Financial Implementation of the Five-Year Plan

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The financial policy of the Government of India during 1951-54 *has been governed more by considerations of stability than of the need for growth. It is contended here that this policy was carried rather too far, and that, but for the bounty of nature, it would have resulted in a gradual fall of* per capita *real income in the country.*

A bolder policy would have involved more deficit financing than was either budgeted for, or actually undertaken (the actual deficits being smaller than those proposed in the budgets of the Union and of the States), and, instead of generating inflation, it would have led to higher money incomes as well as to higher real incomes, for this would have stimulated both the organized and unorganized sections of the private sector.

THE period covered by the First Five Year Plan* of the Government of India is nearing its end, and a Second Five-Year Plan, based on the achievements and experience of the First, is already in the blueprint stage. There is room for interpreting the experience of the years 1951-54 as either commendatory or critical, of the policies pursued by the Government in connection with the implementation of the Plan. On the one hand, spokesmen of the Government can point to the increased production, particularly in agriculture, and more especially in food, to the withdrawal of controls and the abolition of food rationing, to the success of the disinflationary policy as indicated by the fall in prices, to the relatively strong balance-of-payment position, and to the near accomplishment of some of the targets, and, in some cases, the actual surpassing of the targets even before the end of the Plan period, as evidence of success. All this, it may be claimed, has been achieved, in the face not only of a smaller amount of external assistance than was anticipated in the Plan, but even in the absence of surpluses in the State Budgets, and a smaller surplus in Railways than expected, and, with only a moderate amount of deficit financing up to 1954. Let it be remembered, besides, that special emergencies, like floods, or sudden splurges of refugees, which were unanticipated in the Plan, have interfered with the .smooth working out of the projects.

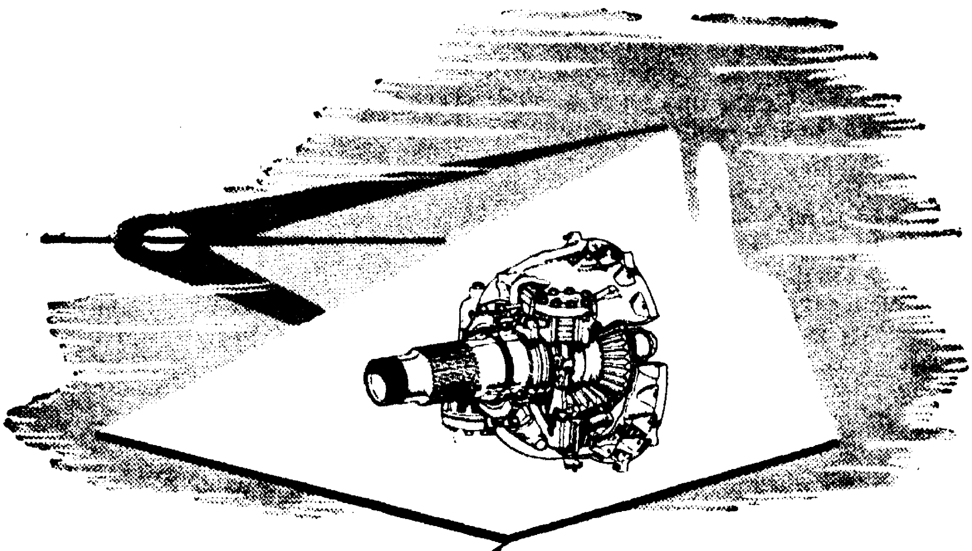
On the other hand, critics may legitimately point out that the First Five-Year Plan was not originally adumbrated as the *maximum* which might be achieved in five years, but rather as something which, in the absence of grave internal and external causes of dislocation, could be *reasonably expected* to be achieved. What measure of success has been achieved during these years, the critics may say, is to be found in a large number of other countries, in many of which, particularly in Europe, the success achieved is much greater on all counts. We have not only failed to march ahead with many other countries, which started with equally grave problems, but we have failed to tackle the problems of agricultural under-employment, industrial and middle-class unemployment, structural maladjustment in the economy, and the inequality of incomes. When it is remembered that three successive good monsoons have favoured the country, the over-all performance of the Government appears to be very meagre indeed, the rise in *per capita* incomes being ascribable almost entirely to nature, but for whose favours, *per capita* income would have most probably fallen to a figure lower than in 1951.

