

GOKHALE INSTITUTE OF POLITICS AND ECONOMICS

PUBLICATION NO. 10

War and Indian Economic Policy

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(Price, Rs. 5 or 10s.)

1943

Published by D. R. Gadgil, M.A., M.Litt. (Cantab.), for the Gokhale Institute
of Politics and Economics, Poona 4, and printed by L. C. Shepard, at the
Oriental Watchman Publishing House, Salisbury Park, Poona. 500-558-45.

Preface

An attempt has been made, in this publication, to set forth plainly the development of the present economic situation in India and to indicate the lines of action that it demands. As far as possible, controversy has been avoided. However, such surprising views have been put forward by highly-placed personages in this country that it has been found necessary to elaborate certain, even elementary, notions. In discussing policy the aim has rather been to explain, with the help of concrete illustrations, how a single comprehensive and co-ordinated plan could be built up, than to treat exhaustively of any particular aspect or aspects. In this connection, the main difficulty experienced has been the lack of reliable information regarding the structure and working of policies in the various regions. Consequently, it was necessary to rely, to a larger extent than would ordinarily be justified, on somewhat disconnected information relating to particular areas.

We have to thank the Manager of the Oriental Watchman Publishing House for speeding up the work of printing, and thus making an early publication possible.

10th April 1943.
Gokhale Institute
of Politics and Economics
Poona 4.

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List of Tables

Table No.	Page
1. Movement of Currency and Prices in India' ..	2
2. Assets of the Issue and the Banking Departments of the Reserve Bank of India	3
3. Increase in Note Circulation	9
4. Consolidated Position of Scheduled Banks	11
5. Relation Between Demand Liabilities of Scheduled Banks and Clearing House Returns	12
6. Index Numbers of Wholesale Prices [Economic Adviser's Index] and Cost of Living	14
7. Indian Money Rates	19
8. Indian Defence Savings Loans of Various Types	33
9. Estimation of the Inflationary Gap	36
10. India's Sterling Debt'	49
11. Estimated Area Under Some Important Crops and Their Estimated Yield	62
12. Production of Certain Industries	63
13. Imports of Certain Industrial Raw Materials Retained in Poona	64
14. Comparison of Income-Tax Rates and Their Incidence in Australia and India	70
15. Supplies of Cloth in India	100

Contents

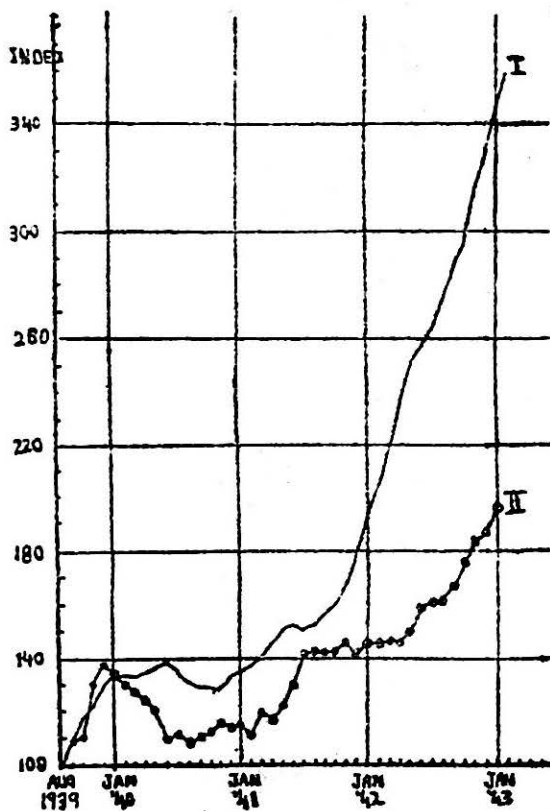
PART I: CURRENCY AND PRICES

	Page
1. Expansion of Currency	1
2. How This Extension Was Brought About	4
3. Nature of India's Sterling Balances	8
4. Rate of Currency Expansion	9
5. Bank Deposits	10
6. Velocity of Circulation	12
7. Wholesale Prices	13
8. Currency and Prices	17
9. Finance of British Purchases	20
10. Problem of War Finance	22
11. Central Government Revenue Deficit	
During the War Years	31
12. Government Borrowing	32
13. Inflationary Gap	35
14. Inflation	37
15. Finance Member on Inflation	38
16. Inflation or Expansion	43
17. Foreign Exchange and Inflation	45
18. Sterling Repatriation	48
19. India's Sterling Balances	53

PART II: FINANCIAL AND ECONOMIC POLICY

1. Prices and Production	57
2. Financial Policy	68
3. Objectives of Economic Policy	74
4. Price Control	77
5. Wage Stop	85
6. Profit Stop	87
7. Control of Investment	90
8. Rationing	96
9. Standard Cloth	98
10. Inflation and Distribution of Income	102
11. Production and Supply of Food	111
12. Artisan Industry	118
13. Transport	119
14. Administrative and Political Factors	123

Part I
Currency and Prices



Graph showing (I) Index of Notes in Circulation and (II) The General Index of Wholesale Prices.
(See Table No. 1, p. 2)

Currency and Prices

§ 1. *Expansion of Currency:* The most outstanding fact of the currency situation in India since the war began is the enormous expansion of currency. Table No. 1 sets out the data relating to this expansion.

The total amount of notes and coins in circulation increased by Rs. 503.72 crores during the period September 1939 to December 1942. Nearly a quarter of the total increase occurred up to March 1941. From March 1941 to March 1942 the increase was more than a quarter of the total. The remaining increase occurred between March 1942 and December 1942. The increase in currency was largely brought about by an increase in notes, coins being relegated to a very minor position. Notes in circulation increased by 38 per cent from September 1939 to May 1940. From June 1940 to October 1940 notes in circulation declined, showing the usual seasonal absorption, and then steadily increased, reaching a level above that of June 1940 in February 1941. From that time onwards notes in circulation have continuously increased up to December 1942, except for two small seasonal recessions, one in July 1941 and another in June 1942. In January 1943 notes in circulation had increased by 236 per cent over the September 1939 level.

Why has this expansion of currency occurred? Under the provisions of the Reserve Bank of India Act an expansion in currency can occur only if there is a corresponding increase in the assets of the Issue Department of the Reserve Bank of India. Table No. 2 sets out the assets of the Issue and Banking Departments of the Reserve Bank of India from September 1939 to December 1942.

TABLE NO. 1. MOVEMENT OF CURRENCY AND PRICES IN INDIA

[Source: Monthly Statistical Summary, Reserve Bank of India]

(In Lakhs of Rupees)

Months	Total Notes Issued	Notes in Circulation	Index of Note in Circulation Base=Aug. 1939=100	Increase or decrease of Rupee coin circulation in	General Index † 19th Aug. 1939=100
1939					
August	2,05.94	1,70.29	100	- 2.46	100.3
September	2,07.78	1,86.06	109	+ 7.33	112.9
October	2,16.53	1,98.52	117	+ 12.60	114.9
November	2,22.66	2,09.03	123	+ 13.04	130.5
December	2,33.97	2,19.09	129	+ 5.28	153.3
1940					
January	2,39.80	2,26.35	133	+ 3.37	131.2
February	2,39.55	2,26.48	133	+ 2.56	129.6
March	2,36.37	2,26.68	133	+ 2.35	127.5
April	2,39.21	2,27.78	134	+ 2.56	125.0
May	2,40.43	2,31.70	136	+ 6.81	120.8
June	2,46.26	2,37.29	139	+ 15.12	110.3
July	2,45.04	2,30.71	135	+ 5.18	112.1
August	2,48.56	2,22.89	131	+ 3.62	108.4
September	2,46.18	2,19.88	129	+ 2.03	111.1
October	2,45.15	2,20.20	129	+ 1.00	112.1
November	2,44.55	2,19.32	128	+ .83	115.7
December	2,43.23	2,25.69	133	+ 1.13	114.4
1941					
January	2,44.40	2,30.20	135	- 1.36	114.8
February	2,48.81	2,33.31	137	- 1.41	111.1
March	2,49.91	2,38.87	140	- 2.28	118.8
April	2,60.72	2,49.28	146	- 1.35	116.4
May	2,66.14	2,54.93	150	- .17	121.5
June	2,72.15	2,59.60	152	- .34	130.2
July	2,72.51	2,56.93	151	- 1.08	140.9
August	2,73.21	2,57.88	152	- .84	142.5
September	2,76.73	2,65.67	156	- .72	142.2
October	2,86.07	2,73.69	160	+ .37	142.1
November	2,94.83	2,84.00	167	+ 1.24	146.5
December	3,14.28	3,04.22	178	+ 3.42	140.8
1942					
January	3,39.54	3,28.39	193	+ 2.54	145.0
February	3,59.25	3,48.96	205	+ 2.16	145.1
March	3,86.42	3,74.97	220	+ 1.95	145.6
April	4,13.41	4,01.60	236	+ 3.05	145.9
May	4,36.94	4,24.85	250	+ 1.69	149.9
June	4,51.07	4,39.17	257	- 1.61*	158.6
July	4,62.34	4,49.53	264	- 2.16	161.2
August	4,80.16	4,67.91	275	+ .98	161.1
September	4,99.43	4,88.06	287	+ 2.03	167.3
October	5,19.35	5,08.77	294	+ 4.87	175.0
November	5,45.99	5,35.26	314	+ 6.53	182.7
December	5,73.04	5,60.57	329	+ 11.12	186.0
1943					
January	6,00.33	5,87.60	345	+ 9.57	195.6
February	6,21.06	6,09.50	338	+ 5.95	-

† As given in Explanatory Memorandum on Central Budget, India, 1943-44, p. 34.
* Note.—Figures for India only from June 1942.

TABLE NO. 2. ASSETS OF THE ISSUE AND THE BANKING DEPARTMENTS OF THE RESERVE BANK OF INDIA

[Source: Monthly Statistical Summary, Reserve Bank of India]

[In Lakhs of Rupees]

Month	Issue Department					Banking Department						
	Gold Coin and Bullion	Sterling Securities	Rupee Coin	Rupee Securities	Notes and Coin	Balances held Abroad	Loans and Advances to Government	Other Loans and Advances	Bills Purchased and Discounted	Investments	Other Assets	
1939												
August	44,42	59,50	74,31	37,39	35,79	4,44	77	2	25	7,11	1,16	
September	44,42	60,50	75,66	37,38	21,95	13,01	85	4	1,10	6,40	2,67	
October	44,42	72,00	73,19	37,35	16,94	13,09	1,89	5	5	6,46	3,67	
November	44,42	80,50	70,59	37,33	13,79	14,14	2,68	3	2,91	6,90	3,75	
December	44,42	96,30	66,42	37,73	14,99	9,71	1,30	1	7,46	6,78	3,34	
1940												
January	44,42	1,07,50	61,91	38,35	13,61	11,92	1,04	-	9,00	7,24	74	
February	44,42	1,12,00	59,09	38,35	13,28	19,24	37	2	5,84	8,51	73	
March	44,42	1,13,50	56,66	38,35	11,82	25,20	4	15	2,33	9,18	87	
April	44,42	1,15,75	54,32	38,36	11,75	25,43	39	23	60	7,34	1,17	
May	44,42	1,19,50	50,14	40,06	9,01	21,48	2,47	15	61	8,65	1,33	
June	44,42	1,29,25	37,65	48,35	9,31	20,13	3,47	15	3,65	7,50	1,33	
July	44,42	1,31,50	32,44	49,60	14,66	19,33	6,66	8	3,36	8,19	1,19	
August	44,42	1,31,50	35,68	49,60	26,03	24,54	45	3	1,90	8,80	94	
September	44,42	1,31,50	33,06	49,61	26,64	32,53	93	-	1,39	8,36	1,04	
October	44,42	1,31,50	31,54	49,62	25,29	37,95	3,87	-	15	7,98	1,03	
November	44,42	1,31,50	30,41	49,62	25,58	44,33	1,91	-	1	7,81	1,06	
December	44,42	1,31,50	29,89	49,61	17,82	54,40	11	1	5	7,00	1,11	
1941												
January	44,42	1,34,70	30,21	49,61	14,47	59,43	50	5	7	7,30	1,20	
February	44,42	1,40,50	31,29	49,61	15,30	65,79	27	7	15	7,03	1,30	
March	44,42	1,30,94	33,07	59,18	11,46	68,30	4,00	9	3	7,00	1,42	
April	44,42	1,08,03	35,44	90,84	11,75	90,63	11,32	6	96	7,71	1,37	
May	44,42	1,12,80	35,85	91,32	11,61	33,83	6,38	1	39	7,75	1,53	
June	44,42	1,18,80	36,00	91,31	12,94	36,92	55	-	-	8,10	1,45	
July	44,42	1,20,94	37,01	89,17	15,97	43,89	1,09	50	-	7,32	1,14	
August	44,42	1,31,62	37,86	78,49	15,74	44,98	1,08	-	-	7,62	1,05	
September	44,42	1,35,37	38,80	77,00	11,43	53,38	1,38	-	-	47	8,33	
October	44,42	1,50,85	38,56	71,68	12,76	64,90	10	-	-	27	8,63	
November	44,42	1,75,40	37,48	57,48	11,19	60,59	16	-	-	10	8,15	
December	44,42	2,15,12	35,15	42,75	10,47	55,58	7	15	5	8,51	1,64	
1942												
January	44,42	2,43,62	32,31	41,50	11,56	47,48	2,27	15	-	11,52	1,90	
February	44,42	2,67,37	30,08	41,50	10,55	38,01	11,92	4	8	11,68	3,10	
March	44,42	2,07,35	27,95	1,33,76	11,69	41,07	13,74	2	23	11,69	4,88	
April	44,42	2,35,10	29,47	1,32,99	11,94	46,36	5,09	6	1,20	8,44	5,68	
May	44,42	2,50,85	28,14	1,43,79	12,21	57,61	3,43	11	52	8,32	6,84	
June*	44,42	2,58,10	26,27	1,22,28	12,01	62,66	3,86	-	13	8,57	7,12	
July	44,42	2,70,84	28,77	1,18,31	12,95	81,81	63	-	6	8,23	2,01	
August	44,42	3,04,29	29,07	1,02,38	12,39	76,95	88	-	18	6,59	2,06	
September	44,42	3,25,29	27,29	1,02,43	11,50	82,16	1,52	-	29	6,59	2,02	
October	44,42	3,18,83	23,71	1,32,39	10,70	87,57	39	-	26	6,60	2,02	
November	44,42	3,51,83	17,35	1,32,39	10,86	85,22	25	-	58	6,61	2,00	
December	44,42	3,88,33	14,16	1,26,13	12,59	76,83	67	8	1,00	6,30	2,25	
1943												
January	44,42	3,64,23	13,72	1,77,96	12,87	70,45	80	1	1,87	6,37	2,58	
February	44,42	3,78,03	13,94	1,84,67	11,69	86,75	13	10	1,59	6,58	2,61	

* Figures for India only from June 1942. Before that for India and Burma.
† Including Government of India one rupee notes from July 1940.

The figures show that the assets of the Issue Department consisting of gold coins and bullion have remained steady at Rs. 44.42 crores throughout this period. The largest increase has occurred in sterling securities held by the Issue Department and a fairly large increase in rupee securities. The rupee securities had increased from Rs. 37.39 crores in August 1939 to Rs. 126.13 crores in December 1942, an increase of 238 per cent. To enable the Reserve Bank to hold the additional rupee securities the Government of India issued an ordinance on February 10, 1941, modifying the provisions of the Reserve Bank of India Act. Under this act the amount of rupee securities and internal bills of exchange that could be held in the Issue Department was restricted to a maximum limit of one-fourth of the total assets or Rs. 50 crores, whichever was greater. The ordinance did away with this restriction, and the new limits that it laid down were that not less than two-fifths of the total assets of the Issue Department should be held in external assets, i.e., gold coin and bullion or sterling securities, and that the value of gold held should not be less than Rs. 40 crores. Accordingly up to three-fifths of the total assets can now be held in rupee securities, rupee coin, and internal bills of exchange.

The sterling securities in the Issue Department increased from Rs. 59.50 crores in August 1939 to Rs. 422.83 crores in December 1942, an increase of about 580 per cent. From August 1939 to July 1940 the sterling securities increased by 121 per cent and remained stationary at that level up to December 1940; they showed a small rise during January 1941. In March 1941 they sharply declined by 27 per cent from the February 1941 level. After this an upswing began, and the January 1941 level was attained and passed in August 1941. They continued to increase up to March 1942, when there was again a sharp decline. Since then they have continued to mount up.

§ 2. *How This Expansion Was Brought About:* The most substantial part of the currency expansion, since the

beginning of the war, is thus connected with the enormous increase in the holdings in the Issue Department of sterling securities. Why has this enormous increase in sterling securities come about? The explanation is not far to seek. It is to be found in India's membership of the British Empire and the "sterling group." This membership means two things; firstly, the "Empire and sterling countries" keep their exchange rate fixed in relation to the pound; secondly, they hold their external exchange reserves partly or wholly in sterling in the form of bank balances or short-term investments in London. As the *League of Nations' World Economic Survey 1939/41* puts it: "This second characteristic has had important results for the external war finance of the United Kingdom. The system is not new; before the war, these countries found it convenient to hold their exchange reserves in the form of sterling balances as a result of the close commercial and financial ties which they maintained with the United Kingdom. The introduction of exchange control in the United Kingdom and in all the other sterling countries reinforced this practice and strengthened the general cohesion of the system. Within the sterling area, a certain freedom of payment was maintained. Under the exchange regulations of the United Kingdom, transactions with other sterling countries were at least partly exempt from restriction. The regulation adopted in the other sterling countries provided in most cases for similar exemptions or relaxations. Thus, for all practical purposes, the sterling area became one monetary unit. Within this unit, the United Kingdom could pay for all the goods she bought with her own money, with pound sterling. . . . Under this system, then, an excess of British purchases in the sterling area over payments currently effected by these countries to the United Kingdom leads automatically to an increase in their sterling exchange reserves. But that is not all. A surplus in their transactions with the non-sterling world tends likewise to increase their sterling reserves, since the foreign exchange received is usually delivered

to the British authorities in exchange for sterling funds in London. Sterling area balances in London are invested directly or indirectly in British Government obligations, principally Treasury Bills. In this way the British Government obtains in effect short-term credits from the sterling area, which help to cover its budget deficit, and which represent the financial counterpart of the contribution made by these countries to the British war effort in terms of goods and services."¹

Under this system, therefore, the rupee finance needed by the U. K. Government is provided by the Government of India. Payments are made by U. K. Government in sterling, and these sterling balances are kept in London. In order to provide the equivalent rupee finance they are transferred from the Banking to the Issue Department of the Reserve Bank of India, and against them rupee notes and coins of equivalent amount are issued and made available in India. The sterling securities cover the new notes issued. As has already been pointed out, under the amended provisions of the Reserve Bank of India Act, once the statutory amount of gold coins and bullion (Rs. 40 crores) is maintained in the Issue Department, there is no restriction on the Reserve Bank as to the amount of sterling securities that can be held in that Department. The Bank can increase its sterling assets almost indefinitely, and is, in effect, entitled to print notes worth about two and a half times their total value. As the sterling balances in London increase, the notes issued in India can also increase. Since the beginning of the war and its approach within striking distance of India's borders, the purchases and disbursement of funds by the Government of India on behalf of the U. K. Government have increased considerably. The accumulation of sterling has also been aided by a continuous and a growing favourable balance of trade and the export and sale of precious metals. The Government of U. S. A. also made

¹ PP. 130-31.

its payments, in sterling, till very recently, to the Government of India, for the upkeep of American troops, etc., and the latter provided the requisite rupee finance. This has also tended to increase the sterling balances held in London on India's account. Thus an enormous amount of sterling securities have found their way into the Issue Department of the Reserve Bank of India, and this has directly resulted in an equally enormous increase in the note circulation in India.¹

In this connection it is necessary to consider why an important place to sterling securities was originally accorded in the Reserve Bank of India Act as cover to issue of currency in India. India was then on the sterling-exchange standard, and sterling was, next to gold, the most liquid and acceptable means of international payments. India had large sterling payments to make each year and also had considerable capital obligations in terms of sterling. The annual favourable balance of trade of India after meeting the various charges and making the various payments was not very large and for operations of exchange control, holding of sterling funds was naturally held desirable. It was thought that this provision would serve as an effective check on an undue expansion of currency, especially as the difficulties of acquiring additional gold were very great. These hopes have been, however, tragically falsified by the experience of war years. With the imposition of exchange controls at the beginning of the war, the essential exchange mechanism has ceased to operate. India is no longer on the sterling-exchange standard. The rupee has become a self-contained currency. The sterling securities in

¹ The following occurs in the *Currency Report of the Reserve Bank of India, 1941-42*: "The heavy addition in the circulation of legal tender currency during the year resulted mainly from the increasing volume of sterling receipts on account of supplies of war materials and services to His Majesty's and other Allied Governments, for which payments had to be made here in Indian currency, as well as the increasing favourable balance of payments on private account from year to year." p. 45.

the Issue Department have ceased to be a limiting factor on the note expansion, and are actually operating as an impelling one. The danger of over-expansion has come from the very direction from which it might have been the least expected.

§ 3. *Nature of India's Sterling Balances:* The sterling balances acquired by the "sterling countries" are kept in London on deposit, and an equivalent amount of domestic currency is made available to the British Government. The nature of this transaction is well put by Mr. Crowther in the following terms: "This is, in effect, a loan of their currencies to us [Great Britain], for what it means is that the Australian wheat farmer is paid for his wheat in Australian pounds by his own Government, which is content to accept sterling in return."¹

The Indian sterling balances in London are, therefore, the accumulated result of the loans that India is continually making to Great Britain. The balances accumulating in London are invested in British Treasury Bills. They would thus appear to be short-term loans. The process of maturity and reinvestment is, however, so continuous that for all practical purposes the investment may be regarded as a fairly long term one. From the English point of view, as the *Economist* wrote, "The investment of sterling area funds in Treasury Bills or deposits is a virtually compulsory investment, made as a result of the revolution caused by the war in the U. K.'s balance of international payments and by the strict control of sterling exchange. It is, therefore, the investment of "good" money and, though made for the moment in the form of short-term debt, it is an investment

¹ *Ways and Means of War, 1940, p. 81.* This is also indicated by Keynes in the following: "For the next year at least the only borrowing on which we can rely will probably take the form of increased balances held in London by the Dominions and other banks as a result of the large contracts which have been placed for the purchase of raw materials within the Empire." J. M. Keynes, *Income and Fiscal Potential of Great Britain, Economic Journal, December 1939.*

which it is reasonable to assume will be fairly permanent."¹ The increasing diversion of Treasury Bills into such channels, as the sterling balances of the Empire countries, which form no part of Britain's domestic credit structure, has enabled the British Government to desist from placing an excessive volume of bills with the British banks and thus to avoid inflationary expansion of bank credit in England. Action and reaction are, however, equal and opposite; every action is followed by an appropriate reaction. If the British Government succeeds in not foisting an excessive volume of bills on the British banks by diverting them into sterling area balances, the success is due to their being foisted on the Empire countries. The inevitable consequence is that there is currency and credit expansion in those countries. The inflation that is "packed up" in Great Britain is safely delivered into the Empire countries.

§ 4. *Rate of Currency Expansion:* The progress of the rate of expansion of currency in India next calls for notice. Table No. 3 sets out the increase of note circulation in India from April 1941.

TABLE NO. 3. INCREASE IN NOTE CIRCULATION
[Source: Monthly Statistical Summary, Reserve Bank of India]

[In Lakhs of Rupees]			
1941-42	Progressive total	1942-43	Progressive total
April	9.46	April	32.55
May	15.31	May	50.59
June	19.27	June	61.94
July	15.35	July	69.75
August	18.93	August	93.01
September	28.46	September	111.54
October	35.79	October	133.45
November	43.76	November	159.11
December	77.94	December	189.11
January	96.75	January	212.00
February	1,22.02	February	233.11
March	1,52.40		

¹ "Floating Debt Policy," *Economist*, July 5, 1941.

A comparison of the 1941-42 figures with those for 1942-43 clearly indicates how the rate of note creation has been accelerating. During 1941-42 the total amount of new notes put into circulation was Rs. 152.40 crores. An amount of notes greater than this had been put into circulation during the eight months, from April to November 1942-43.

This acceleration in the rate of note creation can be attributed to two factors, which may have acted separately or jointly. The increased rate of note creation is clearly related to the increased demand for rupee finance by the U. K. Government for purchases in India. An increase in these financial requirements can come about either on account of an increase in the volume of purchases or an increase in the amount of currency necessary to purchase the same volume of materials, consequent upon a rise in their prices. The second factor is particularly important as it indicates the operation of a spiral movement. As prices increase, an increased amount of currency is necessary to secure the same supplies, and then prices increase because of the injection of an increased dose of currency into the monetary system. Thus price-increases build upon themselves, and each time the dose of currency creation necessary to serve the same effect is progressively larger.

§ 5. *Bank Deposits:* While considering the expansion of currency we must also take into consideration bank deposits; for, they form an important part of the circulating media. In India, bank money or deposits form only a small part of the total amount of purchasing media. They play, however, a rather significant part in the Indian money market. Table No. 4 sets out the relevant information regarding Scheduled Banks.

