

THE PROBLEM OF RISING PRICES
— CAUSES AND REMEDY



FORUM OF FREE ENTERPRISE
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THE PROBLEM OF RISING PRICES — CAUSES AND REMEDY

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Financial Editor. "Times of India"

Public attention has been increasingly focussed on the problem of rising prices in recent weeks. It has assumed such serious proportions that it is not possible to ignore it any more. Continually rising prices affect everybody as all of us are either producers and/or consumers, and is a serious threat to our developmental activities.

Various theories have been advanced for this rise in prices and many of them generally have tended to fall victims to three common pitfalls. First of all, there is the prevalent notion that absolute price stability is a must for economic progress. This belief is erroneous. Absolute price stability is not a practicable proposition, because prices being the index of the forces of demand and supply in the market tend to fluctuate depending on the relative strength of the market forces. They play an important role in allocating resources. These price fluctuations should not, however, be abnormal so as to create general uncertainty. As absolute price stability is not practicable, it is desirable that price fluctuations, such as they are, should be held within reasonable limits.

Secondly, attempts have been made to mark out who is to blame rather than examine the basic reasons. Serious allegations have been made against certain sections of the public, holding them responsible for the rise in prices. This is unfortunate. We must correct deep-seated maladies instead of hunting for scapegoats.

Thirdly, there is a mistaken notion that prices tend to respond to the fiat of politicians. Let it be absolutely clear that politicians only aggravate the situation by their loaded pronouncements. Economic forces cannot be changed by the Aat of politicians.

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

—Eugene Black

It is, therefore, necessary that the factors responsible for the rise in prices should be analysed impartially so as to arrive at a solution.

The problem with us today is one of abnormal price fluctuations. The price level was comparatively stable towards the end of the Second Five-Year Plan and during the first year of the Third Plan. Since 1962, however, there has been a continuous increase in the general price level and in the level of prices of foodgrains in particular. During 1962-63, the index of wholesale price went up by 2.2 per cent, where as in 1963-64 it went up abnormally by 9 per cent. This sudden rise has confirmed the doubts that there is something radically wrong with our price situation, and the fiscal and monetary policies of the Government have been far from helpful in maintaining a steady price level.

Advertently or inadvertently, the Third Plan document hit upon the key to a successful price policy, when it stated that the success of a price policy depended upon a successful farm price policy. But the Government has consistently ignored its own wise dictum. The fact of the matter is that our Government's farm policy in past years, far from being stable, has not been successful either. Though at every available opportunity emphasis was laid on the importance of agriculture to our economy, only lip service was paid and in actual practice nothing constructive was done during the periods of relative stability. This was a grievous error and the consequences have been serious to our economy, because about 70 per cent of its exports and 50 per cent of the national income is still derived from the agricultural sector of the economy.

A question which is often asked is why there is a price rise, in spite of the recorded increase in foodgrains production. There are two explanations for this. Agricultural production has definitely gone up in recent years. However, when we speak of increases in agricultural production, we mean it in relation to the previous years. For example, in 1962-63, foodgrains production fell by 2 million tons as compared to the previous year, whereas in 1963-64 it has increased by 4 million tons. Between 1962-63 and 1963-64

while consumption of foodgrains went up by 5 to 6 per cent, production during same period increased only 4 per cent. It is, therefore, natural that prices should rise.

In an underdeveloped economy in general and in an economy like ours in particular, the first increases in income always tend to be expended on food articles. Recent surveys in isolated pockets like Durgapur and Bhilai have confirmed this view. With every increase in their wages, labourers have shown a tendency to consume more and more food articles. In other words, the level of consumption tends to increase with increases in income. The cumulative effect has been a growing pressure on prices. Further, during the last few years, agricultural production has not been sufficient to meet the needs of the growing population. Our population is increasing at the rate of 2.3 per cent per annum. That is, about 10 million new mouths are to be fed every year. This increasing pressure of population has been another aggravating factor leading to the rise in prices.