OBLIGATIONS ON THE TWO SECTORS

It cannot be gainsaid that there is strength in the critics' point of view. The Five-Year Plan laid obligations on the Government as well as on the private sector. On the Government, the Plan laid, in the first place, certain financial and productional obligations, and in the second place, a number of other obligations concerning the basic re-orientation of the economy which, it was agreed, would take a relatively longer period to be implemented fully, but which could be started within the period of the Plan. On the private sector, the only obligations imposed were the curtailment of non-essential consumption, and the undertaking of productive investment. As regards productive investment, the main reliance was placed on organized industry, which itself participated in the setting up of production targets. About the capacity or the willingness of either the Government or organized industry to act in the manner envisaged, the First Five-Year Plan entertained hardly any doubt. But as regards the unorganized sectors of industry and agriculture, the Plan had grave misgivings, and it addressed its chief attention to these. As things have turned out, it is the agricultural sector, though not the unorganized sector of industry, where the expectations of the Plan are nearest fulfilment, thanks to the bounty of nature, and, to a certain extent, to Government undertakings in connection with agriculture and irrigation. It is in the sector of organized industry, and in the public or Government sector, apart from undertakings connected with agriculture, that the achievements fall far short of expectations.

It might have been expected that, having set up certain output targets for the economy as a whole, the Government would not rest on the assumption that the private sector would carry out its obligations, and the Government's only problem was to carry out its own part of the programmes. Even if the only task that the Government set itself had been the maintenance of effective demand at a high level so as to minimize cyclical fluctuations, it would have been incumbent on the Government to make good the deficiency of aggregate demand by its own expenditure policies, when the approved incentives to private industry had failed to evoke the required response. This obligation could not be escaped by the plea of the tendency of an under-developed country with under-employed resources to start an inflationary spiral from increased Government expenditure, for that argument would apply equally to investment expenditures in the private

*From a paper prepared by the author while he was working on the Economic Development Programme, India Project, M I T, Cambridge, Mass (USA)., an a visiting professor.



sector when their fruits have a relatively long gestation period, (Besides, in a situation of increasing unemployment and falling costs of production as obtained in India since 1952, this argument has little validity in any case.) Nor would the argument that increased Government investment must await the generation and mobilization of genuine private savings, which is the standard argument nowadays for restricting the volume of Government investment, be applicable in a situation in which it has been recognized at the very inception of the Plan (i) that the low national income means a small volume of savings, and (ii) that the underdeveloped character of the economy makes very difficult the task of mobilizing what savings there are. so that, on both counts, aggregate investment has to be stepped up, which is, in fact, the rationale of the Plan itself. Since the Government aims at promoting growth, and not merely at ironing out industrial fluctuations, it was all the more incumbent on the part of the Government to increase the rate of its expenditure when the organized private sector lagged behind.

