Bhatinda, Rs 190 per quintal in Delhi, and Rs 200 per quintal in Hapur. In Bombay, a large consumption centre, wheat may sell in the black market at well over Rs 300 per quintal.

Zonal restrictions depress the prices of wheat in surplus states and push up the prices in deficit states and consuming centres. The gap between the two prices now becomes much larger than would be the case if the movement of wheat was on a par with that of coarse grains. With one exception: the impact of this arrangement is negative or harsh all round. The growers of wheat are deprived of their legitimate incomes to the extent of the repression of wheat prices in surplus states and surplus districts.

The impact on the flow of wheat from farms to *mandis* would be negative if farmers find it economical to consume wheat in place of coarse grains and to use wheat as animal feed. The impact on wheat production in 1975 would be negative too, if the penal procurement prices and the other legal hurdles confronting wheat farmers are not abolished before the coming of the 1974 wheat sowing season (October-December). The impact on consumers is extremely heavy, as they are now compelled – so to speak, under police guard, set up in the 'public interest' by a 'benevolent' administration to 'protect' the 'vulnerable' sections of society –to finance the inflated costs of transporting wheat, including the corrupt payments and the (quasi-rent-like) windfalls of middle-men from surplus states and surplus districts.

Socialist economic recipes are generally the best guarantees of anti-social effects; of undermining, in the longer run, an expansion of production and hence an expansion of employment and income

The only beneficiaries of this weird socialist arrangement are middlemen – the enemies of society, in the theology of socialism – and corrupt functionaries of the state, including the police, politicians, and administrators who are (or who place themselves) at vantage positions in the marketing part of the wheat economy, to share the now extended gap between wheat prices in the *mandis* of the surplus areas and the prices in deficit states, deficit districts, and urban centres.

The remedy to this state of affairs does not lie in looking for 'loopholes' to plug. The damage is inseparable from the prevailing policy measures. The remedy lies only in restructuring our policies.

This illustrates yet again that socialist economic recipes are generally the best guarantees of anti-social effects; of undermining, in the longer run, an expansion of production and hence an expansion of employment and income; and, finally, of continued reliance on external assistance (in the present case, on food imports) for the viability of the domestic economy.

It is most unfortunate that we should treat wheat farmers so unjustly as to make their most ordinary trading and stock management activities appear anti-social, or even criminal, acts. The role they have played merits their being rewarded, not punished. Wheat has been spearheading the spread of the new technology in agriculture. During the four year 1968-72, the foodgrain output rose by 9.6 million tons. This spurt resulted from an increase in the output of wheat, which went up by 9.9 m t.

Had it not been for the uptrend in wheat output, foodgrain production would have remained, during this period, at 95 m t, the level attained in 1968, and our import needs would have been much larger than they are. The drop in the output of foodgrain in 1972 – when wheat yields went up by 2.6 m t and the output of other foodgrain was on the decline – would have been not 3.8 million tons, but 6.4 million tons, and the food position, during the year, would have been somewhat like that of 1973. The chaos on the food front, which followed the cessation of concessional imports, would probably have come sooner.

THOUGH WHEAT ACCOUNTS for only about 25 per cent of total foodgrain production, as against 41 per cent in the case of rice, past performance shows that our best hope of escape from the crisis on the food front lies in expanding the output of wheat. We cannot rely as assuredly on other cereals for this relief. This underlines the need to place wheat at par with other crops: allow the price of wheat to follow its course unhindered by police controls, remove the zonal restrictions and other legal constraints and penalties on the stocks of, and trade in, wheat and release wheat farmers from the obligation to surrender their produce at arbitrary prices.

In view of the proved price sensitiveness of wheat farmers, it would be imprudent to continue the prevailing wheat policy measures. This may lead to widespread scarcity conditions; and the only way of averting it would be to seek concessional imports from the wheat-producing countries of the world, as our capacity for commercial imports may not meet more than a marginal part of our needs.

If the prevailing policies – procurement at controlled prices, price ceilings for other transactions, zonal restrictions, limitations on stock management, and the other measures – are inconsistent with the solution of our food problem, there arises the question of how the administration should feed the Public Distribution System. In the longer-term logic of the food economy of the country, there is no conflict between the needs of the distribution system and the solution of the food problem. If the food problem is solved by covering the market deficit through expanding domestic production, the pressures on the PDS would diminish, its operations would shrink, and, in due course, the system itself would wither and eventually vanish. On the other hand, a continuation of the prevailing policy measures, which deter the expansion of food production, would be self-defeating: the food deficits would increase, the pressures on the PDS would grow, and the reliance on food imports would become chronic.