The table indicates that while time deposits had declined from Rs. 106.00 crores in 1939-40 to Rs. 104.00 crores in 1941-42 and to Rs. 100.00 crores in 1942-43 (average of 9 months, April-December 1942), the demand deposits

TABLE NO. 4. CONSOLIDATED POSITION OF SCHEDULED BANKS

[Source: Monthly Statistical Summary, Reserve Bank of India]

Month	Demand Liabilities (Lakhs of Rs)	Time Liabilities (Lakhs of Rs)	Total Columns 1 and 2 (Lakhs of Rs)	Cash (Lakhs of Rs)	Balances with Reserve Bank (Lakhs of Rs)	Total Columns 4 and 5 (Lakhs of Rs)	Advances (Lakhs of Rs)	Bills Discounted (Lakhs of Rs)	Total Columns 7 and 8 (Lakhs of Rs)
	1	2	3	4	5	6	7	8	9
1939									
August	1,35.50	1,02.66	2,38.16	6.66	23.63	30.31	1,02.97	4.02	1,06.99
September	1,32.59	99.75	2,32.34	7.10	19.19	26.29	1,03.69	3.33	1,09.02
October	1,32.64	96.76	2,29.40	6.99	17.61	24.60	1,07.85	2.46	1,10.31
November	1,35.29	96.72	2,32.01	7.03	18.67	25.70	1,13.29	2.35	1,15.84
December	1,37.99	98.96	2,36.95	7.16	15.66	22.82	1,29.69	3.93	1,33.62
1940									
January	1,39.10	1,02.30	2,41.40	6.78	17.72	24.50	1,43.96	4.61	1,48.57
February	1,37.14	1,04.95	2,42.09	6.90	18.58	25.48	1,43.56	5.12	1,48.68
March	1,38.24	1,05.87	2,44.11	6.50	16.06	22.56	1,47.57	6.09	1,53.66
April	1,39.90	1,08.22	2,48.12	6.83	18.65	25.48	1,47.69	6.43	1,54.12
May	1,40.16	1,09.47	2,49.63	6.78	17.67	24.45	1,48.06	6.35	1,54.41
June	1,36.91	1,06.02	2,42.93	8.44	20.94	29.38	1,39.59	5.25	1,44.84
July	1,43.37	1,02.90	2,46.27	7.95	28.46	36.31	1,29.51	3.64	1,33.15
August	1,50.23	1,00.37	2,50.60	7.62	34.64	42.26	1,19.23	2.20	1,21.43
September	1,56.00	97.79	2,53.79	7.79	43.32	51.11	1,10.40	1.59	1,11.99
October	1,61.82	96.81	2,58.63	8.45	47.52	55.97	1,03.55	1.51	1,05.06
November	1,63.35	98.81	2,62.16	8.29	49.32	57.61	96.97	1.81	98.78
December	1,66.84	97.10	2,63.94	8.63	48.17	56.80	96.66	2.08	98.74
1941									
January	1,69.23	97.42	2,66.65	8.54	44.73	53.27	1,00.75	2.96	1,03.71
February	1,68.72	1,00.33	2,69.05	8.10	45.06	53.16	1,07.53	4.80	1,12.33
March	1,70.46	1,01.20	2,71.66	8.11	38.37	46.48	1,13.98	5.97	1,19.95
April	1,72.75	1,01.20	2,73.95	8.42	26.96	35.38	1,23.08	6.62	1,29.70
May	1,75.72	1,02.26	2,77.98	8.38	26.81	35.19	1,25.23	6.34	1,31.57
June	1,82.20	1,02.87	2,85.07	9.17	28.65	37.82	1,23.42	5.51	1,28.93
July	1,86.35	1,04.11	2,90.46	8.57	29.76	38.33	1,20.68	4.95	1,25.63
August	1,95.36	1,05.72	2,99.08	8.59	36.64	45.23	1,15.38	4.37	1,19.75
September	2,04.55	1,02.79	3,07.34	8.81	46.54	55.35	1,10.97	3.83	1,14.80
October	2,11.96	1,04.29	3,16.25	9.69	47.78	57.47	1,07.09	3.41	1,11.01
November	2,20.75	1,07.78	3,28.53	9.56	46.82	56.38	1,04.42	4.34	1,08.76
December	2,16.72	1,06.32	3,25.04	9.92	55.44	65.36	1,13.60	5.83	1,19.43
1942									
January	2,17.02	1,06.78	3,23.80	10.06	55.50	65.56	1,18.24	5.58	1,23.82
February	2,18.85	1,03.48	3,22.33	10.09	58.89	69.98	1,15.61	4.35	1,19.96
March	2,21.78	1,00.38	3,22.16	10.08	40.03	50.11	1,14.16	3.06	1,17.22
April	2,28.11	96.53	3,24.69	10.35	58.80	69.15	1,11.93	2.27	1,14.25
May	2,41.02	94.66	3,35.68	11.11	48.67	59.78	1,02.26	1.64	1,03.90
June	2,61.01	96.56	3,57.57	12.52	53.73	71.25	97.25	1.50	98.75
July	2,79.60	97.58	3,77.18	12.11	62.77	74.88	89.04	1.69	90.73
August	2,94.75	97.37	3,92.12	11.65	64.69	76.34	83.07	1.51	84.58
September	3,08.95	99.28	4,07.87	12.39	64.29	76.68	78.67	1.45	80.12
October	3,21.64	1,02.74	4,23.80	12.63	65.40	78.03	79.25	1.73	80.93
November	3,33.41	1,05.24	4,38.65	13.96	62.80	76.76	81.92	2.26	84.18
December	3,39.72	1,09.94	4,49.66	13.94	53.33	67.27	91.18	2.79	93.97
1943									
January	3,44.71	1,13.69	4,58.40	15.17	48.73	63.90	1,00.23	2.89	1,03.12
February	3,59.98	1,17.99	4,77.97	14.82	48.52	63.34	1,10.55	3.08	1,13.63

showed an increase from Rs. 139.75 crores in 1939-40 to Rs. 202.00 crores in 1941-42 and to Rs. 290.00 crores in 1942-43 (average of April-December 1942). The cash and the balances with the Reserve Bank also show a progressive increase. The advances of Scheduled Banks declined from Rs. 125,66 lakhs in 1939-40 to Rs. 90,00 lakhs during the period April 1942 to December 1942. Bills discounted also show a decline. The figures clearly show the extreme liquidity of the Indian banking system during the war period.

§ 6. *Velocity of Circulation*: An increase or decrease in the velocity of circulation practically leads to an increase or decrease in the total volume of effective currency. There are, however, no data available regarding velocity of circulation of notes and coins in India. Data with regard to bank money are alone available. Whether one can reach a conclusion regarding the velocity of non-bank money in India from that of bank money is disputable. Table No. 5 sets out the relevant data regarding the bank deposits, etc.

TABLE NO. 5. RELATION BETWEEN DEMAND LIABILITIES OF SCHEDULED BANKS AND CLEARING HOUSE RETURNS

[Source: Currency Report, 1941-42, and Monthly Statistical Summary, Reserve Bank of India]

[In Crores of Rupees]

Year (1)	Average demand liabilities of Scheduled Banks (2)	Total of clearing House Returns (3)	Number of times (3/2)
1938-39	1,23.8	19.29	15.6
1939-40	1,32.6	22.11	16.7
1940-41	1,35.8	20.19	13.0
1941-42	2,02.0	25.69	12.7
April 1942-December 1942	2,89.8	18.85	6.5

The relation between total cheque clearances and the demand deposits of banks may be taken to indicate change in the velocity of circulation of bank money. This index has declined from 16.7 in 1939-40 to about 6.6 in 1942-43 (9 months).

§ 7. *Wholesale Prices:* The Indian index numbers of wholesale prices are, on the whole, not very satisfactory. Since the beginning of the War the Office of the Economic Adviser to the Government of India has compiled a new index number, which may, however, be considered more reliable, and we use that index number throughout the following. Table No. 6 sets out the movement of this index number of wholesale prices since September 1939.

During the week preceding the outbreak of war in September 1939, the acuity of the political situation had already lifted up prices in India. The price index of "all primary commodities" advanced by 11.9 per cent during the first month of the war. During the same period the price index of "other agricultural commodities" showed the highest increase, i.e., 23.9 per cent. During the last quarter of 1939-40 the prices continued on the up grade, and at the end of the year the price index of "other agricultural commodities" attained the peak at 187.1. [These price increases were primarily due to the growth of speculative inventories in the expectation of a further rise in prices.]

When, however, the war became, to use an American slang, a "phoney" war, the expected rise of prices failed to come about. The speculative inventories were quickly brought down, and with the turn of the year prices showed a downward trend. (During the second quarter of 1940-41 the price index of "all primary commodities" receded to 108.1.) In August the price indices of "food and tobacco" and "other agricultural commodities" touched their lowest levels at 103.2 and 98.2 respectively.)

With the dislocation of the normal channels of international trade during the second half of 1940-41, and with the beginning of the era of large purchases by Great Britain in India, prices again looked up. The price index of "all primary commodities" gradually trended upwards and reached 112.9 by the end of 1940-41. During the same period the price index of "raw materials" showed the high-

TABLE NO. 6. INDEX NUMBERS OF WHOLESALE PRICES (ECONOMIC ADVISER'S INDEX) AND COST OF LIVING

[Source: Explanatory Memorandum on Central Budget, India, 1943-44, pp. 34 and 36, and Monthly Survey of Business Conditions in India].

Month	Index No. of Wholesale Prices. (Base—10th August, 1939=100)						Cost of Living Index				
	Food and Tobacco	Other Agricultural Commodities	Raw Material	Primary Commodities	Manufactured Articles	General	Bombay Base Year 1934=100	Madras Base Year 1936=100	Cawnpore Base Aug. 1939=100	Lahore Base 1931-32=100	Patna Base 1914=100
1939											
August	100.5	100.7	100.2	100.3	100.0	100.3	105	98	100	120	-
September	110.7	123.9	103.6	111.9	116.5	112.9	106	103	103	123	112
October	112.7	129.0	109.6	113.1	121.7	114.9	108	104	105	125	116
November	123.7	167.4	119.2	128.2	138.9	130.5	109	105	105	147	120
December	127.1	187.1	129.3	136.5	145.1	138.3	113	103	112	147	115
1940											
January	122.1	174.8	125.9	131.2	140.8	135.2	114	107	114	131	114
February	119.2	162.6	125.4	128.0	135.6	129.6	112	104	112	129	114
March	117.9	151.5	125.4	125.9	133.0	127.5	110	105	107	132	112
April	112.7	157.9	122.8	123.2	131.5	125.0	110	106	110	132	115
May	109.6	135.9	123.4	119.0	127.3	120.3	111	107	109	121	118
June	103.5	112.8	112.2	106.3	117.1	110.3	111	107	106	120	117
July	106.5	110.4	113.4	111.6	113.5	112.1	113	107	109	122	124
August	103.2	98.2	118.9	108.1	109.3	108.4	114	108	112	122	129
September	107.6	107.9	116.9	111.0	111.4	111.1	112	108	113	129	130
October	109.6	100.2	120.2	111.9	112.9	112.1	113	109	112	133	127
November	109.1	106.4	125.6	114.8	118.9	115.7	113	110	112	138	128
December	107.8	102.5	124.0	112.9	119.8	114.4	115	110	111	138	126
1941											
January	107.4	99.6	126.3	112.9	121.6	114.8	117	103	110	135	120
February	103.6	94.5	121.1	108.4	121.5	111.1	119	108	108	133	121
March	108.1	112.4	125.9	115.4	131.7	118.8	119	108	106	131	124
April	103.5	103.2	128.6	112.6	131.5	116.4	121	109	107	144	128
May	104.6	121.0	130.9	116.9	139.7	121.5	122	108	108	135	130
June	114.7	128.7	139.0	126.0	146.7	130.2	122	109	114	131	141
July	127.0	142.2	146.2	136.7	157.3	140.9	126	113	126	137	147
August	123.6	152.7	147.2	139.4	161.2	142.3	131	115	130	144	145
September	125.8	141.6	145.8	135.9	167.3	142.2	129	115	133	150	150
October	126.6	134.6	150.5	136.8	163.0	142.1	125	115	134	160	151
November	128.6	146.3	156.1	141.7	165.3	146.5	126	118	143	172	153
December	127.1	137.5	150.0	137.5	153.8	140.8	129	121	151	172	148
1942											
January	130.6	129.9	158.4	140.7	161.4	145.0	137	117	145	172	141
February	133.7	123.0	157.9	140.7	162.3	145.1	135	115	144	176	141
March	132.9	117.4	161.9	140.6	163.2	145.6	137	115	149	174	150
April	138.5	114.8	162.4	142.8	157.6	145.9	138	119	149	178	152
May	144.9	123.2	160.1	145.7	162.6	149.9	142	121	155	186	159
June	160.2	133.8	161.4	156.3	167.4	138.6	152	128	175	194	168
July	155.5	148.7	163.5	157.4	175.6	161.2	163	133	190	199	181
August	160.2	141.6	161.8	157.5	174.5	161.1	168	127	203	212	209
September	164.1	159.7	164.0	163.3	182.3	167.3	170	145	202	220	204
October	169.9	173.8	166.3	169.9	194.4	175.0	172	152	206	223	-
November	173.6	179.5	171.0	173.6	220.0	182.7	178	156	224	229	-
December	131.1	178.2	172.0	177.0	222.2	186.0	133	158	224	-	-
1943											
January	201.5	193.8	171.5	185.0	225.8	195.6	-	161	225	-	-

est rise, while that of the "other agricultural commodities" showed sharp rises and falls and stood at 102.5 at the end of the year.

During the first quarter of 1941-42, the price index of "all primary commodities" increased to 115.4, shot up to 126.0 during the second quarter, and to 135.9 in the third quarter, and stood at 140.6 in the first quarter of 1942-43. During the same period the price indices of "food and tobacco" and "raw materials" showed a continuous rise, and in the first quarter of 1942-43 had risen up to 132.9 and 161.9 respectively. This rise was not shared by the price index of "other agricultural commodities." It recorded very erratic movements, and attained 152.7 in August 1941, and then slid down jerkily to 114.8 in April 1942. From April 1942, all the indices show a rapid rise with only a few breaks. In January 1943, the indices of "food and tobacco," "other agricultural commodities," "raw materials," and "all primary commodities" stood respectively at 201.5, 193.8, 171.5, and 188.0.

The price index of "manufactured articles" sharply increased to 145.1 in December 1939, and then began to slide down. It touched 109.3 in August 1940, and then began to move upward. It mounted to 167.3 in September 1941, then fell to 153.8 in December 1941, and from that time began to rise continuously with a slight recession in April 1942. In January 1943 it stood at 225.8.

When prices suddenly change, as after the declaration of a war, the different price categories show disparate movements in their upward surge. As the above shows, the prices of "manufactured goods" have advanced to a greater extent than that of the "primary commodities." The same kind of disparate movement in prices was also marked during the last war (1914-18). Then, too, the prices of manufactured goods recorded greater increases than the prices of agricultural products, with only cotton excepted. The

prices of agricultural products had then moved but little. During this war the prices of agricultural commodities sagged considerably after a short spurt at the beginning of the war. They, however, recovered towards the end of 1941 and tended to move upwards. The prices of primary commodities, broadly speaking, have, in contrast with the last war, kept up better with the prices of manufactured commodities. Though the latter have outpaced the former, as in the last war, the distance or the spread between them is considerably narrower than during the last war.

The relative movement of the different price categories is rather interesting, as it has a broad similarity with the pattern of price movements in U. S. A. In U. S. A. in contrast with the last war, the price movement during this war is paced by primary products and by goods intended for human consumption. Necessities of life lead the advance. In 1915-16 industrial products felt the heaviest pressures, and producers' goods led the advance. "In this war the squeeze is on the consumers from the start."¹

The way in which the movements of wholesale prices affect the common man can be gauged by the movement of the index of the cost of living. Table No. 6 sets out the cost of living indices in five different towns in India. These have been chosen so as to give a general picture for the whole of India.

During the first months of the war all the indices showed a continuous increase. In December 1940 the Lahore index showed the highest rise, 24 per cent, and the Patna index the lowest, 3 per cent. During 1940 the Bombay index fluctuated between 110 and 115. While the Madras index vacillated between 106 and 110 during the same period, the Cawnpore index, fluctuating between 108 and 114, actually declined by 3 per cent. During the same

¹ "Price and the Cost of Living in Two World Wars," Prof. F. C. Mills, *Proceedings of the Academy of Political Science, Columbia University*, January 1942.

period both Lahore and Patna recorded increases of 7 per cent and 12 per cent respectively. During 1941-42 all the indices showed larger increases, Cawnpore recording the highest increase, 41 per cent, with Lahore running a close second, with 37 per cent. The lowest increase of 12 per cent was recorded by Bombay. From January to July 1942, the Cawnpore index recorded an increase of 45 per cent, Patna 40 per cent, Bombay 31 per cent, Lahore 28 per cent, and Madras only 16 per cent. In November 1942 the Bombay index had gone up by a further 10 per cent, and the Madras index by a further 25 per cent.

§ 8. *Currency and Prices:* We have next to consider the degree of responsiveness between currency expansion and the rise of prices. For a proper examination of this problem the relation of price changes with changes in the notes in circulation should be considered. The reasons for adopting this procedure are as follows. Firstly, the largest part of the increase in currency since the war began, consists of notes. Secondly, by deliberately confining ourselves to notes in circulation, we can for the most part eliminate the element of hoarding. In India hoarding of currency is largely confined to rupee coins and more recently to smaller coins.¹

As the bulk of the purchasing power in India consists of notes and coins, the volume of currency has a direct bearing on the price situation in this country. (The connexion between the volume of purchasing power and the level of prices might also be expected to be closer during war when there is a scarcity of consumers' goods and conditions of full employment obtain.)

¹ In South Africa, the Opposition party in 1940, launched a movement for encouraging the hoarding of small coins in order to embarrass the Government. Cf. *Round Table*, December 1940, p. 162. A similar political motive might have been partly responsible for the recent hoarding of small coins in India. It is also interesting in this connexion to recall that an insufficiency of small coins was felt in Germany in 1918-19, when prices were lagging behind the volume of circulating media.

(During the first four months of the war prices clearly outpaced the expansion of notes in circulation) (Table No. 1). Prices then rose chiefly because of the development of speculative bulges in the expectation of still higher prices. The increase in note circulation thus followed the rise in prices and did not initiate it. Then came a recession in prices. But though prices fell from January 1940 to September 1940 by about 17.4 per cent, there was only a contraction of circulation of about 7 per cent during the period May 1940 to October 1940. The era of large purchases in India by U. K. began some time during this period. From that time onwards notes in circulation and prices both show almost a continuous increase with prices clearly lagging behind. The prices follow the rise in the note circulation at a distance of time and the distance between them seems to be increasing. The implications are clear. The expansion in currency does not take place following price increases. As already indicated it is related to the sterling securities in the Issue Department, which in turn are related to the needs of the British Government. (Thus the expansion of note circulation in India has been governed by the needs of the British Government for rupee finance rather than by the needs of the Indian economy. Prices instead of catching up with the increase in note circulation are being increasingly out-distanced by it.)

A rise in prices causes an increased demand for cash to be spent and is usually accompanied by (i) a lowering of the cash-ratio of banks, (ii) increased advances from the banks, and (iii) a hardening of money rates. Table No. 7 sets out the information relating to all these points.

✓The percentage of cash and balances at the Reserve

¹ A similar state of affairs, namely, prices lagging behind the increases in circulating media, was observed in Germany from the beginning of the last war to the end of 1919. From early 1920 to August 1921, the movements of volume of money and prices were fairly even. Towards the end of 1923 prices took a decided lead over volume of currency.

TABLE NO. 7. INDIAN MONEY RATES
 [Source: Currency Report and Monthly Statistical
 Summary, Reserve Bank of India]

	Bank Rate Rs.	Hundi Rate Imperial Bank Rs.	Call Money Rate		Bazar Rate		Average Monthly Treasury Bills Rate	Deposits Rates		
			Rs. Calcutta	Rs. Bombay	Rs. Calcutta	Rs. Bombay		Rs. 3 Months	Rs. 6 Months	Rs. 12 Months
1939										
August	3	3	1/4	1/4	6-7	5 1/4				
September	3 1/4	3 1/4	1/4	1/4	6-7	6				
October	3 1/4	3 1/4	1	1/4	6-7	5 1/4				
November	3 3/4	3 3/4	1 1/2	1/4	6-7	5 1/4				
December	3	3 1/2	1	1 1/4	6-7	6 3/4				
1940										
January	5	3 1/2	1 3/4	2	6-7	6 3/4				
February	3 1/2	3 1/2	1 1/4	1 1/4	6-7	6 3/4				
March	3 1/2	3 1/2	1 1/4	1 1/4	6-7	6 3/4				
April	3 1/2	3 1/2	1 1/4	1 1/4	6-7	5 1/2				
May	3 1/2	3 1/2	1 1/4	1 1/4	6-7	5 1/2	2 1/2	2 1/4	2	
June	3 1/2	3 1/2	1	1	6-7	5 1/2	1 1/2	1 1/2	1 1/2	1 1/4
July	3 1/2	3 1/2	1 1/4	1 1/4	6-7	5 1/2	1 1/4	1 1/2	1 1/2	1 1/4
August	3 1/2	3 1/2	1 1/4	1 1/4	6-7	5 1/4	1	1 1/2	1 1/2	1 1/4
September	3 1/2	3 1/2	1 1/4	1 1/4	6-7	6	1 1/4	1 1/2	1 1/2	1 1/4
October	3 1/2	3 1/2	1 1/4	1 1/4	6-7	5 1/2	1 1/4	1 1/2	1 1/2	1 1/4
November	3 1/2	3 1/2	1 1/4	1 1/4	6-7	5 1/2	1 1/4	1 1/2	1 1/2	1 1/4
December	3 1/2	3 1/2	1 1/4	1 1/4	6-7	6 3/4	1 1/4	1 1/2	1 1/2	1 1/4
1941										
January	3	3 1/4	1/2	1/2	6-7	6 3/4	1/2	1 1/4	1 1/4	1 3/4
February	3	3 1/4	1/2	1/2	6-7	6 3/4	1/2	1 1/4	1 1/4	1 3/4
March	3	3 1/4	1/2	1/2	6-7	6 3/4	1/2	1 1/4	1 1/4	1 3/4
April	3	3 1/4	1/2	1/2	6-7	6	0-12-11	1	1 1/4	1 3/4
May	3	3 1/4	1/2	1/2	6-7	6	0-12-7	1	1 1/4	1 3/4
June	3	3 1/4	1/2	1/2	6-7	6	0-13-1	1	1 1/4	1 3/4
July	3	3 1/4	1/2	1/2	6-7	5 3/4	0-13-7	1/2	1 1/4	1 3/4
August	3	3 1/4	1/2	1/2	6-7	4 1/2	0-8-5	1/2	1	1 3/4
September	3	3 1/4	1/2	1/2	6-7	4 1/2	0-8-10	1/2	1	1 3/4
October	3	3 1/4	1/2	1/2	6-7	4 1/2	0-10-3	1/2	1 to 1 1/2	1 3/4
November	3	3 1/4	1/2	1/2	6-7	5 1/2	0-12-1	1/2	1 to 1 1/2	1 3/4
December	3	3	1/2	1/2	6-7	5 1/4	0-15-1	1/2	1 to 1 1/4	1 3/4
1942										
January	3	3	1/2	1/2	6-7	6 3/4	0-15-6	1 1/4	1 1/2 to 1 1/2	1 1/2 to 2
February	3	3	1/2	1/2	6-7	6 3/4	0-15-9	1 to 1 1/4	1 1/2 to 1 1/2	1 1/2
March	3	3	1/2	1/2	6-7	6 3/4	1-2-0	1 to 1 1/4	1 1/2 to 1 1/2	1 1/2 to 2
April	3	3	1/2	1/2						
May	3	3	1/2	1/2						
June	3	3	1/2	1/2						
July	3	3	1/2	1/2						
August	3	3	1/2	1/2						
September	3	3	1/2	1/2						
October	3	3	1/2	1/2						
November	3	3	1/2	1/2						
December	3	3	1/2	1/2						

Bank to the total demand and time liabilities of the Scheduled Banks was 10.00 in 1939-40. It increased to 16.66 in 1940-41 and fell a little in 1941-42 to 14.87. During the nine months from April to December 1942 it has fluctuated round about 17.33. The advances given by the Scheduled Banks declined from Rs. 125,66 lakhs in 1939-40 to Rs. 122,28 lakhs in 1940-41, and to Rs. 116,03 lakhs in 1941-42. During the nine months from April to December 1942, there were on an average about Rs. 90,60 lakhs. The figures of advances, of course, show the usual seasonal fluctuations.

During the first months of the war, money rates firmed up, but showed later a "stickiness" at lower levels, with only the usual seasonal variations. The call money rate at Calcutta rose sharply to $1\frac{3}{4}$ in January 1940, but dropped to $\frac{1}{2}$ in July of the same year, and has remained at that level since. Similarly the Bombay rate shot up to 2 in January 1940, but came down by stages to $\frac{1}{4}$ in August of that year and has since stuck there.

All the three relations discussed above indicate that in spite of the rising prices the demand for money has not increased to a corresponding extent. Idle and floating resources seem to be mounting up. There appears no pressure on banks for accommodation by industry and trade. They also indicate that the total money created is yet not exerting its full pressure on prices. There is thus a lag between the creation of money and the rise of prices. Currency is being expanded at a rate faster than the rate at which prices are rising. In this connexion it is necessary to remember that the Economic Adviser's index numbers would not reflect the full degree of the rise of prices in so far as they fail to take account of the transactions in the extensive black markets.

§ 9. *Finance of British Purchases:* The expansion of currency in India is directly attributable to the system under which all payments to India by U. K., payments such

as those made for British purchases in India, or payments made to the Government of India by His Majesty's Government for war expenditure, etc., are effected. This is far from being a "merely monetary" phenomenon. By making huge purchases in India, U. K. acquires large quantities of Indian materials, which means that so much is subtracted from the supplies of materials available to the Indian people. The problem is the same everywhere in the "sterling area" countries, because the system of payments by U. K. to them is similar to that prevailing in India. The purchases that U. K. makes in the sterling area provide their own financing immediately.¹ The finance for the purchases in India is, for example, provided by the Government of India. Though in after years the accumulated sterling balances in London might be available to India for purchasing real goods and services, for the present, at least, the Government of India has to find the money. It is, therefore, a current charge on Indian finances. As the Report of the Bank of International Settlements observes, "International financing, similar to that involved by the lend-lease procedure in the United States, is a necessary concomitant in India and Canada to the accumulation of sterling assets (whether such financing is included in the budgetary accounts or not). The financing of the budget deficit and of the sterling balances of these two countries must, therefore, be considered as a single problem. A rough idea of the proportions involved is given by the accompanying round figures* in sterling. In each case the financing of the accumulation of sterling is greater than the borrowing necessary to cover the domestic budget deficit, this deficit in India being relatively small."²

¹ "British Government purchases from the Empire or other parts of the sterling area, in a sense, provide their own financing when the proceeds of the sales are kept as sterling balances or invested in sterling securities."—*Report of the Bank of International Settlements*, 11th Annual Report, 1940-41, p. 103.

* Table not reproduced.

² *Report of the Bank of International Settlements*, Twelfth Annual Report, p. 176.

(The problem created by the acquisition of supplies by His Majesty's Government in India is, therefore, primarily a fiscal problem.) All the payments made to India in sterling, whether for British purchases or as "free" gifts from U. K. for war expenditure, etc., create liabilities for the Government of India over and above their own budgetary deficits. The recognition of their real character as a current financial charge on Indian finances, leads us to the examination of the whole system of war finance in India. But before going on to this, it is necessary to digress a little on the general problem of war finance.

§ 10. *Problem of War Finance:* The financing of a modern war means incurring a huge expenditure by the State. The requirements of a modern total war are enormous. During 1918 the British Government needed about 50 per cent of the National Income to cover its ordinary and wartime expenditure.¹ The needs of a total war, like the present, are, however, even larger. "On account of changes which have taken place in prices and earnings since the summer of 1939, it is more than ever difficult to calculate the magnitude of national incomes. But there seems to be little doubt that in Germany, Italy, and the United Kingdom total public expenditure in 1941 will amount to 70 per cent or more of the national income."²

¹ *Economist*, May 13, 1939.

² "The high percentages given in the text represent the ratio between total public expenditure and net national income. But other resources than those which form part of the net national income are drawn upon: internally, amounts are released from embodiment in fixed and working capital and, externally, resources may be made available from sales of gold, foreign loans, mobilisation of foreign investments, contributions from other countries for occupation costs, etc. That public expenditure amounts to more than 70 per cent of the national income does not mean that less than 30 per cent remains for private consumption. In the United Kingdom it has been calculated that in the last quarter of 1940 total expenditure of Central and Local governments constituted 67 per cent and consumption 63 per cent, together 130 per cent of the net national income. Not less than 30 per cent was thus covered by 'disinvestment,' probably mainly the employment of dollar resources."—*Report of the Bank for International Settlements*, Eleventh Annual Report, 1941, p. 7.