DEFICIT FINANCING

To this *prima facie* argument, there are apparently obvious answers, arising out of the facts of the situation in India between 1952 and 1954, and from *a priori* theoretical considerations relating to an underdeveloped economy, which wants to have a democratic plan with a well-recognized private sector. As regards the facts of the situation, it may be argued that the position as regards external assistance, Government revenues and the capital market being what they were, further Government expenditure beyond what was actually undertaken could only be done by deficit finance, *ie,* treasury bill issues and bank borrowing which would have nullified the good effects of the disinflationary policy of the Government, which had been reinforced in November 1951 by the raising of the bank rate and the refraining of the Reserve Bank from buying Government securities to facilitate the seasonal requirements of scheduled banks. Now, in considering this argument it has to be remembered that we are dealing specially with the years 1952 and 1953, and not with the situation in 1950 or 1951. By February 1952, the inflationary impetus of both devaluation and the post-Korean external demand had spent itself and been controlled by monetary policy, and measures had to be adopted to prevent " disinflation from developing into a dangerous recession ". *(Reserve Bank Bulletin* August 1954 Page 731.) These measures included a moderate amount of deficit financing, relaxation of controls, and reductions of export duties. But neither organized private industry, nor the Government itself increased their investment expenditures during 1952 and 1953 to the extent anticipated. As regards private industry, there was little investment in equipment, and the general complaint was about the lack of capital, which led to the appointment of the Committee on Finance for the Private Sector by the Reserve Bank and to discussions regarding the establishment of a private corporation with the assistance of the World Bank. It has to be remembered that during 1951, as the Reserve Bank's analysis of the use of company funds in that year shows, investment had taken principally the form of inventories. During that year, 757 joint stock companies, including most of the organized sector, had increased their total incomes by nearly one-third as compared with 1950 (from Rs 831 crores to Rs 1,076 crores), while their aggregate expenditures had risen from Rs 759 crores to Rs 996 crores, so that their surplus of income increased by Rs 9.08 crores, and this surplus, together with the excess of dosing over opening stocks, gave an increase in gross profit of Rs 24.71 crores (from Rs 84.26 crores to Rs 108.97 crores). " The increase in the value of stocks has been clue to an increase both in *cost* and *quantity"* as the Reserve Bank's analysis points out (page 770.) Though figures are not available on a comparable basis for 1952, it would not be grossly inaccurate to say that it was not the want of financial resources *in that year* which prevented investment in *fixed capital* on a desirable scale. In fact, as statement 38 on control of capital issues, in the Reserve Bank Report for 1952-53 shows there was very little desire for long-range schemes.

EXPANSION OF PRODUCTION

Yet, in spite of little new investment, production in industry has made considerable progress, the index of industrial production having risen from 117 in 1951 to 129 in 1952 and 135 in 1953, being as high as 144.7 in December 1953 (after which date there was a fall up to April 1954 in which month it rose to 145.1, May 140.8, June 146.2). Indeed, in some cases, in cotton textiles, sugar and cement, the targets set under the Plan have been practically reached or are near attainment, which only shows that the original targets were very modest. For, as the Shroff Committee pointed out, " Broadly, . . . the achievements for the past three years or so consist in greater utilization of installed capacity mainly in certain consumer goods industries. In terms of additions to the industrial potential of the country, the gains so far have been much less than are anticipated in the Plan " (page 10).

The reason for the short-fall in private investment in fixed capital has been examined by the Shroff Committee. Briefly, their finding emphasises three causes; (i) over-all shortage of capital, due to " redistribution of incomes in favour of those classes whose propensity to save is relatively small, and whose savings are difficult to tax by the existing agencies in the private sector ", though the Committee admits that it is difficult to say whether or not aggregate savings have changed one way or the other. Besides, " the internal resources of enterprises that could be utilized for reinvestment " have also been reduced by increased labour costs and restrictions on prices; (ii) Government borrowing from the capital markets because of which "the resources available for investment in industrial shares and debentures have been reduced", though the Committee recognizes that the public have shown a preference for Government paper due to fluctuations in industrial securities and to loss of confidence in industry, due to malpractices by some entrepreneurs; (iii) Government's general economic policy, including rumours of nationalization, procedural uncertainties under the Industries (Development and Regulation) Act and the control of capital issues, labour legislation and policy—the net effects of which have been the creation of an unfavourable climate for risk-taking and the increase of costs and uncertainties of production.

INVESTIBLE FUNDS

Apart from its implications regarding Government policy with respect to taxation, control of capital issues and labour legislation, this

analysis implies that Government borrowing on a substantial scale would inhibit private investment in India. But is the analysis acceptable at its face value? If there is over-all shortage of investible funds in India, the main reason for it is not the " redistribution of incomes " in favour of non-investing classes. The rise in their incomes has not been at the cost of the incomes of the investing classes, but has come at best from their securing a relatively larger share from a slowly growing national income, the chief sufferers being the professions, the " middle class ", and the unorganized sector of cottage industries. The trend of industrial profits has been rising during 1951-53, which in fact explains the increase in production by utilizing idle capacity. The chief reason for shortage of available funds is not so much the shortage of investible funds, but an increase in the reluctance of the holders of such funds to invest in private industry including ordinary members of the investing public as well. The Committee themselves have noted this reluctance.

The Committee have noted that many people are unwilling to keep their savings in banks because of inquisitional inquiries by the Income-tax and Sales-tax authorities. The Income-tax Investigation Commission have already revealed the existence of about Rs 300 crores of income which evaded taxation during the war and post-war years. This throws strong light on the shortage of available funds, though not of investible funds in the hands of the " investing classes ".