Clearly, the wiser choice is the path that leads to an expansion of the domestic production and dissolution of the PDS. This implies that the requirements of the distribution agencies are acquired through open-market purchases, at competitive prices. If, for political or other reasons, it is proposed to issue rations at less than open-market prices, it is only proper that the burden of the attendant subsidy fall wholly upon the state.

There is no economic or moral case for using police powers, which we have been doing, to acquire wheat and other foodgrain at less than competitive prices, thereby extort a part or the whole of this subsidy from farmers, and in the process, inflict on them other iniquitous or unjust measures. It is a self-defeating policy that calls for hostile and punitive action against the producers of food – and thereby cause a disincentive to food production – in an effort to tackle and overcome the problem of food shortage. The developing food situation stresses the urgency of replacing these policy measures by the more rational approach indicated by our analysis.

35

Agricultural wages

1965

In his book *Indian Economic Policy*, Shenoy pointed out that constricted agricultural activity has reduced the aggregate demand for agricultural labor, especially since it was given no priority in the five-year plans. The forcing of capital out of agriculture has only added to the misery of weaker sections of the agricultural population

Since 1948-49, almost without exception, the trend of national income has followed the trend of agricultural production. During the past two years, as agricultural production declined, the growth of national income slowed down and per capita real income declined. The share of agriculture in Indian national income was only 45.5 per cent in 1961-62. But the importance of agriculture to the national economy is even greater than agriculture's share of the national income suggests. In 1951, 69.8 per cent of the population drew its living from agriculture. The percentage was virtually the same in 1961.

Of an increase of 78.1 million people between the two Censuses, the rural area took 74 per cent (58 million) or somewhat more than the percentage of the population living on agriculture. The number of agricultural labor households was 16.3 million, the number of people living on agricultural wages being 72 million. This figure was about the same in 1950-51. Thus, the leap forward of the industrial sector has not altered the broad occupational pattern of the Indian people, nor the ratio of the urban to the rural population.

Not only has agricultural production lagged behind the other sectors of the economy, the terms of trade between agriculture and manufactures have been generally tending against agriculture since 1950-51, causing a perverse shift of income from the agricultural to the industrial sector. From 1950-51 to 1962-63, prices of food articles rose by 12 per cent and of industrial raw materials by 4 per cent; during the same period, the prices of manufactures rose by 24.7 per cent, and of fuel, power, light and lubricants by 34 per cent. Food articles and industrial raw materials account for about 66 per cent of economic activity; and the latter two categories of production about 32 per cent.

Male workers were wholly unemployed for 90 days in 1950-51; this figure rose to 128 days in 1956-57. Reduced wage rates and larger unemployment depressed income of workers

Constricted agricultural activity has reduced the aggregate demand for agricultural labor. Mobility of labor not being perfect, the condition of agricultural workers and their families – the number of people living on agricultural wages was about 72 million in 1956-57 – has greatly deteriorated even below the miserable levels which prevailed before the commencement of planning.

The all-India average daily wages of male agricultural workers was Rs 1.09 in 1950-51. It fell to Rs 0.96 in 1956-57. Simultaneously, women's wages fell from 68p to 58p and children's wages from 70p to 53p. Male workers were wholly unemployed for 90 days in 1950-51; this figure rose to 128 days in 1956-57. Agricultural wages were generally higher than non-agricultural wages in 1950-51; the reverse was true in 1956-57.

REDUCED WAGE RATES and larger unemployment depressed the incomes of agricultural worker families from Rs 447 in 1950-51 to Rs 385 in 1956-57; per capita incomes from Rs 104 to Rs 88. Simultaneously with the rise in the cost of living, expenditure per worker rose from Rs 109 to Rs 141. As a result, the indebtedness of families rose from Rs 105 in 1950-51 to Rs 138 in 1956-57. In 1950-51, 50 per cent of the agricultural labor households owned some land; this number declined to 43 per cent in 1956-57, the number of landless labor households rising correspondingly from 50 to 57 per cent.

Forced industrialisation in defiance of the law of comparative costs has not assisted agriculture. What the Indian economy needs is more production, not more industries forcibly created. The development of industries should come about naturally as an incident in the process of economic development. The thesis that Indian agriculture has surplus labor is capable of overemphasis. There is little surplus labor during the critical weeks of peak agricultural activity, when any slackness in effort might make a lot of difference to output. Labor surplus is largely seasonal.

