Prune the Plan

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Full text of a speech by Professor B. R. SHENOY, on the Union Budget and the Second Five-Year Plan, in Bombay on June 17, 1957.

DURING the first two years of the Second Five-Year Plan, the total outlay might amount to Rs. 1,600 crores, according to official estimates. This represents about 75% of the average contemplated expenditure of the two years. At the same time, we are told that the Government is going to stick to the Plan, whatever may be the difficulties. If the determination holds true, then the capital part of the budget will be much larger than what it is today. But as we shall presently see, it is not possible to implement the Plan in full. We just do not possess the necessary resources—both domestic and foreign. It is also not practical to try to implement the Public Sector part of the Plan by drawing upon the potential resources of the Private Sector, because virtually the entire overall gap in plan resources is located in the Public Sector. The overall gap in resources being Rs. 2,500 crores and the Private Sector's target of investment Rs. 2,400 crores, to implement the Public Sector part of the Plan, we have to draw upon all the resources of the Private Sector. This is not practical finance, if we are to apply the democratic techniques of taxation, market loans and small savings.

It is important always to keep before our mind the fundamental principle that economic development is a function of invested savings.

The only difference between planning in a democracy and planning under Communism and other totalitarian regimes is that in the latter savings are made to order, as it were, through the control which the planners have over the consumption of the community. By pressing down consumption sufficiently, it is possible to increase the rate of saving to match the rate of investment. In democracies that is not possible. In democracies, consumption is left to the free choice of individuals and consequently savings increase but slowly. At any given moment savings are a given quantity. They are not capable of being increased by methods which are open to totalitarian planners. That is why in a democracy, planning has first to take into account the available savings. In a totalitarian economy, planners first decide how much to invest and then proceed to gather the necessary savings. We in a democracy have got to do the opposite. We have first to assess how much savings are available and then adjust our investment accordingly.

The difficulty with **regard to planning in India is that we are trying to apply totalitarian thinking of planning to a democratic set-up.**

Many of our difficulties of plan finance are traceable to an inadequate appreciation of the fundamental, unalterable, doctrine that economic development is a function of invested savings. In an underdeveloped economy like ours, the volume of savings is small for two reasons. First, low per capita income; second, the low rate of saving. Let me illustrate this by figures. The per

capita income in the U.S.A. is Rs. 775 per month, in the U.K. Rs. 413 per month, while in India, at the close of the First Plan, it stood at Rs. 23.42 per month. Whatever we wish to do in the field of economics —planning, good living, organisation of a socialistic pattern of society—all that has got to be done within that per capita income.

What about our rate of savings? In the U.S.A. in 1950 the rate of savings was 15% of the national income and the total volume of savings in U.S.A. was Rs. 17,136 crores. It is nearly double the total Indian national income of that year. Our savings in 1950-51 were Rs. 572 crores.

The volume of savings effects the rate of economic expansion. During the period 1948-1955, Indian national income rose at an annual rate of 2.5%, while in U.S.A. the corresponding rate was 4.9%. This higher rate in the U.S.A. is due to the fact that they have more savings to invest. If we have less savings, our investment must be less. The rate of savings increases very, very slowly in a democracy. During the Second Five-Year Plan period, the total savings available for investment may be about Rs. 4,560 crores, assuming that the rate of savings is 8% at the end of the Plan, that is 1960-61, and that national income rises by 20%. To this we may add Rs. 900 crores of foreign aid, and Rs. 300 crores of withdrawals from the currency reserves. We planned to withdraw Rs. 200 crores from our currency reserves over the entire Plan period, but we began by withdrawing Rs. 300 crores in less than a year and a half. By

adding Rs. 300 crores and Rs. 900 crores to Rs. 4,560 crores, we get Rs. 5,760 crores. The Plan aims at a total investment of Rs. 8,000 crores including the December 1956 addition of Rs. 500 crores. This amount of Rs. 8,000 crores does not include the non-monetised sector. The total savings including the non-monetised sector is Rs. 5,760 crores. It is, therefore, a fair guess that the resources gap of the Plan is about Rs. 2,500 crores.

Until recently we had great faith in deficit financing. After 2½ years of discussion on the subject, and a rise in prices by 27% (by 91 point to 433) in 20 months, we have at last discovered the limitations of deficit financing as a means to economic development.

The question we are trying to examine is whether it is possible to save the Plan. The total volume of resources available for investment, i.e. Rs. 5,760 crores, is mobilised through several ways—into the public sector from the revenue surpluses (which are public savings), market loans, small savings and deficit financing. The Private Sector gains hold of saving through the issue of equities and debentures, through self-financing from undistributed profits and through credit creation by commercial banks.

Taxation figures in this scheme of things in so far as it succeeds in creating revenue surpluses. If additional taxation does not create revenue surpluses, taxation does not contribute to plan finance.

Has the heavy impost of the current year contributed to revenue surpluses and by

how much? The budget receipts during the current year from the new impost of last May is about Rs. 73 crores. The whole of this does dot go into Plan finance. How much 'goes? Only about Rs. 40 crores. What about the balance?

