

# DEFICIT FINANCING AND INFLATION

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by

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Now that the new Governments at the Centre and in the States have been formed, it is time to consider the economic situation in the country. It will be necessary for the Government at the Centre or in the States to take concerted action to remove the fundamental maladies in the economic situation in order to enable the economy to go forward.

The object of this series of articles is to draw attention to the most important immediate economic problem of continuously rising prices or the deep seated inflationary trend in the country which has assumed dangerous proportions. In order to bring home to the reader the way in which any Government behaves under conditions of inflation it is proposed to give in this article some illustrations from recent history; in the second and third articles we shall attempt to give an account of the way in which inflation causes widespread misery and makes progress impossible; in the fourth we shall suggest remedies which are urgently required, and in the fifth and last article we shall emphasise the need for a unified approach for the remedies.

Before the First World War, the British people had enjoyed a long spell of prosperity. The average British citizen was not aware of the possibility of the pound sterling being liable to an inflationary situation with rising prices.

The demands of the War of 1914-18 made it necessary for the British Government to resort to inflation of currency. They were however anxious to conceal the fact

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

**—Eugene Black**

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from the public. This was done by severe controls of articles of daily necessities in order to keep prices at a reasonable level.

At the same time the vaults of the Bank of England in which the gold reserves of the country were maintained were kept open for the public to view in order to convince them that the currency had the strong backing of the gold reserves. Under the circumstances, it was not easy for the people to understand that the value of the pound was gradually going down because of the action of the Government in inflating the currency as a measure of war finance,

Economists who understood the situation were not able to convince the public easily about the consequences of the inflationary trend. In order to bring the matter home effectively an unusual step was taken which may be of interest. Dr. Edwin Cannan, then Professor of Economics in the London School of Economics, was well known as a leading authority in economic affairs.

Cannan filed a suit in the Oxford Court against the Chancellor of the Exchequer. His plea was that the Chancellor of the Exchequer was guilty, almost like a thief, in as much as he by his actions, was responsible for taking away the value of the pound in his (Cannan's) pocket. The suit was dismissed but the matter got wide publicity in the British and world press, and everybody knew that it was the British Government which was responsible for inflating the currency and reducing the value of the pound sterling.

Though people in India now talk of inflation with or without understanding its significance fully, they were also ignorant about the concept of inflation till 1943. During the Second World War the position of the British Indian Government was difficult. The political situation in the country was tense with the Gandhian movement at its height in the country. The people were in no mood to co-operate with the Government in the World War. The Allies found it necessary to use India as the base of operations in their effort to drive the Japanese back from the Pacific countries which they had overrun. After taking

Burma, the Japanese were almost on the borders of North-East India.

In order to deal with this situation, the war operations took large dimensions in India with the arrival of allied troops and equipment at Bombay and Karachi to be despatched to the Eastern theatre. The requirements of Allied troops in India had to be financed by the Government of India in the first instance in rupees.

They could do so only by inflating the currency. In consequence, prices were rising rapidly from 1942. It was estimated that inflation of the Indian currency was of the order of a crore a day from the beginning of 1943. Some people who made quick gains out of this were happy; others were confused. But few understood the problem.

The publication of a pamphlet entitled "The Falling Rupee" by the present writer in January 1943, was the beginning of understanding of the inflationary situation among the public. This effort was followed by other economists soon after in different parts of the country.

The Finance Member of the then Government of India denied the fact of inflation in presenting the budget for 1943-44 in the Imperial Legislative Assembly on 28th February and in subsequent discussions. There were no persons in the Assembly then who could challenge the statement of the Finance Member and the Budget Session closed with such denials.

At that time about 30 well-known economists in the country came together and issued a manifesto pointing out the dangers of inflation. This belled the usual impression that economists cannot agree on anything. It appears that during the summer, when the Government of India went to Simla they were able to realise, probably on the advice of their Economic Adviser, Sir Theodore Gregory, of the need for timely action to check inflation.

In June and July 1943 a series of anti-inflationary ordinances were issued by the Government of India controlling prices of food, cloth and other essentials. Though the Government of India thus yielded to the arguments of the economists, they were not happy about the way in which they were exposed. It is believed that the question

was discussed in the Finance Department whether it would be possible to prosecute the writer of "The Falling Rupee" under the Indian Penal Code, in which there is a section to the effect that any one who takes away the confidence from the currency is liable to two years' imprisonment.

