INFLATION THREATENS INDIAN ECONOMY

A. D. SHROFF

FORUM OF FREE ENTERPRISE
SOHRAB HOUSE, 235, Dr. D. N. ROAD, BOMBAY-1

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

—Eugene Black
President, World Bank

INFLATION THREATENS INDIAN ECONOMY

A. D. SHROFF

The Budget of the Government of India is a photographic presentation of the economic situation of the country. Along with a number of papers which are usually circulated with the Finance Minister's speech, there is one paper in particular which should prove of considerable interest to the public. It is called the Economic Survey. The writer of that paper, who must be some official of the Ministry of Finance, must be congratulated for producing a very balanced, objective and realistic view of economic conditions in the country during the last year. I am sorry to note, however, that the Finance Minister, who produces his budget in the background of the Economic Survey, does not seem to have followed the Survey which has been so objectively prepared.

The Survey starts with this sentence: "The Economic Survey attempts to analyse the main trends in the economy during the year 1959-60 and to present in broad outline the background against which the budgetary and economic policies for the coming year have to be considered." Having closely read the Finance Minister's speech, both in Parts I and II, and having tried to understand the estimates made for the coming year and the proposals which he makes to make good a part of the deficit which is estimated to be of the order of Rs. 83 crores, I am unable to understand whether he has accepted this Economic Survey as the real background for preparing his budget. It is a very fine Survey which I would earnestly appeal to interested people who want to understand what is happening in India to study. There are two important paragraphs, 45 and 46, which seem to summarise the Survey.

Para 45 says: "The rise in wholesale prices by about 20 per cent since the commencement of the Second Plan is indicative of the continuing pressures within the economy." Para 46 says: "The economic trends reviewed in the foregoing paragraphs indicate that the imbalance between the resources available and the demands on them that developed in the first two years of the Second Plan was corrected to some extent in the course of the subsequent two years. Agricultural as well as industrial production has shown an increase over the last two years. The step-up in investment has been moderate; budgetary deficits have been reduced progressively; and foreign exchange reserves have remained at a fairly stable level." Then, the writer says: "The task of policy is, therefore, the difficult one, of promoting and fostering the growth of investment on sound lines without creating in the process large or persistent imbalances in the system."

A study of the Survey brings out most prominently the basic feature of India's economy today, viz., the mounting pressure of inflation. It is not generally appreciated by the public that inflation creates a sort of mentality when the average man feels that since money incomes rise everything must be all right. But the Economic Survey says that there has been a 20 per cent rise in the general level of prices during the period of the Second Five-Year Plan with one year to go for Plan completion. The public at large does not sufficiently appreciate the implication of a rise in the general level of prices and particularly when it is of the magnitude of 20 per cent over a period of 4 years. The Budget puts the hallmark of inflation on the economy of the country.

Last year, when I was in the United States, I saw in the newspapers, financial magazines and in meetings a hue and cry being raised against mounting inflation there. When I tried to discuss matters with economists and pointed out to them that during the previous 12 months there was barely a rise of 1.1 per cent in the general level of prices, they thought that that was indicative enough-of how things were going in the United States and that inflationary process must be halted in right time. Here we have from day to day a general rise in prices throughout the country and particularly at a time when we had, last year, a record agricultural production of about 73 million tons and, contrary to the experience of the previous two years, the industrial production also registered a rise of about 7.2 per cent as against 1.8 and 3.5 during the previous two years.

The problem of inflation is one which, unless it is curbed in right time, is going to endanger the total economy of the country. A very fine analysis has recently been made by a research worker as to the trends of prices in the different sectors of the economy. When

prices in only one sector — agricultural, industrial or services — showed a rise, one could understand the situation. But curiously enough, all the sectors of the economy are showing a simultaneous rise during the last three years. Not only the sector of foodgrains but even the sector of non-foodgrains has shown a rise. The conclusion arrived at by the research worker indicates that there is some common factor at work which is affecting every sector of the economy. On close analysis, it only means that there is more money chasing less goods and services, that the pressure of increase in money through growing currency expansion in the country from year to year means that there is more money to buy goods and services which are not adequate to fulfil the needs of the money that is chasing them. This is happening for the obvious reason that in a country which embarks on public expenditure at a rate and magnitude which is disproportionate to the increase in production in the various sectors of the economy, the pressure of increasing purchasing power through mounting public expenditure cannot but result in an imbalance between money supply and availability of goods and services. In simpler terms, when there is more money than goods and services, the law of supply and demand must effectively operate and prices must rise. As a merchant put it to me recently in a most effective manner, the cheapest thing in India today is money!