It is also necessary to take account of the psychological factors that push up prices. An expectation of rising prices may actually result in price rise. Continually rising prices give rise to rising expectations, with the result that farmers and stockists tend to hoard more and more stocks, anticipating further increase in prices. Evidence in recent years has confirmed that large-scale hoarding of foodgrains by farmers does take place. It has been admitted by the Union Minister for Agriculture, that despite increased production, arrivals in the terminal markets of foodgrains have declined by about 16 per cent. The only inference is that hoarding by producers does take place. This is also evident from the fact that normally during the busy season, that is, between November and April, the prices of foodgrains generally decline. But in the last busy season (1963-64) the price of wheat alone rose by 19 per cent as compared to a fall of 3 per cent in the previous year, while there was an overall increase of 4 per cent in the general price level. Thus, hoarding has contributed much to the rise in prices. Probably one explanation is that the farmer is more secure now than what he was a few years ago

when he rushed to sell the first grain he produced; and the various facilities which the Reserve Bank gives by way of co-operative financing have served to increase the farmers' holding capacity.

Government's monetary and fiscal policies have also done much to aggravate the price situation. More and more money has been pumped into circulation. There is relatively more money in circulation now than goods and services available. Between 1955-56 and 1963-64, while money supply rose by 69 per cent, the national income, that is, the value of the goods and services produced in this country, rose only by 30 per cent. The increasing tax burden on commodities, both by the Central and State Governments, has worsened the situation still further. During the same period, central taxation on commodities alone rose from Rs. 300 crores to Rs. 980 crores, while taxes levied by the State Governments rose from Rs. 350 crores to Rs. 950 crores. All these burdens, in the ultimate analysis, have been passed on to the consumer in the present context of our scarcity economy.

Thus, the problem of rising prices is not as simple as is taken to be in certain quarters. It is an absolute must that steps should be taken at least to prevent further damage, if we are to go ahead with our projects of economic development. The remedies call for both courage and caution.

In the first place, steps should be taken immediately to curtail the mounting administrative expenditure which is mostly wasteful, thus adding fuel to inflationary fire. Union Finance Minister Mr. T. T. Krishnamachari's announcement to cut Rs. 70 crores of expenditure is welcome. There is still more room for economy. Secondly, the government must learn to cut its coat according to the cloth available. Increasing deficit financing and high taxes have defeated the purpose of making our economy self-sufficient in foodgrains. As a short-term solution, it is preferable to import foodgrains rather than push up costs and prices and be caught in the coils of inflation. Once the prices begin to decline, the hoarded stocks will also come out rapidly and thus push down prices.

It is also time to reallocate the priorities in our planning and give agriculture number one priority as a long-term policy. The artificial barriers that have been set up in the form of food zones, which act as a deterrent to the levelling of prices, should go. It is an anachronism that we do not have one single market within the country while in Europe the Common Market has overcome boundaries of even sovereign states.

It is essential that these measures should be taken here and now, and with a supreme sense of urgency, if we are not to slip and fall off the precipice. (Based on a talk delivered under the auspices of the Forum of Free Enterprise in Bombay on July 3, 1963).

FAILURE ON PRODUCTION FRONT IS CAUSE OF RISING FOODGRAINS PRICES

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One of the most important problems which faced the country on attainment of Independence was to seek a solution of the food problem, particularly the perennial shortage which the country had faced during the years of the War. The problem became more acute due to the partition of the country and the fact that many of the grain producing areas of the country were on the other side of our border. Seventeen years after Independence, we continue to face the same problem in spite of the three Plans emphasising the need for production. There has hardly been a single year since Independence when the country has been independent of imports of foodgrains.

The crux of the problem is to be found in the failure of production to increase adequately to meet the demands of the population increasing at a rapid rate of 2.3 per cent per annum. The figures in the following table indicate the production figures for the first and the last years of

the Second Plan and for the first three years of the Third Plan against the targets for 1965-66 and show the shortfalls to be made up to attain the targets.

