

**Gokhale Institute of Politics and Economics**  
**R. R. Kale Memorial Lecture 1957**

**Financing the Second Five-Year Plan**

By

**Dr. B. K. Madan,**

*Principal Adviser, Reserve Bank of India.*

**Price Re. 1**

**1957**

NOT TO BE  
LOANED OUT

PRINTED IN INDIA

---

Printed by Shri K. G. Shersinghani at the Aryabhushan Press, 915/1,  
Shivaji Nagar, Poona 4 and published by Shri D. R. Gadgil, at  
the Gokhale Institute of Politics and Economics, Poona 4.

## Financing The Second Five-Year Plan

I greatly appreciate the honour done to me in asking me to deliver the Memorial Lecture on the occasion of the Foundation Day of the Gokhale Institute of Politics and Economics. The subject which I have selected for this evening is rather pretentiously entitled 'Financing the Second Five-Year Plan'. It is not my object to-day, however, to make any detailed or specific suggestions for new or additional ways of financing the Plan. My purpose is more general and more modest. It is rather to deal with some broad and basic aspects of the problem of financing of economic development of the magnitude upon which we in India have embarked, in the general context of our economic conditions and situation as well as to advert very briefly to the kind of climate in which economic development here can best thrive.

2. Those of us who observed the chequered course and tribulations of the early part of the first five-year Plan, will recall that it appeared by its mid-year 1953-54 to be getting off to a rather slow start. The amount of investment (in the public sector) was Rs. 259 crores in the first year of the Plan, 1951-52, and Rs. 273 crores in the second year and seemed hardly to be picking up in the third year which finished with an investment of Rs. 340 crores. From then on, however, the Plan got into stride, the expenditure being stepped up by 50 per cent in the course of one year to over Rs. 500 crores in 1954-55 (revised) and was marked up again by a further 40 per cent in one year to over Rs. 700 crores (budget) in 1955-56. This brings out the rapidly accelerating tempo of the development programme in the last two years of the first Plan which ended up with a rate of development in the public sector in the final year which was more than twice as high as it had been only two years before. In the private sector, the targets of production and investment were achieved or surpassed in many important industries, though output fell

below what had been programmed for several small industries. In the private sector, too, the outlook appeared to be rather suddenly transformed from around the mid-year of the Plan. The first Plan came to successful completion, with the price-level lower than it had been at its start, with only a moderate increase in money-supply and with a smaller draft on the sterling balances than had been envisaged. The comparative stability of prices during the first Plan period appears in an unduly favourable light owing to the inflationary price situation that prevailed in the pre-Plan year when the Korean war boom was at its height. That apart, what enabled the decisive acceleration of the investment programmes in the public and private sectors alike from 1954-55 without any substantial disturbance of price stability until towards the end of the first Plan period? The answer is to be found in the record output of foodgrains in 1953-54 and the record production in agriculture in 1954-55 when the output of foodgrains declined somewhat, but of agricultural raw materials touched new peak levels. These are fully reflected in the figures of national income or net national output which show a spurt in 1953-54 and a further small increase in the following year, primarily due to the rise in agricultural production\*. The favourable opportunity afforded by a succession of good agricultural harvests was thus properly seized by a marked stepping up in the rate of investment which was absorbed without visible ill-effects. Towards the end of the first Plan, however, definite signs of strain were in evidence. Prices actually started rising from the summer of 1955 and with brief halts and occasional relapses have maintained upward trend since. The explanation of this rising trend which, if continued, may soon pose a threat to stability, is to be found primarily in a further increase in the investment outlay on the Plan as well as in the private sector at a time when, unlike in 1953-54 and 1954-55, the level of

*	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56
National Income (1948-49=100)	102.3	105.2	109.4	116.1	119.0	120.5

agricultural production, has *not* increased and has in fact declined somewhat\*. The latest estimates of national income indicate that it showed only a slight increase in 1955-56. The fitful course of agricultural production is the most important among the factors to be taken into account in adapting the tempo of the development programme to the emerging economic context. The Second Five-year Plan has laid particular stress on the need for maintaining a flexible approach to planning. The Second Plan has been conceived as a broad framework within which annual plans will be made. The flexible nature of planning implicit in the Second Plan, as the Plan Report states, "requires a continual watch on current or incipient trends, systematic observations of technical, economic and social data and adjustments of programmes in the light of new requirements." In this context, pursuit of the larger objective of economic development should be consistent with that of maintaining the stability of the economy by adapting fiscal and other policies to the end of maintaining an even course of development, adjusting the pace and content of public expenditure, largely development expenditure, the levels and forms of taxation, and the overall budgetary position—the extent of surplus or deficit on current and capital accounts—with reference to variations of the economic weather, though all the elements of policy must be basically attuned to the climate of economic development. Inasmuch as continuous rephrasing of the Plan is posited in the Plan itself, no basic departure from the conception of the Plan is involved in reviewing from time to time the rate of progress of various projects, including early completion of some and postponement of others.