The balance would be eaten up in administrative expenditure. It is not available for plan finance.

What would be next year's position? We do not know. In a full year, the estimate is that the new imposts will bring about Rs. 88 crores. I am excluding the additional levies on railway traffic. Including the additional levies on railway traffic, it would be over Rs. 100 crores. The whole of this will not go into Plan finance.

Can taxation save the Plan? Taxation has saved the plan during the current year to the extent of Rs. 40 crores. Taxation does not add to the savings of the community. Going back to our fundamental proposition, viz., economic development is the function of invested savings, any measure we may contemplate would contribute to economic development only in so far as it contributes to additional savings.

Overall savings of the community will not increase merely because the Government bas decided to step up tax levies. Savings in a democratic community are a given quantity in a short period. What happens when additional taxes are levied? The resources am taka away from the Private Sector into the Public Sector.

The Private Sector loses at least the amount of the revenue surplus. I say at least

because the Private Sector may lose more.

Taxes are paid not necessarily out of the consumable income. Taxes may be paid out of potential savings. If taxes are paid out of potential savings, since the whole of the tax revenue does not add to public savings, taxation might lead to a reduction in savings of the community as a whole. This limitation, however, would not apply to public savings resulting from administrative economies the scope for which figured prominently in the last debate in the Parliament.

Is it possible to draw on the investment resources of the Private Sector to implement the Public Sector? The finance required for the Public Sector is Rs. 5,300 crores. Originally it was Rs. 4,800 crores. The finance available according to official estimates is Rs. 3,200 crores. Allowing for Rs. 800 crores of foreign aid, this leaves a resources gap of Rs. 2,100 crores. In actual fact, the gap in resources of the public sector may be considerably more than Rs. 2,100 crores, as receipts under several heads, in particular under market loans, contain water. The expected receipts from market loans is Rs. 700 crores. During the last few years, public subscription to Government debt has been rising. It rose steeply from about Rs. 14 crores in 1953-54 to an annual average of Rs. 100 crores thereafter. But this is no evidence that an increase has taken place in the savings. During World War II, Government loans were a great success. The subscriptions exceeded expectations. The increase in public subscription to Government loans is no indication that more savings are being placed at the disposal of the Government.

A study of the subject has shown that during 1955-56 or 1956-57 no part of the voluntary savings of the community has flown into the coffers of the State. The entire amount of the collection represented part of the inflationary funds put into circulation. In the prevailing context, the money flowing into the coffers of the State through subscription to Government debt are as much savings as water seeping into a well near a canal is spring water. If the canal dries up, the well would dry up too. If inflationary finance ceased, the increase in subscriptions to government debt will cease also or it will assume its pre-inflationary proportions which is of the order of Rs. 14 crores. From the standpoint of voluntary savings, therefore, the figure of Rs. 700 crores from market loans is a gross over-estimate. Some over-estimation also exists in the matter of small savings.

Expected tax receipts, mainly as a result of the heavy imposts of current year, will exceed by about Rs. 200 crores, the original target. As against this, we have got to take into account the assumption that Governmental expenditure outside the Plan will be frozen so that entire amount of the additional tax receipts will accrue to plan finance. This is not a safe assumption to make. Viewing the position as a whole, we find that the finance available falls short of the finance expected, and the gap may be much larger than Rs. 2,100 crores; it may be as much as Rs. 2,500 crores.

To implement the Public Sector by drawing on the resources of the Private Sector, we have to raise as much as Rs. 2,500 crores. The Private Sector investment targets being Rs. 2,400 crores, the implication of this is that the Private Sector investment should take a holiday for five years; the investment activity in the Private Sector will be restricted to maintenanee of capital with provision for depreciation only. There would be no expansion of the Private Sector. This to my mind is not a practicable proposition. Collecting Rs. 2,500 crores through taxation, loans and small savings is not a democratically feasible proposition. It may be feasible under communism. But the effort involved would be considerable as, In a community where the masses of people live on the margin of subsistence, the scope for a steam-roller reduction in consumption is narrowly limited.

Let us examine the effect of the tax proposals upon the market. The ratio of revenue collections to national income in India is very small. It is about 9%. Even with the increase in taxation during the Second Plan, it would be still round about 10%. This is doubtless a small percentage. But the experience of the current year's taxation has shown that there are very severe limitations to a steep rise in taxation. During the year ending May 11, 1957, prices of industrial equities declined by about 19%. After budget day, they declined further by 5 to 10%. The decline is more than commensurate with the decline in dividends. The decline in share values is almost wholly due to at first the fear and then the fact of the heavy taxation.

It has been estimated that since August,. 1956, when the decline in share values began, shareholders have lost about Rs. 200 crores.

Thus, as a result of the tax proposals of the current year, taxpayers will surrender about Rs. 73 crores, the shareholders will lose Rs. 200 crores and the Plan will benefit by Rs. 40 crores. Is this prudent finance ?

This and similar predicaments are consequences of our attempt to invest more than what we have saved. To shift from deficit financing to taxation in an effort to collect the non-available resources for the Plan is a case of tail-chasing.