It is perilous to force capital out of agriculture. This has depressed the national product, reduced the pace of expansion of employment and has added to the misery of the weaker sectors of the agricultural population. Both the logic of the Indian situation and historical experience seem to indicate the need for priority development of agriculture. The use of more capital in agriculture might enable withdrawal of labor from it without damage to output. It will also provide industry with a broad- based and assured demand for its output.

36

Remove state-created anomalies

19 JANUARY 1978

The last note written by B R Shenoy before his death, showing the importance he attached to reform of agriculture. This was in response to Professor Gadgil's note *Need for a New Price, Trade and Marketing System of Agricultural Produce*. In this he urges measures to lift up the purchasing power of the rural population, the first step being removal of price ceilings for their produce

I have been convinced for many years now, that no major economic problem of the country, including social injustice, can be corrected unless we reverse the downtrend in the per capita income of the agricultural population. The Janata government has been asked to step up the agricultural part of the public sector investment to 40 per cent of Plan expenditures. But such an increase would not be enough. It is no less important that the flow of funds into the market for farm loans increases. Also, the increase in public sector outlays should be related to the amount of expenditure in the preceding year.

This is important because, under a sound policy package, overall public sector expenditure needs to be stepped down. If this happens, the 40 per cent formula may mean less allocation to agriculture, not more.

Adverse terms of trade react on capital investment by reducing farm incomes, not directly. Moreover, the phrase 'terms of trade', refers to the ratio resulting from trading transactions in the market. The problem we are confronted with is price discrimination by the government in respect of the supply prices to farmers of their inputs and the procurement prices paid for their output. This price discrimination is government-created, and can be remedied by the government alone.

Adverse terms of trade arising from market transactions ensue from:
(i) Zonal restrictions on the international movement of foodgrain
(ii) Restrictions on the export of agricultural produce, and
(iii)Other factors, which are basic, not created by the government.

Of these three factors (i) has been eliminated, (ii) needs to be tackled, and (iii) is beyond the control of government. When the market is open and free from restrictions, control of the terms of trade is far from easy.

I WOULD LIKE TO suggest that a second factor making for the capital starvation of agriculture is the adverse impact on the flow of private capital into the market for farm loans. Available data strongly suggests that the per capita investment in agriculture has been stagnant since 1961-62. The green revolution in wheat, it would seem, was financed not by an overall net increase in the flow of funds into agriculture, but a shift of funds from elsewhere within agriculture into wheat cultivation.

The adverse impact on the flow of private capital into the market for farm loans has resulted from:

(i) Barriers in the way of the flow of funds into the farm sector, such as restrictions on the activities of private bankers and moneylenders; and the restrictions on the free use and transfer of land for raising loans, which is almost the sole mortgageable asset of most farmers

(ii) The shift of private bankers and moneylenders from the business of agricultural finance into industrial and other finance in the urban sector

(iii) The snapping – which has ensued from (ii) above – of the channel for flow of funds from the national money market into agriculture, as the old moneylenders have been replaced by landlords and agriculturist moneylenders who have no direct links with the national money market

(iv) Commercial banks in the countryside are, on balance, agencies for the shift of funds from rural sector into the urban-industrialised sector.

While we have removed the zonal barriers which depress the terms of trade for farmers, other powerful barriers depressing these terms of trade continue merrily. Indeed, the Janata government has added to these barriers, thereby depriving farmers of their legitimate earnings. Indian prices of all manufactures, whether domestically produced or imported, are higher or vastly higher – never lower – than the corresponding ex-factory prices abroad. On the other hand, the prices of agricultural output are generally lower, or vastly lower, than world prices. This has resulted from restriction on the import of manufactures and on the export of agricultural produce.

The consequences are (among others):

- Industry receives heavy or unconscionably heavy subsidies from Indian consumers in manufactured goods
- Heavy or unconscionably heavy subsidies from farmers on their manufactured imports
- Artificial lowering of agricultural prices
- Inability of Indian manufacturers to export their output without subsidies from the state

- Imposition of hurdles and handicaps, by way of physical restrictions, bans or heavy export duties, in the way of the export of agricultural produce.