Commodity	(in thousand tons)						
	1955-56	1960-61	1961-62	1962-63	1963-64 (estimated) by Govt.	1965-66 (Targets)*	Shortfall to be made up for attaining Plan targets
1	2	3	4	5	6	7	7-6
Rice	27,108	33,658	34,247	31,512	35,900	45,000	9,100
Wheat	8,630	10,818	11,849	10,956	*11,000	15,000	3,168
Other cereals & pulses	30,080	35,215	33,635	35,039	*35,100	40,000	5,733
Total Food-grains	65,816	79,691	79,741	77,507	82,000	100,000	18,000

In 1961-62, rice production was 34.3 million tons and in 1960-61 it was 33.6 million tons. Even during these good years, the internal supplies had to be augmented by imports of rice. Compared to 1961-62, the production in 1963-64 has increased by only 1½ million tons or little over 4 per cent whereas, the population has gone up by about 20 million or 5 per cent in the last two years and the consumption has increased by 6 per cent. Compared to the consumption level and the population level, therefore, even the good crop of rice this year shows that it is short of our consumption level and will have to be supplemented by imports. The overall level reveals a more disheartening position. As per the Third Five-Year Plan, the production level at the end of the Plan should have been nearly 89-90 million tons, whereas the estimated production will be about 82-83 million tons, indicating a shortfall of nearly 7-8 million tons. During 1961-62, the total quantity of wheat and grains imported was nearly 4 million tons. During 1962-63, the quantity was nearly 4.5 million tons. The quantity required to be distributed in 1964-65 from imports will have to be 7-8 million tons, partly to be made up from our buffer reserves and partly from imports.

Today, the biggest stockist is the State Government. The State Governments are actuated by only one desire, viz., to conserve stocks. Unless a bold decision is taken to increase the monthly off-take within the next 6 months to nearly 4 million tons at a rate of 7,00,000 tons per month by distributing the above quantity partly through the Fair Price Shops and partly through the trade channels, neither prices can be brought down nor the needs of the consumers met. The country otherwise cannot avoid higher prices and meet the demand. The fact that there is **under-production** has to be faced. Continued efforts to lay the blame on the trade for the present deplorable situation cannot do away with this basic fact. We must, therefore, first examine the various factors relevant to increased productivity.

The failure on the foodgrains production front is due to the failure in attaining the targets set forth in the Third Five-Year Plan in respect of irrigation, soil conservation and dry farming, supply of improved seeds, utilisation of fertilisers and organic and green manures, schemes of plant protection etc. The following table gives in detail the figures of targets set forth by the end of the Third Five-Year Plan for various agricultural development programmes and the progress made during the first three years of the Third Plan against the percentage shortfalls:

Item	Unit	1960-61	Third Plan Target.	1961-62 (actual)	1962-63 (anticipated)	1963-64 Projected	1961-64			
							Additional Net rise level	Col. 8 as % Plan Target Col. 4.	Net % Shortfall over the Plan target.	0
1	2	3	4	5	6	7	8	9	1	0

I. Irrigation (additional area benefited)

	1	2	3	4	5	6	7	8	9	10
Major & Medium Irrigation	M. acres	—	12.8	0.8	1.2	2.5	4.5	35.2	64.8	
Minor irrigation	,	—	12.8	1.8	2.1	2.1	6.9	53.9	46.1	
2. Soil Conservation and dry farming (additional) area benefited										
Soil Conservation	M acres	—	11.0	1.0	1.4	2.0	4.4	40.0	60.0	
Dry Farming	"	—	22.0	1.9	3.0	5.5	10.4	47.3	52.7	
3. Improved seeds	"	55	203	67	81	101	46	31.1	68.9	
4. Consumption of chemical fertilisers	'000 tons									
Nitrogenous (N)	"	200	1000	280	350	450	250	31.3	68.7	
Phosphatic (P205)	"	70	400	72	60	160	90	27.3	72.7	
Potassic (K20)	"	25	200	23	65	100	75	42.2	57.8	
5. Organic & green manuring										
Urban compost	M tons	2.4	5.0	2.6	2.9	3.6	1.2	46.2	53.8	
Rural compost	"	66	150	75	83	109	43	51.2	48.8	