INTERNAL RESOURCES

On the amount of " internal resources available for reinvestment", it is necessary to remember that Indian companies in recent years have not only distributed dividends on a liberal scale, but have also watered their capital by the issue of " bonus shares " in a large number of cases. It is difficult, on all these grounds, to accept the thesis that there is an over-all shortage of investible funds. The funds are there, but the desire to invest is lacking.

One reason for the shyness on the part of some investors must be the fear of divulging unreported income and evaded taxes. Another, and much more serious reason, lies in the structure of Indian industry, particularly in the managing agency system as the US Department of Commerce publication *Investment in India,* notes:

> The concentration of control prevailing in India's large-scale industry provides a means by which the efforts of outsiders to establish enterprises competitive with existing undertakings may be blocked. (p 26, col 2, last paragraph.)

From this brief consideration of investment in organised private industry, it may be concluded that Government investment during the Plan years *need* not have been kept down through fears of undesirable reactions on private investment, the short-fall in which had little to do with the probable magnitude of Government investment under the Plan.

GOVERNMENT PERFORMANCE

We may now consider the performance of the Government. This may be set out in the form of a table.

Financing of the Plan 1951-52 to 1954-55

(Rupees crores)

	Total (Centre and States)		Centre		States	
	1951-56 Revised Plan	1951-54 Total for 3 years	1951-56 Revised Plan	1951-54 Total for 3 years	1951-56 Revised Plan	1951-54 Total for 3 years
Outlay in the Plan - - - -	224.9	884.8	1330.7	444.9	918.2	439.9
(a) Revenue Account - -	—	253.8	—	32.6	—	221.2
(b) Capital Account - -	—	631.3	—	—	412.3	218.7
Budgetary Resources - - - -	1260.5	535.3	410.2	201.8	850.3	333.5
Savings of Public Authorities:						
(a) from current revenues -	572.7	321.2	160.0	161.1	412.7	160.1
(b) from railways - - -	170.0	75.2	170.0	75.2	—	—
Private Savings absorbed through:						
(a) loans from the public -	115.0	34.6	36.0	—33.4	79.0	68.0
(b) small savings - - -	270.0	150.9	270.0	150.9	—	—
(c) deposits, etc - - -	132.8	—46.6	90.0	—29.7	42.8	—16.9
Central Assistance to States - -	—	—	—315 8	—122.3	315.8	122.3
Gap in Resources - - - - -	988.4	349.5	920.5	243.1	67.9	106.4
External Assistance - - -		131.4		131.4	—	—
Grants - - - - -		34.8		34.8	—	—
Loans - - - - -		96.6		96.6	—	—
Deficit - - - - - -		218.1		111.7	—	—
Covered by						
(a) increase in floating debt -		49.6		30.6	—	19.0
(b) sale of securities held in reserve - - - -		22.6		—29.8	67.9	52.4
(c) withdrawal from cash balances - - - -		145.7		110.9	67.9	34.8

Source: *Reserve Bank of India Bulletin,* October 1954, (pp 985-987). (The totals for the three years 1951-54 are on the basis of actuals for 1951-52 and 1952-53, and the revised budget estimates for 1953-54. The figures for the States include those for Jammu and Kashmir.)

In considering this table, it has to be remembered that during these 3 years the chief features of State financing, apart from increased transfers and grants by the Centre, have been a large volume of developmental expenditure outside the Plan, and the low yield of additional taxation. Even though expenditure under the Plan is so low, the necessity of having to incur other developmental expenditure points to a shortcoming of the original plan. That plan could not envisage some of the social expenditure, for example on refugee rehabilitation and famine relief, which became so important during these years. At the same time the additional taxation which it was possible to impose brought in very small amounts. As the *Planning Commission's Progress Report for* 1953-54 points out, "The bulk of the increase in total tax revenues has been on account of the larger share of central taxes, The major increase in State tax receipts has taken place under land revenues consequent on the abolition of Zamindari and other intermediary tenures. Taxes on motor vehicles and motor spirit show increased yields, but these are partly neutralized by decreases under excise and agricultural income-tax."