About 2½ to 3 years ago, when the U.K. was faced with a similar situation, but of a much lesser magnitude, it tried to seek remedies in various directions to control the situation. One of the main remedies the U.K. Government sought was to control public expenditure although public expenditure in the economy of the United Kingdom is certainly of a lesser proportion of the total expenditure than public expenditure which is being incurred in India during the last 10 years.

Public expenditure means creation of so much additional demand for goods and services. The Government proposes to spend Rs. 1,174 crores which will be spent in buying various goods and services and, therefore, the impact of expenditure of such a magnitude cannot but bring such a pressure on the supply side of the economy that it is bound to cause and aggravate the already felt scarcity and shortages in various fields of economy in the last few years. Therefore, the real solvent of the problem of inflation is the curtailment of public expenditure.

From an analysis of the trends of Government revenue and expenditure from 1948-49 up to the last year and estimates for the next budget year, we notice that civil expenditure has been growing from year to year. Whereas in 1948-49 the total was Rs. 35.56 crores, last year it was Rs. 233.35 crores and it is estimated that in 1960-61 it will go up still further to Rs. 267.76 crores. It is inevitable that this expenditure should have risen to this high level because of certain policies and a certain ideology which have been followed by the Government.

We cannot have the luxury of a planned economy which aims at a comprehensive planning of every aspect of the economic life of the country without creating a bureaucracy of gigantic proportions to implement it. Anyone who has paid a visit in recent years to New Delhi could have seen the new buildings which have been going up to house all the new Government departments to look after the various phases of the planned economy. It is said that there are no less than 17,000 peons in the various departments. We do not know how many thousands of new clerks and junior officers are being recruited and employed every year to man these new departments. Therefore, the increase from Rs. 35 crores to Rs. 233 crores is a figure which is understandable though, of course, not in the least justified.

To understand the budget, therefore, we will have to understand that the basis of the budget is an attempt to work the comprehensive planned economy. Nobody has described it as well as Mr. M. R. Masani in his speech in the Lok Sabha when he sympathised with the Finance Minister as being "a prisoner of the Plan". The Finance Minister in recent years is not less than a prisoner of the Plan. He has to frame his budgets within the framework of the Plan which is made in advance for five years and whatever be his personal inclinations or predilections, the Finance Minister since he is a member of the Government, must see to it that these plans are implemented or at least an attempt is made to implement them. The basis, therefore, of the economy is the enormous growth in public expenditure. Unless public expenditure is halted, we are fast reaching a situation where the value of the rupee will decline considerably. The Prime Minister, who is the greatest enthusiast of planned economy, was asked about 2½ years ago at an A.I.C.C. Session a very relevant question. During the course of the deliberations of the A.I.C.C. in New Delhi on June 2, 1957, a member asked the Prime Minister as to why the salaries of ministers at the Centre and the States were not

restricted to Rs. 500 as advocated by Mahatma Gandhi several years ago. The Prime Minister defended the higher salaries paid to the ministers. He said that it was true that the Karachi Congress had suggested that a minister's salary should not exceed Rs. 500 per annum, but today, those Rs. 500 are equal to Rs. 2,000 or Rs. 2,500. The Prime Minister himself is realistic in recognising that the value of Rs. 500 in the past is equivalent to the value of Rs. 2,000 or Rs. 2,500 today. It is a measure of the depreciation in the value of the rupee in terms of the general level of prices. We have been told that since planned economy set into this country an attempt is being made to raise national income by 5 per cent a year. In the Third Plan, it is a little more than 5%, i.e., about 28% for 5 years. But, if we try to measure the increase in national income during the last 8 years as also the increase in the per capita income, in the sense of real income, by which economists mean the purchasing power, the actual rise works out to 1.8 per cent per year.