3. In the Second Plan the country has embarked on a much bigger and bolder effort than in the first. On the whole it is imperative to have a much larger Plan than the

	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56
* Agricultural Production (1949-50=100)	95.6	97.5	102.0	114.3	116.4	116.0

first if the pace of economic development is to be accelerated in conformity with our aspiration to provide a steadily rising standard of living for a growing population. As such the Plan is a challenge to our initiative and our capacity of organisation and leadership. It is perhaps as well that the impact of the challenge has been felt so soon in the progress of the Second Plan. This affords the opportunity for a close analysis and serious stock-taking of current policies and attitudes with a view to discovering the potentialities and limits of planned development, its hazards and pitfalls, and the conditions of its successful implementation, particularly with reference to the financing aspect. On the other hand, there is no occasion for yielding to unjustified pessimism, as there was not, of course, for the mood of unbounded optimism in which some people approached the prospect of the Second Plan during the phase of its formulation.

4. A realistic assessment of the economic position and prospect forms the first stage in this analysis. As I have mentioned, the real national product appears to have shown only a slow increase for some time, despite the investment boom in the public and private sectors alike which has been reflected in a continuing and sizeable increase in industrial production from year to year, owing to the set-back in agricultural output. The investment boom has led to an unprecedented rate of deficit in the balance of payments which is primarily accounted for by the high imports of machinery and capital equipment besides steel; the secondary effects of the investment boom are also reflected in higher imports of consumer goods to some extent and stagnant exports, but the buoyancy of exports is somewhat restrained by quotas and duties and the balance of payments thus reflects a favouring of home consumption of some products at the expense of much-needed foreign exchange; 'deficit-financing' of the public and private sectors as measured by the Reserve Bank's extension of credit to Government and to banks is running at high rates, and money-supply, including deposits

of banks— contrary to a fairly general popular belief, related to last year's experience\*— has shown a rapid increase notwithstanding the severe contractionary effect of the heaviest deficit in balance of payments. The situation in general is one of excess of demand on account of consumption as well as investment over available real resources of production and imports. I will not weary you with figures of each aspect of this picture, which are readily available.

5. The lessons of this situation are fairly obvious. Some slackening of the pace of investment is ineluctable— for *conforming* to the overall targets of investment under the Plan, for the public and private sectors together, of which in several directions we are now running ahead; some of the measures taken, e. g., in relation to imports will bring this about in due course while others, including the budget proposals, will also generally contribute to stability. Speaking generally, the budget proposals have a dual role, that of siphoning off some of the excess demand in the economy and at the same time, making for a more orderly financing of the investment programme of the public sector. It is not my object in the course of this lecture to give a comprehensive review of either the existing resources or new and potential resources or the budget proposals as such but to make some observations of a broad nature bearing on the general problem of financing the programme of planned development in India.

6. It is important, to begin with, to appreciate the fundamentals of the problem of resources for the Plan. Briefly, this problem is to step up the ratio of investible savings in the economy, to direct a larger proportion of national income into savings with a view to investment. For decades past—though accurate statistics are lacking—this ratio

---

\* Note circulation increased from Rs. 1538 crores at the end of April 1956 to Rs. 1585 crores at the end of April 1957, or by about 3 per cent. Bank deposits (demand and time liabilities together) increased from Rs. 1063 crores to Rs. 1221 crores or by about 15 per cent during the same period.