When my attention was drawn to this possibility, my attitude was that I would in that case call ~~Sir~~ Theodore Gregory as a witness and ask a few questions, and he would have to agree that if there was any one guilty of taking away the confidence from the currency it was the Finance Member, even as Cannan proved this earlier in the case of the Chancellor of the Exchequer. Gregory and I both happen to be students of Cannan. What was being done by me was interpretation of the economic phenomenon which it was my duty to do.

Though no immediate action was taken, the vengeance of the Government was directed to another party soon after. In the "Harijan" issued by Gandhiji from Wardha, Dr. Kumarappa wrote a series of articles on the currency muddle, quoting profusely from "The Falling Rupee." He drew attention to most of the evils of inflation in his own way.

He was prosecuted. The difference in the presentation of Kumarappa and the Economists was that whereas the economists were trying to interpret the phenomenon of inflation, Dr. Kumarappa adopted a tone which had some political ring and could be dealt with in terms of the Penal Code section referred to above. He was sentenced to two years' imprisonment.

The conclusion from the above stories is that the author of inflation in any country is the Government of the day, but that the Government is anxious not to acknowledge the fact of inflation as far as possible, and tries to shift the responsibility of the consequences to some one else, if they can find scapegoats. This effort takes the form of controls of prices and distribution of essential goods, of the establishment of consumers' stores and super bazars, of anti-hoarding and anti-profiteering legislation etc.—all intended to divert the attention of the people away from the real guilt.

The illustrations given above refer to war time inflation. The process in peace time inflation is about the same except that the justification if any, for practising inflation is less in peace time than in war time.

The most obvious sign of danger in an inflationary situation is continuously rising price level. The Index number of wholesale prices with 1952-53 as 100, was 125 in 1962, rose to 184 in June 1966 when the rupee was devalued, and is now 204. It is continuously rising in recent weeks and there is no sign of a halt as shown below:—

#### Index Number of Wholesale Prices

June 1966	— 186.0
July "	— 189.0
Dec. 3, 1966	— 190.6
" 10 "	— 192.7
" 17 "	— 194.1
" 24 "	— 194.3
" 31 "	— 195.4
Jan. 7, 1967	— 196.0
" 14 "	— 198.4
" 21 "	— 198.1
" 28 "	— 199.5
Feb. 4 "	— 201.6
" 11 "	— 202.5
" 18 "	— 203.4
" 25 "	— 203.8

We may not be surprised if it reaches 250 by the time the prospects of the next agricultural season are known, unless appropriate steps are effectively taken in the.

The root cause of such a situation is the tendency of large public expenditure by the Government, greatly in excess of its genuine resources, that is, taxes and loans from the public. This takes the form of credit from the Reserve Bank, usually on the basis of *ad hoc* treasury bills. This is called Deficit Financing. The artificial purchasing power thus acquired by the Government is spent for goods or services and has the capacity to create demand like any other form of money.

There are other ways in which inflation can be created such as by wasteful expenditure, by excess bank credit to the business community or by scarcity of commodities due to fall in production and so on. In short, the **existence** of more m'oney in circulation chasing scarce goods is the brief description of inflation. If such a situation is not controlled in time, the economy will be subjected to severe strains. We shall examine in brief some of the evils arising from inflation.

Inflation is a form of regressive taxation. When the State imposes taxes in proportion to ability to pay, that is when it levies the tax burden in such manner that the richer person pays at a higher rate than the poorer, as in our income tax system, it is known as progressive taxation.

The opposite is true when the State takes away resources from the people in a manner by which the burden is relatively heavier on the poorer sections of the people; this is known **as** regressive taxation. Under an inflationary situation, the Government draws resources from Society with the help of artificial purchasing power; the process results in rising prices; in other words, the value of money falls; the ordinary citizen finds that though his 10 rupee note remains intact in his pocket, it fetches much less than before.

As the capacity of the ordinary citizen to suffer such loss is limited, the burden on him with reference to his capacity is much greater than on the richer person, who can put up with the new situation. In fact, it is possible for some businessmen to make large monetary gains under such conditions of rising prices, with the result that they find that inflation makes them richer.

Whereas in the case of a tax consciously imposed by the Government, the people are aware that they are liable to it; in the case of inflation, it acts as a regressive tax in the dark without our knowledge. One may compare this process with the work of a thief, who as a rule takes away one's wealth in the dark when he is operating.