The Government expenditure for war purposes is not ordinarily hampered by financial considerations. As Prof. Pigou puts it, "Finance in modern war is only a camp-follower."¹ The State decides independently of finance. Finance is, however, an important camp follower; for, if neglected or badly managed, it might damage the war effort itself.

Increased war expenditure is financed partly by increased taxation and partly by increased borrowing. The increase in taxation has, however, its limitations, and usually receipts from increased taxation are found insufficient to meet the increase in government expenditure. During this war, in contrast with the last war, governments have, from the beginning, made strenuous efforts at raising a much larger proportion of the necessary finance by taxation. It has been, for instance, estimated that during 1940-41 both Germany and U. K. were able to meet about 40 per cent of their total military and other expenditure by current revenue.²

Apart from enhanced taxation, therefore, borrowing, both internal and external, is pressed into service to meet war needs. Internal borrowing is nothing but anticipatory taxation. That part of the national income of which the State is in need, but which it is unable to absorb and commandeer through taxation, it tries to borrow from the public. For contributing to government loans, the public has to cut down its consumption or investment outlay. Only in this manner can it release and make available to the government the required part of the national income. The command over the released resources, or the monetary tickets to them, are transferred to government through subscriptions to government loans. The above, however, happens only if the gov-

¹ Prof. Pigou, "War and Inflation," *Economic Journal*, December 1940.

² *The Bank of International Settlements*, 11th Report, p. 8.
W. E. F. 3

ernment is able to borrow the "genuine" savings of the public, savings that have their counterpart in an equivalent reduction in consumption. The transference of genuine savings of the public to the government serves a double purpose; they provide government with additional monies and, at the same time, contract the spending power of the public, thus keeping spending from outrunning supplies and starting an inflationary price rise.

(It might happen, however, that government does not or is not able to borrow the "genuine" savings of the public. When, for example, government borrows from the commercial banks either by selling them government securities or by taking up direct credits, the borrowing might not necessarily be matched by the "genuine" savings of the public and might not, therefore, correspond to a reduction in the spending power of the community or the volume of money in the hands of the public.) When the government spends the funds borrowed from the banks to purchase the supplies needed, this new money competes with the old money in the hands of the public and prices rise. With the old money in their hands people are able to buy less supplies at higher prices, the balance being taken away by government. Thus it is through the rise in price that the consumption of the public is reduced. When government borrows through banks, it thus imposes a sacrifice on the public through higher prices. This process of "credit creation" by the banks is a self-expanding one, and if allowed to develop unchecked often leads to inflation. While borrowing from the public checks a rise in prices, borrowing through banks, if unchecked, invariably leads to inflation. Borrowing from the public is, therefore, characterised as "non-inflationary" and the borrowing from banks as "inflationary."

In one particular case, however, financing by borrowing through the banks might not be inflationary. This is during the initial stages of a war economy when "the slack

is being taken up and the aggregate volume of employment of men and machines is being expanded under the influence of war need." During this phase, when economic activity is increasing all round, it is necessary to increase the purchasing power in the hands of the public. It is then necessary to stimulate activity by flavouring the economy with a dose of price increase. Under such circumstances borrowing through the banks is not inflationary because it is accompanied by an expansion in output. But the case is otherwise when we reach "full employment." When the limit of economic capacity is reached and output sticks at a stabilized level, an increase in the amount of purchasing power in the hands of the public "goes into prices rather than output."¹ Then borrowings through banks attain their full inflationary potential. Of course "economic capacity" and "full employment" are undefinable terms under modern technological conditions. But, in so far as they can be measured, they indicate a limit beyond which borrowing through banks, in a not rigidly controlled economy, is definitely "inflationary."²

Whether such a distinction between borrowing of these two types can always be drawn is, however, doubtful. Mrs. Joan Robinson puts the case against it in the following extract. She writes: "It is easy to see that if the govern-

¹ *Federal Reserve Bulletin*, February, 1941, p. 97.

² Note the following in this connection: "Borrowing from the banks on this scale is a once-for-all proceeding. It cannot be repeated in the second year. Having increased output 15 per cent in the first year, we could scarcely expect to increase it by a further 15 per cent in the second year; and having allowed an increase in prices in the first year to correspond to an inevitable increase of costs here and abroad, it should be our object so to control consumption as to avoid repeating this movement in the second year. These considerations combine with the factor of time-lag to enforce the conclusion that it is in the first year that the bulk of borrowing through the banking system is in order. In the first year the right technique is to borrow mainly through the banking system, and thereafter mainly from the public."—J. M. Keynes, "The Income and Fiscal Potential of Great Britain," *Economic Journal*, December 1939, p. 635.

ment expenditure increases more than private expenditure is curtailed, and if supplies are limited, then demand exceeds supply, and prices must tend to rise relative to costs, so that profiteering occurs. It is obvious that the amount of government outlay and not the form of government borrowing, controls the extent of inflation. And it is obvious that every addition to the National Debt is an addition to somebody's nominal wealth. The wealth may be retained by the small man saving, or the savings may be squeezed out of him *via* higher prices and higher profits so that the wealth accrues to the profiteer, but in either case the borrowing of the government is matched by the savings of the nation... If the banks are encouraged to lend to the government, thus increasing their total assets, their total liabilities must increase equally, and their liabilities are deposits owned by the public. Given the rate of deficit, the more the banks lend to the government the less the public lends, and the new savings of the public are held in bank deposits instead of in government loans. There is no way of drawing the line between the 'genuine' savings of the small man and the 'inflationary' savings of the profiteers which will coincide with the line between 'borrowing from the public' and 'borrowing from the banks.' ... The 'inflationary devices' work by themselves through higher prices and higher profits, to secure the savings required, ... and these devices work as strongly if a loan is issued to the public as they do when the banks take up Treasury Bills."¹

The borrowings from the "public" as contrasted with borrowings through the "banks," are characterised as "non-inflationary" because they contract the volume of extra purchasing power in the hands of the public. Borrowings through banks are "inflationary" as they augment the amount of purchasing power in the hands of the public. But this respective characterisation of the two types of bor-

¹ *Economic Journal*, December 1940, p. 506.

rowings is not true under all circumstances. (In a rigidly controlled economy, with an all-embracing rationing and price and wage control schemes in full operation, the extra purchasing power released by "borrowings through banks" becomes unspendable and, therefore, swells the bank deposits. Consequently its inflationary potential is largely neutralized.) Under such an economy, as is broadly prevalent today in U. K., Germany, etc., the distinction between the two types of borrowings becomes superfluous. Mrs. Robinson's views, quoted above, are thus reflections coloured strongly by the present conditions in U. K. (But where the economy is largely uncontrolled the distinction is very real and continues to have importance.

External finance is provided either through the raising of foreign loans or by the mobilisation of domestic holdings of foreign securities and direct foreign investments. The former type of external finance is obviously dependent on political circumstances. Thus during this war Great Britain has been able to borrow the sterling balances of the "sterling area" by keeping them compulsorily in London. But outside the "sterling area" it could not float any loans as it did during the last war. The realisation of foreign securities amounts to disinvestment of a nation's capital assets, and these also may be found insufficient for the needs of war, apart from the time required for their realisation. Both these types of external finance have, however, another side; their repercussions on the country granting the credits or redeeming its own debts. Thus, while Great Britain is realising her old debts, the debtor countries have to redeem them. The latter operation makes it imperative on them to find the necessary internal finance, over and above the additional finance required by their respective war efforts, thus increasing their budgetary deficits. So also when the "sterling area" countries give credits to Great Britain by keeping their surplus sterling balances in London, they, in effect, put an equivalent amount of "domestic currency" at Britain's disposal. This additional internal finance has again to

be found by the respective countries. Thus external finance, while giving relief to one country, increases the amount of internal finance that various other governments have to provide through taxes or borrowings.

Income from all these sources of finance may be, however, found to be insufficient for the conduct of war. Where, therefore, government is unable to meet its expenditure through loans and taxes, the shortfall has to be made good by borrowing through commercial banks or by resort to the printing press to manufacture the required legal tender money, i.e. by inflation. For this purpose, the printing press may be used directly or indirectly; directly, when government by printing new inconvertible paper money meets its requirements; indirectly, when the government meets its needs, as Dr. Dalton puts it, "out of loans to itself from the Central Bank and issues new paper money to the bank in exchange for a deposit of securities. . . 'to support the additional credit thus created.'"¹ The economic consequences of both these methods are essentially the same, i.e., that the cost of goods that the government must acquire rises as fast as or, in advanced stages of this process, faster than the increase in the note circulation. The indirect method puts the state to the additional expense of paying interest on its loans from the Central Bank.

The "gap" between the total government outlay and total government income derived from taxation and loans, both internal and external, during a particular period, has thus to be financed by inflation. This gap is technically being described as the "inflationary gap," and the problem of the budget during wartime is increasingly developing into, what the *Economist* significantly termed, as "The Battle of the Gap." This gap must not be confused with the budget deficit. The "net gap" is the difference between the total financial liabilities of a government, during a particular

¹ *Public Finance*, Dr. Hugh Dalton, p. 184.

period, and the amount that it is able to raise through taxation and loans, external and internal. The usual net revenue deficit does not take account of the proceeds of loans and differs to that extent from the "net gap." On the other hand, when in a country like India, certain important liabilities, such as in respect of purchases by other countries, are not included in the financial statement, the budget accounts fail to reveal the position of the "net gap." This gap has to be financed by the creation of credits which usually means either borrowing from the commercial banks, or resorting to the printing press, directly or indirectly. Such borrowing leads to an expansion of the amount of purchasing power in the hands of the public. Then starts a process of bidding up prices which is usually the beginning of an inflation. The experience of the last war and the wild inflation that developed in its wake has induced and strengthened the desire on the part of all governments to avoid inflation; for, inflation is the most inequitable way of distributing the war burden and usually involves very large transfers of wealth from the poorer and the middle classes to the richer classes. Inflation is also undesirable from the point of view of the war effort itself, for it increases the cost of war and also impairs the war effort. It is, however, recognized that the financing of a full scale war without some degree of inflation is not only improbable but impossible. The problem then becomes one of how best to mitigate the result of the "net gap." The problem becomes essentially one of tying up the extra purchasing power that has found its way into the hands of the public, so that it may not be pitted against the limited quantity of goods in the market to push up prices. (In other words, the problem is how to underpin the vagrant purchasing power at large.)

After this discussion of a rather general character we might now turn to consider the Indian case in particular and to note its significant peculiarities. Perhaps the most signi-

significant thing regarding the Indian situation is the absence of a well-developed money market. The money market being imperfectly developed, the money rates in India are not integrated into a "structure." They largely move independently of one another. Investment is direct and is very sensitive to the yield on such investment. The bulk of savings in India tend to flow from a very small percentage of the population. The great mass of people are poor and the "savable margin" in their incomes is, if at all, very small indeed. Even the little "savings" they might be able to make have to contend with the age old and time ingrained habit of hoarding.¹ [Again the banking system is only partially developed in India and bank deposits form only a small percentage of the total purchasing media in the land. Here, therefore, borrowing through banks cannot be of a significant magnitude.] As for external borrowing, India is actually doing the reverse, firstly by actually lending to Britain, and, secondly, by extinguishing her own foreign debts. The possibility of a credit inflation resulting from borrowing through the banks is, at best, remote in India. If the government fails to possess itself of adequate funds through taxation and loans from the public, the only way open for it is to resort to the printing press, directly, by printing more notes, or indirectly, by borrowing from the Central Bank. Inflation in India can develop only along one of these lines.

¹ The preference of the average Indian to lock up his savings in precious metals has been mistakenly taken to represent his "high liquidity preference." Thus Keynes observes in *The General Theory of Employment, Interest and Money*: "The history of India at all times has provided an example of a country impoverished by a preference for liquidity amounting to so strong a passion that even an enormous and chronic influx of the precious metals has been insufficient to bring down the rate of interest to a level which was compatible with the growth of real wealth." p. 337. This is a wrong view of the situation. The hoarding of precious metals by Indian people is, in the main, a capitalisation of the small savings and is thus best described as hoarding. As soon as these hoards come into existence they become "inert" and go out of circulation for years on end. They are liquid only in the sense that they can be quickly realised if need arises.

§ 11. *Central Government Revenue Deficit During the War Years:* We may now go on to a consideration of the concrete facts of the Indian case. The year 1938-39 closed with a deficit of Rs. 64 lakhs in the Central Budget. The Budget Estimates, 1939-40, showed a prospective deficit of Rs. 50 lakhs, and it was sought to be made up by raising an additional Rs. 55 lakhs by increasing the import duty on raw cotton from 6 pias to one anna per lb. The Budget Estimates, 1939-40, were strikingly affected, however, by the outbreak of war in September 1939, and the Revised Estimates disclosed a surplus of Rs. 91 lakhs in lieu of the expected surplus of Rs. 3 lakhs. This was the result of an increase of Rs. 5,08 lakhs in revenue and an increase of Rs. 4,20 lakhs in expenditure. In the Finance Accounts, however, the surplus increased to Rs. 7.77 lakhs because of an increase of Rs. 6,81 lakhs in revenue and a reduction of Rs. 5 lakhs in expenditure.

The Budget Estimates, 1940-41, showed the revenue receipts at Rs. 85.43 lakhs and the expected expenditure at Rs. 92.59 lakhs. The prospective deficit of Rs. 7.16 lakhs was to be met by new taxation which included (i) a levy of 50 per cent Excess Profits Tax, (ii) an increase from Rs. 2 to 3 per cwt. in the excise duty on sugar and a corresponding increase in the import duty, and (iii) an increase in duty from 10 as. to 12 as. a gallon on motor spirit. In addition Rs. 91 lakhs were to be taken from the Revenue Reserve Fund, and the year was expected to close with a surplus of Rs. 5 lakhs. The Revised Estimates, however, showed a deficit of Rs. 8.42 lakhs because the expenditure increased by Rs. 19.54 lakhs, while the revenue receipts improved only by Rs. 11.07 lakhs. In the Finance Accounts, 1940-41, however, the deficit declined to Rs. 6.53 lakhs.

The Budget Estimates for 1941-42 revealed a deficit of Rs. 20.46 lakhs, with total revenue at Rs. 106.39 lakhs and expenditure at Rs. 126.85 lakhs. It was proposed to meet

Rs. 6.61 lakhs of this deficit by additional taxation and the rest by borrowing. The additional tax proposals were an increase in the rate of Excess Profits Tax from 50 per cent to 66 $\frac{2}{3}$ per cent, an increase in surcharge rate from 25 per cent to 33 $\frac{1}{3}$ per cent, 100 per cent increase in excise duty on matches, an increase from 3 as. to 5 as. per lb. in the alternative specific duty on artificial silk yarn and thread, and a levy of 10 per cent *ad valorem* excise duty on pneumatic tubes and tyres. According to the Revised Estimates for 1941-42, the deficit declined to Rs. 17.27 lakhs due to an improvement in revenue. In the Finance Accounts, 1941-42, the deficit declined to Rs. 13.80 lakhs as revenue improved by Rs. 4.95 lakhs, while expenditure increased only by Rs. 1.48 lakhs.

The Budget Estimates, 1942-43, placed revenue receipts at Rs. 140.00 lakhs and the total expenditure at Rs. 187.07 lakhs. Of the prospective deficit of Rs. 47.07 lakhs, Rs. 12.00 lakhs were to be met by additional taxation and the remaining Rs. 35.07 lakhs by borrowing. In the Revised Estimates, 1942-43, the deficit increased to Rs. 94.66 lakhs, because while the revenue receipts increased by Rs. 26.76 lakhs, expenditure increased by Rs. 86.35 lakhs.

The Budget Estimates, 1943-44, show revenue receipts at Rs. 199.30 lakhs and expenditure outlay at Rs. 259.59 lakhs. The prospective revenue deficit is, therefore, Rs. 60.29 lakhs. Of this Rs. 20.10 lakhs were to be raised by increased taxation and the rest by borrowing. The rates of income-tax for incomes above Rs. 5,000 are increased, and the rates of super-tax and corporation tax are also increased. Excise duties on tobacco and vegetable products are levied. The existing postal and telegraphic rates have also been increased.

§12. *Government Borrowing:* Since the beginning of the war the volume of the internal borrowings of the Government of India has considerably increased. Table No. 8

sets out the relevant figures regarding the Defence Saving Loans.

TABLE NO. 8. INDIAN DEFENCE SAVINGS LOANS OF VARIOUS TYPES

[Source: Currency Report, 1941-42]

[In Lakhs of Rupees]

		June 1940 to March 1941	1941-42	Total
I	3% Six Year Defence Bonds			
	(a) First Series	71	-	71
	(b) Second Series	44.43	-	44.43
II	3% Second Defence Loan, 1940-52	3.47	55.59	59.06
III	Three Year Interest Free Bonds	2.33	34	2.67
IV	Defence Savings Certificates	2.41	2.81	5.22
V	Post Office Defence Savings Bank	-	11	11
	Total	53.35	58.85	1,12.20

1) The First Defence Loan of the Government of India was launched in June 1940. It was essentially a short-term loan repayable at Rs. 101 in 1946, and was offered at 3 per cent. Simultaneously Ten Year Saving Certificates and Three Year Interest Free Bonds were also issued, the former bearing $3\frac{1}{8}$ per cent interest. The total subscriptions to the Six Year Defence Bonds amounted to Rs. 44.43 crores. Its sale was discontinued on January 25, 1941.

2) The Second 3 per cent Defence Loan, 1949-52, was launched immediately after the lists for the First Defence Loan were closed. It was a medium dated loan, and was issued and repayable at par. The total subscriptions to this loan amounted to Rs. 50.05 crores. It was closed on February 14, 1942.

3) The Third 3 per cent Defence Loan was floated on July 4, 1942. It was a re-issue of the 3 per cent 1951-54 loan, of which Rs. 31.92 crores were then outstanding. The loan was issued at par. Up to January 31, 1943, the total subscriptions to this loan amounted to about Rs. 39 crores.

In October 1942 the Government of India re-issued a 3 per cent 1963-65 loan for Rs. 15 crores at Rs. 95 for financing the operation connected with the payment of the capital sum of £ 34 millions to the U. K. Government for meeting the obligations on account of Railway Annuities. Only Rs. 3.41 lakhs out of the Rs. 15 crores demanded were subscribed, and the rest were taken up by the Reserve Bank.

On September 18, 1942, four Provincial Governments simultaneously floated loans for Rs. 7.75 crores in order to meet a part of the liability to the Central Government. All the loans were underwritten under the provisions of the Niemeyer Award. They were 3 per cent loans repayable in 1955. All the loans were fully subscribed.

In addition to the defence loans, the Government of India has placed on the market non-terminable Rupee Counterparts of repatriated sterling loans at 3½ per cent and 3 per cent. These were originally taken up by the Reserve Bank and were issued to the public as need arose. Up to January 31, 1943, of the total Rs. 152 crores of Rupee Paper created in this connection up to the third week of December 1941, Rs. 87 crores were subscribed by the public and Rs. 47½ crores were cancelled, i.e., replaced by Treasury Bills of the Government of India.

There has also been a large increase in the short-term borrowing of the Government of India since the war began. On September 1, 1939, the amount of Government of India Treasury Bills outstanding with the public was Rs. 35.14 lakhs, and this had increased to Rs. 108.96 lakhs on January 31, 1943, a net increase of Rs. 78.81 lakhs. Nearly two-thirds or Rs. 48.00 lakhs of this increase came about during the period of seven months from June 1942 to January 1943.

With a view to encouraging savings for the war effort a new scheme of Post Office Savings Banks accounts known as the Indian Post Office Defence Saving Bank was put into operation on April 1, 1941. Under this scheme

deposits will be repayable only one year after the war. The rate of interest on these was fixed at $2\frac{1}{2}$ per cent, free of income-tax. The deposits in this bank on March 31, 1942, amounted to Rs. 11 lakhs.

The budget for 1942-43 provided for certain measures to encourage savings. "Thus an option is given to new assesses for income tax under the lowered exemption limit, to escape the liability by depositing an amount approximately $1\frac{1}{4}$ times the amount of tax assessed, in the Post Office Defence Savings Bank, such deposits not being ordinarily withdrawable till one year after the end of the war. Besides, to mitigate the incidence of the enhanced surcharge on incomes between Rs. 2,000 and Rs. 6,000, which works out at more than 50 per cent, a provision has been made to refund a portion of the tax equal to $\frac{1}{2}$ per cent of the assesses' total income, after the end of the war. Again, Government has announced its readiness to contribute an amount up to one-tenth of the net excess profits tax, provided that the assessee deposits a sum equal to double this amount, to a reserve to be used for the object of assisting industrial rehabilitation after the war."¹

The above discussion clearly shows that the bulk of the Government of India's borrowing up till now is for short-term. The First and the Second Defence Loans were essentially short-term loans, while the Third is a medium dated one. The amount of long-term issues put up on the market is relatively small.

§ 13. *Inflationary Gap*: We next proceed to the calculation of the "net gap" in Indian finances. Table No. 9 shows the calculation for the period September 1939 to January 1943. The table also shows the net addition to currency during that period.

No elaborate comments on this calculation are called for. The calculation can hardly be expected to be very ex-

¹ *Currency Report of the Reserve Bank of India, 1941-42, p. 29.*

TABLE NO. 9. ESTIMATION OF THE INFLATIONARY GAP
 [Source: Currency Report, 1941-42 and Explanatory Memorandum on
 Central Budget, India, 1943-44]

		Liabilities		Assets	
		Period	In Lakhs of Rupees		In Lakhs of Rs.
I	Central Budget Balance	1939-40	Surplus of 7.77	Total loans during Sept. 1939-Jan. 1943 Treasury Bills Outstanding with the Public on 31st January 1943 Total Assets	2,67.50
		1940-41	Deficit of 6.53		
		1941-42	Deficit of 13.80		
		1942-43	Deficit of 60.29		
	Total Balance	1939-40 to 1942-43	Net Deficit of 72.85		1,06.95 3,76.46
II	Sterling Liabilities Purchased by Reserve Bank	Sept. 1939-Jan. 1940	63.00		
		Feb. 1940-Jan. 1941	86.00		
		Feb. 1941-Jan. 1942	90.00		
		Feb. 1942-Jan. 1943	1,05.00		
		Total Sterling Payments by H. M. G. up to Jan. 1943		5,05.00	
	Total Sterling Liabilities		6,49.00		
III	Total Liabilities		9,21.85		

Net Gap = Total Liabilities Minus Total Assets = Rs. 5,45.39 Lakhs.
 Currency Expansion during Sept. 1939-Jan. 1944 = Rs. 5,39.18 Lakhs.

act; for, the process of adjusting and squaring finance accounts is very long-drawn-out and elaborate. The significance of the calculation is, however, self-evident. The "net gap" in the Indian finances for the period September 1939 to January 1943 works out at Rs. 545.39 lakhs, and the creation of additional currency was to the tune of Rs. 539.18 lakhs. It is, in other words, the method of "payment through the printing press." (The direct method of printing more and more notes against the sterling balances in London has been followed by the Government of India, to close the "inflationary gap.")

§ 14. *Inflation*: The facts and figures adduced above clearly testify to the presence of "inflation" in India. By inflation "is meant an excessive and dangerous general advance in activity and prices, which may arise from a variety of causes but is increasingly aggravated by monetary expansion."¹ The inflation in India, to use Prof. Pigou's term, is "deficit induced." (The "net gap" in Indian finances is being filled by an ever increasing expansion of the note-issue. As already indicated, the rise in prices is lagging behind the increase in note circulation. Wholesale prices and the cost of living indices show an all-round and continuous increase. (The fact that prices have not caught up with the note increase only indicates that money is circulating more slowly.) The existence of large floating funds is fraught with a dangerous inflationary potential. We are only at the beginning of a disastrous inflation.)

Two general types of inflation can be distinguished; fiat-money inflation and credit inflation. In the above discussion attention has been drawn to the absence of credit expansion in India as compared with that of currency. The inflation, in whose octopus-like grip India finds herself today, is of the first type. This occurs "when the resources of a country are being fully utilized, and the government has to

¹ E. A. Goldenweiser, "Inflation," *Federal Reserve Bulletin*, April 1941.

spend more than it can raise either by taxation or borrowing in the market, and, therefore, resorts to the creation of money through the printing press, through borrowing from a Central Bank, or through some other device. The characteristic feature of this type of inflation is that it arises from the necessities of Government.] It is only when a country is in an extremely critical situation that this occurs. When it does occur it is the worst type of inflation; in fact, the most disastrous inflations have all been of this type. This sort of inflation which arises from the dire needs of a government, is never effective in overcoming the government's difficulties."¹

§ 15. *Finance Member on Inflation:* In dealing with the prevailing misconceptions regarding inflation in India, the Finance Member remarked in his recent Budget Speech that there was a tendency to regard the general rise in prices as inflation and to attribute the rise to an avoidable currency expansion. "To my mind," said he, "this notion is the result of confusing cause and effect, and misinterpreting the elementary fact that all the expansion and intensification of government's war activities involves cash payments to an ever-widening circle of recipients in return for labour and raw material or services.

¹ Goldenweiser, *op. cit.* Expansion of currency in India is effected against sterling securities. The sterling securities are the securities of the British Government. Issuing of notes against them is essentially the same as issuing them against rupee securities of the Government of India. The sterling itself has become "fiduciary." To quote the *Monetary Review 1939/40 of the League of Nations*: "The most drastic dissociation of the note issue from the gold reserve was carried out in the United Kingdom. At the beginning of September (1939), all but a nominal amount of the Bank of England's gold reserve was transferred to the Exchange Equalisation Account, and the Bank's fiduciary issue, covered by Government securities, was raised by an amount equal to the value of the gold thus transferred. The whole note issue—apart from the nominal £0.1 million still backed by gold—thus became 'fiduciary.'" p. 43. At one remove, therefore, the note issue in India, backed by the sterling securities, becomes "fiduciary." This is why we characterise the inflation in India as a fiat money inflation.

(The alarms and the excursions of war also tend to create varying preferences for settlement of claims in cash among sections of the public over methods customary in peace time and in other countries, e.g. by cheque, thus increasing the *per capita* cash requirements of a huge and expanding population. To stop issuing the currency which the public needs in such circumstances would simply mean a corresponding or a disproportionate curtailment of the whole war effort.)

This statement, in effect, implies that the expansion of currency in India since the war began is in response to the increased *per capita* demand for cash induced by the war situation. In making this point, however, the Finance Member is himself confusing between cause and effect. For, if the intensification and expansion of government's war activities involves cash payments, it increases the government's demand for more cash, in the first instance. When the government possesses itself of the additional cash, either through increased taxes and loans or by an expansion of currency, and when the additional cash is disbursed, then only can the *per capita* holdings of cash (requirements come later) increase. Thus the expansion of currency, if it is resorted to, precedes and does not follow the increase in the *per capita* holdings of cash. The whole discussion of the "gap" in the preceding pages leads inevitably to the above conclusion. We have also pointed out before that the expansion of currency in India since the war began, is to be directly attributed to the purchases made by U. K. in India. The increased demand for cash during the first four months of the war was only a temporary phenomenon, and the expansion of currency during that period was certainly due to the increased demand from the public. This had, however, nothing much to do with the war effort of the Government of India. And once this temporary phase had worn off by the end of January 1940 (as shown by security prices and money rates) the situation had been

changed radically. The expansion of currency from that time onward, was quite irrespective of the demand from the public. It was in direct response to the cash requirements of the British Government. The Finance Member's attempt to shift the origin of the demand for cash from the government to the people is misguided and incorrect.