of investment to national income appears to have remained stationary, and with it *per capita* national income seems to have shown little change. The essential problem of development then is to move up this lever, the static position of which largely explains the long economic stagnation of the past. The counterpart of an increase in the *ratio* of investment, however, is a decline in the *ratio* of consumption. The essential rationale of this fundamental principle of a resources plan for a development programme is clear enough. The cloud of controversy which has been raised over this principle, however, betrays the amount of fundamental confusion that still exists regarding the validity or force of what, indeed, is an axiomatic statement. A basic aim of planned development is to increase the proportion of national income going into investment. So long as national income is on the increase, this objective can be attained, if a significant and increasing proportion of *additional* income goes into investment, without an actual *reduction* of consumption but with only a *restraint* on the increase in consumption which would otherwise result. Such restraint on increase in consumption is an inescapable necessity under a development programme. It would be still possible for consumption to increase. Increase in consumption is the motivating force behind the increase in investment, but *immediately, at any time*, such increase in investment can take place only at the expense of consumption. In due course the increased investment will lead to larger output and, therefore, to still greater consumption but continued *restraint* on consumption is an arithmetical corollary of the objective of attaining an increasing proportion of investment to national income: unless consumption increases more slowly than investment, it is *not* possible for the desired increase in the proportion of investment to national income to take place. A ton of steel or cement can go into the building of a house (which is consumption) or a dam or bridge (which is investment); every additional ton for consumption means so much less for investment, and *vice versa*.



7. The issues are clear enough if we think of the process of development in real terms. The crux of this process consists primarily in the creation and accumulation of real capital. The process is reflected in the building of dams and bridges and roads, digging of canals and wells, constructing factories and putting up schools and hospitals which are adequately staffed and equipped to impart instructions and encounter disease ; it is reflected, too, in a bigger cake for consumption to-morrow. All this requires, however, that we have to lay by part of to-day's output for increasing the volume and improving the quality and efficiency of the productive equipment for adding to the production and income of the community in the days to come. This implies that the community must be prepared generally for a regime of austerity and discipline and to eschew all waste and dissipation of the resources so urgently needed for assisting forward the country's development.

8. This last observation applies both to the public and private sectors. It has particular applications to the public sector, as it is especially incumbent on Government to utilise the scarce sinews of development to the best advantage, alike with a view to maximising such development and to sustaining and improving the hard-taxed ability and willingness of the people to contribute in increasing measure to the flow of resources. Apart from the general relevance of the quality and character of public expenditure to the effectiveness of the whole process of development, there are one or two specific observations on this aspect of the problem which I may venture to offer. There is a tendency in under-developed countries for the costs of administration to absorb too disproportionate a share of the total Governmental expenditure ; India shares this tendency with other under-developed countries. One of the factors which add to the costs of administration is the relationship of the average salary of the public servant to the average income of the country, which in turn reflects the range of economic inequality in the country in general.

In many economically advanced countries, the average income of the administrator is little different from the general average income. In our country, as in other under-developed countries with a similar range of inequality of incomes, the income of the public servant is a multiple—often high—of the average income. Economic development involves an increase in the functions and scope of the public sector. This implies that the process of transference from private income to public expenditure usually involves the interposition of a public service to cater to the provision of greatly enlarged welfare and other services that are normally associated with the process of economic development. This, however, is inevitable to a large extent, and the process of reduction of real income of the public servant has been continuing as part of the general tendency toward the reduction of economic inequalities, within certain ranges. While the significance of this point should not, therefore, be over-rated, there is an implication of this observation of which we may take note. There is often a choice between extending widely the scope of the services which to-day serve a narrow sector of the community and raising the emoluments of the existing members of the services—low as these are in absolute terms, but often not so low in relation to the average standards around. The choice in effect is between enlarging significantly the numbers of the public force engaged in welfare services and being content with comparative stagnation in this respect with a view to ensuring higher emoluments to those who already happen to be within the public force. This observation has relevance to the controversies that obtain in the spheres, for example, of education or, say, even banking. In effect, the vested interest of existing members of the salariat, or perhaps not even that except perhaps in a notional sense, continues to arrest the beneficent process of expansion of modern facilities and services.

9. There is one other aspect of the economy and efficiency of public expenditure which has a direct bearing on the

effectiveness of the whole process of economic development. This relates to the need, alike in the interests of ensuring the quality of development and keeping its costs reasonably low, of ensuring the fullest participation of the people and of the lower levels of Government, which in many ways are still nearer the people than its higher tiers, in the projects and tasks of development that touch the daily lives of the people. We have to guard against setting up a vast bureaucracy throughout the country with a decisive bias for achieving spectacular results *for* the people, by doing it for them. Durable results will be attained to the extent the initiative and enterprise of the people are aroused and harnessed and the organs of local organisation and government take on the job of preparing and implementing the many projects comprised in the community project and national extension services which are expected to transform not only the outer look but the whole outlook and attitude of the people themselves. In particular, it will be found that the many minor projects which intimately interest the people can often be far more economically completed by a local authority than by State and Central authorities : project costs often vary directly with the level of Government rising steeply in the higher levels of Government, though, it must be recognised, there are strict limits to the capacity of lower levels of Government to undertake projects, and there is only a certain range of tasks which they can perform with reasonably equal efficiency. On the whole, there is nothing more heartening in the enterprise of development than the increasing mobilisation of local labour and local initiative and effort in the co-operative building up of the framework of economic development and social organisation and welfare services like roads, schools, hospitals, and centres of local community life.