The difference in the analogy is that it is possible to **catch** the thief and get him punished by law; it is not **possible** to locate the inflationary thief, much less to punish

him by law though he acts continuously unlike the real thief. It will be seen that the effect of the inflationary process is most uneven on different classes of people, and is not easy to ascertain. In any case, it results in the gradual pauperisation of the middle classes, and inflicts great hardship on the poorer sections of the people, who **find** it difficult to obtain even the essentials of life to which they are accustomed because of the loss of purchasing power of their limited income.

It does not require further proof to **realise** that this is a most unsocialistic process. Instead of reducing inequalities and giving equality of opportunity which is one of the objectives of any type of Socialism, inflation creates new inequalities and **intensifies** existing ones, because it is possible for some to be richer under such conditions, **as** they are able to sell their goods at continuously rising prices, while many find themselves poorer.

The difficulties of the ordinary citizen are aggravated by the fact that inflation creates a tendency to hoard commodities. Those who have money would buy in advance to avoid a higher price. Businessmen would hold stocks in the hope of selling them at a higher price. Industrialists would maintain large inventories.

This tendency creates artificial scarcity and intensifies the rising price level, making the lot of the poor man still worse. In order to prevent such hoarding of essential articles such as food grains, the Government usually passes anti-hoarding legislation and makes hoarding illegal. **In** practice however it becomes exceedingly difficult, if not impossible, for the Government to prevent hoarding.

For example, large numbers of families in the rural areas whether they grow food grains or not are in the habit of keeping stocks of grain at least for a year. It is very easy for them to hold stocks for longer periods as space for this purpose is not a problem for them as in the cities. This is bound to happen, when prices of food grains are rising. It is impossible to **deal** with such large numbers.

Besides it is not possible for the Government to deal with the hoarders of grains effectively when the **Govern-**

ment themselves adopt a policy similar to that of hoarding. The so-called surplus States do not allow the surplus grains to move out of their States by creating zones beyond which free movement of food grains is not allowed. The **consequence** is that food grains may become cheaper in surplus States and continue to be scarcer and dearer in other areas.

The position is carried to such an extent that food grains are sometimes fed to cattle when human beings are starving in other parts of the country. Cases are also known of food grains having become rotten in surplus areas, because they cannot be consumed there and at the same time cannot be transported to deficit areas.

It does not require any argument to prove that this method of surplus States amounts to hoarding of food grains grown in their States, in order to escape the rise in prices for the people in that area. The Government of India not only tolerates the situation, but has now adopted it in the hope that it will be able to procure grains from surplus areas by means of the Food Corporation for distribution in deficit areas.

The success of the Food Corporation depends on the co-operation of the surplus States and every one knows the limited success of this operation. The self-interest of the surplus States has thus **created** a curious situation in the country which no longer behaves as one country in this respect. It is not easy to understand however the Government's claims to be socialistic, when it tolerates or encourages such unequal distribution of essential supplies within the country. This is a glaring instance of the way in which inflation brings about a complete distortion of normal economic arrangements.

We are a country liable to famines now and again in different parts of the country. The history of famines during British Rule has been recorded. We have had serious situations frequently in the past. It must be said to the credit of the British administration that, in times of scarcity, food flowed from surplus areas to scarcity areas. Prices were high and the people concerned had to be assisted by grants of money or otherwise to obtain the food.

This movement was possible because of the working of the price mechanism. The supplies of food automatically went where there was a demand for it and there were no artificial restrictions to its movement as now. It was possible for the Government and public spirited people to organise help to the scarcity affected areas and prevent starvation without interfering with ordinary economic forces in the country.

The Government, having undertaken a system of controlling prices on the one hand and distributing food grains on the other, prevents the operation of normal economic forces in this connection. It becomes therefore its duty to see that the available supply in the country is equitably distributed. It has miserably failed in doing so. It has neither an effective machinery nor the co-operation of the States or of the people concerned in order to implement the control machinery successfully.

Careful estimates have been made to show that in the absence of such controls the operation of normal economic forces would have worked better, and it would have been possible to help the scarcity affected areas in a suitable way to prevent starvation.

