

WHY ARE PRICES RISING ?



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PRICE RISE IS DUE TO BUILT-IN INFLATIONARY SITUATION IN OUR PLANS *

G. D. Somani

WINDING up the debate on the Third Plan in the Lok Sabha, the Union Minister for Planning expressed deep concern over the recent increase in wholesale prices and observed that the Government is at present engaged in a thorough study of the implications of these trends. He even went to the length of suggesting that Government will not hesitate to take whatever action, legal and administrative sanction, that may be required to hold the price line. The attention is focussed on this aspect of high prices built into the economy on the basis of the price indices which stand at 131.8 compared with 128.7 in the previous year at the corresponding period. I need not go into the history of our price inflation as it became very clear in the working of the Second Plan that among the conditions necessary for ensuring stable growth in the economy the holding of the price line should receive priority. In fact, though the business community itself had pointed out the dangers and the wider ramifications of rising trend in prices, it was generally accepted that the problem was to prevent any further rise in the Third Plan period than to attempt to enforce any system of control. No less an authority than the then Governor of the Reserve Bank, Mr. H. V. R. Iengar, while trying to explain the measures taken by the Reserve Bank and the Government to keep the prices under safe limits had clarified that no alarmist attitude should be taken on the

**Excerpt from Mr. Somani's vice-presidential speech at the second quarterly general meeting of the Indian Merchants' Chamber, Bombay, on September 7, 1962.*

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

—Eugene Black
President, World Bank

price situation though it was vitally necessary to hold the price line. The current price rise by over 10 points is not, therefore, a situation that has developed out of any external factors but is the normal follow-up of a built-in inflationary situation.

The Indian Merchants' Chamber had previously indicated that the Third Plan period may have to face a period of rise in prices unless steps were taken through appropriate changes in the fiscal and monetary policies to contain the price-level. In this connection, I need only point out to the major factors that have led to the price rise. There have been shortages in the key sectors of the economy, in power and coal, transport and raw materials. There has been a slowing down in the tempo of industrial development. I have already referred to the slack in agricultural production. Besides, the trends in raw material prices have contributed largely to the rising trend since almost the middle of the Second Plan. In fact, the Chamber had repeatedly invited attention to the rise in the price of raw materials which in turn affected industrial costs. In addition, the continuous and almost successive additions to taxation, direct and indirect, may have contributed to the pressure on prices. It is a matter for examination, how far the additional taxation has been responsible for this inflationary rise in prices. At any rate, taxation is not necessarily an anti-inflationary measure. Under certain conditions, particularly with the characteristic of a weak agriculture and the existence of imbalances in the important sectors of the economy, it is possible that the monetary and fiscal policies have themselves released the forces leading to a chain reaction with higher demands from labour and other factors of production and therefore a rise in prices. It would be necessary to mention the fact of monetary expansion in the economy in the period of the Second Five-Year Plan of nearly Rs. 950 crores of deficit financing. This had already established a condition of inflationary pressures in the absence of the cushion of increased production. The beginning of the Third Plan has also started with a sluggish production trend with an expansion in money supply

of Rs. 210 crores (first two years of the Third Plan) by way of deficit financing. What is important to note here is not the order of deficit financing but the absence of a corresponding support by way of strengthened production in agriculture and industry. In the background of a slow rate of increase in production and shortages, deficit financing even of a small dimension is likely to disturb the course of prices.

To my mind it appears that the present price rise should not have been followed up with forceful suggestions of administrative and legal sanctions to curb the price level. I do not say that the price level is of no concern at the moment or it is not an aspect which requires continuous watch. On the other hand unless we hold the price line the gains in the agricultural or industrial sector would be neutralised by the continuous rise in prices. I only suggest that while every step should be taken to maintain the prices at a steady level, the measures enforced should look to the basic causes of the rise in prices. The mere suggestion of a control or regulation would only adversely affect the climate for rapid development and also disturb the demand and supply factors in the various sectors of the economy. Our experience of controls and regulatory measures in regard to the price situation in the Second Plan period and even previously should serve as a warning against any hasty clamping of regulations at the present stage of development. This may further release a chain of forces which may defeat the very objective in view. The situation may even deteriorate if any such proposals are given effect to without considering the basic factors which have been responsible for the present rise in prices. Essentially, the imbalances and shortages that have developed in the economy have been the main contributing factors in pushing the prices up. Unless a determined effort is made to remove the bottlenecks, the imbalances will persist and the price trends may not improve. The only positive remedy in the present condition appears to me to be increased production and high productivity. It is also necessary to examine and review the fiscal and monetary policies and so adjust them as to

facilitate increased production. I would lay all emphasis on these two factors. I am sure with a co-ordinated effort on the part of Government and the business community it should not be difficult to meet the present situation.