10. We may now address ourselves more directly to the question : How should we finance the greatly enlarged volume of public expenditure that is required alike for direct

development in the public sector and for assistance to the private sector? It may be said at once that over and above the savings placed at Government disposal through the receipts of loans and small savings, the major reliance for financing the expenditure on planned development has to be placed on taxation. In an economy where the propensity to consume is normally high, taxation may be a most effective means of increasing the total volume of savings and investment. Probably the only really effective, or, at any rate, principal method of stepping up capital formation in such an economy would be for the State to assume a major responsibility for securing a diversion of resources from private consumption to public investment. It follows that the structure of taxation, which will be most suitable and efficacious for the purpose is an adequately diversified scheme of taxation—direct and indirect—which seeks to secure the diversion of financial and, withal, of physical resources from consumption to investment, on a scale appropriate to the development programme. Additional taxation of a wide range of luxury or semi-luxury products, at fairly substantial rates, as well as broad-based taxation of articles of mass consumption—somewhat on the lines of the present budget proposals—is, therefore, indicated. In the field of direct taxation, the problem is primarily one of extending the coverage, whether by bringing new and somewhat lower categories of income-earners within the tax net, or of repairing the net and improving its efficacy to collect the taxes that are levied, or diversify somewhat the base of taxation so as to make for a more equitable distribution of the total burden of taxation.

11. Indirect taxation has to remain much the important means of adding to Government resources for some time. A major issue which the extension of the scope of indirect taxation throws up is whether such increase in taxation will itself not be inflationary, by adding to the costs of living, the costs of production and prices generally, so that

the very objective of such taxation, namely, to avoid the inflationary consequences of deficit-financed development, might be in risk of being defeated. The possibly wide appeal of this argument lies in the fact that there is, theoretically, a point beyond which additional taxation becomes itself inflationary, when the only way to avoid inflation is to avoid incurring the expenditure that gives rise to it. The objective of such taxation primarily being to increase public resources by reducing private consumption, if the point is reached where increase in taxation does not reduce private consumption any further, being met by transfer to the State of past savings through drafts on capital or of the proceeds of fresh indebtedness incurred for the purpose and made possible, say, by a liberal credit policy, then taxation ceases to be disinflationary, but becomes itself inflationary. The fallacy of this argument, however, consists in the application of what is undoubtedly correct in a certain theoretical context to the existing context in the country. There is little doubt that selective and discriminating increases in prices resulting from specific excises should help in restraining consumption both generally and particularly of taxed commodities and in releasing resources for investment with possible assistance to exports.

12. If greater resources are required commensurately with the large size of planned development it is far preferable to obtain them as far as possible by levies, direct and indirect, which have known incidence and effects, to following the easy line of deficit-financing which seeks to evade, but cannot avoid difficulties in the financing of development. In fact, it appears unavoidable to extend the scope of indirect taxation to necessities, if significant results by way of diversion of resources for public investment are to be secured. Beyond a point, over and above high rates of taxation on articles consumed by the few, if more revenue is required, it can only be raised by the taxation of articles consumed by the many. The assumption implicit in objections to extending

the scope of taxation to cover necessities of life is that commodities which are essential to the life of the community should not be taxed. This assumption implies that *the whole* of the present consumption of each of a number of commodities is more of an essential to the life of the community than *any* extension of the beneficent services of public health, education, minor irrigation facilities and agricultural improvement. It amounts in effect to saying that we are so poor that we can ill-afford the luxury of economic development. Now there is a vein of thought running through some people's mind that part perhaps of the economic development might be too costly, that there is scope for economy in administration. It is in relation to this feeling that I have observed that efficiency in administration and economy in public expenditure are of relevance to people's willingness to suffer an increase in tax burdens and simultaneous and sustained attention to these aspects becomes necessary precisely when the weight of taxation is increased. Given adequate attention to that aspect, on the choice of alternatives that is presented in economic development, the answer is clear: that a little less consumption in one form or another— not necessarily less consumption absolutely but at any rate restraint on the growth of consumption generally and actual reduction in consumption in several cases— is a worthwhile sacrifice which the community must be prepared to make if it is to enjoy the fruits of economic and social development.