	1	2	3	4	5	6	7	8	9	10
Green manuring	M acres		10.4	41.0	12.4	16.2	22.7	12.3	40.2	59.8
6. Plant protection	,		16	50	16	17	22	6	17.6	82.4

Thus, it will be seen that there are wide gaps between the targets and the present levels of attainment in respect of agriculture. Although three years of the Third Five-Year Plan have passed, production of foodgrains still remains almost at the same level as in 1961-62. The gap between the supply and increasing demand has so far been met by imports from abroad under P.L. 480 or otherwise. The country has imported during the years 1960, 1961, 1962 and 1963, foodgrains to the extent of about 51 lakh tons, 35 lakh tons, 36 lakh tons and 45.5 lakh tons respectively, and spent about Rs. 800-900 crores. In the process, distortion in the demand-supply relation has been increasing from year to year due to geometric increase in our population and shifting demand from coarser grains to rice and wheat and from poorer qualities to better varieties of grains. The shortage has also been accentuated to some extent by the tendency of the farmers to withhold their produce in the expectation of higher prices. The holding capacity of the farmers has been greatly increased due to such factors as the active assistance of co-operatives, larger flow of credit from the Reserve Bank, etc.

The increasing shortage of foodgrains on the one hand and the interplay of the above stated factors have exerted pressure on prices of foodgrains. The tendency of rising prices has been aggravated by the inflationary pressures in the economy. The money supply so generously pumped into the economy since the commencement of planning is having its expected effect.

The shortage of foodgrains has been further aggravated by the creation of various zones in the country with restrictions on the movement of certain foodgrains out-

side these zones. Added to this are other measures, such as compulsory procurement and levy of rice and other grains by Governments, imposition of sales-tax in certain States, irregular and inadequate availability of transport for movement of foodgrains, some of the provisions of the Food Adulteration Act, rigorous legal requirements for the filing of elaborate returns by traders to comply with licensing orders which raise Selling costs, undue stress on the channelisation of **foodgrains** through co-operatives etc. The country has been **divided** into four zones in respect of rice and nine zones in **respect** of wheat. The Government has not been able to appreciate the adverse effects of these measures to **meet the** marginal overall deficit or supply in each zone **which** creates wide disparities in prices in **different** States. The **reasons** for the abnormal condition of acute rice scarcity **and** for the abnormal increase in prices thereof in **Bengal** during the period **September-October 1963** were the result of control, regulation and absence of timely action on the part of the Government. The zonal system has also had **an adverse** effect on consumers and farmers. As a result of the zonal system, while **Punjab** and **Madhya Pradesh** are **surplus** in wheat and **Andhra Pradesh** in rice, the States of **Maharashtra** and **Gujarat** are being starved. In June 1964, acute scarcity of **foodgrains** was **reported** in **Poona**.

One very important reason **contributing** to the rise in prices was the **very** high level of compulsory levy enforced from the beginning of the crop **year** in various surplus States. In the **Punjab**, Such a levy **was** as high as 67 per cent, in the **U.P.**, it was 60 per cent, in Andhra Pradesh 40 per cent, Madhya Pradesh 30 per cent, Madras 20 per cent and Maharashtra 10 per cent. Such a compulsory **levy** had twofold effect; the compulsory levy at lower prices as compared to the prevailing market prices had the spiralling effect on the market with average of the losses on the balance of the rice and other grains sold in the market. The farmer was concerned with the market prices and raised his level of paddy prices resulting in a spiralling effect on the prices. Secondly, this high levy mopped up the supply much more **than the** available surplus which

was required to meet demand in the deficit States and created a scramble for such supplies. The spiralling effect of the levy was thereby further given a pressure and the markets began to show serious shortages in the surplus States as well. This is apart from the huge losses that the trade suffered in surrendering their existing stocks at low prices to the authorities under compulsory levy.