"Some people in politics, in public life, in business, and even in the universities, would have growth at any cost, even at the expense of persistently rising prices and all that this would mean in social injustice at home and financial failure abroad.

"The fundamental objection to persistently rising prices is a simple matter of justice. The principal sufferers from rising prices are pensioners, civil servants, teachers and others whose salaries and remuneration are adjusted infrequently and therefore cannot keep pace with rising prices, and all who have not the means or the knowledge to invest in stocks or real estate but have put their small savings into bank deposits or life insurance. Anyone who knowingly promotes or condones a policy that leads to persistently rising prices is morally responsible for plundering the savings of the poor and of other groups who cannot help themselves, in order to enrich mostly speculators and those who having borrowed on a large scale are able to repay in depreciated pounds."

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"The word 'inflation' is sometimes used to describe a persistent tendency for prices and costs to rise. This word is misleading because it suggests that the quantity of money has been solely responsible and distracts attention from other causes, not least high taxation."

—Colin Clark in "GROWTHMANSHIP"

GOVERNMENT'S POLICY IS RESPONSIBLE FOR PRICE RISE *

THERE have recently been press reports to the effect that the Minister for Planning stated in Parliament that the general index of wholesale prices had risen from 128.5 on August 5, 1961, to 131.8 on August 4, 1962, and that this rise has caused great concern to the Government. The Minister is reported to have attributed the price rise to private enterprise and to have hinted at Government's intention to introduce State trading and Co-operative marketing and distribution as regulatory measures to check the rising prices.

The wholesale price indices for August 5, 1961, and August 4, 1962, are given in Statement I below:

STATEMENT I.
Index of Wholesale Prices.
(1952-53=100)

Items	Week ended	
	4-8-1962	5-8-1961
I. Food Articles	132.9	124.1
II. Liquor and Tobacco	98.6	100.1
III. Fuel, Power, Light and Lubricants	124.5	122.3
IV. Industrial Raw Materials	139.5	150.5
V. Manufactures	129.0	127.9
(a) Intermediate Products	143.6	141.8
(b) Finished Products	126.6	125.6
VI. General Index	131.8	128.7

* This is the memorandum submitted by the Indian Chamber of Commerce, Calcutta, to the Planning Commission on Sept. 15, 1962.

It is seen from the above Statement that the rise is largely under the item "Food Articles", the index of which has risen from 124.1 in August, 1961 to 132.9 in August, 1962, an increase of almost 9 points. There are only marginal increases in respect of the other components of the wholesale price index such as "Fuel, Power, etc.", and "Manufactures". For "Industrial Raw Materials", the index was 150.5 on August 5, 1961, and this has declined to 139.5 on August 4, 1962. For "Manufactures", the index was 127.9 on August 5, 1961, and there is a marginal increase to 129.0 on August 4, 1962.

The Chamber has analysed in detail (from the weekly publication "Index Number of Wholesale Prices in India — Revised Series" issued by the Economic Adviser to the Government of India) the rise in prices of various commodities during the last year, and it is found that, the increase in the Index relating to "Manufactures" which has hardly been 1% despite appreciable rises in raw material prices, or increase in excise duty, railway freight and other factors beyond the control of industry and trade. For instance,

- (a) The price of coal has increased by 7.9% during the last year. The price of raw cotton has increased by 5.9%. Despite this, the price of cotton manufactures has increased by 2.7% only. It may be recalled that there was an upward adjustment of the rates of excise duties on certain kinds of cotton yarn and processed cotton fabrics in the 1962 budget. In spite of higher coal prices, higher raw material cost, higher cost of labour, higher transport cost and the increased excise duty, the rise in prices in respect of cotton textiles has been only marginal.
- (b) The price of raw wool has advanced by 10.3% and this is reflected in an increase of 14.1% in woollen manufactures. The weightage of "Woollen Manufactures" for the wholesale price index is only 3 out of 1000 units and so the effect (on the Wholesale Price Index) of 14% increase in the price of "Woollen Manufactures" would be negligible.