Recent examples of the last are bans on the export of vegetables and onions, and the ban (imposed on 9 January 1978) on the export of *zeera* and turmeric. The last ban is reported to have caused a crash of upto Rs 300 per quintal in the price of *zeera* and Rs 25 per quintal in the price of turmeric. What is the economic crime that the farmers producing *zeera* and turmeric have committed to merit this harsh blow? And what is the justification of the Janata government – the proclaimed champion of agriculture – in adding to the already existing penalties on agriculture?

Unless these barriers to trade – on the exports of agricultural produce, on the import of agricultural inputs and on the imports of consumer goods used by the rural community – are removed, four consequences may be unavoidable:

(i) The terms of trade will remain heavily against farmers
(ii) It will not be possible to arrest and reverse the downtrend in the per capita income of agriculture
(iii) Unemployment may continue to increase
(iv) The near-stagnant overall state of the economy may persist.

Unemployment may continue to increase because, unless agriculture develops, the expansion of unemployment is apt to fall short of the demographic additions to the labor force, as has been happening hitherto; and stagnation may ensue because, if we fail to remove the barriers to trade we would be – through the attendant price penalties – developing the unviable agricultural sector.

IF THE LEVEL OF FARM PRICES IS lower by 10 to 25 per cent than non-farm prices, this is almost wholly the consequence of the barriers on imports, which drove up prices of manufactures, and the hurdles on exports, which depress the prices of agricultural production. The remedy to the problem of Indian agriculture getting less than world prices for its output while it has to pay more than the world prices for its requirements in manufactures – lies in relaxing or removing these trade barriers; in removing food zones, in abolishing monopoly procurement and such other depressants of agricultural prices. There is no other practical method of relieving the adverse terms of trade in agriculture.

It is obvious, too, that to raise the standard of living of the masses, we have to adopt measures which will lift up the real purchasing power of the agricultural population, which is 72 per cent of the total population. It is no solution to this problem to open a school here or a hospital there.

In tackling this problem, three propositions must be kept in mind:

(a) An increase in the real purchasing power of agricultural population (as of any other people) cannot properly be achieved through price manipulations in their favor: such increase is but the counterpart of an increase in their output

(b) An increase in the real purchasing power of agricultural population can also ensue through eliminating (i) the artificial depression of agricultural prices, (ii) the artificial inflation of the prices of their inputs and other requirements, thus eliminating the artificially creates terms of trade adverse to agriculture

(c) After having eliminated the artificially created adverse factor (b) above, it is just not possible, in the prevailing Indian context – which, in many ways, is unique – to lift up the purchasing power of India's agricultural population through manipulating prices and the terms of trade.

Since 1973-74, price pressures moving against agriculture have – so to speak – risen above the surface: they have accentuated to such a degree that they have manifested as an outright adverse trend in the norms of trade between agriculture and industry. The overall position is brought out when all agricultural prices and all industrial prices are viewed as a whole. The terms of trade went against agriculture, from 100.2 in 1973-74 to 108.8 in 1975-76 and stood at 103.1 on 24 December 1977.

Prices of agricultural products are – with the exception of pulses – lower than the national average commodity prices. The price of agricultural inputs – all outputs of manufacturing industry – with one exception, are higher than this average. The remedy to this gross economic injustice lies in eliminating the factor responsible for this injustice:

- Remove import restrictions
- Thus compel domestic industries to reduce costs and improve quality
- Remove bans, other restrictions and heavy export duties on agricultural produce
- Abolish arbitrary procurement prices for agricultural produce, monopoly procurement and compulsory levies;
- Remove all barriers to internal movements of agricultural produce.

These measures will restore to the agricultural population its rightful purchasing power, which today is denied by policy measures.

The impossibility – in the prevailing Indian context – of increasing the real purchasing power of a bag of wheat or rice, beyond what is possible through correctives mentioned earlier are, briefly:

(i) It is possible for government of India to depress agricultural prices through food zones, monopoly procurement and export barriers, export bans or export duties. It is not in the power of the government to lift up, in any appreciable degree, the prices of agricultural produce. The task is unquestionably beyond its abilities.

(ii) In the US, agricultural prices are maintained at artificially high levels, above world prices, only because agriculture accounts for but 4.4 per cent of the US national income (GDP). It is feasible through price sup port operations, for the rest of the economy to bear the burden of levelling up the incomes of a fraction of the population. In India, this is out of the question, as 28 per cent of the population would have to bear the burden of levelling up the incomes of 72 per cent of the population.