This low yield of additional taxation by the States is a matter of serious concern. While all students of the Plan emphasize the need for securing additional revenues through increased taxation by the States, it is not clear how this can be done. As has been evident for a long time, the revenue resources of the States are inelastic, particularly since the introduction of prohibition. In fact, as the *Eastern Economist* put it (March 26, 1954, pp 523-24), "The States have mental reservations regarding the ability to repay their loans which the Centre is advancing out of the incomes which have been or will be created out of loan expenditure—a fear which has already been expressed by the Mysore Chief Minister, and which may in the future lead to an argument in favour of grants rather than loans by the Centre."

PLIGHT OF THE STATES

As it is, the plight of the States, due both to unanticipated expenditure and the low yield of taxation, has compelled them, in spite of increased central transfers, to borrow from the public on a relatively larger scale than contemplated in the Plan and also to increase their floating debt and withdrawals from cash balances and the sales of securities held in reserve/ As these cash balances arc almost depleted/ they would have to rely much more on loans from the public and transfers from the Centre in the coming years.

As for the Centre, apart from the complication caused by the plight of the States, which has caused it to come to their aid, there has been disappointment as regards practically every one of the expected resources. Only the savings from current revenues have apparently come up to expectations. The Plan envisaged Rs 160 crores on this account for the whole period, whereas they have amounted to Rs 161.1 crores for 1951-54. Of this, however, Rs 119.6 crores were realized in the year 1951-52 alone, while Rs 41.4 crores were realized in 1952-53, the realization in 1953-54 being only Rs 0.1 crore. Evidently, it was the post-Korean boom which was responsible for this happy result and though Rs 31.8 crores have been provided under this head in the 1954-55 budget, this is going to be a headache for the Finance Minister unless economic conditions in India and abroad improve considerably. The greatest disappointment has been the small contribution from railways. Among the budgetary resources the only encouraging item is small savings. As regards external assistance, the amount actually realized (Rs 131.4 crores) was much less than anticipated. Apparently, the only way in which the total outlay could be increased was by increased loans from the public. During these three years there was a net discharge of such loans by about Rs 33.4 crores, though the Plan had envisaged Central borrowing of Rs 36 crores during the Plan years. To some extent, increased borrowing by the States offset the repayment of loans by the Centre, but still there was apparently considerable scope for increased loans from the public.

THE HEART OF THE PROBLEM

This question of increased borrowing brings us to the heart of the problem of financing the Plan. It has to be noted that, like the States the Centre covered its deficit largely by withdrawals from cash balances, the increase in floating debt (Rs 30.6 crores) being practically offset by the sale of securities held in reserve (—29,8). There was thus hardly any interference with the volume of money in circulation by Central Government action during 1951 -54, The state of the capital markets during these years may seem to have made it difficult to expect much from the floating of new long-term loans, In our discussion about the supply of investible funds in connection with the private sector, we suggested that there was not so much over-all shortage of funds as a reluctance to lend, particularly to private industry. Following the same train of argument, we may state that the outlook for Government loans was much better than has usually been supposed, which is borne out by the successful floatation of loans by some of the State Governments. It seems as if it was not so much the impossibility of securing funds through loans or by increasing the floating debt, which circumscribed the total outlay by the Centre during 1951-54, as the fear of the direct and indirect repercussions of an increase in total outlay brought about by these means. That this was the reason is indicated by the failure to spend appropriations made in the budgets in each of these years. Besides, not all the external assistance, including sterling releases and IBRD loans, have been utilized to the extent that one expects them to have been during these three years. We thus have an improving external balances position, a not inconsiderable amount of unutilized budget appropriations, a small amount of borrowing from the public, a small amount of deficit financing, and a large short-fall of outlay on the Plan by the Centre, co-existing during these three years.