- (c) The other significant increase in the Index in respect of "Manufactures" has occurred under "Chemicals". The Index for General Chemicals was 97.7 in July, 1961. It increased to 99.9 in April, 1962. In July, 1962, it had increased much farther to 110.9. It may be recalled that in the 1962 budget excise duties at the rate of 10% **ad valorem** have been levied on basic chemicals like sulphuric acid, hydrochloric acid, nitric acid, chlorine, ammonia, oxygen and carbonic acid. These items are used in the manufacture of various other chemicals, and consequently the Index for "General Chemicals" has increased by eleven points between April and July, 1962. New excise duties were levied in April, 1962, on asphalt, bitumen and tar, and this probably accounts for the increase of almost 26 points in respect of coal tar products. The Index for copra has increased by more than 15% and this is reflected in the ten point increase in respect of soap.
- (d) The Index for "Iron and Steel" was 146.7 in July, 1961. It rose to 151.5 in April, 1962. By July, 1962, it had further increased by 5.3% to 160.5. It may be recalled that excise duties ranging from 5% to 7½% **ad valorem** on certain kinds of iron and steel products were imposed in the 1962 budget, and this probably accounts for the 5.3% increase in the index in respect of "Iron and Steel" between April 1962 and July, 1962.

The fact that despite the increases in the cost of iron and steel, fuel, raw materials, labour and rail transport and also increased or newly levied excise duties, the Wholesale Price Index in respect of "Manufactures" has shown only a marginal increase of less than 1% between August 1961 and August, 1962, is a significant factor which redounds to the credit of manufacturers and those trading in manufactured articles.

The Statement II below gives the Wholesale Price Index in respect of 'Food Articles' during the period March to August, 1962:

STATEMENT II.

(Statement showing the progress of the Wholesale Price Index in respect of 'Food Articles' month by month).

(1952-53=100)

Item	3-3-62	7-4-62	5-5-62	2-6-62	7-7-62	4-8-62
Food Articles	119.6	119.2	122.1	126.0	126.7	132.9

It is seen from the above that the Index in respect of 'Food Articles' has risen from 119.2 in April to 126.7 in July and 132.9 in August. Thus there appears to be a steady rise in respect of "Food Articles" since March this year. A scrutiny of the Index relating to the last 36 months in respect of "Food Articles" shows that the Index is largely at its highest in July/August each year. Apart from this, it will be noticed from the above Statement II that there has been a steady increase in the Index during the last five months of the current year. In March 1962 Government announced the policy of buying certain major food items at fixed prices. That was essentially the fixation of floor prices. But since March 1962, the price index of all food items has continued to increase and as the weightage on food price contributes 50% of the total price index, this obviously had repercussions in all sectors.

Between July 7, 1962, and August 4, 1962, there is a spurt in the index in respect of "Food Articles" from 126.6 to 132.9. In the Government's Press Note dated August 28, 1962, this is attributed to increase in the price of rice, milk, ghee, fish and sugar. "Fish and Meat" accounts for only 17 units out of 504 in the "Food Articles" index: so the 7% increase in the price of fish cannot have any decisive effect on the six point increase in the "Food Articles" Index between July and August. For the same reason the 1% increase in sugar, and the 2% increase in ghee are not any major factors. Rice accounts for 112 out of the 504 units in the "Food Articles" Index, and Milk accounts for

47 out of the 504 Units. The 9% increase in the price of milk, and the 5% to 6% increase in the price of rice are probably major factors responsible for the increase in the "Food Articles" Index from 126.6 in July 1962 to 132.9 in August, 1962. It may also be recalled that with effect from July 1, 1962, increased freight rates have been brought into force. Goods earnings of the Railways are expected to be 4% more than in the previous year. The impact of the increased railway freight has also to be taken into account in determining the factors responsible for the spurt in the "Food Articles" Index since July, 1962. The trend of foodgrains prices depends largely on the weather conditions and the transport availability for moving the foodgrains to the points of demand. But this could be easily controlled by suitable releases from the buffer stock under P. L. 480.

The main reason for the increase in the general price index during the period August 1961 to August 1962 has been the rise in food prices, and for this the attack has largely been on the trade which is accused of large-scale profiteering and hoarding resulting in higher prices. As remedial measures it has been suggested that to improve distribution State trading and co-operative organisations should come into the picture.