The Finance Minister says that the number of new industries has gone up, national income has gone up and that the economy is in a state of healthy balance. A healthy balance means a lot of things so far as the economy is concerned. For instance, let us take the balance of payments position. The foreign exchange reserves of our country were frittered away by a most unjustified spree on importing goods from abroad, with the result that since November 1956, we are in a very tight corner so far as foreign exchange resources are concerned. For two years of the Second Plan, when the country had some modest reserves to draw upon, they served as useful cushion to the economy. Whilst production was dragging behind and supply of money was increasing we could make use of foreign exchange reserves in importing more goods which helped us in controlling the level of prices. Now, though the foreign exchange position is slightly better than what it was 12 months ago, we have reached a stage where we cannot use any of our foreign exchange resources to bring about that balance in the domestic economy which was possible in the previous years by our ability to import goods to supplement the production at home to bring inflationary pressures under control. The adverse balance of trade still continues though in 1959-60 it was lower than in 1958-59. This adverse balance was met through increased borrowings abroad. We are mounting up a huge debt abroad. One most interesting revelation of the Explanatory Memorandum, which is a supplement to the Budget, is the growth in debt charges. We have not only more debt, but we are mounting up our indebtedness abroad with the result that in 1960-61, we shall have to find Rs. 72 crores by way of payment of interest on our indebtedness, The balance of payments position continues to cause anxiety. Even the Finance Minister admits that.

We are embarking on a Plan for the next five years which assumes that we shall need Rs. 2,900 crores of foreign exchange assistance to implement it. Out of these Rs. 2,900 crores, we will require Rs. 600 crores to service and amortise a part of the foreign debt which is due for repayment between 1960-67. One fails to see how the Finance Minister sees any signs of health in a situation of this character. We have incurred a net liability of Rs. 600 crores to be repaid during the next 6 or 7 years to maintain our credit in the international market.

There are two ways of doing that. One has to export more and earn more abroad so that one can liquidate a part of the indebtedness. Let us see our ability to export. The range of exportable goods is extremely limited; although it is true that we have created a number of small and medium-scale industries in the light engineering sector, the products of which we can export abroad, the magnitude of those products in the aggregate forms such a small fraction of our exports that they would hardly make any significant impact in the coming years. Therefore, the only other source left open is that we must borrow more to liquidate our immediate indebtedness. A situation like this, which must cause considerable concern and anxiety, can by no stretch of imagination be described as a sign of healthy balance in our economy.

Nearer home, what are the signs of economic health which we are witnessing? The Finance Minister expresses some satisfaction about the booming conditions on the stock exchange. The oversubscription of a few new capital issues is taken as a symptom of the healthy condition of our economy. There could be no worse symptom of ill-health in our economy than the booming conditions of the stock exchange which have created a situation where people are losing all sense of proportion and sense of money's worth, and where leading stocks are quoted on a basis at which no man of commonsense would put in his savings. It is said that new capital issues have been spectacularly over-subscribed. In fact, they are, but we must not forget that our national income

is now in the neighbourhood of Rs. 12,000 crores, while the aggregate of the new capital issues made in this country forms only an insignificant fraction of the total income. Contrary to the assumption of a healthy economy, it emphasises the very negligible investible surplus available in the country to make possible a large-scale and rapid development. I am astonished that people in high positions vested with such tremendous responsibility for shaping the economic destinies of India should put before the country considerations which have no validity at all and which are more apt to mislead and blind people to the actual realities of the situation. Therefore, it is essential that every intelligent, educated person must try to understand for himself or herself as to what is happening in the country.

The tragedy of uncontrolled inflation has happened in many countries in the past. I fear it may happen also in this country. Speculation on the stock exchanges gradually transfers itself to speculation in commodities and ends in speculation in land values, with the result that the whole economy gets permeated with the most virulent type of ill-health that an economy can ever suffer from. The result will be terrible and widespread misery for large sections of the people. Particularly in this country, where apart from a small, almost infinitesimal number of people who may be described as wealthy and comfortable, the large bulk of the 400 million people living on a margin of subsistence are likely to suffer the most as a result of inflationary pressures which are mounting and which have led to the rise in the general level of prices.

We should clearly understand the real meaning of the rise in prices, as indicated by the various indices complied by the Government of India. There are two main indices which purport to give an index of some of the important economic trends in the country. One is the wholesale price index and another the cost of living index. If we study the compilation of these indices, we find that they are absolutely out-of-date and out of tune with with the existing economic conditions in the country. The base for both these indices is out of date and the commodities and services which go into their compilation are out of date. The variety of commodities which have entered into the cost of living of the people has changed completely in recent years. For instance, it is assumed that the working man only wears coarse cloth and, therefore, what is included in the consumers' cost of living index is the price of coarse cloth. Anybody who is interested in the cotton textile industry knows that for the last few years, there is a definitely increasing trend in the consumption of medium and even finer cloth by the large bulk of the people. Therefore, to the extent to which the cost of living index does not reflect this new trend and new habit of the people, that index is inaccurate. In the case of the wholesale price index, the prices are selected as prevalent at certain centres whereas prices vary considerably all over the country. Therefore, a man living in *the* South may find that the prices he is called upon to pay are something very different from the prices which are compiled in the wholesale price index. The actual burden of rising prices on the average person is much greater than what is indicated in these indices. To that extent the misery and suffering which is caused to the vast bulk of the people cannot be measured in terms of these indices. It must be appreciated that the real burden that we are carrying is not really measured in terms of these indices but by the actual prices that we have to pay for the necessary goods and services we buy from day to day, and these prices are certainly higher than those indicated in the indices published by the Government.