The Finance Member then goes on to point out that "not all the government disbursements on war purposes necessarily or proportionately contribute to the rise in prices, even though government's war effort curtails the production or imports of civilian goods. . . . That purchasing power may not all be employed for the purchase of such goods, and much depends upon the rate at which money is being turned over in the process." He further showed, from the declining ratio of bank deposits to bank clearings since the beginning of the war, that cash is being hoarded and the velocity of circulation is declining. This increase in liquidity preference, he said, while it lasts, tempers the rise in prices.

That the liquidity preference of the people in India has increased during the war period is undoubtedly true. But it is necessary to inquire why this has come about and how long it is likely to continue. The increase in the normal liquidity preference of the Indian people is in fact the result, as in all other countries, of the uncertainties of the war situation. It should be emphasised, however, that this increase is also in a way related to the expansion of currency itself. A plethora of money on the market might itself decrease the velocity of circulation.

A further point for consideration would be the degree of increase in the liquidity preference or the hoarding of cash. The Finance Member's remarks suggest that pools of hoarded cash have been created in the land. In such circumstances, according to the Finance Member, the creation of new money to meet government needs is not only necessary but actually non-inflationary. If new money is not created, the government will be denied access to la-

hour and materials, not because they are not available, but because the monetary tickets to them have become lost or jammed in the process of circulation. Such a view would be tenable only if the degree of cash hoarding is such as to absorb the whole, or at least a large part, of the new money created. There can be no direct evidence on this point, and we have to rely on certain indirect pointers to gauge the prevailing degree of liquidity preference. These pointers are the money rates in the market and the pressure on banks for accommodation. If the increased liquidity preference of the public were to absorb all or the major part of the new money created, the money rates would not tend to fall.¹ But as we have seen before, the money rates in India have shown, except for seasonal hardening, a tendency to decline. The easy money conditions in the market also show that such demand as there might be for trading and other accommodation is being easily met. This indicates that the increased liquidity preference of the public is not absorbing even a major part of the new money created. [Consequently, it appears that the increase in the liquidity preference of the public has been exaggerated out of all proportion by the Finance Member.]

It is also pertinent to consider how long the increased liquidity preference can be expected to continue. The continuously rising price-level will not allow it to last much longer. The experience of many European countries after the last war emphasizes the danger of counting on a continuance of this phenomenon. It is clearly a temporary phase, and with a further rise in prices a preference for holding commodities instead of money might manifest itself. The increased "liquidity preference" of the public, therefore, is not the initiatory factor, nor is it large enough to justify the enormous expansion of currency in India; it certainly does not justify complacency. The Finance Member seemed to be aware of this when he remarked, "It would

¹ Keynes, *op. cit.*, p. 173.

be foolish to ignore the crux of the matter, which is that in a lopsided economic set-up of a country at war, free purchasing power is a source of potential danger."

In denying the presence of inflation in India, the Finance Member remarked, "In my opinion some of the fear which is now expressed arises from a failure to distinguish between pure credit inflation and the temporary situation in which an increase in the volume of purchasing power impinges for a time on a stationary or diminishing volume of consumable goods. Here in India, I think, we can say with a clear conscience that the government has at no time resorted to credit inflation. The easy expedient of borrowing from the Reserve Bank has not been adopted for making up the revenue deficits of the governmental budgets or for augmenting governmental balances for the purpose of meeting disbursements."

In the above the Finance Member makes two claims; first, that there is no credit inflation in the country, as there has been no or very little borrowing by the government from the Central Bank; second, that budgetary deficits have not been met by borrowing from the Central Bank. The obvious conclusion that follows is that government is not financing the war by inflationary methods. The Finance Member seems here to labour under the mistaken notion that "inflation" can only be a "credit inflation," and even "credit inflation" comes about only if there is borrowing from the Central Bank. Both these notions are utterly wrong. Inflation, as already pointed out, can be "credit inflation" or "fiat money inflation." It has been stated above that the present inflation in India is of the latter type. There is no credit inflation in India, or rather there cannot be any.

Once the character of the inflationary phenomenon in India is clearly grasped, the second observation of the Finance Member goes by the board. We have maintained that all the sterling payments made to India, for which

the government of India have to provide rupee finance, are a current charge on the Government of India's finances. They are the disbursements made by the Government of India on behalf of the U. K. Government. And as these are being met by the printing of notes, it is obvious that the deficits of the government are being met by the printing of "fiat money." The discussion and calculation of the "net gap" proves this beyond doubt. (Borrowing from the Central Bank is only the indirect way of financing war by a resort to the printing press. The other way is to directly print inconvertible notes and use them for disbursements.) The Government of India has chosen the latter. There is no virtue in claiming that government has not chosen a particular inflationary device while shutting one's eyes to the other device that they have actually used.

§ 16. *Inflation or Expansion:* The recent expansion of currency in India has sometimes been justified on the ground that this expansion is adequately covered by sterling securities and cannot, therefore, be inflationary. The argument is almost touching in its *naivete*. The answer to it must begin by asking what is "cover" and what function it is intended to serve.

(Cover for the note issue is a mere technical device for maintaining, under certain monetary standards, a parity with gold or any other type of external asset, and under others for controlling the relations with foreign currencies.) It is also intended to act as an automatic check on over-issue. But it can serve merely a negative purpose. The provision regarding cover serves to indicate the limits beyond which expansion of currency might be considered inflationary. It does not make it justifiable for the currency authorities to issue notes to the last limit of the available cover. As a matter of fact, in most countries it is usual to hold a much

¹ L. Nemenyi.—"Expansion or Inflation," *Times of India*, March 5, 1943; also G. D. Birla, "Inflation or Scarcity," 1943.

larger, though varying, proportion of cover than is required by legislation.

The expansion or contraction of currency at any particular time has, in the main, to be determined by the internal needs of a country's economy.] During the last two decades, for example, large amounts of gold were deliberately sterilized in U. S. A. and France. (Again, the belief that a fully covered note issue cannot lead to inflation rests on the mistaken notion that inflation and depreciation of currency necessarily go together.) The currency history of the U. S. A. and of many other gold standard countries during the last war is a valuable object lesson in this connection. The great influx of gold into U. S. A. during the last war resulted in a large expansion of currency in that country. Though this expansion was fully covered by gold, inflation did occur.¹ (Merely because an expansion of currency is fully covered, even by gold, it does not mean that it is not excessive or inflationary. "For inflation means the existence of a currency in a quantity larger than is actually needed to carry on business transactions at a normal price level.")²

Further, "cover," however "real," serves no purpose as long as there is no readiness to use it. A disastrous fall in the value of currency is not arrested, or is not the less disastrous, merely because the currency authorities possess passive resources. In this connection the wholesome wisdom of Cannan's words comes back to us. "The belief that

¹ "Where, as in the United States during the recent conflict, the increase in the media of payment assumed the form first of the growth of coin due to the great influx of gold from abroad, and later the expansion of credit rendered possible by the adoption of the Federal Reserve System, there was inflation without depreciation of currency."—*Currency Inflation and Public Debts—An Historical Sketch*, E. A. R. Seligman, The Equitable Trust Company of New York, 1921, p. 10. See also Chapter IX, Reserve Credit and Gold Policy, in *Credit Policies of the Federal Reserve System*, Charles O. Hardy, The Institute of Economics of the Brookings Institution, 1932.

² Seligman, *op. cit.*, p. 10.

a hoard of gold can influence the value of notes merely because it is called 'cover held against' them is gross superstition. Whether it can be exorcised by reasoning seems doubtful, and it has so far successfully resisted ridicule. We can only hope that abandonment of the superstition may at last come from further repetition of the universal experience that 'cover' which is not to be touched by the profane hand of man is absolutely useless for the purpose which it is supposed to fulfil."¹

The note issue in India is covered by sterling securities. Even if the so-called cover to rupee notes had been today gold or silver instead of sterling securities, the situation would not alter as long as the exchange or financial policies remain unchanged. Reference to Indian monetary history during the last war may make this clear. As it is, however, the sterling is at present "fiduciary," and but for exchange control its exchange value would depreciate considerably. As an external asset the sterling cover is worthless and, in fact, we cannot use it. The belief in its ultimate solvency amounts only to a confidence in the financial solvency of the U. K. Government. The talk of an adequate cover to the note issue in India is, therefore, patent nonsense.

§ 17. *Foreign Exchange and Inflation*: It is necessary, in this connexion, to consider also the role of the rupee-sterling exchange. We may begin by an examination of the exchange position during the last war. In 1914 India was on the Gold Exchange Standard, and her normal favourable balance of trade with Great Britain was usually liquidated by import of specie. When war broke out, this normal procedure could not be followed because of the restrictions imposed on the movement of gold and silver. The payments due to India, because of her growing favourable balance of trade, were accepted in sterling in London,

¹ *Modern Currency and the Regulation of Its Value*, Edwin Cannan, 1931, p. 71.

and against these balances in London rupee coins and notes were issued in India. Under the present arrangements also, India accepts payment in sterling and these balances are kept in London. The circumstances today are, however, radically different from those of the last war. During the last war the people of India had not taken to currency notes and the bulk of the Indian purchasing power consisted of metallic money, i.e., silver rupees. An expansion of currency, against the accumulating sterling balances in London, therefore, meant a large coinage of new rupee coins. From 1915 to 1918 the total currency in circulation in India (notes and coins) increased by Rs. 141 crores. Of this increase, about Rs. 91 crores were rupee coins and the rest notes.

The minting of rupee coins, in its turn, meant the purchase of silver. As the war proceeded the price of silver began to mount rapidly. It rose to 43 d. per standard ounce, in August 1917, thus reaching the melting point of the rupee then valued at 1 s. 4 d. The price of silver continued to rise and the rupee began to appreciate in value in proportion. For reasons of prestige the Government of India was unwilling to debase the rupee coin. The exchange value of the rupee, therefore, increased continuously in relation to the sterling. In fact, India then became a full-fledged silver standard country and the rupee exchange came to be directly controlled by the world price of silver. Consequent upon a continuously rising exchange the amount of rupee finance that the Government of India had to provide for the sterling payments accepted in London was considerably reduced. The rising exchange thus operated as a check on currency expansion in India.

As compared with this the conditions today are very different. The people of India have now become accustomed to currency notes. A predominant part of the purchasing power in India now consists of notes, and the expansion of currency is mostly synonymous with the ex-

pansion of note issue. This time, again, the Government of India is not only willing to debase the rupee coin, but has actually done so.

When England went off gold in 1931, the rupee was linked to the sterling at the old peg of 1s. 6d. per rupee. The sterling link implied two things; first, that the exchange value of the rupee in terms of the sterling was fixed; and, second, that the sterling link acted as an operative factor in adjusting the respective internal price structures in India and Great Britain at the fixed parity. It acted as a good and efficient conductor of price changes in Great Britain to India.

When the present war broke out in September 1939, the rupee was in a linked position to the sterling at 18 d. On the declaration of war, exchange controls were imposed.¹ The exchange rate between the rupee and the sterling remained fixed at 18 d. Apparently the sterling link is still in existence. (But it can be argued that this link has snapped in its vital aspect after the imposition of the exchange controls in September 1939.) It has been made clear previously that these exchange controls make it imperative on India to accept sterling in payment for her dues in London at the fixed rate. Under such arrangements the enormous disbursements of British funds in India, and the large purchases made in India by the U. K. Government, cannot even remotely affect the sterling rupee exchange, as the balance of India's dues is not cleared. (The essential sterling link, which used to bring about an equilibrium between internal price levels of Great Britain and India respectively, has snapped and the two price levels are now entirely divorced from each other.)

¹ On 5th September 1939 an official sterling dollar rate was fixed—a selling rate of \$4.02 and a buying rate of \$4.06 to the pound. These new rates representing a reduction of 14% as compared with the "peg" rates—namely \$4.18 and \$4.22—recorded on September 2, 1939. *Monetary Review of the League of Nations, 1939/40, Vol. I, p. 18.* In sympathy with the "sterling" the rupee fell by 14% in relation to the dollar.

If the rupee had been on a free exchange the U. K. Government would have been forced to enter the exchange market to purchase the necessary rupee finance for use in India. This would have meant, as during the last war, the appreciation of the rupee in terms of sterling. The consequent rising exchange would have, perhaps, restricted the purchases of the U. K. Government in India. This, however, might not have happened to any appreciable extent, as the amount of purchases of the U. K. Government are probably determined only by war needs and not by considerations of finance. This would have then resulted in the accumulation of larger sterling balances in London than those that have accumulated at the fixed exchange.

But a rising exchange would have had another effect, more relevant to the issue under consideration. As in the last war, the rising exchange would have operated as a damper on the rising prices in India. A rising rupee-sterling exchange would have reduced considerably the amount of rupee finance that the Government of India would have had to provide for all the payments made in sterling, such as the purchasing of sterling debts, etc., and might have thus occasioned a much smaller expansion of currency in India than at present.¹

During the last war there was a rise of prices in India, though the exchange was continuously rising. There was inflation but no depreciation. The external and internal price of the rupee was identical. During this war there has occurred a complete divergence between the external and the internal price of the rupee. Today the rupee is internally falling in value with the rise of prices, and because of the fixed exchange rate, is externally overvalued.²

§ 18. *Sterling Repatriation:* The large accumulations of sterling in London on India's account have been used to

¹ Cf. K. L. Datta's Evidence before the Babington Smith Committee, Minutes of Evidence, Vol. II, p. 279.

² This can be easily seen from a comparison of the purchasing power parities of India and the other sterling area countries.

purchase the loans placed in London in the past. A beginning in this direction was made in 1937, when India had a large favourable balance of trade with England and government liabilities on account of the Family Pensions Funds to the amount of £ 9½ million were liquidated. Table No. 10 shows the progress of the process of repatriation of India's sterling debt from the beginning of the war.

TABLE NO. 10. INDIA'S STERLING DEBT
[Source: Currency Report, 1941-42 and Explanatory Memorandum on Central Budget, India, 1943-44]

Year	Manner of Repatriations	Face Value (£ Million)	Purchase (£ Million)	Value (Rs. Crores)	Amount of Rupee Counter Parts Created (Rs. Crores)	Total outstanding Sterling Debt (Rs. Crores)
1937-38	Open Market Purchases	0.84	0.75	1.00	1.12	
1938-39	—	—	—	—	—	469.10
1939-40	Open Market Purchases	17.09	16.54	22.05	22.79	442.49
1940-41	(1) Open Market Purchases	9.22	8.52	11.36	12.10	
	(2) License Scheme of 22nd Feb. 1940	2.02	2.02	2.69	2.69	
	(3) First Compulsory Scheme of 8th Feb. 1941	60.05	64.70	86.27	80.07	
	Total	71.29	75.24	100.32	94.86	344.93
1941-42	(1) Open Market Purchases	12.11	12.36	16.48	16.14	
	(2) First Compulsory Scheme of 8th Feb. 41	13.08	14.14	18.85	17.44	
	(3) Second Compulsory Scheme of 24th Dec. 41	73.85	65.78	87.71	—	
	Total	99.04	92.28	123.04	33.58	190.00
	Total for all years	188.26	184.81	246.41	152.35	

India's sterling balances began to mount up after the declaration of the war in September 1939, and the Government of India took the opportunity to reopen the scheme of sterling repatriation. The procedure was described by the

Currency Report of the Reserve Bank, 1939-40, as follows:

"The Reserve Bank is authorised to purchase non-terminable Indian Sterling securities in the open market as and when they become available and transfer them to the Government for cancellation. In their place additional Rupee Paper of the 3½ per cent and 3 per cent non-terminable loans is created up to the same nominal value, which is issued gradually by the Reserve Bank in accordance with the requirements of the market. The first such cancellation was effected on the 15th November, 1939. The total amount of non-terminable sterling loan repatriated during the year 1939-40 came to £ 9,337,000, the nominal value of the Rupee Paper created against the sterling debt cancelled being Rs. 12,45,00,000."¹ The first scheme of the repatriation of terminable loans was announced on February 22, 1940. The amount repatriated under this scheme was £ 7,755,000, and the nominal value of rupee paper created in its place was Rs. 10,34,00,000. The second scheme was announced on December 24, 1941, and under this scheme stock worth £ 73.99 millions was repatriated. The remaining sterling debt was paid off on January 5, 1943, under the third scheme. The outstanding sterling stock not surrendered and falling beyond the scope of the vesting order, is about £ 13 million. "Up to 1st December 1941, of the Rs. 139 crores of rupee counterparts created, Rs. 51 crores were in the hands of the public, Rs. 47½ crores were cancelled, Rs. 31 crores held by Reserve Bank, and Rs. 9 2/3 crores were held in Government account."²

In October, 1942, the Government of India took steps to liquidate its liabilities with regard to the payment of railway annuities. Toward this end the Government of India made a capital payment of £ 30 million to the British Gov-

¹ P. 19.

² Finance Member's Budget Speech, 1942-43. In his recent budget speech the Finance Member stated that during the period from 1st February 1942 to 31st January 1943 rupee counterparts worth Rs. 36 crores were taken up by the public.

ernment. This amounted to an investment at $2\frac{1}{4}$ per cent. For financing this scheme, the Government of India floated a loan of the amount of Rs. 15 crores at 3 per cent, to be repaid in 1963-65. Of this an amount of only Rs. 3,41,47,200 was subscribed to by the public, and the rest was taken by the Reserve Bank. On January 16, 1943, the Government of India announced the arrangements made for the repaying of the Indian Railway debenture stocks of the aggregate value of £ 20,200,000 by about March 12, 1943. Besides, a year's notice has been given for the redemption of £ 11,100,000 of other railway debentures.

Thus India's sterling debt which stood at £ 376 million in 1936 has been reduced to below £ 100 millions, including railway capital under notice of repayment, at the beginning of 1943. The only substantial liability for which India is now required to make sterling payments is that connected with sterling pensions, family pensions, and provident funds. This liability is estimated at about £ 5 to £ 6 million a year. The Government of India is considering a scheme for making advance provision for these remittances on the lines of similar arrangements made with regard to the Railway Annuities. Other British investments still surviving in India have been estimated at £ 200 million.

The utilization of India's sterling balances for the repatriation of her sterling liabilities is welcome. For the first time in history India is being enabled to wipe out the larger part of its debts on international account. The liquidation of sterling loans and the possible buying up of other British investments in India, subsequently, might lead to the almost complete elimination of the British financial stake in India.

The financing of the whole repatriation scheme was partly carried out by issuing to the public, rupee counterparts. Of these, counterparts worth Rs. 87 crores were

bought by the public up to January 31, 1943. To this extent the external debt of India has been replaced by an internal debt. The service of this domestic debt in the post-war period will necessitate a transfer of purchasing power from one individual to another. These will have their inevitable result on the future financial organization in India and its working. (The service of domestic debt, however, does not involve a direct deduction from India's national income as does the service of a foreign debt.) Fixed foreign debt service in the past has always aggravated the fluctuations in India's export prices and also dominated its exchange policy. This disturbing factor might now be eliminated.

It has been frequently claimed by official spokesmen in India that the repatriation of sterling loans is an anti-inflationary measure. This is only partly true. By the repatriation operations the sterling balances in London are used up and, therefore, reduced. A reduction in the sterling balances means a reduction in the available cover to the note issue in India. So far, however, as the reduction in the sterling securities in the Issue Department is made good by an increase in rupee securities or *ad hoc* Treasury Bills, as under the provisions of the Ordinance of February 11, 1941, it even nullifies that effect. It has also to be borne in mind that the Government of India can at present issue notes in India worth two and a half times the sterling balances in London. It actually issues only an equivalent amount of notes in India in the first instance; so that, even if the sterling balances in the Issue Department are considerably reduced through the redemption of Sterling Bonds, this would not necessitate any contraction of the actual currency in India. (It is, however, true that the reduction of sterling securities to the extent that its place is not taken by rupee securities, though not necessitating the contraction of currency, does reduce the inflationary potential of the securities still remaining in the Issue Department.) The ster-

ling loans have been made available to the public by the issue of rupee counterparts. To the extent to which these loans are subscribed to by the public, they, of course, act as a true and positive anti-inflationary factor, as in effect they reduce the inflationary gap. All this merely emphasises the essential point that the present inflationary process is to be measured directly by the extent to which finance for British purchases in India is not covered by the proceeds of either internal taxation or internal borrowing.

§ 19. *India's Sterling Balances:* It is now almost certain that only a part of the sterling balances in London will be used up in repatriating sterling obligations, including even private British investments and that India might have to her credit large sterling balances after the war. These can be put to some use only after the war; in fact, they have accumulated because they could not be used during the war period. As the amount involved is enormous and as it represents the real goods and services that India has sacrificed to make them available to Great Britain, their future is of vital significance to us.

India's experience during the last war was not very encouraging. Then also some sterling balances, very small as compared with those of this war, had accumulated in London in India's Paper Currency Reserve. After the war the Government of India fixed 2 sh. per rupee as the official exchange rate. Soon after, the price of silver began to decline and the real rate of rupee-sterling exchange fell. The Government of India, however, tried to maintain the official rate by selling Reverse Councils. Speculators rushed in to take advantage of the government rate and, from January 1920 to September 1920, £ 55,382,000 worth of Reverse Bills were sold, involving an enormous loss. These were paid out in London out of the matured Treasury Bills and sterling securities belonging to the Paper Currency Reserve. They had been invested at the rate of Rs. 15 per £, and they were realised at the average rate of Rs. 10 per £. The ex-

change policy of the Government of India thus wasted away India's balance surpluses accumulated during the last war.

The first point often raised regarding the future of the sterling balances that have accumulated, or are accumulating at present, is whether it is wise to hold these surplus balances in sterling. The question arises because of the misgivings about the value of sterling after the war. What is likely to be the position of sterling in the post-war period? On a general consideration of the problem two points are obvious: First, that Britain's post-war balance of payments would be considerably adverse, as it is running into enormous liabilities for its war purchases; and, second, that to make up for this Britain will have to export more. The obvious way to achieve the latter is to depreciate the sterling. According to the estimates of the *Report of the Bank of International Settlements, 1942*, on the eve of the outbreak of war U. K. had a total holding of international resources of about £ 5,000 million.¹ Of these about £ 1,100 million were in gold and dollar assets. According to the *Federal Reserve Bulletin*, of the \$ 4,483 million gold and dollar assets with which U. K. entered the war, \$ 3,934 million were liquidated or pledged at the end of two years of war, and the anticipated available holdings on March 1, 1942, were \$ 547 million.²

The National Planning Association of America estimated that the total decline in the net worth of U. K. at the end of two years of war against the rest of the world was £ 1,550 million, or a little less than one third of the total assets with which she began the war. During the third year Britain lost her investments in Malaya and Burma. Canada, South Africa, Australia, and India will have mostly liquidated their sterling debts by the end of the war.

¹ P. 103.

² "Gold and Dollar Resources of the United Kingdom," *Federal Reserve Bulletin*, December 1941.

The misgivings about the future value of sterling are, therefore, just. This has induced some quarters to put forward the suggestion that India's sterling balances should be invested in gold or dollars. The talk of acquiring gold is, however, merely utopian in the present circumstances; for, there is no supply of gold available so far as we are concerned. The only payment that we can offer for it, is sterling and no important holder of gold is likely to part with any of it for a payment in sterling. For the same reasons dollar assets are also not available to us. The accumulation of assets in terms of sterling is, thus, inevitable and must be stoically accepted as part of the war burden. Also, in the realisation of these balances in the post-war period we must expect to encounter the numerous difficulties experienced in the transfer of assets from one country to another during the corresponding period after the last war. It is, therefore, too early to calculate the extent and the form of the return we might expect to obtain, in the future, for these balances.

Financial and Economic Policy

§ 1. *Prices and Production:* An attempt has been made in the previous part to trace the history of the rise in prices and that of currency expansion and to show that they are causally related. It has also been indicated how the large expansion of currency has been brought about directly by the peculiar system adopted by the Government of India for financing the purchases of His Majesty's Government in this country. The extension of current accommodation for this purpose by the Government of India as against the accumulation of sterling resources in England is tantamount to currently lending the necessary funds to the British Government. The responsibility for raising these monies by taxation or internal borrowing rests on the Government of India to the same extent as that in respect of any item included in its ordinary budget. Indeed, it is the course of ordinary financial prudence to treat these disbursements as part of our national deficit. It is only in this manner that the total burden that national production in India has to bear each year can be clearly visualized and calculations made as to whether that burden can be properly borne or not. Instead, the government has followed the policy of financing this effort wholly by the issue of additional currency. This is no more than meeting one's deficits by printing notes. The present inflation can thus be rightly described as a deficit-induced fiat-money inflation. Before going on to discuss the principles of correct financial and economic policy in the circumstances, it is necessary to deal with one important general misconception which seems to be also, at least partly, responsible for the misdirection of the policy of the Government of India.

The following occurs in the address by Sir James Taylor, the late Governor of the Reserve Bank of India, to the last annual general meeting of the shareholders of the Bank (August 10, 1942): "As regards the former, I dislike the term inflation, which, as popularly interpreted, often confuses cause and effect, as meaning a general rise in prices caused by avoidable expansions of the currency. Though there has been a considerable rise in prices in India, I do not consider that this is the result of the increase in the currency, but rather that the two phenomena together are the unavoidable result of the large purchases of goods and services being made by the British Government in India for which they give us sterling which we exchange for rupees. Unless this increase in purchasing power can be met by an equal increase in the supply, not only of the articles being directly purchased by the Government, but also of the food-stuffs and other necessities of life which those who are producing these supplies require to keep them going, and which they are now in a position to purchase owing to the money accruing to them, there is bound to be an increase in commodity prices in this country."

This extract describes the relation between the monetary system and productive organization in a curiously reversed manner. (The late Governor of the Reserve Bank of India seems to imply that unless the large real resources required for war purposes in India are raised by increased production, there is no alternative to raising them by issuing more notes; and he does not like the latter process being called inflation.) The possibility of increasing production is distinctly limited by physical conditions, while the only similar limitation on the increase of paper currency is the capacity of the government security printing press. It is fantastic, therefore, to say that the former should adjust itself to the latter. But similar talk about the fault lying with production effort has been indulged in also by others. This makes it necessary to make clear what war effort means in terms of real resources to a belligerent country, and how in this

effort production and monetary organization are mutually related.