The Committee would like to point out that the introduction of State trading and of distribution through co-operatives will change the entire structure of trade. It will throw out of business a large number of self-employed persons engaged in the distributive trade. Further, the new methods suggested may result in higher costs to the consumer. It may be recalled that State trading in foodgrains during and after the Second World War caused a loss of over Rs. 230 crores between 1944 and 1953. More recently when State trading was resorted to in respect of certain chemicals like mercury, camphor, acetic acid, caustic soda, etc., on the ground that the prices charged by the established importers were high, the prices of these chemicals, after their import by STC, instead of coming down, went up still further. Nor are co-operative societies any answer to the problem of distribution. The experience so

far has been that co-operatives have tended to increase the costs to the consumer. In the sugar industry, for instance, the Government's policy of encouraging supply of cane to factories through cane-growers' co-operative societies has only resulted in the mills having to pay higher price for the cane, which in turn has become reflected in higher sugar prices to the consumer to the extent of eight annas per maund of sugar.

Traders in foodgrains and other agricultural and semi-agricultural products work on small margin. Co-operative Societies, on the other hand, will have to work on much higher overheads, and also on capital assistance from Government, which means that at some stage the expenses will have to be borne by the community as a whole. The Committee wish to point out that the price charged by the producer to the distributing agency will be the same whether the distribution is made through a co-operative society or through private traders. The difference between the producer's price and the price charged by the distributive trade arises from the cost of moving the foodgrains from the points of production to the points of demand; milling costs; the cost of storage from the time of acquisition to the time of sale; the cost of finance; and in addition a profit margin for the trader. In the case of co-operatives, the institutional costs are a further item. The trade serves the consumer at less cost than the co-operative societies. Before the Government resorts to distribution through the co-operative sector, it should carefully assess the cost structure of the private distributive trade and compare it with the cost structure of the co-operatives, when it will be found that the private distributive trade is much more economical.

While food prices have increased since Government's announcement of a price support policy for foodgrains, it is not yet clear as to at what level the Government wants the food prices to be established. By and large, therefore, the whole question of the increase in prices is related to Government policy in regard to food and the return it **wants** to ensure to the cultivators, and there does not appear to be any justification to accuse the trade.

PAPER CONTROLS ARE NO SOLUTION TO PROBLEM OF PRICE RISE *

S. Venkataraman

THE question of holding the price line is engaging the attention of the Government. While a rise in prices cannot be altogether eliminated in an expanding economy, the rise is taking place in such proportions that it bears no relation to the extra money now put into the hands of the individual. The average index of wholesale prices (with 1952-53 as the base, i.e., 100) which was 127.5 in 1960-61 came down to 122.9 in 1961-62. From April 1962 onwards however there has again been an upward trend in prices and the average for July has exceeded 130. A study of the index of wholesale prices by groups reveals that the increase is noticeable in the case of food articles, industrial raw materials, fuel and power while the increase in the price of manufactured goods is only 2 points. It is, therefore, seen that the present increase in prices is more due to increase in the price of food articles.

If the high price level continues in spite of large import of foodgrains it only indicates that we are not making enough efforts to import or produce adequate quantities of rice. The present food problem is more a problem of availability and supply of rice. The Governments at the Centre and the State should see that adequate supply of rice is made available under the various aid programmes. I am sure, if such a step is taken the price of rice would certainly come down. The other day the Minister for Food and Agriculture has stoutly defended the need for giving the producer an economic price and he is not in favour of any elaborate control machinery. On the other hand,

**Excerpt from Mr. Venkataraman's presidential speech at the 34th annual general meeting of the Andhra Chamber of Commerce, Madras, on September 26, 1962.*

the Minister for Labour and Planning has said in very clear terms that the problem of prices can be tackled effectively only by elaborate control over distribution, licensing of dealers and by the creation of co-operative distributive organisations. Whatever the agencies created and regulatory measures introduced unless adequate rice is made available to meet the demand, the price of food articles cannot be brought down. After all the principle of supply and demand cannot be negated by paper controls.

I express the hope that the Government would not ignore the vital role played by the business men in the distributive trade. The private trader operates in a free and competitive market and he has built the distributive mechanism over years of experience. It is not wise to disturb the well-established channels of trade and experiment with the creation of new agencies whose utility or success is not quite certain, if not doubtful.

INFLATION HAS COME TO STAY *

G. R. Chandrasekariya

AS a result of the Five-Year Plans and the pumping in of money into the hands of the workers in the shape of higher emoluments, we have been witnessing, over the last one year, mounting inflation and sharp shooting up of prices, particularly the prices of consumer goods and food-stuffs. In order to combat this successfully, production should be stepped up and the schemes adumbrated in the Five-Year Plans both in the private and public sectors should be made to bear fruit and the over-all availability of consumer goods, sufficient to meet the demands. At least, the immediate objective should be self-sufficiency in food production.

