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Economy under Inflationary Pressures and Planned Development

The steady rise in the general level of commodity prices which started in Iudian economy in mid-1955, acquired the characteristics of strong inflation in 1964. Consequently, the rupee today has only two-fifth of tne value it had twelve years ago. Further more, the erosion in the value of rupee which commenced in early 1964, has destroyed more than one-third of its value in less than four years. There is an increasing wave of discontent at the abnormal and phenomenal rise in the prices of all consumer commodities, especially of food stuffs, which has increased misery for the toiling masses. Economic distress and soaring prices, have continued to play havoc with industrial peace[1]. Besides, price resistance movements. bundhs and gheraos are haunting the national scene.

The Economic Adviser's general index of wholesale prices, with the year ended March 1953 as the base[2]., touched a low of 89·9 in May 1955 due mainly to the bumper crops in 1953-54 and 1954-55. The price-index at this level was the lowest since March 1948. An up-trend in prices commenced in June 1955, and continued almost uninterruptedly, exepting minor price-terracings caused by seasonal deceives in agricultural r ices. The General index touched a peak-level of 221 in October 1967, recording a net rise of 146 per cent over that for May 1955. Thus the average annnal price increase during the period has been of the order of about 12 per cent. The average annual price rise between October 1963 and October 1967 has, however, been still higher at 15.5 per cent. Further, the year 1966-67 experienced no seasonal fall in prices recorded normally between September and March. On the other hand, there was a contra seasonal rise in prices.

The average annual level of prices, which cancels out the week-to-week fluctuations, also registered an average annual rise of 9.7 per cent

1. The number of man-days lost during 1966 was 10.0 million, which is the highest ever recorded since the commencement of planning. The number of man-days lost during 1967 is expected to be still larger.
2. The weight base of the index, however, relates to 1948-49.

between 1956-57 and 1966-67. It is interesting to note that the average annual rise in the general index of wholesale prices was 7.0 per cent during the Second Plan period, and merely 2.8 per cent in the first three years of the Third Plan. The precipitate rise in prices which commenced with the cold wave of January 1964, brought about a net rise of 41.3 per cent in the annual average index for the year 1966-67 over that for 1963-64. The largest increase in any single year was of the order of 26.1 points in 1966-67. The year 1967-68 is also likely to close with a similar rise and continues to pose a serious problem for the Indian economy.

It May, however, be added that during last few years the weight of the price-regulated items has increased precipitately and is nearly one-third of the total weight of the index at present. It is difficult to indicate how effective price controls have been in ensuring the supply of the regulated items to the consumers at official prices, incorporated in the preparation of indices. The price rise experienced in the last four years, therefore, seems to be in the nature of "repressed" inflation.

Contributions of the commodity Groups—

All the commodity groups contributed to the rise in prices during the period. The 'food articles' and 'industrial raw materials,' which together command a weight of 65.9 per cent in the general index, have been responsible for more than three-fourths of rise in the price level due mainly to their relatively low elasticity of demand against a virtual stagnation in the agricultural production for a number of years. This is evident from Table below :—

TABLE I

Percentage contributions of Groups to General Wholesale Price Change-1955-56 to 1966-67.

(Base : 1952-63=100)

	Weight	1966-67 over 1955-56	1960-61 over 1955-56	1963-64 over 1960-61	1966-67 over 1963-64
Absolute rise in General Index.	1000	98.7	32·4	10.4	55.9
Percentage contribution of :					
Food Articles.	504	57.8	51.9	81.4	56.8
Liquor & Tobacco	21	1.0	1.9	1.9	0.4
Fuel, Power etc.	30	2·3	2·3	5·6	1·7
Industrial Raw materials	155	20·3	22·2	—8·8	24·8
Manufactures :—					
Intermediate products.	41	4.3	3·9	3·5	4·8
Finished Products.	249	14·3	17·9	16·5	11·4

Note :—Computed from figures published in the Report on Currency and Finance, 1965-66 and 1966-67, Reserve Bank of India, Bombay.

A study of the percentage contributions of all the component groups to the rise in the general index of wholesale prices reveals wide flucnattions. The 'food articles' group alone had been responsible for the total annual rise in the years 1958-59 and 1962-63, whereas in 1960-61 the group contributed only 6·5 per cent to the total annual price change. The 'industrial raw materials' group generally contributed substantially to the total annual price rise. The negative contribution of the group in the early years of the Third Plan had been due mainly to the high leveals achieved by it between 1959-60 and 1960-61. The 'manufactures' group generally contributed to the total annual price rise lesser than its assigned weight of 29 per cent. This group, however, occupied the first place among the contributing groups in 1960-61, when it contributed as much as 45·4 per cent to the total annual price change.

The contributions of the remaining two groups, namely, 'liquor and Tobacco' and 'fuel, power, light and lubricants' have been meagre due mainly to their relatively low weights in the general index of wholesale prices.

CAUSATIVE FACTORS :

The precipitate rise in the prices has been the result of several factors in the economy, some of which have affected the demand while others acted on the supply; and even a very sophisticated analysis of these factors will be insufficient to apportion the responsibility correctly.