There are 48,000 Rice Mills in India from small cottage units to Modern Mills with specialised staff. If they are nationalised, a minimum of **1,50,000** trained and **specialised** staff will be required to **manage** the above units to purchase the paddy and mill the rice.

By **nationalising** the foodgrains trade, the law of demand and supply cannot be abolished. The distribution of scarce supplies through any scheme of rationing requires an efficient, incorruptible and flexible administrative machinery to meet the variable and differing demands of consumers whose consumption pattern it is impossible to channelise into standardisation. The absence of adequate availability may necessitate **compulsory** procurement and levy and interference with the farmer on the one hand, **and** feeding the semi-rural and **urban** population on the other, a task which is colossal by itself. The **standardisation** of compulsory levy may raise problems which may seriously affect production as it **did** in the years of the war and immediately thereafter. The experience of confusion and corruption which prevailed during the days of rationing in the forties and early fifties should not be so lightly forgotten. It will be well to recall the tremendous **increase** in production which resulted from decontrol in 1953-54. Rather than dissipating energies in pursuing such ideological pursuits, it is best to concentrate **efforts** designed to satisfactorily meet the present situation. Adequate imports should be arranged to make it possible to **satisfactorily** meet the requirements of the people. Immediate and effective steps should be taken **to** distribute at least 10 million tons of foodgrains in the **country** economically **and** expeditiously, partly through Fair Price Shops and **partly** through the trade machinery, at a monthly rate of

7,00,000 tons or more from imported wheat and rice. This is quite practicable as the Government is expected to import further 4.5 million tons during the next six months and has over 3 million tons of wheat and rice in stock partly acquired by compulsory levy during the last 12 months. This is the only effective and practical way of meeting the present situation. (*From a memorandum submitted to the Union Food Minister on June 20, 1964*).

ADEQUATE IMPORT OF FOOD SUPPLIES NECESSARY

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A question which is of vital importance to our economy today is that of our food supplies and distribution. The policy governing the scheme of distribution and the way in which it is being implemented will necessarily have a determining effect on (i) the position of food supplies, and (ii) the functioning of the pipe lines through which food supplies reach consumers, spread all over the country.

The food situation is unsatisfactory, does not require to be repeated. The prices of foodgrains have continued to rise and against this background, the Government has decided to adopt regulatory measures for the distribution of trade, designed to serve, as the Union Minister of State for Food stated in the Parliament "larger social objectives", which one must presume means lowering the food price for the consumer.

The main reliance of the Governments so far for checking the rising prices of foodgrains is on (i) building buffer stocks; (ii) importing foodgrains from abroad; and (iii) opening fair price shops and consumers' co-operative stores.

These measures and the schemes of restrictions on movement of grains have not yet had the effect of preventing the rising trend of prices.

We all realise that the food situation in the country is difficult and while in the long run the situation is to be met by increasing production, in the immediate future, the only way by which we can avoid a worsening of the situation is to arrange for adequate imports of food supplies. The position on food production, however, is that even the revised target of 95 million tons of foodgrains production per annum during the Third Plan period is not likely to be fulfilled. As the Ford Foundation expert has said, it would indeed be difficult to cross the figure of 86 million tons by the end of the Third Plan. Against this, the population explosion poses a serious sociological problem. In this context, the problem of higher food output can only be tackled on the basis of an integrated policy which, while seeking to push up the output and the yields at a rapid rate, will, at the same time, harmonise the interests of the consumers, producers and the traders.