Inflation has come to stay. People are unwilling to invest in fixed yield securities, in spite of attractive yields. They are afraid that their investments in terms of the purchasing power of money will depreciate in value and hence the emphasis is more and more towards equity shares. Equity shares as representing the real assets of any undertaking are considered as good as real property and this explains the scramble for equity shares witnessed from April 1961. The growth prospects of equities were freely canvassed and prices of shares soared up, yield considerations being relegated to the background.

* *Excerpt from Mr. Chandrasekariya's presidential address at the annual general meeting of the Madras Stock Exchange on September 22, 1962.*

INCREASED PRODUCTION OF FOOD- GRAINS IS THE SOLUTION TO PRICE RISE *

M. H. Hasham Premji

IN recent years, the Government appears to be greatly perturbed at the rise in the wholesale prices that has taken place in the country, particularly in respect of foodgrains. Mr. Gulzarilal Nanda, Vice-chairman, Planning Commission, has referred with concern in his recent statements in Parliament to the rising prices and mentioned that studies were being made of the production, distribution and trading aspects of the main agricultural commodities. The Parliamentary Congress Committee for Prices has expressed its anxiety over the recent rising trend in prices as this might endanger the Third Plan. It is further learnt that with a view to arresting the so-called trend of rise in wholesale prices, the Planning Commission is envisaging a return to the scheme of licensing wholesale traders in foodgrains and the concept of "strategic controls" is being worked out in detail by it, whereby the regulatory measures would touch wholesale traders, leaving out the primary producers and retail traders untouched.

It is not fair on the part of the Government to throw blame, every now and then, on the foodgrains trade, for the present state of affairs, as has been done by Mr. T. T. Krishnamachari who recently unwarrantedly blamed the foodgrain traders as standing between the producer and the consumer. It is necessary to investigate thoroughly the inherent causes for the so-called rise in the wholesale prices in the country and to find out the correct diagnosis of the "disease" before taking steps to cure it.

* Excerpts from a statement issued to the Press by Mr. Hasham Premji, President of the Federation of All-India Foodgrains Dealers' Associations, on September 25, 1962.

Price indices for recent months have no doubt shown some rising trend. With 1952-53 as the base, the wholesale price index for all food articles reached 120.6 in June 1961 and climbed upto 125.4 by June 1962. Thus, the price-index of food articles as a whole has come up by about 8% during the six months ending June 1962. The index numbers having risen from 118.3 to 125.4 (1952-53=100), the price of agricultural commodities as a whole have risen by merely 1.7%. The main reason for the spurt in prices of foodgrains is not the rise in prices of wheat or pulses, the index number of which during the period January to June 1962 shows a rise of 3 and 6 points only, respectively, from 102 to 105 in respect of cereals and 97 to 103 in respect of pulses. Among cereals there was a rise in the index numbers of rice by 10 points (from 101 in January 1962 to 111 on the 30th June 1962). The prices of wheat actually declined by 10 points (from 98 to 88) during the same period. The so-called unduly large rise in the prices of food articles during the first six months of this year is mainly on account of the other constituent items in the index numbers, namely, those of Fruits and Vegetables which show a rise of 9 points (from 133 to 142), milk by 22 points (from 112 to 134), ghee by 7 points (from 116 to 123), sugar by 9 points (from 122 to 131) and gur by 21 points (from 108 to 129), and others by 6 points (from 164 to 170). Thus, it will be noticed that the recent price rise in the country is largely on account of the marked rise in the prices of the items other than the main foodgrains, namely, wheat, rice and pulses. There has been a rise in prices of millets, especially Jowar. Its index number rising from 115 (in January 1962) to 133 (on June 30, 1962) due to a serious fall in production last year. But these are minor items in foodgrains. The new Jowar and Bajra crops will be coming to the market shortly and the prices of these commodities are likely to come down within 3 to 4 weeks.

It might be stated that there has also been a considerable rise in the cost of production to the farmer on account of the use made by him of better seeds, fertilizers in increasing quantities, execution of several farm-improve-