The steadily accelerating tempo of investment in the public sector and the method adopted to finance this increasing investment through an inflationary gap in budget receipts, or to use Prof. B. R. Shenoy's words 'the futile attempt to invest non-existent resources'[3] to the tune of Rs. 2952 crores during the years 1956-57 to 1966-67 has resulted in an almost continuous[4] increase in money supply with the public from 1,955 crores in March 1955 to Rs. 4,954 crores in March 1967. This phenomenal rise of 153 per cent or an average annual increase of 12·8 per cent in money supply which reflects an increase in national disposable income, not only pushed up the demand for essential consumption commodities for an ever-increasing population, but also brought structural increase in the demand for supplementary foods and sophisticated consumption goods.

Besides the above, emphasis on heavy and basic industries having a larger gestation period and a higher capital-output ratio, misdirected

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3. B. R. Shenoy : *Indian Planning and Economic Development,* Bombay, 1963 p. 123. Also "P. L. 480 Finances." *The Economic Times,* Bombay 1st September. 1967 pp. 4—7.
4. Excepting slack seasonal declines between May and September.

schemes and delays in completing projects have fed the inflationary spiral. The simultaneous stepping up of defence and non-development expenditure has further aggravated the pressure of demand in the economy.

While all the above factors and ever-increasing demand from the private industrial sector—financed through a substantial increase in the volume of bank—accelerated the pressure on demand for consumption goods as well as for industrial raw materials, the increase in production failed to keep pace with the rising demand. The increase in real national output averaged 4.7 percent and 2.7 percent a year during second and third plans respectively, whereas net national expenditure rose at the rate of 7.6 percent and 8.5 percent a year during the two plan periods. Thus, the gap between spending and real output widened steadily reflecting the persistent imbalance between aggregate demand and aggregate supply. Consequently even small declines in the production of agricultural commodities pushed up the prices substantially. Fluctuations in agricultural production in general and a stagnation in foodgrain production particularly in the first three years of third plan, have tended to generate large scale attempts at hoarding foodgrains and at inventory build-up of important raw materials largely with the help of "unaccounted money". A new class of large and medium cultivators with business outlook have also played an increasing role in withholding the supplies from the market.

On the other hand, the rise in the prices of manufactured goods has been, to a considerable extent, the result of the "growing stream of individual income payment rampaging over the dam of productivity"[5]. Further, the policy of imposing substantial excise duties on basic necessities of life has also caused a rise in the prices of essential goods like clothing, kerosene, sugar, tea, cigarettes etc.

The Basic Ramedy

In a developing economy, there is always a lag between the creation of new incomes and increase in available supplies on which they can be spent, due mainly to the longer gestation period in certain projects. The basic remedy for keeping the inflationary pressures under control in such economies is, therefore, increase in internal production both in agricultural and industrial sectors. Further concentrated effort to complete existing projects—dams, canals, power stations, factories, roads etc.—in the public sector as expeditiously as possible may bring about a substantial rise in production. No new projects should be taken up

5. Sidney weintranb : *Growth Without Inflation,* a report prepared for NCAER, New Delhi, February. 1965, p. 67.

beyond the country's ability to complete and the emphasis should be laid on small and medium projects which may bring about quick and favourable results. But all these efforts would be of no avail, unless we tackle our population problem quickly and effectively.

Need for an Effective Price Policy

An effective price policy is needed for successful inplementation of planning and to ensure that further devluations are not forced upon us due to continuous uptrend in prices. In order to safeguard the interests of consumers, such a price policy is required to regulate and control the prices of all the commodities in general, and certain essential commdities in particular. On the other hand, the producer should be assured a minimum price for his produce, which in addition to the cost of production will fetch him a fair return on investment.

The present inflationary pressures, however, can be curbed with a judicious alignment of monetary and fiscal policies and a stricter control system on the one hand, and streamlining of distributive machinery to ensure the supplies of essential commodities like cereals, pulses, Kerosene, oils etc., on the other hand.

An increase in the Bank rate generally has little impact on the decision to save or to invest. On the other hand it adds to the interest burden on the public exchequer and increases the cost of credit to the private sector. The credit policies, therefore, should be reformulated in such a manner, so as to provide necessary funds to productive industries and sectors including export and import-substitution industries, and to discourage bank credit from going into speculation and sectors not preferred. An efficient operation of selective credit controls may, thus, discourage specultive holding of commodities and accumulation of inventories. The establishment of the National Credit Council with the Finance Minister as its chairman and the decision to lower the Bank rate by a full point to 5 percent are two important steps in the right direction. Steps should also be taken to bring the unofficial money market in line with the organised credit system for an effective control over the flow of funds,

The inflationary pressures can be subdued if resort to deficit financing is generally avoided and the tax structure is also reconstructed. Efforts should be made to raise taxes on agriculture, which are contributing hardly about one per-cent of the total income in the sector in the form of land revenue and agricultural income-tax. On the other hand, excise duties and essential consumption goods should be reduced by a suitable extent. Tax evasion should also be rooted out by some suitable measures. The pruning of un-productive government expenditure and dismantling of all non essential controls may result in considerable economy and would stimulate economic development.

The abolition of the single State food Zone system would help evolve one 'all India' price, so essential for smooth economic growth. The large Zone system also leads progressively to restrictions at lower levels. and can not, therefore, serve even as a transition to free movement. To wait for a 'comfortable' supply position for removing movement restrictions also is not logical since the movement restrictions cannot alleviate the shortage, but aggravate it for the consumers of the deficit states. The Government should, however, build buffer stocks through compulsory levy with a view to stabilizing prices and at the same time, compelling by law every farmer, possessing a certain minimum area, to deliver at fair prices a part of his produce on a graduated scale to the State.

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