The primary function of war finance is to obtain for government the huge additional resources that it requires in order to wage a total war. These resources might, no doubt, partly be obtained by increasing productive activity. It is possible to increase production by either employing resources which had been unemployed or under-employed before the beginning of the war, or by increasing the efficiency of the resources in production. There are, however, very distinct limitations to this process. Agricultural production is notoriously inelastic, especially in an old country. The increasing of the productive capacity of artisan industries is also beset with special difficulties. In times of war, though the production of factory industry might not encounter the difficulty of lack of unskilled labour in a greatly increased expansion in India, yet the paucity of trained labour and the difficulty of procuring additional plant and equipment makes it impossible to proceed far. Further, certain circumstances connected with the strains of war economy itself, tend to make difficult the progress towards further efficiency, if they do not make for actually decreasing that efficiency. To take an ordinary example, high cost of fuel may lead to the greater use of dung in that direction and thus decrease the manure resources utilized in agriculture. In the main, therefore, no country expects in a modern war to raise the resources required for prosecuting it by being able to increase the volume or efficiency of productive effort. It must divert, for war purposes, a very large part of the fruits of current production which in normal times are left in the hands of citizens at large. It is calculated that in some countries the war effort absorbs even more than half of the total national income. While the proportion in India is not perhaps as high as this, it is high enough to make it necessary for government to obtain by special means an extra large proportion of the total national income. In order to obtain this large share of the national income the

government must have command over correspondingly increased financial resources and the only way in which a government, which cannot borrow or recall funds from abroad, can raise these funds is to either tax the citizens or borrow from them.

A third way of financing, which in the ultimate analysis amounts also to taxing the citizens, is that of inflation. Inflation has been defined as "the process of making additions to currencies not based on a commensurate increase in the production of goods."¹ Therefore, before going on to a further consideration of the problem, it is necessary to set out the available statistical data relating to productive effort in India during the recent past. Because of the lack of reliable statistics it is difficult to determine, or even to guess correctly, the extent of the expansion of total production in India since the beginning of the war. It is, however, possible to indicate very roughly its outside limit.

Agriculture is the largest productive industry in India. [Agricultural production is proverbially inelastic.] During the short space of about three or four years it cannot be expected to show any large or sudden increase. [Progress in this sphere is possible in two directions; either by an extension of cultivated area, or by more intensive farming.] The extension of cultivated area is a very slow process, as is shown by the fact that the total cultivated area increased by about 14 per cent only during 1901-30. Moreover, during the last two or three decades, under the pressure of growing numbers, almost all the cultivable land in many a region in India, has been brought under cultivation. [Intensive cultivation is a matter of technique, and nothing can have happened within the short period since the war started to affect this in any marked manner.] (The possibility of considerably extending or intensifying agriculture, by the development of artificial irrigation, can be almost ruled out

¹ *Federal Reserve Bulletin*, July 1, 1919. Quoted by Foster and Catching, in *Money*, 1927, p. 377.

during the war period.) Available detailed statistics show that agricultural production in India is almost completely stationary. This is well brought out in Table No. 11, which shows that agricultural production has actually decreased in many lines and that the increases in other lines are not sufficient to outweigh these deficiencies.

In the field of the Indian large-scale industry, the limit to an increase in output during the war period is set by the potential of the available industrial equipment. (Large-scale industry in India is almost completely dependent upon foreign imports for its mechanical equipment.) The imports of machinery and machine tools have almost stopped since the war began. Any increase in the plant in the Indian large-scale industry cannot thus be contemplated. Under the influence of war-time demand, only the productive potential of the existing plant can be realised by such means as a system of greater shifts. The increase in output brought about in this manner cannot, however, be expected to be very sizable. (India also suffers from an inelastic supply of the sources of motive power for industry, like that of coal and electricity.) Table No. 12, which sets out certain available data regarding industrial production, shows that the production of paper increased the most and that of cotton manufactures came second, though at a long distance. All others show actual decreases in 1941-42.

In the sphere of the Indian handicrafts or artisan industry, statistics are almost completely lacking. (But here also the possibilities of expansion in output are limited. In most cases these industries derive their supplies of certain basic materials from large-scale industry.) The biggest artisan industry in India, handloom weaving, is almost entirely dependent on the cotton textile mills for the supplies of its most important primary material, cotton yarn. The second most important series of artisan industries consists of various metal-crafts. For primary supplies of sheet metal, etc., these are mostly dependent upon the metallurgical in-

TABLE NO. 11. ESTIMATED AREA UNDER SOME IMPORTANT CROPS
AND THEIR ESTIMATED YIELD

[Source: Indian Trade Journal, Summary of Crop Forecasts]

Crop	Measure	Average of 1936-37 to 1938-39		1939-40		1940-41		1941-42		1942-43		No. of Forecast
		Final	%	Final	%	Final	%	Final	%	Estimate	%	
Rice	(000 Acres)	7,28,16	100	7,42,55	102.0	7,30,59	100.3	7,35,79	101.2	7,49,19	102.8	Final
	(000 Tons)	2,61,67	100	2,58,00	98.6	2,21,50	84.6	2,53,51	96.8	2,45,53	93.7	
Wheat	(000 Acres)	3,47,16	100	3,40,03	98.0	3,48,62	100.5	3,99,79	98.0	3,43,11	99.0	Second
	(000 Tons)	1,01,72	100	1,07,84	106.0	1,00,05	98.3	1,00,70	99.0	—	—	
Groundnut	(000 Acres)	80,22	100	84,10	104.8	87,70	109.6	70,70	88.2	74,31	92.6	Final
	(000 Tons)	91,45	100	31,65	100.5	37,02	117.7	25,86	82.3	27,14	86.3	
Rape & Mustard	(000 Acres)	55,74	100	59,70	107.2	60,63	108.8	62,08	111.5	94,29	61.7	Second
	(000 Tons)	9,72	100	10,97	113.0	10,83	111.5	11,09	113.9	—	—	
Sesamum	(000 Acres)	42,74	100	41,00	95.9	40,79	95.4	40,97	95.9	41,81	97.7	Final
	(000 Tons)	4,36	100	4,15	95.1	4,22	96.6	4,15	95.1	4,51	103.5	
Linseed	(000 Acres)	37,76	100	37,13	98.3	35,83	95.0	33,40	88.5	27,13	71.8	Second
	(000 Tons)	4,40	100	4,67	106.2	4,30	97.8	3,61	82.1	—	—	
Castorseed	(000 Acres)	12,51	100	10,05	80.2	10,21	81.6	9,58	76.5	13,52	108.0	Final
	(000 Tons)	1,14	100	97	85.2	1,05	92.2	91	79.8	1,47	129.0	
Sugarcane	(000 Acres)	38,13	100	36,40	95.7	45,98	120.8	35,15	92.3	35,90	94.3	Final
	(000 Tons)	50,92	100	46,62	91.7	57,94	114.0	43,71	86.0	56,92	111.8	
Cotton	(000 Acres)	2,46,15	100	2,13,56	86.6	2,29,02	92.9	2,35,47	95.5	1,87,16	76.0	Fourth
	(000 Bales)	56,59	100	49,42	87.2	57,85	102.0	59,80	105.5	44,29	78.2	
Jute	(000 Acres)	29,80	100	31,61	106.0	56,69	190.5	21,60	72.5	32,92	110.5	Final
	(000 Bales)	83,87	100	97,50	116.3	1,31,83	165.0	54,74	65.3	90,14	107.5	

TABLE NO. 12. PRODUCTION OF CERTAIN INDUSTRIES

[Source: Monthly Survey of Business Conditions in India]

Industry	Measure	Average for 1936-37 to 1938-39		1939-40		1940-41		1941-42		1942-43	
		Actual	%	Actual	%	Actual	%	Actual	%	Estimated	%
Cotton Manufactures (Excluding Twist and Yarn)	Lakhs lbs.	85.55	100	87.78	102.5	98.14	114.8	10.93	127.7	—	—
Jute Manufactures	(000 Tons)	12.62	100	12.77	100.7	11.08	87.6	12.59	99.6	—	—
Paper	(000 Cwts.)	10.77	100	14.16	131.7	17.34	161.3	18.71	174.1	—	—
Matches	Ten Thousand	21.13	100	21.97	104.2	23.13	109.5	16.52	78.2	—	—
Sugar†	Gross (000 Tons)	8.98	100	12.42	138.5	10.95	122.0	7.78	86.6	10.61	118.5

† Estimates of the Director, Imperial Institute of Sugar Technology, Cawnpore. Sugar year is from November to October next.

dustries and on foreign imports. The latter have now completely stopped. In these circumstances, it would appear that the production of Indian artisan industry has decreased to some extent in recent years. As illustrative of the trends in artisan production we may cite (Table No. 13) the statistics relating to retained imports of yarn and brass and copper in Poona. Handloom weaving and brass and copperware are the important artisan industries of the city. The raw material for them is wholly imported, and the quantity of retained imports is a good index of the size of production.

In all the three fields of production, therefore, the possibilities of increased production are so limited that a substantial increase in output during the war period verges on

TABLE NO. 13. IMPORTS OF CERTAIN INDUSTRIAL RAW MATERIALS RETAINED IN POONA

[Source: Courtesy of Octroi Office, Poona City Municipality]

Name	Average for 1936-37 to 1938-39		1939-40		1940-41		1941-42		April 1942 to January 1943
	Mds.	%	Mds.	%	Mds.	%	Mds.	%	Mds.
Brass & Copper Scrap	9,681	100	11,838	122.5	21,356	221.0	25,416	262.0	23,531
Brass & Copper Sheets	35,538	100	12,261	34.5	8,060	22.7	2,221	6.3	2,796
Total Brass & Copper	45,219	100	24,099	53.4	29,416	65.2	27,637	61.2	26,327
Cotton Yarn	8,346	100	12,389	148.5	2,986	35.8	2,708	32.5	5,188

the improbable.) We must make additional allowance for the production of the ordnance factories, as also the production of certain special war products, such as tents, etc., not included in any of the tables above. Such production cannot, however, amount to a material percentage of total Indian production, especially as against it must be partly offset the reduction in the production in small and miscellaneous industry brought about by paucity of skilled labour and materials.

✓ At any given level of prices, productive activity, and monetary habits, the currency requirements of a nation are stabilized. Increase in production might cause a further demand for money, and thus justify the issue of more currency. If this happens the larger issue will, however, not have the result of increasing prices; for, the new supply will be absorbed in transactions effected against increased production. In the same manner, if monetary habits of people change, that is, if, for example, they tend to keep larger balances of cash with themselves or in the banks, this will result in a generally felt shortage of money, in response to which the monetary authority may issue more of it.

This fresh currency will again be obviously absorbed in the larger cash holdings, and will not have any effect on prices. When, however, money is put into the system which is not required by any change on the side of production or of monetary habits, prices are bound to rise. (Thus, other things being equal, an expansion of currency called forth by increased productive effort cannot lead to an increase in prices.)

In this connection, a clear distinction must be drawn between a general rise of the price level and the rise in the prices of individual commodities. It is likely that a marked worsening of the supply position in a particular line might enable holders of supplies in it to levy a special tribute from the public. But this will be evidenced only by a relative rise of individual prices and not in a general rise in the price level. In particular cases, increases in some directions might have even a depressing effect on others.

There is, however, one possibility in which a rise in productive effort might lead to or justify a rise in prices. This is when increased production is brought about at the cost of average efficiency. This is said to happen at certain stages of the upward movement in a trade cycle, and might well happen when all resources are being hurriedly put to use in war times. (Increased production brought about by an increase in the cost of production, which the lessening of average efficiency implies, must lead not only to an expansion of currency but also to a rise in prices.) Such a lowering of average efficiency cannot, however, be of a large magnitude and, though difficult of measurement, it has been usually put at levels like 10 to 15 per cent only.

The analysis in Part I, by its measurement of the amplitudes and sequences of currency expansion and price rise, must have made clear that those who talk in terms of a crisis in production are clearly in error. The cry for an increase in production because of, or following upon, the

expansion of currency is entirely misplaced. (An attempt to maximize productive effort is always necessary in times of war; but this objective is not helped by the issue of redundant currency.)

It needs to be emphasized that an indiscriminate expansion of currency actually hampers productive effort instead of helping it. Though there might not be unanimity amongst monetary theorists relating to the aims and methods of monetary management, there is yet very general agreement that the maintenance of a stable relation between prices and costs is most conducive to an efficient working of the productive organization. If prices do not rise when costs rise (deflation), productive effort is discouraged. Recent monetary policy in India has, however, not been marked by any deflationary tendencies. (It has been noted above that currency expansion took place in India in response to what was merely a speculative rise of commodity prices at the beginning of the war. As this rise was not founded on any real advance in costs or expansion in production, it could not be sustained. The later movement towards expansion was not related to needs of production and trade. And such expansion is defined as inflationary.)

A small initial rise of prices might, in certain circumstances, stimulate productive activity; a continuous large rise, definitely checks it. A continuous rise means the automatic accrual of money gains to mere holders of stocks of commodities. It, therefore, encourages hoarding on the part of traders as well as producers. This, by itself, is apt to dislocate the smooth working of the productive organisation. Secondly, the rise in prices is usually not evenly spread over the whole price structure; so that, the spread in some directions becomes wider and in others narrower than the normal. This unevenness of the spreads opens up a large number of opportunities for the speculator whose operations usually worsen the situation further. The result is to upset the normal balance of the productive system and to encourage unduly some producers while unduly discouraging

others, a situation obviously not conducive to the maintenance of the highest productive efficiency. The variations in the relations between the prices of cotton, yarn, and cloth since the outbreak of the war and the special handicap imposed thereby on the handloom weaver is an instance in point.

Wars are fought with real resources, and all countries must increase their annual output of goods and services to as large an extent as possible in order to sustain the war effort. But nowhere is it found possible to procure all the resources needed for war without drawing upon normal civilian consumption. [The elasticity of the Indian productive structure is perhaps even smaller than that in other countries. Therefore, in India, as in other countries, a curtailment of civilian consumption becomes necessary.] No doubt the standard of living in India being already low, such curtailment imposes on the mass of people a heavy and an almost unbearable sacrifice, but this must be taken to be the inevitable consequence of war economy. (And the real purpose of economic policy during the war must be to see that this sacrifice is so distributed as to cause as little hardship to the poor as possible.)

One of the main merits of the policy of avoiding inflation is that such an effort necessarily yields a direct measurement of the concrete sacrifice called for from the nation at large. It enables governments to see whether the total burden can be met, or at least to visualize how it should be distributed. (It is hardly honest financial policy to plead, on the one hand, that the limit of taxation is reached and that no further funds can be raised by internal borrowing and to keep on incurring concurrently enormous liabilities which are met by resort to the printing press. For, however unpleasant, it needs to be stressed that the inflationary method of raising resources means taxing the people as much as any tax measure, with the added result that it also leads to a most inequitable distribution of the burden of taxation and, by the way, in-

creases enormously the wealth of a small class of traders and speculators. Whether the purchases by His Majesty's Government in India of real goods and services, are made out of the proceeds of taxation raised in India, or by issuing in favour of that government new currency, it is obvious that these purchases withdraw that set of real resources from being available to the people at large and reduce to that extent their real standard of living. A government, therefore, which keeps on meeting its obligations by inflationary means and refuses either to increase taxation or to raise internal funds by borrowing, is merely shirking its proper responsibility.)

§ 2. *Financial Policy:* Inflation can be avoided by resorting either to retrenchment or by increasing the proceeds of taxation and borrowing. Deliberate attempts at economic management do not suit well the urgency of war effort, and it is notorious that considerable waste necessarily takes place at such a time. However, even in such times it is vital that the necessity of retrenchment of expenditure and economy in administration should be kept to the fore. For example, [the salary policy of the Government of India in respect of new posts of all kinds seems highly open to objection.] The salaries and allowances to these have been modelled on the most extravagant of older scales, and their influence seems to have been felt in the similar departments in the provinces also. Further, apart from the direct effort connected with the war, where perhaps deliberation might be less reasonably expected, [there seems to be no definite attempt at keeping down expenditure in the other departments in either the Central or Provincial Governments. A considerable amount of effort which could be dispensed with or postponed is unnecessarily undertaken. It is necessary to emphasize that all resources saved, whether at the centre or by the provinces or by local authorities, and all expenditure postponed, relieves to that extent the total strain on finance.] It is notable, for example, that in Germany special contributions have been called for from the resources of

local authorities towards war expenditure. A plea for severe effort at retrenchment in all directions might seem out of place in times like the present, and it might also appear as if the result of such retrenchment or postponement of expenditure would be very negligible. But at a time when all available resources and administrative personnel are severely taxed, all curtailment of activity is to be welcomed. Also the extent to which it is possible to avoid expansion today and to put by a number of projects and reserve resources for them will correspondingly help the meeting of the post-war deflationary crisis. Today the problem is of economizing to the largest possible extent and withdrawing all non-essential public activity and expenditure. Unless this is done, government might find itself unable to undertake the proper policy when in the post-war depression pump-priming by public expenditure becomes desirable. Reckless behaviour just now would make the post-war efforts all the severer.

The Finance Member of the Government of India has unfortunately taken the usual line of Finance Members when faced with a plea for increased taxation. He has stated that in the opinion of government, taxation has reached the highest point. There are no means of objectively judging the taxable capacity of a people, or a class, and as long as tax rates have not reached limits difficult practically to administer, a plea that further taxation is impossible is difficult to accept. This is especially so when it is made on behalf of a government which calmly acquiesces in visiting much greater sacrifices on still poorer classes by its policy. A comparison of the Indian system of direct taxation with those of other countries shows clearly that in India the rates of direct taxation and the steepness of its gradation are less than in many of the belligerent countries.

The degree of the disparity in income tax rates in India with those in other countries is brought out in Table No. 14, which sets out the consolidated rates adopted in

TABLE NO. 14. COMPARISON OF INCOME-TAX RATES AND THEIR INCIDENCE IN AUSTRALIA AND INDIA
 [Source: (i) Parliamentary Debates, House of Representatives, Australia, 15th May 1942; and (ii) Explanatory Memorandum to the Central Budget, India, 1943-44, p. 54]

Australia				India					
Income from Personal Exertion				Property Income					
Actual Income	Tax-payer with no Dependents	Tax-payer with Dependent wife and two children		Tax-payer with no Dependents	Income	Tax	Tax less Maximum Exemptions		
		Tax	%				Tax	%	
£		£	%	Rs.	Rs.	%	Rs.	%	
100	—	—	—	—	1,500	—	—	—	
150	—	—	—	—	2,150	50.8	2.4	42.3	
200	7.9	9.9	—	9.9	5.0	78.1	3.1	65.1	
250	19.2	7.7	—	24.0	9.6	3,000	117.2	3.9	
300	31.5	10.5	10.0	39.4	13.1	4,000	195.3	4.9	
350	44.2	12.6	18.3	55.2	15.8	4,500	234.4	5.2	
400	57.3	14.3	28.0	71.6	17.9	5,000	273.4	5.5	
500	84.8	17.0	50.2	106.0	21.2	6,500	468.8	7.2	
600	114.0	19.0	75.7	142.5	23.7	8,000	664.1	8.3	
800	179.4	22.4	135.2	224.2	28.0	10,000	924.5	9.2	
1,000	256.0	25.6	206.2	320	32.0	13,000	1,549.5	11.9	
1,500	495.0	33.0	432	35.5	619	41.3	2,747.4	15.3	
2,000	804	40.2	729	36.5	1,005	50.3	27,000	5,341	19.8
3,000	1,599	53.3	1,569	50.3	1,902	63.4	40,000	10,820	27.0
5,000	3,374	67.5	3,279	65.6	3,702	74.0	70,000	25,602	38.0
10,000	7,874	78.7	—	—	8,202	82.0	1,50,000	74,779	49.9
20,000	16,874	84.4	—	—	17,202	86.0	3,00,000	1,84,154	61.4
40,000	34,874	87.2	—	—	35,202	88.0	5,00,000	3,45,612	69.1
								3,44,073	68.8

Australia last year with the rates levied in India according to the budget proposals for the year 1943-44. A comparison of India with a Dominion in the same war sphere might be taken to be fair. The taxation in United Kingdom is severer than even in Australia. The table requires no comment, except the added observation that the class paying the income tax in India is a much smaller one and is much higher up in the general distribution of income ranges than in most other countries. Therefore, from the point of

view of social justice it is proper to treat it, at least, as severely in this matter as the much wider class liable to income tax is treated elsewhere. The inadequacy of direct taxation in India is exemplified by not only the personal income tax, but also in the taxation of companies and corporations. The rates of these taxes are everywhere higher than in India, apart from the fact that in many countries employers of labour have, in addition, to pay a tax on pay rolls which is entirely absent in India. Similar is the case with the taxation of profits. The treatment of profits in India is far too lenient. The limit of a minimum absolute amount exempted from excess profits tax, while perhaps making the administration easier, not only leaves out a large number of properly taxable individuals and concerns, but also opens an easy way to others for evading altogether, or lessening considerably, the incidence of the tax. The provision laid down for the exemption of standard profits is too liberal. In both Australia and Canada all profits above 5 per cent are taxed as excess profits. In South Africa, where this limit is somewhat more liberal and is based on pre-war profits, a Trade Profits Special Levy has been imposed in addition to the Excess Profits Duty since 1942. This levy was intended specifically to make up for the advantage gained by tax-payers with a high rate of standard profits. One of the special anomalies of the Indian tax system is the treatment accorded to recipients of large agricultural incomes. Big landholders throughout the country escape very lightly, and it is necessary, in view of the conditions of emergency, that an appropriate burden should be placed on them. Difficulties regarding division of powers or problems of division of proceeds ought not to be allowed to hamper this essential tax reform.

Considerable reliance has to be placed in a war economy on measures of indirect taxation also. A general sales or purchase tax has been found to be specially efficient in mopping up redundant purchasing power, and has been adopted by a large number of belligerent countries. Such

indirect taxes have this merit, that their yield increases with the expansion of purchasing power; they also compensate somewhat for the fall in customs revenue which results from the general fall in the volume of foreign trade. The difficulties connected with the imposition of a general sales tax are chiefly administrative, and without a proper agency being set up for collection it would be unwise to institute it in India. At the same time, these considerations indicate that Government should resort much more freely to internal excise or commodity taxes, and should increase the rates of those already existing. Apart from a possible increase in the customs tariff, production and trade in important selected types of luxury and quasi-luxury goods should be made liable to taxation. For reaching a wider circle, taxes on tobacco, sugar, etc., would seem to be appropriate. The tobacco group is less taxed than elsewhere in this country. It was unfortunate in this connection that the Finance Member should have reduced the rate of his projected tax on vegetable ghee. It is true that the tax would have partly hit the lower middle classes. But the objectors to it fail to realise that perhaps a majority in this country do not consume even vegetable ghee, and in order to combat inflation, which hits the poorest most, such taxation would have to be tolerated. (When necessaries are rationed and their prices controlled, the force of redundant money is felt more strongly than ever on the market for other commodities. Taxation of commodities other than those consumed by the poorest is, therefore, justified from all points of view in times of war.)

Again certain essential commodities and services whose supplies and prices are controlled, show rises in prices which are distinctly smaller than the general rise. Petrol, though admittedly taxed heavily, is yet today comparatively cheap. There is no reason why the tax burden on it should not be further increased. Similarly, the increase in passenger fares charged by the railway system are much less in proportion to the increase in the general level of prices. Neither

competitive nor any other reasons justify this small increase. Road vehicle fares have, as a general rule, more than doubled, and the railways want obviously to discourage travel. In the circumstances, a substantial increase in fares may result in partly relieving the burden on railways and partly in increasing the revenue receipts of the state railway system. In view of the difficulties of imposing a general sales tax in India, it is also to be considered whether an increase in railway freights would not be justifiable. Food grains may well be exempted from the increase, but it might properly be imposed on other goods. Subjecting them to a much higher charge for rail transport would be a specially appropriate way of taxing the trade in all semi-luxury goods. In view of the need of discouraging increased investment and building activity, it might also be justifiable to increase the charge on the movement of certain materials. [A graded increase in freight charges is thus indicated.] Of course, as distinguished from the effects of a purchase tax, a rise in freight rates has a regressive effect as within a rates group and the increase has, therefore, to be necessarily lesser in extent.

Increased taxation has in no important belligerent country been found to meet completely the needs of war finance, and borrowing has been resorted to everywhere to a very considerable extent. The most striking difference in the method of raising internal loans as between this war and the last Great War has been the present policy followed by all governments of not increasing the rate of interest offered on loans as an inducement to heavier subscriptions. For the most part reliance has been placed on patriotic appeals and on closing competitive investment opportunities. But in many instances this policy has not completely succeeded. Recourse has then to be taken to methods of compulsorily collecting the savings of the people. Instances of such measures in connection with the poorer sections of the community are afforded by the compulsory savings scheme of U. K. and the "iron savings" of Germany. In India op-

portunities in this direction do not seem to be considerable. With us the mass of earners is very poor, and inflation has cut deeply into such meagre savings as they could make at the best of times. Apart from an extension of the arrangements in force in respect of lower ranges of payers of income tax, schemes of "deferred pay" or "compulsory savings" would be possible in this country only in respect of industrial labourers obtaining a wage above a certain minimum, and they would be specially appropriate in case of employees on special war-time employment. (The bulk of capital savings in India is, however, made by a proportionately very small class, and inflation and war conditions have considerably increased the degree of this inequality.) The analogy of compulsion exercised in respect of industrial and trading concerns is likely, therefore, to prove much more fruitful in this country. In Germany the approach is partly voluntary and consists in calling for certain types of deposits—business investment deposits and commodity stocks replenishment deposits—from industrial and commercial concerns and holding out certain tax exemptions as inducements. In England, on the other hand, a part of the 100 per cent excess profits tax on companies is to be reserved in favour of the taxpayer and to be repaid after the end of the war. In other countries forced loans on a variety of bases have been raised. The situation in India might, perhaps, not immediately justify forced loans of the last type. (It is, however, clearly urgent to increase considerably the extent of internal borrowing, and for this purpose the raising of excess profit tax collection to the English level and then impounding a part of the collection as a compulsory loan which might be available to concerns as a reserve at the end of the war, seems to be the best first approach.)

§ 3. Objectives of Economic Policy: The main tasks that are set before wartime financial and economic policy are (i) raising adequate financial resources for Government, (ii) directing productive organisation so that produc-

tion effort is maximized and turned into channels required for purposes of prosecuting the war, and (iii) the distribution of the necessarily limited supplies of goods and services so that the proper production effort is helped and the most equitable distribution of consumers' goods is brought about. Inflation hinders the attainment of all these objectives. It does not adequately satisfy even the first because a rising price level makes government estimates of expenditure continuously inadequate and leads to self-defeating steps at further inflation. The second, it makes impossible by dangling before the eyes of producers the adventitious profits to be made from rising prices, leading to the frittering away of effort through speculation and hoarding. The third, it makes a mockery of by distributing burdens and sacrifices in the most iniquitous manner. (Correct financial policy which will bring about the maximum effort in order to avoid any inflationary trend is, therefore, the very foundation on which economic policy during wartime has to be built.)

Governments at war require not only a larger proportion of the results of productive effort within their boundaries, but find it also necessary to turn this effort into channels which are in many respects different from those in which it flows in times of peace. In a normally functioning modern economy, the ownership of money, that is command over purchasing power, entitles one to an appropriate share of the national dividend and the expenditure of money serves to give direction to the productive organization. War finance should thus ordinarily mean the obtaining of command over the appropriate monetary resources and thereby of the national dividend, presuming, of course, that the value and stock of current money is not altered to a substantial degree. Obtaining the appropriate proportion of monetary resources could, however, by itself fulfil the needs of government in war times only if the new direction to productive organization would be given automatically and immediately on the expenditure of money.