ment schemes, introduction of better farming methods, etc. Added to this are the costs which he has now to bear on account of the larger incidence of various new taxes, such as the water cess, development cess, etc. in case of vast areas of newly irrigated lands. The farmer now has to incur larger amount of expenditure over items other than necessities on account of his greater association with the urban sector consequent to development in roads, transport and communications as also on items like housing, sanitation, clothes, education, etc. These factors have contributed towards the all-round rise in the cost of living of farmers and of agricultural labour, and production costs in the agricultural sector. There is, therefore, a very strong ground to grant the farmers some compensation by allowing a slight increase in prices of foodgrains to cover part of these higher costs, to provide him incentive to make use of better and more effective farm-production practices and to keep his interest alive for higher production, which is one of the main aims of the Third Plan. Appreciating this fact, the Government, as a policy, has raised the price-levels of jute, cotton, sugarcane, tea, which has also reflected on the prices of oilseeds which are high. Naturally, the farmer looks forward to a little higher realisation in foodgrains, and the Government, therefore, must raise the level of foodgrains a little higher so as to prevent diversion of foodgrain crops to the production of cash crops which might appear attractive to the farmers from the point of view of prices and benefits gained thereby. This point seems to be well appreciated by the Union Food Minister, Mr. S. K. Patil. While speaking of prices of certain better varieties of foodgrains, he said: "70% of the consumers were producers themselves and the whole agricultural economy would not be shaped to suit the convenience of 30% of the consumers living in towns. In agriculture, it is the farmer who has got to be protected more than anybody else." This emphasises the necessity of providing incentives to farmers producing foodgrains by way of offering slightly higher prices.

There has also been an important shift in the articles of consumption by the people in the country due to urban-

isation of the population and the rise in the standard of living. Consequent to this change, the Index Number of Prices itself cannot reflect the change in prices correctly. The Parliamentary Congress Committee for Prices itself rightly felt the need for a change in the items included in the Index Numbers so as to have correct reflection of the price trend, in view of the fact that a considerable change had taken place in the articles of consumption.

For whatever rise in prices of foodgrains that has taken place, it is futile to throw the blame entirely on the foodgrains trade as such. The stocks with the trade constitute hardly 3% of the total production in the country and the benefit of the rise in prices does go almost entirely to the agriculturist. The trader is only interested in his normal margin of 8 annas per maund that he very often does not get. This constitutes hardly 2½% to 3% of the total sale price, which the trader gets by way of remuneration for all services he renders in respect of distribution.

It has also been often alleged that due to expansion of money and bank credit, there has been hoarding of foodgrain stocks by the traders. This is not quite true. With the stringent money conditions and the restriction on bank credit, it is impossible for the foodgrain traders to hold any stocks of foodgrains. Besides all the stocks with the trade are known to the Government which calls for and receives their stock statements periodically under statutory obligation. On the contrary, Government distributive machinery requires considerable improvement. These are all factors which are beyond the control of the trader and which affect the prices.

It is noteworthy that the Planning Commission in its anxiety to arrest rise in prices of foodgrains is devising a scheme of imposing new pattern of controls over the wholesale trade by licensing them, fixing a range of prices within which they will carry on buying and selling operations and thereby enabling Government to procure foodgrains, both from the wholesale dealers and mills and release them to consumers' stores, co-operatives or other-

wise. These measures would, in fact, constitute imposition of the wartime controls on foodgrains from the backdoor — old wines in new bottles only — and would necessitate a large bureaucracy. This is likely to bring forth in its train all evils which had cropped up in the past. It would hamper the smooth functioning of the foodgrains trade, and might prove detrimental to the interests of consumers as well as farmers ultimately. These proposed measures to impose controls on the wholesale trade of foodgrains are likely to defeat the very purpose for which they would be devised. In the past, all sorts of measures from full control to partial have been tried. Experience of the last 15 years has, however, shown that the economy under decontrol has had the greatest effect on increasing production, improving yields and providing incentive to the agriculturist in increasing productivity of the land. This has enabled the country to attain the record production level of 80 million tons. The consumer has had the greatest benefit under the present set-up. Any panicky and ill-conceived measures of control by the Government at this juncture would certainly retard the progress and discourage agriculturists in their greater efforts at increasing production and productivity.

The general rise in prices over a period is mainly due to large expenditure on developmental projects and the accumulation of money in the rural and urban areas as also with the co-operative sector which means higher purchasing power in the hands of consumers. This is accompanied by the growth of population at the rate of 2% annually in contrast to a slower rate of production. The production of foodgrains last year remained at the same level as that of the previous year. Before the commencement of the Second Plan, there was a considerable fall in prices, and bright hopes were entertained about the future at that time. During the period of the Second Plan, from 1956 upto 1958, the food prices rose by 14.5 per cent more than the price of raw materials and manufactures; during 1960, however, prices of the latter advanced more than those of the foodgrains. This has caused instability of prices. The unbalanced correlation between

prices and production can, therefore, in brief, be attributed to many internal factors, such as, restraining measures like controls, procurement and formation of zones and variations in marketed surplus, imports, transport bottlenecks and several obstacles in the way of the smooth functioning of the distributive channel, as also to several external factors, such as, the rapid population growth — increasing at the rate of 8 million per annum —, the rising levels of **per capita** consumption, which has increased by 276 calories between 1950-51 and 1955-56, and wide regional variations in cereal consumption in the country.