UNUTILISED APPROPRIATIONS

As regards unutilized appropriations, Ministers in charge of Planning and Production have expressed the opinion that these are due to the stringent financial scrutiny exercised by the Finance Ministry, while the Finance Minister has declared that "it was not so much a question of financial scrutiny as the question of the thorough planning and formulation of schemes." *(Eastern Economist,* April 23, 1954.) But when we know the predilection of the Government of India for quick-yield projects during these years, while most of the plans have been rather long-period and slow-yield ones, it appears that the defence put forward by the, Finance Minister cannot be taken at its face value. Since the Government of India, is now known to be planning

a higher rate of expenditure, it stands to reason that it has not suddenly lighted upon worthwhile projects, but has merely taken out of cold storage projects mooted during the past few years but shelved at the time because of their slow yield. There is no doubt some scope for increased expenditure through attempts to make up for the lagging under the existing projects like the DVG. But, for any substantial increase, new plans have to be set into operation, and these, it is submitted, are the ones brought out of cold storage. The Planning Commission has summarized the reasons for the lags in expenditure in the Progress Report for 1951-52 as follows: "These lags are attributable in part to the late finalization of the Plan, in part to the late commencement of some of the schemes, and in part to what might be called insufficient working out of schemes in advance. In some cases, the lack of availability of certain types of equipment, shortages of technical personnel and the time needed for setting up the necessary administrative machinery have prevented more rapid progress." While these reasons were no doubt operative to a certain extent, a real urge for getting on with the plans would not have allowed them to stand in the way the sort of urge which surmounts difficulties when a country faces a war, and the plan is nothing but a war against poverty and low standards of living.

RELUCTANCE TO INVEST

In the case of the private sector, it has been hinted at above that the will to invest: was lacking, rather than the means. Similarly, in the case of the public sector, there appears to be a similar reluctance to expand investment, even within the means available. This is in direct contradiction to the finding of the International Monetary Fund (Berstein) Mission, in October 1953, who came to the following conclusion:

> "The analysis above indicates that resources will not be available for carrying out the investment contemplated under the Five-Year Plan. Domestic savings, private and public, cannot be expected to reach the estimates. A large part of the foreign resources required for the Five-Year Plan is not assured. Active measures will have to be taken to increase the total resources available to carry out the Plan. In the absence of additional resources from domestic and foreign sources, the planned level of investment will result in inflation." (Report, P 37)

The position taken here rests on the possibility of undisclosed, resources in the private sector, the activatior of those resources through Government investment, and a more open mind regarding inflation than the Bernstein Mission. Even the Planning Commission's Progress Report now says that,

> "It is clear that a rapid and substantial stepping up of expenditures, both at the Centre and in the States is called for from now on, and indeed, this must be regarded as a matter of top priority."

The only explanation of the low level of public expenditure is that, with the memory of the instability caused by inflation in the past, the Government was afraid that the stepping up of expenditure would undo the good effects of the disinflationary policy initiated by itself and by the Reserve Bank. It has already been noted above that, by the middle of 1953, this policy led to the emergence of recessionary conditions which the Government should have been able to anticipate at least a year ahead. However much we may harp on the difference between an underdeveloped economy like India's and that of a developed country like USA and the United Kingdom, and emphasize the inapplicability of Keynestan analysis to a country in which agriculture and the unorganized industrial sector, using relatively little money, form a preponderant part, it is still true that the concept of aggregate demand has a role to play in such an economy, unmeasurable though it may be in practice. In the economy of India, a decline in private investment expenditure and in the value of exports has bitter consequences which can only be offset by increased production in the unorganized sector of industry and agriculture, and by increased expenditure by the Government. Since there is no reason to assume an automatic offsetting from agriculture and unorganized industry, it is the clear duty of the Government to increase its rate of expenditure when there is a short-fall in investment in organized private industry, and a fall in exports.

INFLUENCE OF EXPORTS

As regards fall in exports, it has been pointed out by Mr Wallich, in *Money, Trade, and Economic Growth*, that exports occupy a strategic position, more important than private investment, in an underdeveloped country though he excepts India, because it does not live predominantly by foreign trade. On the other hand, the *Economic Survey of Europe in* 1953 points out that the Western European countries during 1951-53 were influenced more by changes in the export earnings than by any other constituent of the national incomes. Thus, some underdeveloped, as well as some developed, economies, at least since 1950, have found the key to fluctuations in the value of the exports. India is not so different from either of these groups of countries that export earnings would not be almost as important in her case as in theirs. In fact, after the First World War the relative importance of export earnings in India's economy has been emphasised again and again, during the depression of the thirties, during the war period, and again during the Korean episode. Though obviously the effects of changes in the balance of payments work themselves out in quite a different manner in India than in most developed countries, a change in this balance has been found to tip the scale for industrial employment and that part of the national income which is measured in money on every occasion. Hence, a fall in export incomes has to be offset for practically the same reasons as in many developed countries. It has been singularly unfortunate that the Government of India did not apparently think on these lines during the last three years.