This, however, does not happen. There is always some interval of time before producers react to changes in price structure, and there is also the time lag involved in the ordinary process of a change-over from one kind of productive set-up to another. These reasons make it imperative that governments in modern war should not only obtain command over a sufficient volume of purchasing power but should also directly interfere with the working of the productive organization. Indeed, in view of the time taken, even in a completely directed economy, for switching over productive effort from one type to another, the control and direction of production has in a number of cases to come even before the raising of monetary resources.

Further, the seizure by government of a large part of current production necessarily leaves a much smaller share than before to the ordinary population. An equitable distribution of this reduced share among the population would follow only if appropriate changes were automatically brought about in the incomes of the population in all classes and in all regions. Actually, however, the changes in the receipt of income accruing to various classes and in various localities are a number of times the contrary to what, from the above point of view, would be appropriate. Interference in the distributive organization thus becomes imperative in the interest of equity.

All these considerations are greatly emphasized when the financial measures adopted by governments in war are not wholly adequate to their needs. When, in the circumstances, the needs can be met only by a resort to some degree of inflation, the redundant monetary supply now on the market makes the problem of the direction and control of productive and distributive organization still more difficult. The sphere and the minuteness of government control become necessarily very wide in this case. In short, it now becomes impossible to retain the normal connection between command over money and the power to consume and to give direction to the productive organization. This

connection has to be made increasingly less and less real and national consumption and production to be brought more and more under authoritarian control.

§ 4. *Price Control:* (An attempt to separate the close connection between income and consumption must begin with the control of prices.) In the normal economic system, price is held to be the chief regulative factor. Individual prices measure the relation between the demand and supply of particular commodities, and the price level as a whole defines the inter-relation between the prices of different sets of commodities. The whole system functions in relation to effective demand, i.e., to the pull that individual consumers exercise on account of their outlays, which are ordinarily bounded by their incomes. (In a war economy government requires a large portion of the total production, and when it enters the market as an urgent customer the result must be to send up the prices of all commodities unless the outlays of the other customers are correspondingly diminished and made less urgent. (An unchecked initial rise in prices will have a cumulative effect!)) Prices represent charges to producers as well as to consumers. They influence the cost of production of commodities, and a rise in primary prices might send up the prices of commodities in general. It also tends to set up a demand on the part of wage earners and other recipients of fixed periodic payments towards increasing their remuneration. But an increase of wages leads also to further increases in costs of production and justifies another increase of prices so that unless the movement is checked by the currency authority or by external control there is no means of arresting its progress.

(We have seen that control of the rise of prices from the currency end is impossible unless government is able to close entirely the inflationary gap.) As long as some proportion of war finance continues to be raised in this manner, [the control of prices must be effected by direct intervention of government.] The existence of an inflationary

gap leads to the continuous creation of what might be called redundant money incomes. (If these are left unhindered to exert their influence on the markets, they must set up a movement towards a rise in prices which in turn will increase government outlays and government deficits, leading to further demand for currency to sustain the higher price level, and so on indefinitely. Price control, which means the fixation directly of maximum prices by government, has thus assumed considerable importance during this war, especially in all cases where conditions of war finance led to a perceptible movement towards a general rise in the level of prices.)

In this connection recent history may be divided into two broad periods. The first was the period during which a rise in prices was brought about by the actual or apprehended scarcity in individual commodities and by speculative purchases of traders. This movement was neither general nor could it be sustained over any length of time, except in the case of the few commodities, the technical market situation regarding whose supply had definitely changed for the worse. The second period is marked by the greater strain on the resources of governments and by the movement towards the rise in prices being general and continuous. The problems of the second period were thus very different in nature from those encountered in the first. In the first period the control exercised had reference only to special sets of commodities, and (the objective of control was that traders and producers should not be allowed to take unfair advantage of the special circumstances in order to penalize the consumers of those commodities or to hinder war effort. In the second period the objective had naturally to be the more general one outlined by us earlier. (It was that the recipients of money incomes should be prevented from exerting their full force on commodity markets and from initiating an inflationary spiral.) The methods appropriate for attaining this objective were also, it is clear, different from those appropriate to the earlier period. In

the earlier period the control of the supplies and prices of particular individual commodities was obviously called for. In the later period these measures of individual control were necessarily insufficient. For, the problem no longer related only to the demand and supply of individual commodities or services or any particular groups of such commodities and services; it related to the entire correspondence of money incomes on the one hand, to the total supply of commodities and services on the other. (The system of control had, therefore, necessarily to be all-inclusive. [No particular sector of prices could be left out of the system of control.] Two methods of approach to this type of control have been tried. [One is that of total control of the whole field, and the other that of an attempt to control what have been called only the "key" points, leaving the minor series of prices to take care of themselves.] The second method which was attempted, notably in the U. S. A., has, however, been given up in that country, and even there the control now adopted is blanket control. In the authoritarian countries rigid price control of all commodities and services had been a common feature of their economies for some years even before the war. But even in democratic countries such powers of comprehensive control over prices came to be exercised not many years after the beginning of war. In the United Kingdom this dated from July 1941, in Canada from November 1941, and in U. S. A. from April 1942.

A price level represents at any point of time the inter-relationship between the prices of a host of commodities and services. It then presents a static picture. Individual movements of prices represent dynamic forces which give an index to the changing character of individual demand and supply and to the changed relationship of the individual item to the whole. (General price control aims primarily at stabilizing the relation of prices as a whole to money in general at a particular point.) It aims at making the price system insensitive to further accretions to the supply of money. It cannot, however, hinder all movements of individual

prices; because, if it did this, it would rob the working of the price mechanism of all significance. The usual procedure in price control of this general character is, therefore, divided into two stages. The first stage is that of the imposition of a general order regarding maximum prices of commodities and services. Such a general order has, for purposes of convenience, usually reference to prices at a certain date or during a certain period of time. This initial general order thus takes for granted a given stage historically reached in the relation between money and prices and a given set-up of the inter-relationship between the prices of individual commodities and services. The second stage in the procedure is to allow for variations from time to time in individual prices in the light of circumstances as judged by the controlling authority. Or it might happen that the controlling authority might deliberately, for any period of time, free any particular set of prices from all control. Obviously it would do this only in those respects in which any movement upwards could not be expected to affect materially the general level. (The whole objective of price control at this stage, when inflationary influences have begun to be evident, is to keep in check the influence of additional money on the price level as a whole, without affecting substantially the usefulness of the instrumentality of the price mechanism.) Such an aim, it has now been proved, can best be attained by a general control which, at the same time, leaves room for particular discretionary variations.

In India, beginnings with price control were made almost immediately after the declaration of war. The Defence of India Rules provided generally for controlling prices at which articles or things might be sold, and by a notification dated 8th September 1939 the Central Government conferred on Provincial Governments power to control prices especially in respect of necessities such as medical supplies, foodstuffs, salt, kerosene oil, and the cheaper qualities of cotton cloth. The order laid down that the minimum

under control shall not be lower than 10 per cent above the ruling price of 1st September 1939. The method of control thus envisaged was general price control, which had reference to prices on a certain date. The sphere of price control was, however, limited, and it was confined to a few essential consumers' goods. The notification also expressly laid down that Provincial Governments should not control the prices of imported goods without obtaining the previous sanction of the Central Government. The first all-India Price Control Conference which met in October 1939 endorsed the general policy implied in the September notification. It added that it was desirable to develop a price intelligence service in order, presumably, to enable price control to be really effective in the future. As has been indicated elsewhere, a short-period price boom developed soon after the beginning of the war, and a second Price Control Conference was called in January 1940 to consider problems raised by this boom. At this Conference, as at the First Price Control Conference, opinion was largely in favour of not checking immediately the rise in the prices of agricultural commodities. This was the natural result of the belief that the level of agricultural prices had been low as compared with the prices of manufactured goods in recent years and that the agriculturists who had suffered severely from the depression should be allowed to reap some advantage from changed conditions. At the Second Price Control Conference, decision was also taken regarding the division of the spheres of action of the Central and the Provincial Governments. It was generally agreed at the Conference that the fixation of prices for the producer and in the primary wholesale markets should be undertaken by the Central Government, the Provincial and State Governments being responsible for the later wholesale stages and the retail stages. The early boom was experienced chiefly in relation to agricultural commodities. There arose, therefore, no question of extending the sphere of price control or of making it stringent as long as some rise in the level of the

prices of agricultural commodities was thought desirable. For a long period after the Second Conference the price level as a whole in India did not cause any anxiety, with the result that a number of Provincial Governments which had issued orders fixing maximum prices for necessities, following the September 1939 notification, allowed those orders to be inoperative. Apart from the control exercised over supplies which were required for war purposes directly, the Central Government also paid attention only to a few individual problems which had become specially acute. The usual method of the control exercised by the Central Government was to appoint a special Commissioner, and to entrust to him the work both of the regulation of supplies and of the fixation of prices.

Towards the end of 1941 the supplies and prices of two important commodities began to cause concern. These were wheat and cloth. The Government of India attempted to tackle the wheat problem first by issuing a warning, and then, following the division of spheres indicated by the Second Price Control Conference, by fixing maximum wholesale prices at the primary Punjab markets. The Provincial Governments were free to fix the retail prices, having regard to the normal relation between them and the primary Punjab prices. The Provincial Governments had, however, no clear instructions regarding methods of obtaining a statistical measurement of this relation, and no directions also as to the course of action in areas where the prices of wheat were not normally in close relation with the wholesale prices in the Punjab. The mere fixing of the maximum price by the Government of India was not found to be sufficient, and in December 1941 a special Wheat Commissioner was appointed to deal with the whole problem. In 1942 the problem of price control became rapidly more and more insistent, and three Price Control Conferences, in all, were held during the year. It is, however, remarkable that in none of these Conferences was any idea of a general control of prices raised. The Third Price Con-

trol Conference (October 1941) had confined itself chiefly to the problem of cloth and yarn, and to it must be attributed the origin of the idea of standard cloth. The Fourth, the Fifth, and the Sixth Conferences went into detail regarding the machinery of control and the various stages at which control should be exercised. The problems of co-ordination of control with transport authority and of the licensing of various sets of dealers were considered, but the extension of control to all prices was not thought of, even though sometimes general references were made, as in the speech of the Honourable Mr. Sarkar to the Sixth Price Control Conference (September 1942), relating to money income and the price level.

Today, therefore, the position of price control in India is that the Government of India is directly acting in relation to the control of prices of certain staple commodities such as wheat, sugar, and tea, while the Provincial Governments are acting, chiefly through the district authorities, in the field indicated by the September 1939 notification. Of even that field only a restricted proportion is attempted to be controlled. Control over the prices of foodstuffs is generally limited to the main cereals, and does not extend to other important consumption goods such as pulses, vegetable oil, chillies, etc. Prices of sugar are controlled, but ordinarily not those of gul. There is no check, actual or contemplated, on the rise in price of cloth, except such as might later become operative through the working of the standard cloth scheme. Further, the controlled prices have no relation to prices ruling at any specific date in the past, but are liable to vary largely at the discretion of the District officers. The Central and the Provincial controls are again uncoordinated, so that no relation between prices of, say, wheat and the millets, or of sugar and gul, seems to be taken into account at the time when action is taken by one or the other set of authorities. It will thus become clear that the sphere over which price control is exercised today in India is extremely limited, and even in that sphere, or rather on ac-

count of the limited nature of that sphere, the measures of control have practically failed.) Such an admission of failure was implicit in the decision taken in recent months to abolish the control over the primary wheat prices imposed by the Central Government. This decision, it was said, was forced on government by the fear of an insufficiency of supply developing otherwise. Similar fears have led to the abolition of price control in individual districts in some Provinces. The present situation thus borders on the chaotic.

The moral of the failure of price control in India is not that price control was unnecessary, but that the situation today demands a much more drastic and much more completely co-ordinated and highly centralized system of such control. As has been suggested above, the initial problem is not that of regulating the price or supply of any particular commodity, but that of relieving the pressure of redundant money on the total supply of commodities and of preventing the scramble for goods leading continuously to further inflationary movements. For this purpose, the control of prices of individual commodities is of no use. What is required is a general price control putting a stop to further rises in all prices. Unfortunately, this has not been yet contemplated by government in India; but without it a real regulation of the evils of unrestricted price movements cannot begin. Such an initial fixation of a general price level will have the further advantage of preventing regulation from moving individual prices seriously out of relation with others, such as continuously happens when the prices of only a few commodities are controlled, while those of others which are related to them are left free. The next step in a price control of this character, as has been pointed out above, would be to allow specifically for variations in individual prices. Price control, of necessity, lies at the core of all economic regulation. And unless it is both comprehensive and detailed, other economic controls are bound to fail.

It might be objected that where specific price control confined to a few individual commodities fails, wide blanket control must prove impracticable. This, however, does not follow. The failure of the present policy of price control is related chiefly to its sectional, uncoordinated, and dispersed character. For example, failure becomes certain when the agriculturist finds the price and movement of his produce restricted, while the prices of the goods he consumes are left uncontrolled. Price control also fails when the parities of related commodities are seriously disturbed or when an attempt is made to enforce widely varying prices in contiguous regions. A blanket control, while no doubt giving rise to the phenomenon of the black market over a wider sphere than today, will yet be easier to plan and administer. [Further, whatever the difficulties in the way, it has been the experience of all countries that when a serious shortage of supplies develops while there is a rise in money incomes, price control, coupled with rationing, is the only method of maintaining social justice and communal peace. It is equally true that if new redundant money is being continuously manufactured, no price control measures can adequately deal with the situation for a long time. So that while, in the existing circumstances, stringent price control must be imposed in order successfully to finance the war, such finance must also be conducted on proper lines so that an unbearable burden is not imposed on the machinery of control.]

§ 5. *Wage Stop*: The problem of price control raises also the question of the control of wages. Wages form a very important part of the cost of production of most commodities. So long, therefore, as wages are allowed to rise without limit, it would be very difficult to control effectively the prices of either agricultural or manufactured goods. This is really part of the general argument for extending control to the whole sphere of prices, wage being the price of labour. Any one important uncontrolled sector makes the continuance of control in other sectors impossible.

Wages again are an important factor in the cumulative inflationary process. An upward movement of the general price level leads to a cut in the standard of living of wage earners. A wage rise intended to meet their demands puts additional money incomes in the hands of consumers, and not only sustains the older rise of prices, but leads to a further increase in it. [Without a policy of a wage stop, a policy of price stop is unlikely to be successful.] In this matter the policy of the Government of India has been unfortunately the opposite of what was appropriate. Instead of attempting a wage stop in conjunction with price control, the government as an employer has actually taken the initiative in bringing about an increase in the level of wages and salaries. A war economy makes it necessary that government should obtain control over the services of a much larger trained and untrained personnel than it employs in times of peace. The way to recruit such personnel is to get their services transferred from previous employers, and for this purpose considerable powers have been acquired by belligerent governments in most countries. In India there was the additional problem of training new personnel. Perhaps the training and recruitment of new personnel was even more important here than that of the acquirement of services by transfer. In all this, however, the government, in its anxiety to secure an immediate supply, relied chiefly on inflated economic incentives, with the result that whether for unskilled, skilled, or clerical labour it offered remuneration which was entirely out of relation with prevailing market rates. [The transfer of labour to government thus created in itself an inflationary nucleus.] And progressively, the government, instead of thinking of acting on the price level, is at each stage adding to the cost of living compensations. Thus while it is, no doubt, taking what appears to be the easy road, it is increasing the difficulties of all other employers and feeding the inflation.

A policy of wage stop might appear to be apparently opposed to the interest of labour; in fact, when accom-

panied by a stabilization of the price level it is to their real advantage. Even the cost of living bonuses that are granted by government are for the majority of wage earners not high enough fully to compensate for the increase in the cost of living. And outside the ranks of government employees it is only in a few of the organized industries that a substantial measure of relief is given for each increase in the cost of living. The bulk of the urban wage earning classes and the almost entire class of rural wage earners thus suffer from a cut in their meagre standard of living at each stage in the progress of inflation. A wage stop, therefore, far from being opposed by wage earners, should actually be welcomed by them. It is understood, of course, that a general wage stop, like the blanket price control, will leave room for any special adjustments that might become necessary.

§ 6. *Profit Stop:* The policy of controlling profits and investment has a twofold aim. It helps in the general control of the price level, and it also enables the proper amount of lending being made by the public. The policy of controlling any unnecessary increase in the rise of prices involves logically the holding down of profits to the ordinary average level. Profits are defined as the price of entrepreneurial services and there is no reason why they should not be severely kept down when a stop is imposed on either wages or the prices of agricultural produce. From this point of view the policy that was followed in Germany till the beginning of 1942 appears to be highly consistent. In that country, instead of imposing an excess profits tax, prices of all commodities were cut down, the producers of which seemed at any time to be making extra profits. Granting the need for maintaining the entire set of price relationships at equilibrium, the emergence of any extra profit must necessarily be taken as the sign of departure from correct policy. The maintenance of profits at no more than the average level is thus a necessary part of the policy of the maintenance of a stabilized price level. There are, however, a

number of difficulties in the way of carrying out this strictly logical course. The price level is never completely rid of all element of inflation. Further, [the profit-making capacity differs so greatly from unit to unit in many occupations that the maintenance of the average level of profits might still give rise to high returns in some units while perhaps causing losses and thus discouraging production in others.] Also the emergence of profits and their definitive calculation take place on an average some months after the time when the products are sold. The "skimming" of prices following the discovery of the extra profit level leaves room, on this account, for a considerable time-lag. The attempt not to let extra profits originate through a vigilant control over individual prices had, therefore, to be given up even in Germany. In all countries today prices are generally determined on the basis of average costs, and the special profits that might result in particular concerns or occupations are subjected to independent control.

In a comparatively regulated economy, such as that in wartime, the existence of a high level of profits may be considered unnecessary as an incentive to entrepreneurs.] The controls over supplies, markets, prices, etc., that are widely exercised reduce to a very large extent the element of uncertainty and risk in all productive and trading enterprises. Economic activity is made to flow in a limited number of regulated channels and the scope of expansion is strictly controlled. When all classes are subjected to severe taxation and a price and a wage stop operate, there is no justification for not imposing similarly a profit stop.

There is one special reason why it is often advocated that profits of industrial enterprise should not be taxed to the fullest in India. This is the need for Indian industries to build up special reserves for difficult times ahead in the post-war period. There seems to be, however, no real force in this plea. [The special height of war profits is the result of purely state-created circumstances and means no more

than a transference of wealth from all other classes to those entrepreneurs who happen to be specially well-placed to profit from the situation.) There is no reason why such a transference should be tolerated.) Further, the strength or weakness and the survival capacity and the need for survival of different types of enterprises in the post-war period are matters to be judged in the light of the complete plan of post-war reconstruction to be evolved later. The general responsibility for helping any useful and vital activities through the difficulties of the post-war period will fall on and will be borne by the post-war state. It is neither proper nor necessary that the accidental profits of war circumstances should be allowed to specially prop up the position of particular industries or enterprises. There is no reason, therefore, why profits at anything above the average level should be treated in this country in a manner at all different from the way in which they are treated in, for example, U. K.

In this connection it is necessary also to be strict about the items that are allowed as parts of the expenditure in arriving at calculations of profits. A scrutiny of these items is necessary from the point of view of the wage as well as the investment policy. It is one of the anomalies of present arrangements that wage bonuses of any amount are allowable deductions in the calculation of excess profits. This harms the main objective in two ways. Firstly, it decreases tax revenue and thus widens the inflationary gap. Secondly, it directly increases money incomes in consumers' hands and thus increases the pressure on the market for goods. Both aspects of this measure, therefore, have the effect of increasing the inflationary tendency. The wage stop that we advocate implies logically a ban on the current distribution of bonuses, though not against the grant of bonuses which are blocked into compulsory savings. Similarly, it is necessary to see that the allowable expenditure does not enable additions to plant, buildings, or equipment, or any considerable replacement either. Such provisions are no doubt dif-

difficult to administer, but want of strict control in this regard does, it is feared, lead to a considerable use of inflated profits in making what is practically new investment or for specially writing off old liabilities.

§ 7. *Control of Investment:* Closely related to the question of absorption of all excess profits is that of control of investment outlets. It is obvious that if free investment of funds is allowed and if inflationary tendencies help in a rising tide of profits, the attempt to control prices and absorb all the redundant money would be defeated. Because even though this money may not reach consumers directly, it may go out through outlays made in building up new investments by way of the demand for, say, new producers' goods. The existence of investment outlets is also closely connected with the control of rates of interest. The rate of interest as a controlling device has attained great importance during recent years. In the last Great War the attempt by governments to meet the increasing inflationary gap led them to offer, in the ordinary course, higher and higher rates of interest for the increasing amount of internal loan finance that became necessary. It was, however, seen that the offering of the higher rate of interest led by itself to an increase in the total deficit, which increased in its turn the extent of internal borrowing, and this latter the rate of interest in succession. Governments have, therefore, been specially insistent on not increasing the rate at which internal borrowings are made during the period of this war. As a matter of fact, in some countries the rate at which these borrowings were made was forced to a point lower than at the beginning of the war, two years later. In India a policy of low interest rates has also been followed. The rate has not been allowed to increase, but it is evident that the internal borrowings that it was found possible to raise at this rate have fallen far short of the requirements of government, especially during the last year. Obviously one of the main reasons for this is the existence of alternative investment outlets.

Attention has been drawn above to the phenomenon of the extreme liquidity of the Indian money market. It is possible that this is due to a variety of reasons. Primarily, of course, it is the result of an unprecedented expansion of currency. This expansion leads to a rapid accumulation of money incomes into the hands of the classes of persons who specially profit from the inflationary process. Certain results of war economy, such as the shrinkage of international trade and the great difficulty experienced in increasing the productive capacity of established industries, or starting new industries, has blocked a number of channels in which these rapidly acquired money resources would have ordinarily been diverted. This, by itself, leads to a greater amount of money balances being kept on hand by the richer members of the trading and the speculating classes than they would ordinarily do. The channels even of certain types of luxury expenditure are narrower than in normal times. Add to this the factor of political uncertainty, which played a considerable part, especially during the year 1942. Barring a marked development of the demand for bullion, this year did not show a decided preference for any type of investment by holders of money income. It was not that the richer classes had any confidence in the stability of internal currency, but rather that, barring bullion and perhaps some kind of real property, they were even more apprehensive regarding the future of other kinds of claims. This, no doubt, accounts partially for the comparatively poor response to government efforts at borrowing. Towards the end of the year, however, the uncertain situation had considerably eased. The threat to property in the big industrial and urban centres was not held to be as acute as earlier in the year, and investment in existing industry began to be more freely sought. Together with this, investment in commodities or commodity speculation also became more considerable. Even during the earlier part of the year 1942 there had been some movement towards investment in grain and cotton; but this was

neither on a very large scale nor spread widely throughout the country. In recent months, however, there seems to have come about a distinct change of sentiment in the share and the commodity markets. The extremely rapid rise in prices of shares and that of some commodities like cotton, is the result evidently of idle money seeking investment or speculative outlets. It is difficult yet to judge whether this is to be definitely connected with lack of confidence in the stability of the future of money. This need not necessarily be so interpreted, as with narrow investment outlets a speculative rise of share prices may come about even in a country like Germany. Coupled, however, with a rapid inflationary tendency, investment in shares and commodities may suddenly manifest itself as an attempt at a flight from money into real resources.

The point of emphasis here is, that, in spite of the great redundancy of holdings of money, the Government of India has to complain regarding an insufficiency of response to their attempts at borrowing. This, as has been pointed out, may be due to two sets of reasons. On the one hand, to the extent that money resources can be invested into the operations of the existing industries and trades, they are bound to yield, as long, at least, as inflation continues, a very much higher return than that given by investment in government securities. Inflation thus directly hinders government attempts at borrowing funds. Further, even though a large amount of money remains over, after the demand for funds from the existing industrial and trading activities is satisfied, these funds are not readily invested in any long-term government securities. This is because the present situation, with inflation as its dominant note, necessarily creates a feeling of uncertainty, and holders of money today are unwilling to lock up their funds in long-term money claims. Instead, they find it generally more profitable to invest directly or indirectly in speculating in commodities and shares, and as usual a feverish and unhealthy activity has rapidly developed in

these markets. This might be taken, on the experience of past history, as a sure sign of a dangerous inflationary situation. The attempts of government to borrow adequate funds from the public can, therefore, be never successful, and the fulminations of the Finance Member against speculators will remain futile, until the necessary steps to control all economic activity are taken by government.

These steps are a blanket price control, a profit stop, and a closure of alternative investment outlets. All these three are simultaneously necessary; because, in their nature, all attempts at direct economic control have to meet the danger of evasion. It should thus be provided that the profits that might accrue in even considerable proportions, in spite of a comparatively efficient price control, might be mopped up by excess profit taxation, and the proportion of profits that further escapes taxation, should be turned from other directions into subscription to government loans. It has been the experience of countries where economic controls have been operating over a long period that, however efficient the system, it works well only with a series of connected measures supplementing each others' effects. Control of investment is to some extent already achieved by the difficulty of obtaining new plant and equipment and of some kinds of essential raw materials. This, however, is not sufficient by itself in checking attempts at investment in general. Symptomatic of the pressure of funds seeking new investment outlets, is the remarkable activity in the founding of new banking companies evidenced during the last year. It is obvious that this large number of new, some of them very highly capitalized, banking companies is not the result of any considerable new demand for banking accommodation. If anything, the tendency in times like the present is the other way round. It has been remarked elsewhere, for example, that in times of a high level of assured profits like that of war, even industrial companies tend to build up strong internal financial resources and to depend less on external accommodation. It is, therefore, not enough to

depend on the natural results of the paucity of equipment and resources to check investment efforts, but an attempt must be made to check directly new floatations and allow only those which seem to fit in in the general economic plan as envisaged for the duration of the war. In addition to the control of new floatations the increase in the capitalisation of existing concerns must also be brought under regulation. At present even the issue of bonus shares, instead of additional dividend, seems subject to no check. Not only should this, but also the increase of all other additions to capital, not required directly for purposes of war production, be discouraged.

Another aspect of the policy of investment control is the liberty to invest in real property. It is a natural consequence of all times of uncertainty, whether political or monetary, that men should desire to get hold of concrete possessions; and by general consensus of opinion possession of land and buildings is taken to be the concretest of all. Already, therefore, signs are apparent of a rise in the prices of urban sites and urban properties, and the movement has also spread to rural sites and agricultural lands. As regards the former, special precaution needs to be taken in connection with new building activity. Even at increased costs a certain amount of such activity persists and, as in most other countries, this should be brought under stringent regulations. Also, dealings in urban lands and properties might be made liable to special taxation on the lines of the South African Fixed Property Profits Tax. The transfer of rights in rural areas is, in India, fraught with specially grave possibilities. There is a danger here, especially to the position of the small peasant who is unable to profit from the rise in the prices of agricultural commodities. The small peasant and the still smaller holder who is only a part-time cultivator are among the worst sufferers of the inflationary process; to a large extent they can survive only by seeking employment outside. For the major part they would be increasing, through this period, their debt obligations, and they may

either be forced to give up their holdings or might be tempted by the high prices to alienate them. If the present situation lasts for any length of time, such transfers of land may be considerable. Whether the transfer takes place in favour of the richer peasants, or whether it is the trader-moneylender or some urban speculator who gains possession of the land, the result from the point of view of the structure of land-rights is highly undesirable. It might, therefore, become necessary as a part of the policy of checking investment outlets and also of seeing that no considerable social upheaval takes place during this time, to exercise a strict check on transfers of, especially, agricultural land.