Another serious consequence of inflation is erosion of savings. Middle class people who have limited savings ordinarily keep their savings in the form of Provident Funds, Life Insurance Policies, National Savings Certificates, Fixed Deposits and so on. In recent times the Government has a systematic propaganda arrangement to encourage small savings to **mobilise** resources for the Plan. They have succeeded to some extent in persuading some people to put their savings in such forms of investment.

At the same time by the inflationary policy of the Government the **value** of the rupee has been continuously falling. The effect of this policy is that those who have saved in the above manner are cheated of their savings. Their savings nominally remain intact in terms of figures, but in terms of the goods which they can fetch the savings have been continuously losing their value.

It is ironical for the Government to ask the people to invest in small savings and at the same time to adopt

a policy by which the value of such savings rapidly goes down. It is easy to see that instead of removing the **inequalities** between the rich and the poor and giving more opportunities to the poor, the inflationary policy of the Government does exactly the opposite, because it manages to cheat the middleclass and poor people out of their **hard-earned** savings of which they become conscious too late.

There must be millions of people in the country who must have put by small savings throughout their working career for old age or for emergency. They now find that the value of these savings has **disappeared** considerably to their dismay and they may legitimately fear whether it **will** not go down to the zero level.

Because of such tendency which operates under conditions of inflation, there is usually a flight of capital from the country. Those who have large savings desire to convert the same into foreign assets in order to **escape** from the falling value of the rupee.

The conversion of internal savings of rupees into foreign exchange for this **purpose** is obviously difficult because of the existence of exchange control. But as the urge to preserve the value of one's savings is so powerful, the people have a tendency to organise to defeat the exchange control and obtain foreign exchange in the black market. They do not mind having to pay higher price **for** the foreign exchange. They feel that whatever they are able to save in this manner will be preserved in the form of foreign exchange and will be available to them in future whenever necessary.

They prefer this to the prospect of continuously falling value of their rupees assets. Unlimited amounts of rupee savings may have gone out of the country in this manner at a time when capital is needed for further investment in the country. In other words the inflationary policy of the Government defeats the object of further genuine investment in the country for its development.

There are others who invest in gold and silver or **jewellery** or in land and buildings in order to escape the inflationary effect. We see that the demand for such things has been abnormal in recent times. This tendency also

comes in the way of productive investment, the capital market becomes dry in consequence.

When difficulties arise for the people, the Government tries to help by introducing controls of prices of essential goods, by equitable distribution of such goods by means of rationing, by consumers' stores at which goods can be sold at reasonable prices and so on. Though such **measures** may do some good to some people for some time, they do not succeed unless there is full co-operation of the people and efficient administration of such controls. **As** we have neither, the controls remain as costly palliatives and cruel reminders of a deep-seated economic malady which is concealed below the surface, which the Government does **not** try to remove or perhaps aggravates by its own policy.

For example, persons with fixed incomes get into **difficulties** under conditions of inflation, as their money income remains the same though they require more money to purchase their requirements to which they are accustomed. Such a situation **leads** to the demand for more wages on behalf of industrial workers and for more salaries and/or dearness allowances on behalf of the **staff** of Government offices as well as of other large offices in public and private sectors.

Most of these groups are **organised** under trade unions and most of the trade unions are under the control of some political parties. The demand for more rewards to **compensate** for the rising prices takes the **form** of what is known as go-slow methods, or work to rule methods which amounts to the same thing and of strikes sometimes prolonged.

Apart from strikes in individual concerns, there are occasions when we have a general strike affecting the **entire** Government machinery or the entire activities of a city. In order to meet such a situation a policy of additional rewards to such organised groups, in the **form** of revised scales of pay and/or additional dearness allowances is adopted.

While sympathising with the difficulties of people in this category, one is not able to understand either the methods adopted by them to ventilate their grievances or

the policy of the Government in meeting them. The methods adopted by these groups have resulted in a state of general indiscipline in most establishments, public or private. A feeling has been created that people can get more money by organised trade union activities by putting pressure on the management including threats to the personal safety of those in authority.

There is no desire on the part of those concerned to do hard work in order to make it possible for the management to obtain more resources for the increased rewards. A feeling has grown that it is possible to get more rewards without working, because in some cases the trade unions have been successful in extracting more rewards without corresponding work.

There were cases of this tendency in the recent general election. Some candidates are known to have adopted the method of promising away many good things which are now scarce and not easily available. The ignorant masses, some having difficulties of getting drinking water, some not being able to obtain their food supplies, some not having adequate shelter and so on have been promised by some candidates that if elected, they would be able to solve their miseries and bring them the millennium.