Of course, it may be argued that expansion of Government expenditure would increase the demand for imports, both directly in connection with the purchase of capital goods from abroad and indirectly through increased demand for consumer goods imports due to increased incomes, and thus impair the favourable balance of payments position. But this depends on the way in which the increased expenditure is financed. To the extent that such increase can be financed from external resources, the pressure on the balance of payments will immediately be alleviated. Again, to the extent that such expenditure is devoted to schemes which require littte of imports, the detrimental effects may be reduced. As in every other case of Government expenditure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is not merely the volume, but the type of project and the kind of resources used, that would determine to what extent it would be inflationary. Only if prices and wages rose proportionately to the increased expenditure or more, would there be an adverse income and employment effect. With careful selection of the type of project and method of financing, there is no reason to fear an unhealthy inflationary development. On the other hand the failure to offset the diminution in export earnings would result, as it already has done in an aggravation of the unemployment situation and fears of a deflationary spiral which persisted for some time.

There is little reason for believing that increased Government expenditure in the face of a fall in *export earning* would increase the export earnings themselves, and it may conceivably even diminish them, through a rise in export prices and the consequent fall in demand from abroad- though we do not think it would have been so in the case of India, during 1951-54, particularly if it had been accompanied by a more far-sighted export promotion programme. On the other hand, increased expenditure by the Government to offset the lack of *private investment* would very probably have acted as a fillip to the latter. Thus, there was a revival in the capital markets after increased Government expenditure programmes were announced in the budgets of 1953-54 and 1954-55. The lack of enthusiasm on the part of investors, bewailed by the Shroff Committee, could very well have been cured by a more liberal dose of public expenditure. Indeed, something like this seems already to have come about, though as yet on a modest scale.

LIMITS OF DEFICIT FINANCE

At this point it is desirable to look at the problem of financing the extra expenditure a little more closely. In the above pages, the source of finance contemplated is borrowing from the public by means of medium-or long-term loans which are supposed to come out of so-called " genuine " savings. It is to the inadequacy of such savings that the Shroff Committee and the Bernstein Mission refer when they talk of the necessary limitation on the scale of Government expenditure. Much of the extra expenditure contemplated in the last two budgets has, however, depended on deficit financing, which we usually, regarded as inflationary. The Bernstein Mission, however, has argued that, within certain limits, such deficit finance need not be inflationary, and to that extent may be resorted to. It seems then that the Government of India has been following the analysis and the advice of that Mission which sets a rather rigid limit to the amount of deficit finance.

Of course, both on *a priori* grounds, as well as from experience of the recent past, any method of finance which might appear to be inflationary would seem to be condemned in the case of India. Yet, fighting shy of the slightest trace of inflation is inconsistent with the adoption of a development programme. It would not be very much to the point to refer to the role played by " forced " savings which is another name for inflation—in the earlier phase of capitalism. This is so not only because the social and economic conditions in India' are so different and the period in view is so short, but chiefly because of another reason. In the case of the earlier phases of capitalism, the mechanism of credit creation and forced savings operated through the transfer of real resources to the growing class of entrepreneurs, and thus by swelling the profits, and encouraging the reinvestment of the same, fostered economic growth. This is not the process contemplated by and large in the Five-Year Plan of the Government of India, but though the processes have to be different, there is this to learn from the earlier history of capitalism—that credit creation may so activate the economy, if accompanied by proper institutional and fiscal changes, that new resources are created and released, and thus made available for transfer. It is to the Government sector, rather than to the private sector that the bulk of these resources would be channeled, though the private sector would not go without its share. The chief objections to such a point of view are two: (1) that in an underdeveloped country like India resources would not in fact be created so that there will be inflation and dislocation of economic life, and (2) that the processes would limit the scope of the entrepreneur, inhibit his activity, retard the development of the private sector and either bring stagnation to the economy or lead to the all-comprehensive socialistic state in the not very long run.