13. In looking for evidence of additional taxable capacity in framing tax policy, two practical guides of some value suggest themselves: (a) have any significant changes taken place in the relative incomes of groups or classes of the population or economic sectors, which give a clue to where scope for additional taxation may exist? (b) taking disbursements of plan expenditure as a whole, are additional incomes generated in some sectors which could bear a larger tax burden or contribute more to savings? It is difficult to

devise taxes designed specifically to tap the additional incomes in consequence of plan expenditure, and although theoretically it should be easier to take a proportion of new and growing incomes, in practice the new incomes tend to be used in the same proportion as between consumption and savings, which means mostly consumption, as the old incomes. In particular, where they accrue to low-income groups, the task of the tax-gatherer is all the more difficult. A combination of indirect and direct taxes and a vigorous savings campaign carried to the door-step of the new income-earner through every employer and pay-master acting as savings agent as in some other countries, which have recently developed rapidly, may help to increase the contribution of new and larger income-earners under the Plan.

14. For the rest, an outstanding fact of the economic situation in the last few years is the considerable increase in the prices of foodgrains and raw materials or all agricultural products, partly as a result of lower output but also stimulated to an important degree by the pressures of the development programme. On the other hand, also considering the broad shifts in the incidence of taxation, the burden of the land tax has now remained static in money terms for a generation. Altogether, there is here a sector where sizable additional resources could be found. Even in terms of the very modest recommendations of the Taxation Enquiry Commission in relation to this sector, which with the further reorganisation of States, throwing parts of States with different land revenue systems and history together, should be easier of adoption, there would be an addition to receipts which could not be lightly disregarded. In fact, it appears extremely difficult to conceive that a Plan of the dimensions which we have embarked upon could be satisfactorily financed without a bold attempt—comparable in boldness to that of the Plan itself and the present budget—to secure a significant contribution from all but the smallest agricultural producers *qua* producers.

15. It may not do to hark back to the days of Manu, the Hindu Law Giver. But it seems the task for the Indian economy in the next decade or so is to work up or work back to securing for investment or in savings— whether through taxation, or borrowing, or non-inflationary deficit-financing—the proportion of the gross national production which he permitted the ruler to receive, namely 1/6th. Given the necessary adaptations in policies and attitudes, and with improvement in the efficiency and productivity of the economic system, over the next decade, this should not be beyond reach. It is only when this goal is approached that the process of economic advance would acquire an adequate momentum so as to be assured of continuity, and hopes of banishment of poverty over the years could be said to have acquired a firm foundation in fact.

16. We may turn for a moment to consider the broad field of commodity taxation in which the overlapping tax powers of the Central, State and local governments give rise to another category of problem, namely, of adequate demarcation and co-ordination of the relative scope of various forms of commodity taxation and relative spheres of various levels of Government with a view to effective utilisation of this most important resource for financing the Second Plan. The main forms of commodity taxation are customs and excise duties (Central) and sales tax (State), besides octroi and terminal taxes. These last are largely local levies and, in their present form of development, raise fewer problems of overlap and of demarcation of fields of taxation. Customs duties, too, because they are levied at a specially convenient point, have a well-defined field of application, within which revenue considerations pertaining to other taxes do not arise to any significant extent. As internal consumption comes to be based more and more on domestic production, however, there is a shift to excise duties in place of customs duties. It is then in the field of growing (Central) excise duties and expanding (State) sales taxes that the



problem of co-ordination with a view to regulating overlapping taxation arises to some extent. There is no problem, however, of duplication in tax jurisdiction here. For excise and sales tax are technically different forms of taxation—one on production, the other on sales. But they have a common base and both fall on the consumer. According to the legal conception as well as the practical form of development of these taxes, excise is levied at the point of production, while sales tax is imposed usually at the point of retail sale, or at different or all stages of sale, or occasionally only at the first stage. Also, the sales tax commonly applies to a large range of commodities and is, therefore, unlike excise, in the nature of a general consumption tax, with specific exemptions, rather than a tax on specific goods or industries as excise is. Although selective sales taxes on luxury articles form part of the sales tax structure of most States, the distinguishing characteristic of sales tax from excise is its generality rather than selectivity. It follows, too, that the rates of excise taxes have usually to be higher than of the general sales tax, in order to bring in a significant revenue. *Where* rates are high the tax is best administered on a uniform basis, for the tendencies to diversion of trade are encouraged by high and discrepant rates at different places. Besides, an excise duty being levied at the point of production is liable to cause less evasion and less dislocation to trade than equivalent sales taxation. It is partly these considerations which suggest that, for a fuller utilisation of the field of commodity taxation, a significant extension of the field of Central excise taxation is appropriate.