Harassed by the prevailing situation of scarcity and rising prices, many ignorant voters have succumbed to these temptations and are reported to have voted on the basis of such promises. If the tendency of trying to obtain rewards without corresponding work which is already in operation is encouraged at the political level, the future of the country will be in danger.

So far as the policy of the Government in giving these additional rewards from time to time is concerned one fails to understand whether they have any policy at all. As soon as one dose of such additional reward is given, the Government should realise that unless it exerts to the utmost to stabilise the price level, the process will have to continue at short intervals.

The basis of such rewards is a higher price level; the existing forces which increase the price level are aggravated by the fact of more money in the hands of these groups

because of the additional rewards will result in greater demand for essential goods. As the goods do not seem to increase in the meanwhile, the tendency for the price level to rise is bound to be aggravated. This must result in another demand for further increases in salary scales or dearness allowances as the case may be and the circle goes on repeating itself at short intervals.

Not realising its own mistake, the Government creates an impression of doing something good to these groups by appointing commissions of enquiry for fixing salary scales on a different level as well as dearness allowances on a fresh basis. So long as there is no stability of the price level, there can be no basis for implementation of the recommendations of such commissions and yet additional cost is incurred on such Commissions merely to add to the inflation.

When a country adopts an inflationary policy with a rising price level it also gets into difficulties in its relations with other countries. The prices of its products become high and it would not be easy to sell them abroad because the foreign markets are bound to be competitive. Success in the foreign markets goes to those countries which are able to make quality goods and sell them cheaply.

In a developing country like ours with the continuous need to have to import large quantities of capital goods on the one hand and the inability to export more in order to pay for the imports on the other, we soon get into balance of payments difficulties. The falling value of the rupee within the country is reflected in its falling value in terms of foreign currency.

The exchange control may try for some time to operate the value of the rupee at a fixed rate in terms of other currencies, but in practice the value of the rupee is determined by its purchasing power within the country in relation to the purchasing power of the other currencies.

When a situation of this nature continues for a long time, there is no other alternative for the country but to face the realities of the situation and bring the value of the internal currency in line with its real value in terms of



goods and fix a new value in terms of other foreign currencies. This process which is known as devaluation had to be adopted by us in June 1966.

It was curious to find at the time that several responsible persons were blaming the World Bank and the USA for putting pressure on our Government to bring about the devaluation of the rupee. By diverting their attention on such real or imaginary pressure, they forgot that the real cause of the trouble was the inflationary situation with continuously rising price level in the country, which had reduced the value of the rupee not only internally but also externally. Such mistaken notions therefore came in the way of making the policy of devaluation a success as subsequent steps which were necessary were not taken in time.

In consequence our exports instead of increasing have shown a fall since devaluation. At the same time though the Government made frantic appeals to maintain the price level we have found that it is continuously rising.

The appeals of Government make no sense so long as they are not able to carry out their own promises of not practising deficit financing and of controlling the States, who indulge in spending more with the help of continuous overdrafts from the Reserve Bank.

It is to be hoped that those in authority will at least now realise that further aggravation of the inflationary situation will inevitably lead to further devaluation of the rupee, irrespective of the advice which outside parties may or may not give us. This has happened in several other countries such as Brazil.

We have referred to a few important consequences of inflation and shown how the tendency is to emphasise symptoms and not the disease itself. In the effort to tinker with the symptoms the Government may succeed in diverting the attention of the people from the real cause of the trouble for some time. But the forces of inflation are more powerful than the authority of any Government, asserting themselves in a manner which baffles them.

If the right remedy of controlling inflation at the root, that is by avoiding wasteful or unproductive expenditure,

is not taken in time, we are bound to have a great upheaval in Society due to widespread discontent and unrest which follow inflationary conditions.

The discontent of the people found an expression in the recent general elections when the voters were in no mood to listen to or appreciate the work of the Congress party, but were determined to ask for a change in any case, irrespective of the merits of the rival parties or rival candidates. It is to be remembered that no economic plan will work satisfactorily so long as inflation continues, and therefore the economic progress of the country will be hindered in spite of other efforts.

It would not be possible for us to expect more credit from friendly countries or the World Bank which we require badly for our progress unless we put our house in order. The same is true of foreign investment. We cannot expect the foreign investor to invest in this country unless he is assured of stable economic conditions which includes stability of the value of money.