One objective which the Finance Minister has emphasised at more than one place in his budget speech is that of bringing about increased investment in the country. What he meant by investment in that context was that he wanted to see greater capita1 formation, expansion of existing economic activity and promotion of new activity. If we examine the budgets of the past three years, if there is anything which is calculated not to aid capital formation, we will find it there.

A former Finance Minister presented to the country what he called an Integrated Pattern of Taxation, meaning income-tax, super-tax, corporation-tax, estate duty, wealth tax, gift tax, expenditure tax and whatnot. It is that pattern, instead of promoting capital formation, has, in actual fact, disintegrated those healthy forces in the economy which induce saving and capital formation. It has militated against and defeated the very objectives of basic planning. We will never succeed in bringing about large-scale development of the country unless we provide incentives today. Far from making people feel that it is desirable to save and that their savings can be invested profitably so that their future can be provided for, the so-called Integrated Pattern of Taxation is providing a disincentive to save. Let us take, for instance, the

Small Savings Campaign. It was estimated in the Second **Plan** that small savings will contribute annuallv at least Rs. 100 crores. We are in the fourth year, but we have not reached a figure anything like that. The Finance Minister's modest estimates for next year are Rs. go crores. If there is large-scale development in the country and we are really going ahead, why is it that out of 400 million people we cannot get Rs. 100 crores annually in small savings? The reason is that as a result of the general rise in prices, the capacity of the people to save has been reduced. But the more important reason is the psychological factor, that there is no inducement and there is a feeling of uncertainty round the country about the future that you are creating by denying yourself the enjoyment of money today. If you save, whether the savings will have the same purchasing power after 5 or 10 years is a doubtful proposition. This scepticism regarding future is the more potent factor in providing a disincentive to saving than any other. Unless, therefore, this factor is corrected, small savings or savings in general and capital formation cannot be accelerated.

The budget figures throw considerable light as to the expectations which the former Finance Ministers had in introducing new taxation and the extent to which they have been fulfilled. When the estate duty was introduced for the first time, the Finance Minister of the day had confidently anticipated that in five years, the duty will yield Rs. 15 crores a year. The figures of estate duty collections since it was instituted show that the highest figure of collection was Rs. **3** crores. Even for the next year, it is estimated that the duty will not bring in more than Rs. 3 crores. The figure must be viewed in the context of the overall budget figure of Rs. 980 crores for next year.

The most fantastic tax is the expenditure tax. The tax was aimed at collecting a modest amount but at the same time was supposed to enable Government to plug loopholes in the system of taxation. It had brought in last year Rs. go lakhs. **A** good tax is one which brings in a substantial amount of revenue to the Government, causes the least harassment to the people who are paying it, and causes the least ill-will among the public of the country. One cannot imagine a tax which is more vicious than the expenditure tax, in the sense of causing the maximum harassment to the limited number of assessees who are called upon to psy and creating the maximum amount of ill-will against the Government.

The Government of the country, unfortunately, is not run on a rational basis. If a mistake is found, it should be corrected. But to the Government, if a mistake is sought to be corrected, then there is loss of political face and prestige. The logic is that it should riot, therefore, be corrected but continued for ever! The least that the Finance Minister could have done in this budget was to abolish the expenditure tax, because in a budget of Rs. 980 crores, which itself leaves about Rs. 60 crores of deficit uncovered, an amount of Rs. go lakhs in the collection of revenue could not have made any considerable difference. But the Government rests on prestige and does not want to own its mistake in levying the tax. As regards gift tax, the public was told that unless that tax was imposed people would pass on their wealth during their life-time. But the actual collection is only Rs. 2 crores in a country of this size!

Although during the last three years, the pace of direct taxation was forced in this country, even the Finance Minister admitted in the Lok Sabha in answering a question, that there is very little more that could be got out of direct taxation. Therefore, the only other course is to have indirect taxation. Indirect taxation is a very ingenious form of getting the average consumer in the country to pay the tax without realising that he pays it. There is a very interesting compilation in the explanatory memorandum about the various items on which the Government collects excise duties. The following are some items on which the common man is contributing to the State Exchequer every day of his life, by way of indirect taxes, called excise.