This problem may be tackled by a new marketing system in which farmers could be advanced a fair part of the value of their output, the procurers being free to sell the warehoused output at market prices, whenever the market situation is more favorable

(iii) Add to this the basic difficulty that for the past 25 years, the industrial sector has been receiving heavy subsidies from the rest of the population, including the agriculture sector. These subsidies include cash subsidies of Rs 463.3 crore in the Union budget for 1976-77 and Rs 567.2 crore in the budget for 1977-78. Also, there are the subsidies extorted from domestic consumers through the device of captive markets, which keep the prices of industrial prices artificially high. Then there are tax concessions and tax refunds, concessional power and freight rates, 'entitlement' import licenses on exports.

(iv)The subsidy burden already being there, these subsidies – from agriculture to industry – must first be eliminated before agriculture plans to draw subsidy support from the industrial sector

(v) Any attempt to defy this basic rule of social accounting and the other considerations – (i), (ii) and (iii) – listed above may land the economy in utter chaos in addition to generating heavy inflationary pressures.

WHILE THE GREAT need for a fair deal to the agricultural population on both political and humanitarian considerations is obvious, it is little use attempting the impossible. The removal of the price ceiling and other injustices we have been piling up on the rural masses – and still continue to do – would constitute a great forward step in this direction. The expansion of agricultural production through a larger flow of funds, both public and private, of agriculture would add to the well-being of the masses considerably.

Once the price injustice has been corrected; the problem facing agriculture would be the problem of seasonal fall in prices. Such price fall may cause great hardships, in particular, to the weaker among the farmers, more especially in view of the inordinate interest rates. This problem may be tackled by a new marketing system in which farmers could be advanced a fair part of the value of their output, the procurers being free to sell the warehoused output at market prices, whenever the market situation is more favorable.

In a scheme of seasonal price support, there is no room for a ceiling price. Any arrangement for a ceiling price may, quite unfairly and inequitably, deprive farmers part of the benefit of rising prices; and rising prices may be a general rule in a background of continuing inflation. Ceiling prices in such a context are apt to become but devices forcing farmers to subsidise the urban population, through the public distribution system, with all its attendant ill-effects.

With the acceleration of agricultural production for which there is considerable scope, we should be – after fully meeting domestic needs – exporting foodgrain, and increasing the export of agricultural output. With this development, there would not be any real need for the Agricultural Prices Commission, the Food Corporation of India and the Public Distribution System, though it is always possible to devise ways of creating some work for them. This would be a waste of public resources. Pending the surplus production of foodgrain, their activities should be drastically cut down; and when the surplus production materialises, these organisations merit being liquidated. This will enable considerable reduction or elimination of inflationary deficit financing.

CENTRE FOR CIVIL SOCIETY

The Centre for Civil Society is an independent, nonprofit, research and educational think-tank devoted to improving the quality of life for all people of India by reviving and reinvigorating civil society. The motivation behind the Centre is the poignant paradox of intelligent and industrious people of India living in a state of destitution and despondency. But we don't run primary schools, or health clinics, or garbage collection programs. We do it differently: we try to change people's ideas, opinions, mode of thinking, the mindset by research, seminars, and publications.

We champion limited government, rule of law, free trade, and individual rights. These principles promote civil society – peace, harmony, and prosperity.

The Centre was inaugurated on 15 August 1997, signifying the necessity for achieving economic, social, and cultural independence from the Indian state after attaining political independence from an alien state.

WHAT IS CIVIL SOCIETY?

Civil society is an evolving network of associations and institutions of family and community, of production and trade, and of piety and compassion. Individuals enter into these relationships as much by consent as by obligation but never under coercion. Civil society is premised on individual freedom and responsibility, and on limited and accountable government. It protects the individual from the intrusive state, and connects the individual to the larger social and economic order. Civil society is what keeps individualism from becoming atomistic and communitarianism from becoming collectivist. Political society, on the other hand, is distinguished by its legalised power of coercion. Its primary purpose should be to protect, and not to undermine, civil society by upholding individual rights and the rule of law.

RELATIONSHIP BETWEEN CIVIL AND POLITICAL SOCIETY

The 'principle of subsidiarity' demarcates the proper arenas for civil and political society, and for local, state, and central government within the political society. The principle suggests that the state should undertake those tasks that people cannot undertake for themselves through voluntary associations of civil society. The functions thus assigned to the state must be entrusted first to local governments. The functions that local governments cannot perform should be given to state governments and only those that state governments are unable to undertake should be delegated to the central government.