It is well known that for some time past both the friendly foreign countries who have been giving us credit in the past as well as the foreign investor who is anxious to invest have been sitting on the fence and have been watching how the political and economic structure of the country takes shape after the general elections.

What are the principal remedies against inflation? The main thing to do is to reduce demand so far as possible and increase supply as much as possible.

We have at present increasing demand because of the increasing money supply and inadequate supply of goods because of natural calamity as well as other difficulties for more production. If we are able to balance the two sides the objective can be realised.

The demand for goods and services is made on behalf of the Government as well as the public. In order to reduce such demand the available purchasing power of money in the hands of the Government and the public should be limited as far as possible for essential purposes. This means that in the first place the Government should

set an example by strict economy in public expenditure either for the Plan or for non-plan activities. In other words, whatever the overall size of the Fourth Plan that may be adopted, the Plan for the year 1967-68 should be limited to essential purposes to continue schemes that are in progress by postponing other things till conditions improve.

It should be realised that expenditure involving a long gestation period adds to the inflationary trend and we cannot afford such expenditure while we have at first to control inflation. There is also need for removing the surplus staff in Government departments throughout the country. It should be possible to do more efficient work with a smaller staff.

It is well known that the existence of surplus staff leads to a general state of irresponsibility and indiscipline which must be removed in the interest of efficiency. There are many cases of wasteful or avoidable expenditure which must be stopped; and deficit financing should not be adopted in any case.

The system of taxation both in Central and State Governments should be revised with a view to relieving the burden on articles of common consumption. This means that excise taxes which have become increasingly heavy on certain commodities need to be reduced and if possible abolished. The same applies to sales taxes.

So far as land revenue is concerned it is in fact a tax on agricultural income. It corresponds to income-tax in urban areas levied on non-agricultural incomes. It is low in incidence, because the rates of land revenue were fixed many years ago and prices of agricultural products have increased considerably in recent years bringing large money incomes to the farmer.

Whereas there may be special cases for relief in areas which have suffered from famine, there is no justification for relief in land revenue in other areas. Some States announced sometime ago the abolition of land revenue in their areas. This must be pronounced as wholly inconsistent with the principle of equitable taxation and the idea should be revised as soon as possible.

In other areas it should be possible by way of re-organisation of the tax-structure to reduce the burden of taxation on the poorer classes of the people and to retain taxes on the richer classes. In the case of the richer classes too, it is desirable to consider whether it would not be possible to give an incentive to greater production by reducing some of the taxes. The total yield will not be affected as more production will bring more revenue.

The objective of reorganising the tax-structure should thus be to put reasonable resources at the disposal of the Centre and the States to enable them to carry out their functions, and at the same time to make it possible for the different classes of people to produce more and have a more equitable share of the tax burden.

We have mentioned above that there should be strict economy in public expenditure. The limit of such expenditure should be set by the available resources of the Government in the form of their revenue receipts. Some loans from the public may be justifiable for really essential things which may bear fruit without delay for the benefit of the people.

Once the Governments live within their resources in this way and decide not to go in for wasteful or prestige expenditure, a good deal of demand now created on their behalf will be controlled. This implies that the Governments will have made a firm determination not to go in for deficit financing in any form. They should therefore have surplus budgets as far as possible and at the first sign of a deficit cut down expenditure to restore the balance.

If the Centre and the State Governments set an example of this nature they would have the moral authority to ask the public to restrict their demand, on the scarce goods in the country. This should take the form of a general freezing of all incomes, profits and dividends, salaries and wages, interest and rent etc.

It would not be possible to get the co-operation of the public in bringing about such freezing of incomes, unless the Government themselves show their determination as

indicated above. Once the public realise that the Government takes such decisions in the interests of the public at large, they would naturally be inclined to co-operate in the general effort.

The opposition to the freezing of incomes usually comes from wage and salary earners. This class of people have been getting frequent instalments of dearness allowances in line with rising prices. If they are assured that there is no intention to harm them in any way, and that the proposed policy will help the country to have a stable and perhaps a lower price level, they will realise that their money income will fetch more in terms of goods and there may not be any need for them to demand more dearness allowances.

In other words trade unions and similar organisations will have to be educated into an understanding of the problem for which their co-operation should be sought. It should further be made known that freezing of all incomes is a temporary measure for about a year or so.