The estimates for the next year:

		(Rs. in crores)
Kerosene	..	6.35
Sugar	..	46.40
Matches	..	18.00
Vegetable products	..	5.25
Coffee	..	1.35
Tea	..	7.65
Cotton cloth	..	43.00
Footwear	..	1.15
Soap	..	2.05
Paper	..	7.75
Electric fans	..	0.53

The revenue from Union excise duties in 1948-49 was Rs. 50.63 crores as against the revised estimates for last year of Rs. 350 crores. With the new excise duties which have been imposed in this budget, it is estimated that about Rs. 380 crores will be collect-ed. It must be remembered that excise duty is paid not by the few wealthy people but by the large bulk of average people in the country and it is in addition to sales tax. As the excise duty goes higher, the incidence of sales tax also increases.

Whether one agrees or not with Government policy, one need not agree that all the public expenditure is justified. Even assum-ing that it is justified, I feel the selection of commodities and services on which new excise has been levied is not judicious. The main items are those which go in the transport services of the country. The Second Plan has broken down at various stages and for many reasons. One main reason why the Plan is not very effective is that transport has been found to be a serious bottleneck. While, therefore, commonsense should suggest that the Government should take every possible step to increase the availability of transport in the country, the excise duty on vehicles and trucks, diesel oil and bicycles will not only continue the bottleneck but further aggravate the difficulties in implementing the Plan. The trend in the whole world is towards dieselisation. Instead of encouraging further promotion of dieselisation of transport services diesel oil has been so heavily taxed that it will retard, if not definitely discourage, the use of dieselised forms of transport in the country.

Another fundamental thing is that in the levying of excise duties, one has to take into account the actual economy of a commodity. The country is suffering from acute shortage of a number of goods and services. Particularly motor vehicles and trucks are in acute shortage so much so a truck commands a substantial pre-mium over the selling price in the open market. The selection of transport services for the additional impost is fundamentally wrong. One cannot understand the Finance Minister putting the additional burden of the order of Rs. 23 crores of new excise duty on those commodities and services which need to be made available in larger quantities and at cheaper prices.

Apart from the judiciousness, the impact of the excise duties on the economy is also important. A very interesting article published recently in *Tata Quarterly* on indirect taxation analyses the impact of indirect taxation on the various phases of the economy. In that objective article, the writer could not but come to the conclusion that indirect taxation has a direct bearing on **the** inflationary situation in the country. Every additional excise duty, therefore, is a further spurt and impulse to the inflationary processes in the country, and the burden is borne by the average man in the shape of higher prices of commodities and services.

If we want to make real economic progress in the country there are certain elementary prerequisites which must be provided to the community. A few random examples will suffice to show that the Government is failing in this essential duty to the community required for rapid economic progress. For instance, recently, a citizen complained in a letter to the editor of ***The Timer of India*** in Bombay that in an important area of the city like Matunga, the post office was short of money order forms and that he had been given to understand that months had passed by without supplies although an indent. had been placed. It is gathered that a village near New Delhi which needs a well very badly, after repeated appeals to the higher authorities, has been told that there is no money for the well at least during the Second Plan period! It is understood that there are about 600 non-functioning joint-stock companies which are not wound up because the telephones in their names would be forfeited!

I have personal knowledge of a large new factory which is being erected near Bombay on which Rs. 1½ crores has been already spent, but whose application for a telephone is still awaiting consideration. If Government fails in its elementary duties of providing the most essential prerequisites to the economic progress of the country, that Government cannot justify what would be described rightly as the public waste of thousands of crores of rupees on wasteful projects and also giving an impetus to inflation which will hit the common man the hardest.

Based on a lecture on "The Union Budget — 1960/61" delivered in Bombay on March 10, 1960.

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

—A. D. Shroff

HAVE YOU JOINED THE FORUM?

Annual Membership Fee is Rs. 10/-

Bona *fide* students can get our booklets for a year by becoming Student Associates on payment of Rs. 2/-.

Published by M. R. Pai, for Forum of Free Enterprise, "Sohrab House," 235, Dr. Dadabhai Naoroji Road, Bombay 1, and printed by S. Krishnamoorthy at Western Printers & Publishers, 15/23, Hamam Street, Bombay 1.

8/March/1960

98