A solution to this problem cannot be controls and irksome restrictions on the movement and distribution of foodgrains. The correct answer to this problem lies in increased agricultural production. The removal of restrictions on the movement of wheat has had a salutary effect on equalising the price-level all over the country. As a result of the removal of inter-State restrictions on movement of wheat, there has not only been a fall in the all-India index number of wholesale wheat prices, but the differentials in the prices as between various States also have narrowed down. This has brought down the high prices of wheat in the deficit States, while the prices in the surplus States have remained steady to a large extent. The same healthy effect is sure to follow by the removal of the present zonal restrictions on the movement of rice also. The zonal barriers on rice are ill-conceived. They do affect the overall price-structure as the net effect of rise in prices in one zone affects the overall price-structure in the zone formed of different States and causes undue rise in prices. It is wrong to presume that the removal of zonal barriers will result in larger consumption of rice. Moreover, we have at present a buffer stock of two million tons of rice and wheat which would provide the necessary cushion against possible fluctuations in prices.

The corner-stone of our whole food policy should be the attainment of a sustained increase in our agricultural production so as to meet the three-fold needs of a rapidly rising population, a steady improvement in the standard

of living and the vital necessity of the country to earn foreign exchange as much as possible. Optimistic signs are visible on the foodgrains production front. There is a record level of food production of about 80 million tons during the current crop year, when rice and wheat—the two major items of our foodgrains—have reached the highest level of about 34 million tons and 11.5 million tons, respectively. This makes us hopeful of attaining the envisaged target of 100 million tons by the end of the Third Plan.

At this stage, it would be pertinent to record that a good deal of adverse effect on prices is caused by certain ill-considered steps that are being undertaken by certain State Governments under their foodgrains policies. Many of these policies exert serious and vital effect not only on the price structure within the State itself, but on other States also. One recent experience was the statement of a Madhya Pradesh Minister to the effect that if the monsoon rains did not come in time, it might be necessary to stop exports from Madhya Pradesh. The adverse effect of such statements in other States on very sensitive prices of foodgrains can readily be appreciated. It must not be forgotten that it would be a rare occurrence if the rains were very good in all the States over the country in any year. Parts of the country which might receive less rains are bound to be affected, whereas other parts might get bumper crops. Food situation, therefore, must be considered in its overall aspects concerning the country as a whole. The present arrangements in Madhya Pradesh to permit exports of only a percentage of foodgrains against delivery to the State of a certain percentage does result in adverse effect on the prices by withdrawing from the consumers that large quantity. The policy of the Punjab Government and that of the U.P. Government in other respects also affect vitally the price-structure. The agitation in Orissa against exports to Bengal also adversely affects the foodgrains prices in certain surplus States. The ill-conceived statements and measures of the State Governments result in price rises for which the foodgrains trade should not be blamed.

OVER-INVESTMENT IS THE REAL CAUSE OF PRICE RISE *

Prof. B. R. Shenoy

PROF. B. R. SHENOY, an eminent economist and Director of the Gujarat University School of Social Sciences, has attributed the spiral of rising prices to what he calls over-investment and warned that the steps contemplated by the Government of India to check the price-rise were apt to render the existing confusion worse confounded.

Analysing the Price situation and the country-wide debate on the measures to check the rising prices, Prof. Shenoy told "The Economic Times" that it was a sad commentary on the economic and monetary enlightenment of the Indian people that vested interests should be able to sell the queer notion that a "rise in prices is the very condition of economic development" and that legislative and administrative measures could restrain rising prices.

More dangerous and misleading economic untruths were not spoken, he said, and added that logic and experience had repeatedly demonstrated that price stability was an essential **pre-condition** of stable economic growth even as the growth of an infant into manhood was not a disease to cause an inflationary upset. Economic development at near-record rates in the EEC countries, in Japan, Hong Kong, Israel and other countries had materialised under price stability and there was no device of controlling inflation other than putting a stop to it.

In reply to a question as to why the prices were rising after a decline of 3.4 per cent in 1961-62, Prof. Shenoy said the current phase of the price-rise, which began in May 1955, and the spurt in prices within this phase since April 1962 should be distinguished.