Since we **cannot** invest resources we do not possess, there is no device, heroic or otherwise,. of implementing the Plan.

The uncritical public is treated to heroic pronouncements regarding the determination of the Administration to see the Plan through. It is just not possible to do so. If we insist on the Plan, development will be less than the permissible maximum.

In the last budget speech, the Finance Minister observed that those who regard the Plan as too ambitious should have a good look at the level of living of the bulk of our people. None can dispute the importance and urgency of lifting up the living standards of the Indian people.

But an inflationary expansion of money incomes through overinvestment is not the best method of achieving it. Over-investment, as post-war experience has shown again and

again, is the root cause of many economic ills.

We are experiencing today an acute foreign exchange scarcity. This is an outcome of our attempt to invest too much. Over-investment adds to the money incomes of the community. Money incomes add to domestic consumption. We can only consume what we have produced. As in the meanwhile production has not gone up, the additional consumption is drawn from potential exports or by increasing imports. During the eight months of the current year, 1957-58, for which figures are available, the index of volume of exports has declined from 112 to 106 and the index of volume of imports has shot up from 106 to 135. The remedies proposed by the Government are more in the nature of palliatives. They include further restriction of imports, deferred payments, use of foreign loans and foreign credits.

They have a part to play as respite measures, but the malady being deep rooted, it needs fundamental remedies.

If we must solve the foreign exchange problem, we have got to reduce the size of the Plan to eliminate over-investment. We must restrict the volume of money supply to the needs of production. The unrealistic value of the rupee must be corrected. There is no escape from it. The rupee must be devalued, to adjust for past inflation. Strangely, inflation and a rise in prices are not much objected to on sentimental grounds; but when it comes to devaluation, it is taken as a national humiliation. We mix sentiment

with economic facts although devaluation is nothing but a projection in the sphere of the exchange rate of the inflationary rise in internal prices.

This aspect of the Indian economy brings us up against a very difficult situation. The world outside is progressing in the direction of freedom from exchange restrictions and currency convertibility. In the case of India there is no progress at all in that direction. We are up against serious difficulties because of the wide gap which exists between the internal and external prices of gold. The external price of gold is Rs. 62.50 per tola and the internal price keeps fluctuating, the current price being around Rs. 105. The presence of this wide gap has necessitated the banning of the imports of gold. Does the ban work? The off-take of gold in Bombay exceeds the output of the mines of Mysore and the inflow of gold via goldsmiths. The ban does not work; it will not and cannot work, when the price gap is so wide. It is physically impossible to keep a vigil round the clock, for 52 weeks in a year, and year after year, over several thousand miles of sea coast and land frontiers. The Government is trying its best to make the ban work. The efforts of the Government in this direction reminds one of what the medieval monarchs did when they were confronted with the problem of the clipping of the coins and the disappearance from circulation of every fresh issue of coins. The irate monarchs clipped the fingers of the guilty. To assist the Police in enforcing the ban, we have amended the Sea Customs Act. Under the Sea Customs Act it was the

responsibility of the Police to prove that seized gold is smuggled gold. Until that proof was forthcoming, the person with the gold was innocent in the eye of law. Under the amended Act it is the responsibility of the apprehended party to prove that the seized gold is not smuggled gold.

Now this is a case of clipping the civil liberties of the individual.

There was no remedy to the clipping of coins until the coming of milled coinage and until the mints themselves abandoned debasement of coinage. There is no remedy to gold smuggling until the price gap has been eliminated. The only way of doing so is the devaluation of the rupee. There is no point in sticking to an antiquated exchange rate to the bitter end, though that is what we are trying to do. To do so would be a ruthless waste of our foreign exchange resources. It would also impede production.

The budget speech of the Finance Minister was an excellent discourse on the importance of non-inflationary finance of the Plan. But the budget for the current year provides for a deficit financing of Rs. 280 crores. Last year, it amounted to Rs. 266 crores, due allowance being made for the public debt holdings of the banking system. The annual average of deficit financing as originally contemplated is Rs. 240 crores. The Finance Minister told us in the Budget Speech that according to his analysis deficit financing on the scale originally contemplated is not economically feasible. We are entitled to ask for some reconciliation between pronouncement and fact. I have a suspicion that the reconciliation exists in the theory that it is possible to get away with inflation through controls. However, we are not told that is the case. In a background of inflation, fiscal policy should aim at a balanced or surplus budget in order to restore economic stability. Inflation causes instability.

Inflation is dangerous from the point of view of the Plan because in a background of inflation achieved development would be less than the permissible maximum as, under inflation, part of savings would be diverted away from Plan investment.

If we insist on the Plan, the pace of economic development will be retarded and we will have in the bargain economic, monetary and payments instability. If we prune the Plan to match the available resources, we will have both maximum economic development and economic stability. As stated earlier, post-war experience has proved more conclusively than ever before that over-investment is the root cause of many economic ills. Let us not vainly attempt to write a new set of economic laws and add to human suffering.

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