Publicists and industrialists often speak as if it were possible to expand and diversify, at the present, the industrial equipment of India. To these the advocacy of a policy of strictly checking investment outlets would appear as against national interests. However, such talk obviously misconceives the present situation. As has often been emphasized, talking in terms of real resources, the deduction made because of the needs of war is so great as to leave a definitely subnormal residual for satisfying the needs of the civil population, even allowing for the small addition made to the total output by extra efforts. Therefore, barring the new investment that has to be made for purposes of war production, there is little scope left for adding to the capital wealth of the country. As a matter of fact, in such times most belligerent countries find that they have to live to some extent on their accumulated capital resources and even to forego essential expenditure on replacements and repairs. If at such a time any class of industrialists finds it possible to build up new capital resources, that can only be because of a misdirection of or on account of a failure on the part of national economic policy. For, such acquisition of new capital wealth is obviously at the expense of the vital consumption needs of some classes of population. For capital replacements or capital additions of the future we must trust to what we can get out of the sterling balances which

are being accumulated at present, at such considerable sacrifices to the poorer sections of the populace.

§ 8. *Rationing*: A policy of price control is, by itself, insufficient to meet the problem raised by the inflationary gap. As a matter of fact, price restrictions themselves give rise to important problems of distribution. It is assumed in all measures of price control that the equilibrium position between money and commodities would, in the absence of control, lie above the control level. Also, when it is said that price control is necessary to combat the effects of redundant money on markets which have restricted supplies of commodities, it is clearly implied that the supply of commodities would be insufficient to meet the total demand from owners of money incomes at the controlled price level. Control of prices thus intensifies the prevailing shortness of supply. Obviously the supply would then be ill distributed unless the control of prices was accompanied by some measure which brought about equitable distribution. This makes rationing and the administration of priorities an important feature of the administration of all war economies. Without a system by which important raw materials and producers' goods were distributed according to some preconceived system of graded requirements, production for war and for purposes of meeting the minimum requirements of the civilian population would be impossible. Problems of equitable distribution are even more insistent in the sphere of consumers' goods. The bare necessities of life such as food and clothing of the civil population must be met to a minimum degree, if only to maintain peace. In war the needs for military purposes, direct and indirect, levy a special tribute on the sources of normal supply. Further, the possibility of the increase of such supply from abroad is lessened, and the available supply for civil needs is consequently usually less to a greater or less degree than in normal times. If in this situation people have redundant money incomes at controlled price levels, the pressure on supplies is bound to increase, and unless special precautions

are taken the poorer classes will find it difficult to obtain supplies adequate to their needs. The only manner in which this problem can be met is by directly regulating the distribution of supplies and allocating them through regulated channels to meet family or individual needs during measured periods.

The system of rationing, no doubt, involves a considerable administrative effort; but in all cases, where the supplies are not definitely sufficient as compared to the demand, it must be undertaken. A half-way measure tried in respect of certain commodities in some provinces in India has by its working proved this abundantly. Instead of allocating supplies to specific individuals or families, it is attempted, in this case, to limit the unit of sale to an individual. It was expected that, if the size of each unit of sale was limited, and if the supply was put forth through a limited number of selling agencies, some kind of rationed distribution would thus be brought about. This device was, however, sufficient to meet the situation created by only a purely temporary lack of physical supply or by psychological reasons. The guarantee of supply, however limited in amount that this measure held out, could allay suspicions which were not essentially well founded. Again there was a greater chance of this method being successful where the distribution of supplies could be effectively controlled and hoarding checked, as in kerosene, than where the supplies were scattered as in food grains. The measure, however, could not meet a situation where the supply was not centrally held and was itself strictly limited, because in this measure there was no guarantee that all those who needed a commodity would necessarily obtain it. Also it did not prevent anybody, if he took the proper means, from obtaining an excessive individual supply. For a case of really short or just sufficient supplies of necessaries detailed rationing on an individual or family basis is inevitable. It has been the experience of all countries where the supply of necessaries has not been abundant that rationing has to be

undertaken, and that its sphere of operation has to be made steadily wider and wider. It was, perhaps, chiefly administrative problems that deterred the Government of India from thinking of rationing so far. There are, however, even now curious misconceptions current regarding the *raison d'être* of rationing. For example, at a recent meeting the Food Advisory Council is said to have advised government not to undertake rationing except in places where a sufficiency of minimum supplies was available. It is, no doubt, true that such a sufficiency of supplies would make easy the administration of a rationing system. It is, however, not clear what the Food Advisory Council would advise government to do where basic supplies were insufficient. Would it then, one wonders, rely on the natural method of food riots for bringing about an equitable distribution of the short supplies? It is not yet generally realized that with the pressure of war needs and with the diversion of a considerable part of productive resources, bare physical supplies of many types of commodities might become inadequate, and that when this happens direct rationing must be undertaken unless a grossly unequal distribution is thought to be both desirable and safe.

§ 9. *Standard Cloth:* Next to food grains the most urgent problem of supply today is that of the supply of clothing. The Government of India has been driven, however reluctantly, to accept rationing of food for the urban areas. It does not, however, seem yet to think of the problem of the distribution of cloth on similar lines. Prices of cloth have increased enormously during the last eighteen months in India. This increase appears to be the result solely of lack of effective government action. No important elements in the cost of production of cloth have gone up to anything like the extent of the rise in the price of the manufactured article. Raw cotton, whose price plays by far the most important role in the cost of production, has lagged greatly behind, and showed, till very recently, only slight increases. The total rise in the wage bill keeps substantially

below the average increase in the cost of living. The total cost of living has itself risen in a lesser proportion than the average price of cloth. Some of the smaller items in the cost of production have no doubt risen in a somewhat greater proportion, but the net result has undoubtedly been a liberal widening of the profit margin in favour of manufacturers of cloth. It is not entirely clear why government has not attempted to control the price of cloth, and why they have followed in respect of cloth manufacturers a policy somewhat different from that followed in the case of, say, sugar mills. Whatever that may be, the greatly increased price of cloth has created very great difficulties, and 'entrenches seriously upon the standard of living of the poor.

In order to meet the problem so created, government has adumbrated the policy of the production and controlled distribution of standard cloth. This policy aims at persuading manufacturers of cloth to undertake production of special varieties of standard cloth in given quantities, and of distributing this standard cloth at especially cheap rates to the specially needy. Though the scheme has been under consideration for a long time, enough details regarding it are not available to judge properly the extent to which it will really solve the problem. The latest public announcement regarding it contemplated a production of nearly 1,500 million yards of standard cloth being made available to the public during the course of the year. The announcement also contained the statement that the Indian Textile industry had agreed to manufacture cloth required by government not exceeding 60 per cent of its productive capacity. The 60 per cent was inclusive of the orders placed by the Supply Department for war requirements. This means that, in return, the industry expected to be left entirely free of control for at least 40 per cent of its production. It is also evidently not contemplated that the prices of either the controlled or non-controlled production of the industry would be fixed. As regards the price of standard

cloth, the expectation is no more than that the price will be about 40 per cent less than the current market rates.

The figure of 1,500 million yards is obviously a very optimistic estimate. A representation made by the Federation of Indian Chambers of Commerce and Industry to the Commerce Member in December, 1942, put the estimates of net available supplies for civilian consumption during recent years as shown in Table No. 15. The Federation puts the total supply available for all classes in India during the current year at 1,550 million yards. Even if the standard cloth scheme works fully as intended, the supply of that type alone could not reach anything like the announced figure. In the circumstances, a quantitative estimate of the effect of the scheme cannot be framed. It is clear, however, that, at best, it cannot cover the needs of any classes except the poorest. For example, the Poona Committee for

TABLE NO. 15. SUPPLIES OF CLOTH IN INDIA

[Source: Memorandum submitted by Federation of Indian Chamber of Commerce and Industry, New Delhi, to Commerce Member to the Government of India, New Delhi, 22nd December 1942]

	1938-39	1939-40	1940-41	1941-42	1942-43 Estimated
[Millions of Yards]					
Supplies					
Mill production in India	42,69.2	40,12.5	42,69.5	44,93.6	39,00.0
Imports	6,72.9	5,79.1	4,47.0	1,81.3	50.0
Total supplies	49,42.1	45,91.6	47,16.5	46,74.9	39,50.0
Demand					
Exports	3,07.7	3,59.0	5,54.6	9,85.6	12,00.0
Purchased by Supply Dept.	—	3,00.0	6,00.0	10,00.0	12,00.0
Total Demand (i.e. supplies not available for civilian consumption)	3,07.7	6,59.0	11,54.6	19,85.6	24,00.0
Net Supplies available for civilian consumption	46,34.4	39,32.6	35,61.9	26,89.3	15,50.0

the distribution of standard cloth does not think that with its quota of standard cloth it would be possible to meet the needs of urban classes with an income, per adult member, of more than Rs. 10 p. m.

This should make it clear that the whole approach of government towards this question of the production and distribution of cloth seems wrongly conceived. The serious increase in the price of cloth has affected all classes in the community, and the bulk of the people are poor. To try and meet the needs of a small section of those affected, and leave the rest to their fates, is neither wise nor equitable. Also, the idea of the basis of industrial regulation implied in the agreement regarding Standard Cloth needs to be firmly repudiated. An industry, in times of war, is not socially responsible only for a part of its production and not for the other. The whole of the production of the industry must, if the circumstances so require it, be put under control. If supplies are short, then production must be so planned that the essential needs of the whole community are satisfied before any non-essential or luxury production takes place; and also prices in the field of an essential commodity like cloth have to be strictly controlled. Ultimately, if the present conditions continue for any length of time, a definite rationing of cloth will have to be undertaken, and government policy beginning with controlled and directed production and prices of cloth must aim at this possible eventuality. Clothing is a need which is to some extent elastic. The demand for it can be postponed temporarily, and old clothes can be made to last a little longer. There are limits, however, to this process, and already the high prices during the last two years have led to drastic curtailment of the purchases of clothing by the poor people. A further forced postponement of purchases will mean serious diminution of the protection of the populace against inclemencies of weather. Already there has been a noticeable drop in the consumption of protective foods. Coupled with a serious lack of clothing this will

lead to a situation which will make the population over large regions very sensitive to epidemic attacks like that of influenza, as towards the end of the last war. This is a danger which no government can afford to treat lightly.

§ 10. *Inflation and Distribution of National Income:* It is necessary, for a proper framing of economic policy, to visualise how inflation affects the distribution of wealth and income among different classes in society. Perhaps the best expression of the general position is to be found in the following extract from the statement made by the Prime Minister of Canada in announcing the Canadian Government's decisions regarding the general control of prices and wages (October 18, 1941):

“Rising prices—a rising cost of living—do not have the same effect on all households. The smaller the family income and the larger the family, the more serious the hardship imposed. For those with small incomes, rising prices of clothing, food, and other necessities may mean serious hardship, while for those with larger incomes only luxuries and small comforts may have to be given up.

✓ “Rising prices thus serve to aggravate the inequalities in society, and to throw the heaviest burdens on those least able to bear them. ✓ Wartime experience has shown that prices rise faster than wages or salaries, and bear more heavily still on those who live on small pensions or life savings.

“Nor is the position of the farmer any happier than that of the wage-earner. The present war is a war of machines. Because of the heavy demands of war on industry, the scarcity of manufactured goods is likely to be greater than the scarcity of farm products. (The rise in prices will consequently be unequal, if prices are left to themselves. The things farmers have to buy tend to go up in price, more than the things they have to sell.

“The truth is that all but an insignificant minority of

the population would be worse off as a result of rising prices, if prices were permitted to rise unchecked, and, in general, the relatively poor would suffer more than the relatively well-to-do."¹

The lack of adequate data makes it impossible to generalize regarding the incidence of inflation in Indian conditions; data relating to a particular region might, however, help in visualizing some of the effects. A sample survey conducted by the Institute into income distribution in Poona City revealed that nearly 45 per cent of the total number of families had an income of less than Rs. 200 per annum, while nearly three-quarters of the families had an annual income of less than Rs. 400. The proportion of income tax-payers to the total was less than 5 per cent. These statistics which refer to the year 1937 give some idea as to the extent of the people in the lower ranges of income. An increase in the cost of living, which is in the neighbourhood of 100 per cent, means such a large cut in the real incomes of persons in these ranges of income that they have perforce to deny themselves some of the basic necessities of life. It might be argued that with rise in prices the income of some of these classes might rise proportionately or even more than proportionately. A detailed analysis will show this assumption to be incorrect. In Poona, for example, the bulk of the earners are employed in general casual labour, domestic service, and certain artisan industries. The wages in none of these, in spite of Poona being a large centre of wartime employment, have risen to anywhere near the proportion of the rise in the cost of living. A few skilled trades have, no doubt, profited by special wartime employment in and around Poona, but their numbers are comparatively small. On the other hand, artisans like weavers have definitely suffered a setback on account of war conditions and have lost a great part of even such employment as they had formerly. The classes to profit have been, no doubt, in a place like

¹ *Labour Gazette* (Canada), November, 1941, p. 1363.
W. E. F. 8

Poona, traders and wartime contractors and those holding certain key positions in the enterprise of the latter. (The rising tide of money income has concentrated in favour of a very small number and acted to the detriment of the vast majority.)

It is sometimes argued that while the bulk of the urban classes suffer during an inflation, as do those of the industrialized countries of the West, the rural population is not so affected by it. The effects of inflation on the rural population, therefore, require more careful consideration. It has been contended, on the ground that the rural population is that of producers, that it wholly profits from the inflationary rise of prices; and even a statistical estimate has been put forward that the present trends in prices consequently favour the interests of 80 per cent of the Indian population. If true, the fact would be extremely comforting; it is, however, so much at variance with the results of analysis and experience that it could be accepted only if confirmed on detailed examination.

It is, in the first instance, a gross exaggeration to say that the rural population consists wholly of producers. ✓ Agricultural conditions differ considerably from one region of India to another, but village menials, village artisans and classes depending mainly on agricultural labour, form a substantial proportion of the population in all rural areas. ✓ Neither the agricultural wage nor the regularity of agricultural employment have increased significantly in recent years, and the rural labouring class has been one of the hardest hit by inflation. The village menials and artisans experience a similar plight. Village industry as a whole is depressed, and the artisans and the village menials, who depend for part of their living on a share of the produce, find that the agriculturist, on account of general pressure on supplies, no longer gives them their customary dues. To these classes might be added that of the very small cultivator who is in the main a labourer. It is impossible to arrive at

any idea of the strength of these classes as a whole. Estimates might be made only for particular regions. The following estimate drawn from statistics collected during a recent survey by the Institute of farming conditions may be taken as illustrative. The survey was conducted in one of the more favourably situated tracts of the Bombay Deccan (Wai Taluka, Satara District) and covered twenty villages and one Taluka town. The rural population of the tract was approximately 30,000, and the total number of families in it was more than 7,000. For purposes of the survey, detailed lists were prepared of cultivators in the tract who were owners of at least one bullock. A person who did not own at least one bullock could not be considered, so far as this tract was concerned, as one who was, in the main, an agriculturist producer. The total number of farmers owning at least one bullock was found to be 3,216, which would indicate the proportion of agriculturist producer families in the tract as being distinctly less than half of the total number of families in the rural population.

No series of official statistics can be used in a similar manner to indicate the proportion of the rural population whose main occupation is farming. (The occupational statistics of the Census which claim to show the occupational distribution of the population are seen, on examination, to be one of the most unreliable in print.) The Government of Bombay, however, publishes a quinquennial statement of the distribution of agricultural holdings by acreage groups. The latest available figures (for the year 1935-36) show that for the Central Division of the province, out of the total number of holders of agricultural land, 40.2 per cent had a holding of less than five acres, and 32.8 per cent had holdings of more than five but less than fifteen acres in extent. It is a safe generalization that for this Division a holder of less than five acres cannot be, in the main, an agriculturist: as a fact, the unit for many districts in the Division could be easily extended upwards for the purpose. There is, however, one objection to drawing any definite conclusion from

these statistics. It is that, for our purpose, the relevant data are not of owned holdings but of cultivated holdings. Officially compiled statistics for cultivator holdings are, however, nowhere available for whole regions. As part of an intensive survey of subdivision and fragmentation the Institute is collecting data regarding the distribution of cultivated holdings in selected villages in the Wai tract. An advance compilation of these data indicates that in this tract the approximate distribution of the size of cultivated holdings is as follows: Less than 5 acres, 60 per cent; 5 to 10 acres, 25 per cent; 10 to 15 acres, 10 per cent; above 15 acres, 5 per cent.

(A large proportion of the rural population is not thus, in the main, of the agriculturist producer class.) It is next pertinent to enquire whether the entire class of agriculturist producers profits from inflation. For a proper understanding of the situation it is necessary to begin with a few observations on the manner in which producers as a class profit from an inflation. Producers as a class will profit from an inflationary movement on account of two possible results of that process. Firstly, items in the cost of production of a producer might not rise in the same proportion as the rise in the price of the finished commodities which he sells. Secondly, even if the rise in the price of items in the cost of production is not less than that of the finished goods, the fact that production takes time gives an advantage to the producer in so far as he is continuously selling at a date later than the date of his corresponding purchases. The latter advantage is enjoyed during the time that there is a continuous movement of prices upwards. The profits of the trader and the speculator are also derived mainly from this phenomenon. In considering the case of the small producer it is further necessary to take account of the fact that he is a consumer. The net advantage to such a producer, of the whole process, is dependent on the extent to which his extra gains as a producer are not eaten up by the extra rise in the prices of the commodities that he consumes. All

the richer producers and traders profit enormously because it is the residual surpluses that inflation augments.

We shall now proceed to consider the position of the Indian agriculturist in the light of the above. India is known to be a land of (un-economic holdings) and of (subsistence farmers) and it will be interesting to see how this class is affected by the present situation. Turning to the cost of production it is clear that it is only in a few directions that the small agriculturist stands to gain. So far as his cost of production consists of outlays on agricultural produce, such as seeds or plant or fodder and concentrates, the increase in cost is not likely to be less than the increase in the price of produce. In some respects, on the other hand, such as the investment in and maintenance of livestock and implements, the rise might well be proportionately greater. To the extent, however, that he employs hired labour, he will gain by the fact of wages lagging behind the general rise. Also the payment of land revenue, being fixed in money, will bear much less heavily on him, as also the rent if it is fixed in money. If the rent is in terms of a share of the produce he will not improve his position in this respect. The charge in respect of annual interest payment that he bears will also be lightened. The smaller the field of operations of the cultivator and the larger his family, the smaller is the extent of his outlay on hired labour; so that the small farmer will profit from the inflation chiefly in respect of the fixed money payments viz., land revenue, money rent, and interest charges. The fact of the prolonged period of production is not likely to profit the non-capitalist small farmer to any considerable extent, because his cash outlay each season is small and his chief dependence is on his land, family labour, and his cattle and implements. Each successive season, through the period of inflation, will thus result chiefly in reducing the burden on the agriculturist of his fixed money payments and affording a somewhat larger return on his total owned capital investment.

As against this must be set the hardship imposed by inflation on the farmer in his capacity as a consumer. Throughout the period of this inflation, as during the last war, the rise in the prices of agricultural produce is distinctly less than that of manufactured goods. The disparity in the movements of the prices of cotton and cloth has been specially large, but it is marked, though not equal in extent, elsewhere. Two special points deserve notice in this connection. The production in agriculture is seasonal, and the cultivator disposes of his produce within a short period of its being harvested. The smaller his resources the less is he able to hold the produce on hand. As is well known, in many tracts the cultivator ordinarily sells even a part of the food requirements of his family, being forced to buy it back later in the season at enhanced prices. This practice has perhaps been somewhat lessened during times of war; the smaller cultivators are, however, not yet able to hold on to their produce long after the harvest. It thus happens that while he sells at stated periods in the year, he comes as a consumer on the market throughout the year. During the inflationary process, therefore, he buys, on the average, at more inflated levels of prices than those at which he sells. Further, conditions of war increase the spread between various prices, making costs of transport, storing charges, trader's profits, etc., all higher. The increase of the spread hits the rural producer both ways. It gives him a price for his produce which is lower proportionately than the prices in the wholesale market, and also increases for him as a consumer greater than proportionately the prices of the manufactured and other goods that he consumes. On a balance of these considerations it will be clear that for a cultivator to profit from the inflationary process he must grow enough food for the annual requirements of his family, and must have a surplus of food or other production sufficient to meet fixed and other items of cost, and buy the other consumption needs at the present price level. In the measure that his scale of operations is larger than this, he

stands to gain, but to the extent that it is smaller, he suffers because of the rising price level.)

The proportion of such farmers in any region could not be determined without a very detailed survey, and little information is available on this score in India. Some of the results of the survey of farm business in Wai conducted by the Institute are interesting in this connection. They cannot, however, be used for framing a statistical estimate, because the sample selected in that survey was not representative from this point of view. The survey was directed towards the study of farming as such, and, therefore, included a large proportion of the more substantial farmers. The test proposed, in this connection, to determine the farmer with a large enough holding, might be that of a sufficiency of annual food production.¹ Jowar and bajri cover more than two-thirds of the tract surveyed and the annual food requirements of a rural family may be placed at between 15 and 20 maunds of Jowari-bajri per annum. A special classification of the group of farmers in the survey revealed that for the year 1937-38, out of the 557 farmers studied, 226 had produced less than 15 maunds of jowar and bajri together, 115 produced between 15 and 20 maunds, and 216 grew more than 20 maunds during the year. As pointed out above, this sample contains a disproportionately large number of big farmers. Another intensive enquiry undertaken last year in the same tract, which however is not yet complete, gives another set of results useful in the ultimate calculation. This enquiry consists of a survey of all households in a number of selected villages. The total number of households in these villages is approximately 2,000, of whom returns are available regard-

¹ Concrete recorded experience in the 1942-43 season showed how small cultivators suffer in this regard. Because of inadequate stocks of food the bulk of the cultivators were forced hurriedly to draw upon the bean crop, which is the earliest of *khari* crops to mature. Also the difficulties of obtaining grain supplies were even greater in the restricted rural markets than in towns, and the prices of even local grain almost equally high.

ing 1,034. The enquiry covers the whole rural population, and includes both agriculturists and non-agriculturists. It revealed that out of this enumeration of 1,034, 875 had a production of less than 15 maunds of jowar-bajri, 70 had between 15 and 20 maunds, and only 89 had more than 20 maunds during the last year. All these data lead us to conclude that in the Wai tract the proportion of rural households who could be held to profit from the inflation could not be placed at the outside at more than 20 per cent. The proportion would naturally vary from region to region. Thus in the drier tracts of the Bombay Deccan it would be distinctly less than 20 per cent. The poorer the natural resources of a region and the greater the pressure of population in it, the more severely would it suffer; the richer its resources and the greater its average income, the better off it would be. Thus whether between classes or between regions, inflation favours the better-off; the rich it makes richer, and the poor, poorer.

When considering this question certain important non-economic considerations must not also be lost sight of; for, they make it clear that even the larger peasantry is not likely to retain the gains it makes. (The gains are windfall gains, and neither in the organisational nor in the psychological set-up at present is the larger peasant so conditioned as to be able to improve his position permanently. It has been the experience of former times that at the end of such a price boom the larger peasant is equally likely to be found saddled with a greater burden of debt than ever, as to be found debt-free. No efforts are being made either through marketing or credit organizations to specially enable, induce, or force the large peasant to reap the full advantages of the situation. In default of such efforts it is futile to talk of even this small class of the rural population profiting from the inflation.)

The industrialist, the trader, the speculator, on the other hand, are all making the greatest gains out of the present opportunities. The more substantial their scale of opera-

tions, the greater their gains, and the more likely are they to retain them permanently. Among these again the industrialist is perhaps in a less favoured position because his activities are more liable to be controlled, and more likely to be effectively controlled. The operations of the trader and speculator, especially the latter, being less tangible, are less effectively controlled or taxed, and give much greater scope for evasion.

Finally, a word might be said regarding the concept of a "national minimum" which has attained such a vogue recently in other countries. Even in *laissez faire* England and U. S. A. the idea of a compulsory regulation of the consumption of all classes, so that the poor might get at least a minimum of necessities, is widely welcomed and acted upon. Under existing conditions, in India such concepts are far outside the field of practical politics, even though in this country the range of dispersion of income levels is far wider and the concentration of wealth and income in the hands of a small class even more pronounced than in other countries. This makes it all the more necessary that the burden of taxation and of the regulation of consumption should fall specially on the rich.

§ 11. *Production and Supply of Food:* The imposition of price control involves also the regulation and direction of productive activity. In normal times variations in prices result in stimulating or curtailing productive activity in various directions. The price mechanism cannot effectively act in this manner when prices have to be controlled. Also, it takes a long time for variations in output to be brought about through variations in prices. The needs of war cannot, however, be made to wait upon the deliberate working of the economic system. Hence government tends directly to acquire control over all productive resources, including labour, and to turn them into channels required for war purposes. It is also undesirable, for government in wartime, to use the price mechanism as an important instrument for bringing about changes in productive effort. The quick

and large scale changes that governments desire at these times could be brought about through price incentives only if the rise in prices, including that of labour, offered by government, in order to divert supplies from their present employment, is very high indeed. But such a sudden raising of prices of government purchase would have serious consequences for the finance of war, and would perhaps lead to an incipient inflationary movement. The proper policy for government to follow is, therefore, not to disturb the price and wage levels, as far as possible, and to directly undertake the guidance, the regulation, and control of productive effort. The intensification of production of all kinds for war purposes is part of this problem. In this regard, as has been pointed out above, the main criticism to be directed against the policy of the Government of India is that it has not paid enough attention to the danger of unduly raising prices and wages in a competitive manner.

Apart from organization of production for war needs there is one important aspect of the direction of production which intimately concerns the large body of the civil population. This is the problem of the adequate production of food and its proper distribution among the various regions in India. The problem of food supply in India is the creation mainly of transport difficulties. The total internal food supply is not significantly deficient in normal times. The amounts withdrawn on account of army needs or for export purposes are not fully known; but it has been stated that the quantities retained are not inadequate. Further, as the problem of increasing the total area or supply is very difficult to tackle in a short period, the problem must be dealt with as of the relation between food and non-food crops. It must be dealt with, in the main, as that of rendering particular regions more self-sufficient than they are at present. It is a problem that is best considered regionally and for each region quantitatively. It is necessary to emphasize this latter aspect. The total area under crops in India is not liable to any sudden or large expansion. The

problem of food supply has, therefore, to be studied in the general context of the total agricultural production. For purposes of war, as for meeting needs of the civilian population, India must continue to produce other agricultural products as well as food grains. Therefore, once it is conceded that absolute production is comparatively inelastic, the problem is one of an appropriate adjustment of acreage between different crops in view of the requirements of the country as a whole and of each particular region, i.e., of the regional balance of food and non-food crops. For those regions in which the internal production of food grains does not fully meet internal food requirements, the problem is specially acute. For surplus food regions, such as the Punjab, it is one mainly of making available the maximum surplus in order to meet requirements of other areas. The Government of India has slowly come to realise that the problem of the disposal of regional surpluses must be dealt with centrally on a national scale, and cannot be left to work itself out through the means of the ordinary trade agency. The demands for the available supplies from surplus regions arise from two sources, (i) the demand from military and quasi-military departments, and (ii) the demand for meeting the deficits of the deficit regions. A policy which directs army purchases chiefly to surplus regions and makes for a co-ordinated centralized distribution of available surpluses to meet the deficits *pro rata* would, in the main, meet the situation. These policies seem at least to have been accepted in principle by the Government of India. It is not known to what extent they are being practically implemented.