It would provide a breathing space for the economy to adjust itself to a new price level. As a number of adjustments will have to be carried out to take the economy out of the present mess, it is bound to take some time, and unless freezing of incomes is done for that transition period, it would not be possible to bring about a normal state of affairs.

While the above suggestions will help in controlling the demand it is also necessary to take steps to increase the supply. In this case also all the Governments, irrespective of political parties, and the public have to co-operate to produce more. One of the most immediate essential requirements in this connection is to create an atmosphere of sustained and disciplined hard work by all.

It should be realised that we are in no position in this country to afford the luxury of more holidays, or more strike periods or of more bandh arrangements. All such activities come in the way of production because not only do they affect production during the period that they are staged, but they also create a sense of irresponsibility in the people.

We are unfortunately lacking in that sense of responsibility which alone can make us work better and more, and unless leaders of society set an example in this connection, we are not likely to change this habit soon.

It is a paradox of our life that those who organize such bandhs and paralyse all activity become heroes in the public eye, though there can be no greater anti-social activity in the country. It should be remembered that no other country which has achieved economic progress has done so without disciplined hard work. It should also be remembered that with our large and growing population it is possible for us to utilise human energy more effectively in order to remove our poverty.

Various schemes of improving agricultural production are known to exist, both scientific and general. Crores of rupees of expenditure has been incurred during the three Plans for the development of agriculture directly or indirectly. But it is not possible to feel that the country has got the results that it can legitimately expect from the efforts which are supposed to have been made under the three Plans in the form of planned expenditure for the purpose.

This shows that there has been some serious weakness in implementing the Plans or in the administration. The success of the Plan should be measured not in terms of expenditure but of performance. If this was done it would be possible to trace the weakness and introduce appropriate remedies in time.

We need not wait for more irrigation or more fertilisers, better seeds or more implements, more credit or co-operative efforts and so on. What is needed is to utilise the existing ideas and agencies more effectively in an honest manner in the interests of production. This does not mean that we should shut our eyes to new methods and new techniques which should be welcome.

In the case of industries immediate attention should be paid to the development of those industries which help agricultural production and which help in the production of consumption goods. If the starting of new industries however desirable, which do not conform to this category

is to be postponed for some time, it would not come in our way. The effort to bring more production into the market for consumption by the above methods is the only way in which we can achieve the desired results.

If we succeed in this way in increasing and maintaining production at a high level on the one hand and controlling public and private expenditure on the other hand as suggested above, we shall have succeeded in bringing about an equilibrium between demand and supply or a stable price level which we can maintain with reasonable stability. Once such an equilibrium has been achieved it would not be difficult to think in terms of other projects and development. They will however have to be so planned and implemented that we do not relapse into a state of inflation once again.

In order to get a correct idea of the way in which remedies we proposed in these articles should be implemented, one may in the first place refer to the dimensions of the problem.

We have referred to the need for curtailing public expenditure. The following table gives the growth of public expenditure in recent years, showing the rapidity with which it is growing both in the Centre and the States. The scope for wasteful expenditure increases with such rapid growth of public outlay when the administrative machinery is not up to the task. The scope for economy is equally large.

**PUBLIC EXPENDITURE — CENTRE AND STATES**  
(Rs. in Crores)

Year	Centre Rev. Acc.	Centre Cap. Acc.	States Rev. Acc.	States Cap. Acc.	Total
1955-56	441	471	604	336	1852
1960-61	826	1001	987	633	3447
1961-62	912	1172	1121	669	3874
1962-63	1314	1454	1261	749	4778
1963-64	1659	1760	1412	914	5745
1964-65	1807	2076	1585	1033	6501
1965-66 (R)	2018	2260	1913	1357	7548
1966-67 (B)	2170	2207	2086	1075	7538

The gravity and urgency of the problem may be seen in the way in which prices are continuously rising in recent times. The Index number of wholesale prices is shown alongside the growth of money supply in the following table:

Year	Money Supply with the Public (Crores of Rs.)	Index Number of Wholesale Prices (1952-53 = 100)
1960-61	2869	124.9
1961-62	3046	125.1
1962-63	3310	127.9
1963-64	3752	135.3
1964-65	4080	152.7
1965-66	4529	165.0
Dec. 1966	4664	193.5
17 Feb. 1967	4827	203.4
24 Feb. 1967	4815	203.8

The deficit financing done by the Government is indicated below:

	Rs. in Crores
1st Plan period	... 297.6
2nd Plan period	... 1383.5
3rd Plan period	... 1320.2
1966-67 upto 24-2-67	... 275.0

The Finance Minister promised in his budget speech in February 1966 that there would be no deficit financing during 1966-67. The draft outline of the Fourth Plan also has indicated that there should be no deficit financing during the Fourth Plan. In spite of this in the first year of the Fourth Plan, we are likely to exceed the figure of Rs. 300 crores of deficit financing by 31st March 1967.