No doubt, so long as the position of shortage relative to demand continues, a scheme of rational regulation of the trade is essential and even desirable if we are to ensure that anti-social elements are not to exploit the situation to the detriment of the community. The chief among the armoury of these regulatory measures is the foodgrains dealers' licensing order which ostensibly has been brought into force to regulate the wholesalers' profit margin and which enjoins upon the trade the fulfilment of many requirements and carrying out of various obligations. The order had many objectionable features including the possibilities of administrative harassment. It is not necessary to go into these features as, since the announcement of the order, better counsels have prevailed and fortunately both the Government and the trade have taken counsel and come to a working arrangement for which our sincere thanks are due to them. The Government has relaxed the order in certain essential directions and the trade on its part has accepted the inevitability and the desirability of

a broad scheme of regulation which it has agreed to work in a spirit of co-operation.

While the Government of India has advised all the State Governments to **implement** the **scheme** of regulation as modified, it is disconcerting to find that the order is not being implemented on a uniform basis in all the States and the advice given by the Central Government for relaxing the licensing provision of the order is not being followed in its entirety by many State Governments. Absence of a uniform policy is bound to result in considerable confusion and give rise to conditions which are likely to defeat the purpose for which the Government of India brought into force this regulatory measure. It is, therefore, essential to ensure that all the State Governments are persuaded to fall in line with the scheme of regulation as decided by the Central Government.

In an effort to encourage a favourable impact on prices, the Government has also brought into force, apart from the regulations of trade, certain restrictions, affecting the movement of foodgrains. For instance, Government has created zones for the purpose of movement of wheat in the country but the objective that the Government had in creating the zones is not being realised. On the contrary, it has given rise to a lopsided price structure with prices of wheat in the surplus zones falling appreciably and those in the deficit zones showing an abnormal rise.

Since one of the avowed objectives of Government's policy is to safeguard the interest of farmers, it **pre-supposes** that the farmer will be encouraged to produce more and be assured of a remunerative price for his produce. If there is a substantial fall in prices as has happened with wheat in the surplus States, would the objective of encouraging the farmer to increase production be achieved? Will not the farmer in this situation be inclined to consider diverting his land from foodgrains to cash crops? The experience some years ago on the working of zones for movement of wheat was not a happy one and the zonal system had to be withdrawn. The existence of zonal re-

restrictions on the movement of rice had also not helped in ensuring a timely **flow** of the surplus rice from one zone to the other. The working of the zonal system would have to be reviewed periodically and at short intervals and no opportunity **should** be given to anti-social elements to resort to questionable methods of effecting unauthorised movements across the zones. This can only be done provided there is a flexible approach to the problem of movements.

Apart from the restrictions on movement at the zonal level, some of the State Governments have gone a step further and banned the movement of foodgrains and pulses even between one district and another of their States. This is carrying the regulatory order to its extreme and needs to be immediately reviewed.

Another far-reaching decision taken by some of the State Governments is to effect imports of wheat from outside on Government account. Some of the State Governments have also decided to enforce **Government-to-Government** arrangements for the purpose of movement of rice. This is tantamount to eliminating the wholesale traders from the inter-zonal or inter-State trade. This decision involves an unjustifiable interference with normal trade channels and seriously affects the livelihood of an important link in the chain of distribution, *viz.*, the wholesaler.

The entry of the State in direct trading shows an anxiety on the part of Government authorities to satisfy a section of political opinion which advocates State trading in foodgrains, as being the only panacea for resolving the difficulties on the food front. It should not, however, be forgotten that the problem of food is essentially one of increased production; only an increase in production and productivity can lead to the desirable objective of price stabilisation. Any attempt to seek a solution of the rising prices in foodgrains by the elimination of the normal trade channels and replacing them by State Trading is bound to result in diverting the attention of Government from

its most important task today *of* increasing the production of foodgrains and In the process disrupting the normal trade channels without any apparent benefit to the consumers. *(From the speech delivered at the first quarterly general meeting of the Chamber on ,June 9, 1964)*

The views expressed in this booklet are not necessarily the views of the Forum of Free Enterprise

"Free Enterprise was born with man and shall survive as long as man survives."

--A. D. Shroff

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