**This is the report of an interview in "Economic Times", Bombay, dated September 18, 1962.*

Prof. Shenoy said the current phase of the price-rise was the direct outcome of our desire to "invest" resources which we did not possess. The link between such investment and the price-rise could be easily seen, he said. "Investment beyond the available resources takes the form of budget deficits. The deficits are covered by printing money, part of which goes to commercial banks from the contractors or others who receive them, and the banks add to the finance they provide—through loans, advances, discounts and overdrafts—for investments in the Private Sector. Over-investment thus spreads from the Public Sector to the Private Sector.

"Meanwhile, as over-investment cannot add to the available physical resources, it cannot add to the flow of the national product either. The expansion of money ensuing from over-investment will, therefore, outpace the output and a price-rise will emerge inevitably. This explains the expansion of money by 60 per cent from 1954-55 to 1961-62, while the national product rose during the period only by 27 per cent. As a result prices rose by 34 per cent during the interval," he said.

Replying to a series of questions, Prof. Shenoy explained the 3.4 per cent fall in prices in 1961-62 by saying that the expansion of money during the year, resulting from over-investment on the Plan did not all remain in circulation. Most of the inflationary funds flowed back into the Reserve Bank in payment for the foreign exchange being drawn from the general purpose foreign aid. The amount of the utilised foreign aid during the year was Rs. 344 crores and the largest bulk of it was general purpose foreign aid. As a result, the expansion of money during the year was held down to Rs. 170 crores, which apparently fell short of the needs of the economy, the national product rising during the year by over 3 per cent.

Explaining the point further, Prof. Shenoy said foreign exchange from the general purpose aid could be sold to any party, so it could withdraw inflationary funds in circulation. Aid tied to projects concerned could not be used to

withdraw from circulation inflationary funds. This also explained our eagerness for general purpose foreign aid, he said.

Analysing the spurt in prices since last April, he referred to the meetings of the Aid-India Club and said quantum of the general purpose aid was still in doubt and the country, due to pressure for foreign exchange resulting from over-investment persisting, was drawing on currency reserves to the utmost possible extent. The result was that the inflationary moneys issued out through over-investment remained in circulation and drove prices up. During the 4½ months ending August 18, 1962, the price index had risen by 7.2 per cent to 131.7 (1952-53 as 100). This amounted to an annual rate of increase of 19 per cent, which was an all-time record, the previous high being 11.2 per cent in 1955-56.

Analysing the slump in the share market in the background of inflation, Prof. Shenoy said that the country's Plan depended on foreign aid to a dangerous extent. The scarcity of utilisable foreign aid had lowered industrial activity, through the short supply of raw materials and accessories. The adverse effects of this on production, in the context of rising production costs, were apt to reduce profits and dividends. A slump in share prices was a natural result. He linked the sharp fall in January 1962 of the "Economic Times" index of ordinary share prices to the second adjournment of the Aid-India Club meeting, and said that the factor had been reinforced by the Chinese border incidents.

Agreeing to a suggestion that the shifting of the projects aid to general purpose aid might provide a temporary relief both from the price-rise and the share-market slump, he said that the root cause, which was the futile and self-damaging effort to invest non-existent resources, should be removed.

"If we must have orderly and stable development, we must first put a stop to this strange pursuit. The correc-

tive to boiling water — rising prices — is to remove from underneath the fire of deficit budgeting: to pour cold water — foreign aid — can lower the temperature only temporarily. If aid fell short of inflation, prices will resume their upward trend," he said.

"It is therefore inescapably the duty of the modern industrial State, as it certainly lies solely within its power, to guard against the twin causes of inflation: first, the combined overspending on current and capital accounts by the State, as compared with the funds the State is subtracting (by taxes and borrowing) from its citizen's flow of purchasing power; and secondly, the ordering of its own programmes and those of the nation, through its monetary powers, so that total monetary demands run ahead of the nation's total real resources.

"There are only two ways to stop continuous inflation. Both are needed at once :

"1. To cut down the pressure of new money and credit, by cutting Government and State expenditure to fit reasonable tax revenues (such as give people of all classes and incomes incentives) and to fit the available savings which the State and private enterprise can borrow at free market rates of interest, at medium or long term; and

"2. To raise productive efficiency (productivity) in all walks of economic life, by cutting down restrictive practices of all kinds, by improving managerial techniques and training, and by getting more modern machines and then letting them turn out all they are capable of producing (which means revising both trade unionists' and managements' attitude to shift-work, organization, machinery managerial methods, etc.)."

—Graham Hutton in "Inflation & Society"

The views expressed in this booklet do not necessarily represent 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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