It is chiefly in regard to the course of action in the deficit regions that policy of government seems hesitant and ill-directed. The problem in the deficit regions is one chiefly of diversion of acreage and, in specific cases, of change of consumption habits. To consider the latter point first, it might happen that a particular type of food supply such as rice or wheat is seriously deficient in a region in

relation to its normal requirements, and that it cannot easily be obtained from either contiguous or distant regions. In this case substitution in consumption is the only remedy. In an area like the Konkan, for example, rice requirements had been in the past largely met with by imports from Burma. If these are no longer available, the total food supply must be made up by, say, millet imports from neighbouring regions. This has been known to happen formerly under stress of famine conditions. Again, the growth in the consumption of wheat in Peninsular India, as a whole, is a recent phenomenon, the result chiefly of the comparative cheapening of wheat during the last two decades. If wheat supply becomes scarce, a change in price parities might easily suffice to revive older habits of millet consumption.

The really important problem, in this regard, is that of making each region as self-sufficient as possible. In some cases self-sufficiency may be impossible to attain. In the Southern Konkan most of the area under crops is already under food crops. There is almost no scope for increasing the total area and little for diversion. The problem in such a region must always be met through the allocation of the nearest available surpluses. In most deficient regions, however, there are usually some possibilities of diversion of area from non-food to food crops. These possibilities are the greatest in regions where a considerable area is under cotton. In considering possibilities of this diversion, careful attention needs, however, to be paid to the total non-food as well as food requirements of the country. There are not many important crops grown extensively in India, a serious diminution of whose present supplies can be considered desirable. During the early years of the war, for example, groundnut supplies were thought to be redundant, and government had under serious consideration a scheme for the restriction of the area under groundnut. Soon, however, the general pressure on supplies of vegetable-oil products manifested itself in a sharp rise of groundnut prices, and today a marked contraction of the area under groundnut is no longer thought

desirable. Similarly, the Government of Bengal is said to have met with considerable success in one year in its efforts to transfer large areas under jute to rice. The transference was confined, however, to the particular year, and a rise in jute prices led to the resumption of the old relation between the acreages. In the case of cotton, however, a diversion of acreage from non-food to food crops is considered desirable in the interests of both the country and the cultivator. Cotton supplies are definitely redundant since exports, especially to Japan, have stopped, and cotton prices, till recently, lagged behind in the upward movement of the prices of agricultural raw produce in general. A decrease in area under cotton and consequent diminution of the total supply of cotton would improve the technical market position of raw cotton and yield remunerative prices to the cultivator. Immediately the problem concerns the grower of short staple cotton, but it cannot be met with only by a general transfer, wherever possible, from short and medium to medium and high staples. For the duration of the war, the take-off of Indian cotton is limited, in the main, by the consuming capacity of Indian manufacturers, and a considerably increased supply of medium or high staple cotton would merely make their position analogous to the position of short staple cotton today.

The need for improving the market price position of cotton thus indicates the desirability of a restriction of acreage under that crop. The need for attaining greater self-sufficiency in the matter of food similarly indicates restriction of acreage under the crop in certain regions. The decrease in the area under cotton required is not a vague general decrease in all directions, but is a quantitatively measurable decrease to be brought about in specific directions as indicated by the requirements of cotton manufacturers. In the same way the need to attain self-sufficiency indicates the desirability of diverting given areas from under cotton to, say, jowar. It is not that all cotton area should be put under jowar, but that, in any given region, a specified

proportion should be so diverted. Any redundant production of jowar, once the point of regional sufficiency has been reached, would be disastrous to the cultivator. The additional area under food crops required in order to enable a region to attain self-sufficiency, is measurable within fairly close limits. It is this extent of the area that requires to be diverted from under cotton; not much less would do, and much more would seriously upset the economic balance. It would be thus clear that the approach to the cotton problem from both directions gives us a specific quantitative measure. There is, however, this difference in the manner of the two approaches. The first gives an answer in the all-India context and in terms of staples, and the second gives a regional answer in terms of food and non-food acreages. The added up result of the two may not necessarily tally. That, however, does not matter; for, in case the regional food requirements lead to a diversion larger than that indicated by cotton market requirements, the answer given by the second approach will have to prove effective in view of the paramount requirements of food. It is, however, more likely that the total acreage diverted because of food requirements may fall short of the requirements of the market position. In that case some further measure of diversion from cotton to other crops will have to be carried out, and the movement in this case would not be confined only to areas which are not self-sufficient in the matter of food, but would extend to all cotton-growing areas.

A somewhat detailed discussion of the cotton problem has been thought necessary in order to make clear what appears to be the main principle of a sound policy in this regard. The main instrument for bringing about diversion on which government have relied so far has been almost entirely propaganda. Propaganda, however, is a hit or miss method. Its results may either fall too short of requirements or may transcend them too much. It will be only an accident that yields quantitatively the exact desired result.

Further, these results are likely to be highly temporary, because the incidence of sacrifice brought about in this manner is necessarily ill-distributed. The decrease in acreage under cotton, brought about by those who have been impressed by the propaganda, might result in an improvement of the prices of cotton grown by those who have refused to listen to it. Thus, neither from the point of view of measurable results nor of equal distribution of sacrifice is propaganda to be relied upon. Moreover, its results are not likely to last from year to year unless cotton prices remain depressed all the time. If they mount up in any particular year, an expansion of the area under cotton at the expense of food grains is bound to take place in the subsequent year.

The proper approach to this question is, therefore, only on the lines adopted by the Agricultural Adjustment Administration in U. S. A. Here the action taken was by way of prescribing the percentage of his total crop acreage that each cultivator was expected to divert from under cotton, and of paying a subsidy in respect of the acreage so diverted. The fund for the subsidy was raised by a processing tax on cotton. The principle underlying is clear. The diversion of a given proportion of acreage from under cotton results in a much better price for the produce of the area which was left under it. A part of this betterment is justly given as a compensation for the voluntary diversion effected by the cultivator. Such a scheme can be worked so as to yield the required quantitative results, and is doubly safeguarded by an incentive and a deterrent. Among the Governments in India the C. P. Government is the only one which has this year gone beyond propaganda and offered a monetary incentive for those changing over from cotton to food grains. This incentive is not related to certain fixed variations of the area under cotton and other crops, as in the A. A. A., and is not accompanied by a tax on cotton prices. The adoption by the C. P. Government of the monetary incentive, however, shows that a scheme based on the A. A. A. ideas is not impracticable. It is only in this manner that concrete

crop planning can be undertaken; and this is a crying need of the hour in all regions where food supply is deficient.

The successful operation of such a scheme in any region obviously depends on the co-operation of other regions. If some regions do not feel the need for a contraction of the area under cotton to increase their food supply, they must not, at least, jeopardize the success of the experiments in the other regions by allowing freely an increase in their cotton acreage. Whereas, on the food side the scheme could be worked out separately for each region, from the point of view of cotton prices it must be co-ordinated and regulated for India as a whole.

If it becomes possible to render, in this manner, each region largely self-sufficient in the matter of food supply, the rationing of food grains may not continue to be equally urgent. However, the need for rationing does not depend only on the production of given total quantities. Even if the supply is sufficient as a whole, rationing may still be necessary because it is not made available to the urban consumer. The surplus regions might not release a sufficiency of surplus stocks. The cultivator might bring for sale into the market less than the normal proportion of his production. The cultivator, the trader, and the consumer may each hold or hoard in excess of the normal for fear of rising prices or difficulties of supply. All these factors, however, have relation to political, administrative, and price problems, and are dealt with elsewhere.

§ 12. *Artisan Industry:* Among problems of direction of production an important one is that of the production of artisan industries. It has been pointed out above that on the eve of the war the equipment and labour in artisan industry were, on the whole, under-employed, and that the difficulties of obtaining supplies of primary materials has since increased this under-employment. The full utilisation of these productive resources is a problem to which government policy should pay special attention. Thus, the handloom until recently supplied a considerable portion of re-

quirements of garments for women, especially in the South. A minimum guaranteed supply of yarn is necessary to keep up the production of these looms. This supply of yarn might well be obtained from special extended shift working on the spinning side of the machine industry. It is well-known that night shift working on the spinning side presents less difficulties on account of lack of skilled labour, etc., than on the weaving side. Already the extent of additional shift working in the textile industry is very considerable, but efforts need to be made to increase this on the spinning side to the largest possible extent, and to make available yarn supplies to the handloom weaver so as not only to help the artisan industry, but also to help to relieve the acute cloth shortage. This is a matter in which control and direction of production and supplies on an all-India basis need obviously to be planned. A consideration of the problems of artisan industry, on these lines, is no doubt hampered by the scattered character of that industry. In wartime, concentrated efforts are preferred, on a variety of grounds. If, however, important centres of artisan industry are organized to act co-operatively, this might help to solve not only the administrative problems of the present, but also help the reconstruction of the future.

§ 13. *Transport*: The problem of regulation of transport is intimately connected with that of the direction of the productive effort. As has been emphasized above, the shortage of food supply is more the result of the difficulty of moving supplies freely over large distances than that of actual shortage of production. The demands made by war over movements by rail seriously curtail railway facilities for transport of goods for civilian purposes. The limited supply of petrol has put considerable restrictions on movements of goods by mechanical road transport, and the shortage of tyres threatens to intensify these even further. It becomes necessary, therefore, to adapt production and distribution systems to the changed transport situation.

The food problem discussed above is only one part of
W. E. F. 9

this general problem of adaptation. The problem can be conceived as one of a throw-back to an earlier economy. Cheaper and more efficient transport leads to an extension of the area over which production and distribution agencies can operate effectively, and the transport revolution ordinarily precedes that in commercial and industrial organization. Cheap transport leads to bulk exchanges over large areas. A restriction of transport facilities must reduce *per contra* the volume and distances of the movement, leading, in short, to greater self-sufficiency in comparatively small regions.

In the Indian situation two factors governing the possibility of going back to older arrangements are obviously important. The first is that the present pattern of production and distribution is not suitable to these arrangements. Production is already concentrated to a much larger extent than before. This has happened not only in the case of machine industry, but also in that of artisan industry and even in respect of the growing of agricultural produce. Specialization of commercial production and concentration of artisan centres involve considerable movements of produce in both directions. It is not possible at short notice to reverse the process and re-attain the older structure. Certain basic transport needs must, therefore, be taken for granted. It would be uneconomic to let any part of national machine equipment lie idle, and, therefore, the transport requirements in both directions of machine production must be fully met. In the case of artisan industry also, where a considerable movement has already taken place in the decay of rural centres and towards concentration in urban areas, the revival of the former presents great difficulties; at least, it cannot come about in the short period. Where, for example, the handloom weaver or the wooden oil-mill have ceased to work, they cannot easily be re-established. It should not, however, be very difficult to encourage them where they exist, but are underemployed. To the extent that these artisans are dependent on centrally distributed supplies, the

difficulties of short supply may hinder the attainment of full employment over large areas. This problem is especially acute in the case of the distribution of yarn to handloom weavers. But where, as in the case of the oil mill, both the raw material and the consumption are local, encouragement of the local industry would be hampered only by the competitive prices offered for the raw material by the machine producer. In this case, therefore, proper price control should prove sufficient. In regard to agricultural production, the resumption of a more diversified economy, making each region more self-sufficient, is much more possible than in the case of either machine or artisan industry. The whole of this movement will follow lines similar to those indicated above, in the consideration of the problem of the diversion of cotton acreage to food crops. As in that case, the diversion, if it is to take place economically, must be planned and directed in quantitative terms.

Action on the production structure which re-distributes production activity in such a manner that all regions are more self-sufficient than before, would obviate to a considerable extent the need for movements of goods over larger distances. This result could also be achieved by preventing competitive supplies by producers to areas at a great distance from their centres of production. The policy of saving transport costs as evolved by cartels of producers is obviously suited to present conditions. It is said that in the working of the control by the Government of India over such products as cement, sugar, and paper, these considerations are given due weight. The scope of the policy might, however, be easily extended by applying it to the requirements of transport for raw material supplies and distribution of finished goods of all other industries.

While the progress made towards concentration and specialisation in productive and distributive organisations makes the resumption of the basis of the older economy difficult, one factor in Indian economic life renders a transition backwards somewhat easier. This is the existence of large

numbers of bullock carts which have been comparatively underemployed, especially during the last two decades. Particularly in those regions where a considerable amount of crop acreage is not to be found under well irrigation, the bullocks of the cultivator have considerable leisure through a large part of the year, and cart transport can be made available to a very large degree. A progressive diminution in the demand for this transport has followed the introduction of mechanical road transport. Therefore, there is considerable possibility of increasing transport facilities in a region by drawing upon this not-fully-used agency. Bullock cart transport is, however, efficient and really economical for comparatively small distances. For longer stages it would be distinctly more costly than mechanical road transport; but in the event of a considerable stoppage of such transport, it is a second string which it would be possible to bring into use.

The main basis of a proper transport policy in the circumstances is the strict regulation of rail and road transport with a system of graded priorities of aims. Production and distribution connected directly with the prosecution of war, the supply of materials to all centres of machine production, and the distribution of finished goods from them to consuming centres, the supply of raw material to artisan industry centres, and the supply of essential materials required for re-planned agricultural production, must all be provided for. In all these matters the formation of regional zones of supply and the allocation of markets in order to minimize transport requirements would, of course, be previously planned. In this transport the long point-to-point haul would be undertaken by rail or motor transport, all shorter hauls being left, as far as possible, to accessory bullock cart transport. Such a system could be so worked out as to rely to a much greater extent than is done today on short haul movements. While the supply of rail and motor transport would be governed by a system of priorities and be rationed, the local bullock cart transport may be taken, at least ini-

tially, to be ample and elastic enough to be left uncontrolled except by way of control of rates. Such greater use of bullock cart transport would no doubt involve some increase in the fodder requirements of each region. This would have to be necessarily taken into account in planning for the agricultural self-sufficiency of that region.

§ 14. *Administrative and Political Factors:* (The varied types of controls of economic activity that we have illustratively discussed make it clear how comprehensive and many-sided the policy of economic control needs to be. Unless the control of prices, of the distribution of necessities, of wages and profits, of transport and supplies, of acreage under crops, of the working of artisan industry and of machine industry, are all co-ordinated and made to subserve one single centrally devised plan, the success of war economic policy is highly doubtful.)

The initiation and operation of such a policy of economic controls has very important administrative and political aspects which cannot entirely be ignored in the present discussion. Economic regulation by the Government of India, it must be realized, is a policy that goes against the grain of the bulk of the traditions of that administration and its administrative personnel. *Laissez faire* has always been the dominant note of state policy in India. Even the last great depression, which led to such revolutionary changes in economic policy all over the world, was unable to galvanize the Government of India into action. (There was thus at hand no experience of economic control available to the Indian Government nor any machinery which was equipped to deal with it.)

Another grave handicap which previous policies have entailed on government has been the lack of relevant statistical information. Frequent recommendations, made in earlier years, towards the improvement of various types of economic statistics and towards the passing of a statistical act, have, for the most part, been ignored. As a result,

barring the factory industry and its production, information regarding other economic production and regarding the volume and character of internal trade is very imperfect. In the Zamindari provinces even the basic agricultural statistics are lacking. It is obvious that a policy of detailed control has to face grave difficulties in planning and operation because of lack of adequate relevant data.]

The most important constitutional factor, in this connection, is the division of powers between the Centre and the Provinces. The full federal scheme contemplated by the 1935 Act has, no doubt, not yet come into effect. Quasi-autonomous provincial governments have, however, been set up, and these possess a very large number of detailed powers. The Indian central government, while assuming to itself very wide powers under the Defence of India Act, is operating its provisions, for the most part, by delegating all authority to provincial governments. The result has been that whereas it was of the utmost importance that economic policy should be initially hammered out in pursuance of a single co-ordinated plan whose detailed administration alone could be left to the Provinces, in actual working, the framing of policy itself has been left to provincial governments with only general suggestions or directions from the central government. It would, perhaps, be truer to say that the responsibility for the framing of a plan or policies lies with no defined authority. Conferences of provincial administrators or Central advisory committees make recommendations which are addressed to both central and provincial governments. But it is difficult to see how a plan or a co-ordinated policy can result from such recommendations, which might or might not be accepted by any particular administration, however large the number of the conferences and committees, and however frequent their meetings. ✓ Conflicting action by different governmental agencies is a natural consequence of this state of affairs. The central government might, for example, attempt to pool and distribute resources on an all-India basis; but its efforts

in this direction will be nugatory if one province, as has happened, can independently ban the export of food grains outside its borders and another that of yarn. Also, as long as there are no definite directions and compelling powers, most well-meant attempts at co-ordination become abortive. One Price Control Conference thought of regional divisions of the country for purposes of general guidance regarding price policy. But where each district goes its own way, the concept of a regional unit must prove still-born. Even the appointment of special co-ordinating officers results, in this chaos of functions and powers, in no more than the addition of a fifth wheel to the coach.

This is in sharp contrast with the trend in other federations in times of war. In Canada, Australia, or the U. S. A., wide powers have not only been assumed by the federal governments, but have in detail been exercised by them. For example, the policy of blanket price control adopted in Canada and U. S. A. was not only conceived by federal departments, but is worked out in detail by them. The very different course taken in India does not seem to have been justified by any circumstance. As a matter of fact, the difficulties in the way of the assumption of central control were much less marked in India than in the other federations. In these other federations there has been a long tradition of a very considerable measure of state autonomy, which was jealously guarded. The scope and sphere of federal administrative departments was in consequence also restricted. In India, on the contrary, we had the practice of a highly centralized administration for almost a century, and it is only in recent decades that any considerable measure of decentralization or devolution has taken place. As a matter of fact, the Indian constitution is, even today, not that of a complete federation. A policy of centralized planning and central responsibility for taking decisions should, in the circumstance, be much easier to follow in this country.)

The position might not have been so difficult if the provincial governments had continued to be popular gov-

ernments as contemplated by the scheme of provincial autonomy. The non-formation of such governments in the majority of Provinces has robbed the maintenance of the provincial-federal division of powers of all significance, even if the circumstances of war had justified such a course of action. The result of this turn of events has been somewhat curious. (The central government which has, perhaps, a larger representative element than the majority of provincial governments now, takes on, for the most part, a passive role and leaves very important decisions to be taken by the provincial administrations.) The majority of these administrations are constituted of old official administrators with a very strong *laissez faire* prejudice and very little knowledge of the working of economic controls. The popular provincial governments might, at least, have been supposed to have been quick in response to the distress and difficulties of the large mass of their voters. By the very nature of their constitution the present administrations can neither have the same knowledge nor the same responsiveness in respect of the conditions of the field. The present measure of decentralization in economic policy, therefore, while creating great difficulties in the way of proper regulation, seems yet to serve no real purpose.

For the proper framing and administration of economic policy, it is not only necessary that the central government should directly formulate all the main measures of economic policy, but also that it should do so for the whole of the field. It is obvious that if any considerable area is left out of the scope of the administration of this policy, the results would be disastrous. Take, for example, the policy of controlling investment outlets. If this policy is followed only in the Provinces and not administered with equal rigour in the Indian States, a diversion of funds will undoubtedly take place. As surplus funds seek investment in the States, not only will an unfairness in treatment be caused, but also the whole economic policy, of which the closing of investment channels is a part, will break down. The whole manner of

prescribing economic policy for India at present adopted must, therefore, be radically changed. (The compelling necessity of the situation is exemplified by the action of State governments in Canada and Australia agreeing to vacate the field of income and corporations taxes, which they had so long occupied, and leaving it entirely to the Federal Governments for the duration of the war. Unless the governments, not only of the Indian provinces but also of the States, are induced to act in a similar spirit, war effort as well as the interests of the community will be seriously jeopardised.)

The present division of responsibility leads to a weakening of the central government itself. Central policy also seems to be departmentalized, so that a Food Conference fights shy of considering the question of the price of food grains, and a Price Control Conference contents itself with vaguely worded resolutions regarding the need for co-operation from transport authority. It seems within the power of nobody and nobody's responsibility to unify the consideration of all aspects. This departmentalization leads to even such measure of central planning or guidance as is available, being sectional in character. It is the experience of all countries that during such times of emergency all aspects of economic policy must have a common origin; and everywhere, in whatever form, some small nuclear body is responsible for conceiving economic policy as a whole.

Another outstanding feature of Indian administrative machinery is its complete reliance for all purposes on the non-expert bureaucrat. Whereas in other countries industrialists, businessmen, and other types of experts have been freely drawn upon to help in shaping and working policies, in India the key positions are not open even to experts in government service. In general, therefore, the holders of key positions are not well acquainted with the objectives and methods of economic control, and considerable hesitation and confusion have thereby resulted.

Perhaps the worst feature of the administrative situation has, however, been the carrying to absurd length of decentralization in certain provinces where the chief District Officer has been invested with almost all powers. The situation is so absurd as to be unthinkable anywhere outside of India. Not only is economic policy not centrally planned, but it is not planned even for the province or any large region of it as a whole. The head of each district possesses wide discretionary powers so that while one district may follow a policy of rigid price control, the contiguous district might abandon all price control. The methods of control as well as the content of control policy might differ radically from district to district. It follows that in a matter like prices each district officer might fix a varying set of them for his own jurisdiction. It thus happens, to take a concrete instance, that of three contiguous districts, the control price of jowar in one might be seers 9 per rupee, in another seers 6 per rupee, and in the third there might be no control, but other action might be so inappropriate that jowar might not be obtainable in the market at even seers $4\frac{1}{2}$ per rupee. It is difficult to contemplate any arrangement more surely calculated to promote active smuggling, corruption, and black markets, and black discontent among the people who are its victims.

The dire results in respect of, say, food policy of these measures of so-called decentralization are easy to observe. A Food Conference attended by the representatives of all provincial governments unanimously supports a policy of the equality of sacrifice on all consumers in the country. The enunciation of such sentimental platitudes is, in the main, the central sphere. When it comes to a calculation of actual surpluses available for distribution, no province readily confesses to having a surplus, and it becomes possible for any District Officer to upset the calculations of, say, the Wheat Commissioner of the Government of India. To the hoarding of traders and consumers, is thus added the efforts, in the same direction, of provincial administrations.

Not only is there no real pooling of resources in the country as a whole, but present arrangements make it impossible for their proper utilizations even in a whole region or province. Individual District Officers decide whether they will permit movements of grain from their districts, the extent which they will permit, and the representatives of provincial governments, who have subscribed enthusiastically to the principle of equality of sacrifice of all consumers, coolly look on while food grains are sold in one district at prices double those being paid in the contiguous area within their jurisdiction. One of the major difficulties in meeting the food problem has been the possibility, left under present arrangements, for the triumph of the narrow views of district administrators leading to complete chaos in the price and the distribution structure.

The urgent need of the hour is, therefore, the formation at the centre from among members of the Viceroy's Executive Council of a directive economic committee. A supreme committee of this kind must ultimately be responsible for evolving the single co-ordinated financial and economic plan. All organs of government must subserve the purposes of this plan. Whatever the devices adopted for consultations with provincial and state governments, these governments must shape their activities in pursuance of and according to the direction of centrally evolved policy. Only a strictly limited discretionary field can safely be left to the provinces, while the units lower down in the scale such as districts cannot be left with any independent powers. It is equally necessary that this policy should be based, in the main, on positive measures. So far, central and provincial governments have relied on mere propaganda as an important weapon for implementing policy. In most belligerent countries the use to which propaganda is put is to ensure the proper response to and the appropriate functioning of the measures of control. It never takes the place of these measures themselves. And this happens in countries where the government propagandist can hope to whip up,

for his purpose, the patriotic sentiment much more successfully than in this country. Production, prices, and distribution are all directly guided and regulated, and even in such a sphere as that of subscription to government loans which was, for long, left to be covered entirely by propaganda and voluntary effort, considerable element of compulsion has now entered. In India, on the contrary, we have only campaigns. "Grow More Food," "Consume Less," "Avoid Unnecessary Travel,"—these and a host of others assail our eyes and ears constantly. And we have serious suggestions regarding additional ones, such as "Use Less Cloth," in order to remedy the shortage of cloth. As aids to positive measures such campaigns might have their use, but by themselves they can lead to no substantial results.

Even this necessarily brief discussion of the financial and economic policy of government will have made clear how uncoordinated and ineffective that policy has been so far. This is due, in the main, to the underestimation, by those in charge, of the gravity of the problem. This underestimation, as we have shown, was based chiefly on a misapprehension regarding the responsibility for and the part played by the finance of British purchases in India. It is likely that the policy first adopted under misapprehension is now continued because of a feeling of helplessness. At least, it is possible to interpret some of the utterances of government spokesmen in the legislatures at the time of the recent budget sessions in this manner. The position is, however, too serious to be met with a formal plea of *non possumus*. An inflation once under way has never been known to arrest itself automatically. Without drastic steps being taken to check it, it has a natural tendency to expand quickly. The large extent of liquid funds already on the market threaten a rapid development of the situation, and the recent trends in prices and the speculation in commodities and shares emphasize the need of immediate action. The situation has already grown so serious that a continued disregard of it would be the height of irresponsibility. As

experience everywhere has repeatedly shown, the acquiescence in the inflationary process leads to what may be regarded as almost a social revolution. Logically it imposes the heaviest of sacrifices on the wage earners and might lead to a virtual extinction of the middle classes. The microscopic minority that profits at the expense of all is composed chiefly of traders and speculators.

Opposition to further elaboration of the control machinery might be expressed on the ground of the lack of efficiency and honesty experienced in working the controls. It is, however, not possible to pay heed to such opposition; because, here again, the choice is not between the present control and de-control. The removal of controls is, in the circumstances, unthinkable. The choice is rather between a set of half-baked and uncoordinated controls and a strongly centralized and well planned single policy of control. The risks in respect of both corruption and inefficiency are patent to all those who know anything of the working of the present system; but these risks have to be taken with open eyes. Not only in respect of the immediate present, but looking also to the future, economic regulation and the planning of economic life by the State must be taken as having come to stay; and the existence of an efficient and honest public administrative machinery is vital to the operation of these regulations and plans. It cannot, however, be built up in a day, and, however discouraging the initial experience might be, we must need to persist in the effort, trusting to experience, education, and public vigilance to improve the working of the system. It goes without saying that in all programmes with such comprehensive aims the fullest co-operation of the public is of the utmost importance. Here, again, it is not a question of the political creed to which you might subscribe. Given the grim fact of a war economy, an intelligent, vigilant, and co-operant public is necessary in order to maintain the barest of distributive justice in society. Co-operation in the working of economic controls thus becomes a primary social duty. In its absence governments

must need adopt the policy of inflationary finance, and this policy profits none but the speculator and trader. Those who deliberately put obstacles in the way of the evolution and functioning of a rational policy of central economic controls are serving, in effect, the interests of these classes at the expense of those of the masses. Perhaps, this fact also is not without its political significance.