We have referred to wasteful expenditure. No estimates of such expenditure are available. If careful inquiries are made of the way in which expenditure is incurred and the same correlated with the performance, we may get some idea of the dimensions of wasteful expenditure. One may hazard a guess that the total of such wasteful expenditure

since 1951 is likely to be greater than the total of deficit financing; the effects of both on the price level are similar, with the difference that much is not known about the former. The staggering figures in the tables given above tell their own tale; no comments are necessary to show that things have gone too far.

If it is realised by all parties that control of inflation and rising prices is the most importance measure that is necessary to restore health to the economy and to make progress possible, there should be a general agreement that radical steps are necessary for such radical disease some of which have been already discussed.

One of the first things that will be required under the new political situation in the country is that there should be a perfect understanding between the Central and State Governments on these **problems** and arrangements should be made to bring about complete co-ordination in implementing the policy that may be necessary.

It will be the test of statesmanship of the **different** political parties whether they are willing to go together mainly for the common object of doing good to the poor man in the country and to the economy as a whole. As such an objective would be **easily** acceptable to all political parties, it should not be **difficult** for them to agree on a common programme for controlling inflation and need for preventing the continuous rise in prices.

The question may be raised whether one or more States can work in isolation in order to prevent the rise in prices. Chief Ministers of the newly formed Governments, whether Congress or non-Congress, have been proclaiming their desire to control prices. They make appeals to the **business** community to help them in reducing prices.

When this does not work persons in authority threaten dire consequences to those whom they consider guilty for the rising prices. It is possible that some people may be punished as it is possible for the Government to locate some **profiteers** and black marketeers. This may divert the attention of the public to the action of the Government in dealing with the so-called guilty. But it is well known

that the situation is not cured in this **way**, because such effort is away from the real root cause of the malady, which requires a more radical treatment.

Inflation and rising prices being countrywide phenomena, it is not possible for any one or more States by themselves to adopt a policy independent of others. Irrespective of their political complexion, it is necessary for the Centre and States to evolve a common policy and to implement it in a uniform way with determination, if the problem of inflation and rising prices is to be attacked successfully. While this is essentially true, each State can do certain things to help in the process, **firstly** by strict economy in public expenditure, reducing it as much as possible, avoiding all waste, **secondly**, by simultaneously taking systematic prompt steps for increasing production of articles of common consumption to the maximum extent.

For the **first**, they will need considerable self-restraint, **as** the Governments in the country have been hitherto known for their reckless spending propensity, reflected in several cases in unauthorised overdrafts from the Reserve **Bank**. For the second, they will need conscious **co-operation** of the public who will have to be enthused to do hard work in order to raise more production.

The most important aspect in which a co-ordinated effort is necessary is in the production and distribution of foodgrains. For this, the States have to put aside their regional considerations and think of the country as a whole.

The interdependent economy of the country cannot function smoothly unless the country is treated **as** one unit in such matters. In the absence of such a really national policy, the States will drift apart, making rapid progress of the economy difficult, leading to political complications.

**The** fond hope of some Governments that they will be able to increase production by nationalising or **taking** over certain activities is not likely to succeed as the people have realised that the Government is incapable of making

a success of productive activity in spite of whatever they have said in the past.

Instead of a unified policy, if the Governments work at cross purposes, the solution of the most important problem before the country will become difficult leading the country to unknown disasters. We have emphasised the rapidly mounting menace of inflation and the urgency and gravity of dealing with the problem in a unified way for the country as a whole.

The determination and efforts of all parties and the public must be directed to this imperative need, if we are to escape economic chaos. The task of the Union Cabinet and the Union Finance Minister is unenviable; let us hope that they will be able to **carry** the **State** Governments and the people with them in bringing order out of the present situation.

*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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