FISCAL MEASURES

As regards the second of these arguments, it depends very much on the extent of deficit financing and the fiscal measures adopted along with it. So long as a free rein is not given to inflationary forces, the Government should not be unduly afraid of moderate price increases. The very recognition of the private sector sets a limit to the fiscal measures that can be adopted by the Government to prevent too great a rise in profits. In a mixed economy, where the responsibility for economic development has been undertaken by the Government, organized private industry must accustom itself to an enlargement of the public sector. The Shroff Committee has urged as follows: " Indeed, the business community has to recognize the fact that planning in a mixed economy necessarily involves some control and regulation of the private sector." (p 52 of the Shroff Committee Report.)

As regards the first objection above, it depends basically upon the fact that on account of inelasticities in supply, " the normal state of the Indian economy can be assured to conform to the classical model of an economy on the verge of full employment," and therefore " in financing the investment of development expenditure, which is intended to raise the full employment ceiling on these lines, the classical prescription should be applicable". (The Theory of Indian Economic Development" in the *Economic Weekly,* August 15. 1954.) The specific discussion of the theory with reference to deficit financing by the Bernstein Mission on pages 41-45 of the Report is inspired by the assumption that the availability of resources is independent of deficit financing, that is to say, by the assumption of inelasticity of resources. Thus, the Report states:

> " As deficit financing is undertaken without regard to its effect on the money supply *and the availability of resources,* it will inevitably lead to inflation and hamper the achievement of the Plan" (page 41).

Now, if the projects financed through deficits aim specifically at removing these inequalities, through education, propaganda, provision of opportunities for migration, etc. the argument loses much of its force. Besides, the change in relative incomes brought about in this way exercises some influence at least in breaking down bottlenecks, as was experienced in India during the later years of World War II. As Professor Samuelson has pointed out,

> " Especially for young developing countries, where investment opportunities always seem (at conventional interest rates) to be running beyond the full employment voluntary saving of the community, control over inflationary banking policies may slow down the rate of progress; and this possibility should be admitted. On the other hand, if over the years the public authorities find themselves pursuing expansionary monetary and fiscal policies in order to offset incipient stagnation, then savings which would have been abortive may be brought into effective being." *Income Stabilization for a Developing Democracy,* Edited by M F Millikan. page 570.

OPPONENTS OF DEFICITS

It might not be amiss to refer in this connection to the theoretical predilections of opponents of deficit financing. In general, they are impressed by the effectiveness and the necessity of thrift as the precondition of the growth of capital. and of economic development. Thrift, may, however, be regarded as an effect rather than as a cause. Thus, A K Cairncross writes "on the one hand, this (growth of capital) resulted from the prodigious thrift of the Victorians. In a deeper sense, however, the faith and outlook that express themselves in thrift were born of economic expansion and growth of capital, and the line of causation was from accumulation to thrift rather than the other way around." *(Home and Foreign Investment,* 1870-1913, chapter 1, page 3.) The possibility of savings being a residual, and of investment not having to wait on prior savings is ruled out in the minds of the opponents of deficit financing because of the applicability of the classical analysis to the case of underdeveloped countries. We are here trying to make out a case for deficit financing, even if it leads to some degree of inflation, partly on the ground that it will activate idle savings, partly that by increasing incomes it will make for more savings, and partly because it will break down rigidities and bottlenecks.

Enough has been said to demonstrate that the Government of India need not be tied down to the rigid rules limiting the amount of deficit financing, laid down by the Bernstein Mission. There are sources enough which work to make it impossible for the Government to go on a spree with deficit financing, The need now is to advise boldness rather than caution. To the extent that agricultural production improves, whether due to the working out of the Plan, or any other cause, the dangers from deficit financing would be reduced, and indeed a stronger case would be made out for such financing, because it would otherwise lead to disastrous price falls. Again, to the extent that external resources become available, the need for deficit finance will be lessened. But, in working out the Plan, as has been proved during the last few years, much reliance cannot be placed either on external aids or on the private sector. The responsibility is the Government's and ft must not fight shy of having to use one of its most potent weapons because of supposedly unfavourable effects, conjured up by people who are more interested in maintaining price stability, even if it leads to stagnation than in economic development proper.