The rampant growth of the political society – the institutions of government – since independence has hindered the flourishing of civil society in India. It is only by rethinking and reconfiguring the political society that India will be able to achieve economic prosperity, social peace and cohesion, and genuine political democracy. The focus on civil society enables one to work from both directions; it provides a 'mortar' program of building or rebuilding the institutions of civil society and a 'hammer' program of readjusting the size and scope of the political society. Both programs are equally critical and must be pursued simultaneously. Weeds of the political society must be uprooted and seeds of a civil society must be sown.

SUPPORT

In accordance with its purpose, the Centre accepts support only from individuals and institutions of civil society.

RESEARCH AGENDA

- Law, Liberty, and Livelihood
- Education: Choice and Competition
- Market-based Initiatives for Environmental Concerns
- Good Governance: Laws, Budgets, and Performance
- Provision of Social Services: The Role of Civil Society
- Assuring Quality and Safety: Self Regulation or State Regulation?
- Birth to Death Certification
- Radio Privatisation
- Role of the Private Sector in Provision of Infrastructure
- Farmers and Consumers: Is the State or Market a Better Intermediary?
- Protecting and Creating Jobs: De-regulation of Labor Markets
- Government as Manager or Supervisor of Financial Markets?
- India in the Global Market: Liberalisation of Trade
- Corporatisation and Privatisation of Public Sector Units

EDUCATION PROGRAMS

- Liberty & Society Seminar
- Economics in One Lesson Seminar
- Liberty, Art & Culture Seminar
- Research Internship Program
- School Lecture Series
- Business Journalism Workshop

JEEVIKA

A National Livelihood Documentary Competition was held in January 2004.

DIALOGUES & PANEL DISCUSSIONS

The Centre holds regular Dialogues to provide a discussion forum for topical issues. Some Dialogues held:

- IPR: CopyLeft, CopyRight, CopyConsent?
- Fighting Poverty Diseases
- Corporate Social Responsibility?
- Should We Ban Quacks?
- Liberalisation & Livelihood
- Economics Curriculum in Schools
- Education Policy: Choice and Competition

FRIENDS OF FREEDOM

To provide a platform for self-development and deeper understanding of the principles and policies of liberalism, graduates of our seminars come together to form Friends of Freedom (FoF). Young professionals and others interested in liberal values also become members.

PUBLIC INTEREST LITIGATIONS

- BALCO: With the help of advocates Parag Tripathi and Suranya Aiyar, the Centre filed an intervention PIL in the Bharat Aluminium Company (BALCO) privatisation case to support that the privatisation of public sector companies is in the public interest; its opposition serves only parochial interests.
- VIP Security: To stop harassment and inconvenience under the guise of VIP Security to ordinary citizens of Delhi in using roads.

LEGISLATIVE ALERT

A bill pending in the Parliament is analysed, clause by clause and an alternative bill is drafted. The changes are then discussed with interested Members of Parliament, formally and informally.

SWAMINOMICS

The Centre maintains www.swaminomics.org and www.swaminomics.com to house the popular Sunday column 'Swaminomics' in *Times of India* by Swaminathan S Anklesaria Aiyar.

RESOURCE CENTRE

The Centre maintains a library of several thousand books, publications of a large number of public policy research institutes and computers with internet access. It is open to the public for use but borrowing privileges require membership. The Centre plans to open similar resource centres throughout India.

THE MAN WHO SAW INDIA'S TOMORROW

After gaining independence from British rule in 1947, the Government of India embarked on a path to evolve a socialist pattern of society in India, which it called a mixed economy – a compromise between communism and capitalism. Most economists went along with the tide, and so did those businessmen who could divert the resources appropriated by the state for their own use.

B R Shenoy, with his sharp intellect, his dogged individualism, his education in the London School of Economics and stints at the Reserve Bank, the World Bank and the IMF was eager to bring about economic progress along with social progress. This, as he repeatedly said, is possible only if a market-friendly policy appropriate for a free society is pursued.

When economic chaos and a foreign exchange crisis brought matters to a head in 1990-91, the Indian government decided to go in for globalisation and liberalisation. B R Shenoy did not live to see that day. This book presents his prophetic writings to those who need to understand history so as not to repeat it. You need not be a student of economics to appreciate the basic logic underlying Professor Shenoy's prophecies.

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