17. A consideration which has a bearing on co-ordinated utilisation of the field of commodity taxation derives from the distinguishing characteristic of sales tax to which I have just referred, viz., its generality. In the nature of this tax, too many separate rates of tax on individual commodities complicate the structure, encourage diversion of trade, open loop-holes for evasion and make tax-compliance and admini-

stration more difficult. The point that is of particular importance in the present context is that it is separate selective sales taxes that raise the problem of co-ordination of tax policies of the Central and State Governments in relation to the total burden of taxation appropriate to particular industries or commodities. Emphasis on generality in the future development of the sales tax would serve to minimise the potential dimensions of the problem of coordination in the growth of excise and sales taxation. A single general rate of tax for the sales tax, and not too many separate special rates, with progressive extension of the field of excise taxation whenever a high-rate tax is indicated as desirable for any article, would appear to offer the best approach to ensuring the maximum productivity and efficiency of commodity taxation in general.

18. There is another large area of additional resources, where public understanding of the objectives of a tax policy, in the broad sense, for a development programme is badly called for. That is in relation to the pricing policies of large State undertakings. It is usually assumed, on the basis of pricing policies followed by some public utility undertakings in advanced industrial countries like the U. K., that there is a peculiar merit in large State undertakings like electricity, transport, irrigation and other projects aiming at covering the bare costs of service and 'breaking even' with no profit, which might often mean, with some loss. In economically under-developed countries, however, in cases where the State has made substantial investment, a policy of regulating prices so as to secure an adequate return on the capital invested is not only unobjectionable, but would, indeed, be desirable. Public enterprise, itself fostered at State expense, may in turn appropriately play a role in financing the country's development. In private enterprise a principal means of financing development in recent years has been the reinvestment or ploughing back of profits. A policy of making profits on old established projects with a view to assisting the development of new

projects would be equivalent to pursuing the same policy in the field of public enterprise. Though economic development should automatically increase Government tax revenues in a variety of ways, the task of re-capturing additional incomes generated by public investment—and this has been referred to earlier as a principal practical guide for seeking sources of capital formation—is by no means easy. It follows that additional incomes arising directly in consequence of large scale public investment have a greater obligation to contribute to re-investment, to enable the cumulative process of larger investment, higher production and wider prosperity to go on. This suggests an approach to pricing policy for public undertakings somewhat different from what obtains generally in advanced countries. It is highly inappropriate, at any rate, to raise the cry of profiteering which is heard every now and then in relation to the pricing policies of public enterprises aiming to work at a profit. True, public purpose rather than profit should be guiding factor in the operation of a public undertaking but the anti-thesis is not as sharp as is often represented. In the public sector, profit is not necessarily inconsistent with public purpose; it may, indeed, constitute a public purpose, even though this should remain secondary.

19. There is another aspect of indirect taxation to which reference may be made. A few years ago there used to be an unexploited resource of some considerable importance in the quotas on imports, which directly helped to put money into the pockets of the private importer at the expense of the domestic consumer of imported articles. Progress has been made in the direction of obtaining a share of these profits for the public exchequer through replacement of quotas by import duties. On the export side, perhaps, quotas have not held a place of similar importance. There still remain, however, some bans and some quotas. To the extent that it is desired to restrict exports, the same general reasoning as in respect of imports, would advise the replacement of quantitative restrictions by tariff duties. This may

bring much needed succour to our exiguous finances. But the whole rationale of restrictions on exports has to be considered in the new context of a serious shortage of foreign exchange resources. To take an illustration, exports of groundnut oil have been banned for some time, in the interests presumably of the domestic consumer. *Per capita* consumption of groundnut oil, however, shows a distinct increase during the last few years. Here, then, is an instance of good foreign exchange being used to augment domestic consumption ; it is little different from using foreign exchange to finance imports of an important consumer article which is in reasonably good supply at home. On the other hand, however, this furnishes an illustration of the fact that the full buoyancy of our exports has not been realised and their relative stagnancy should, therefore, be interpreted with due reserve. It is important at the same time to appreciate that we have to be prepared to face up to the implications in terms of domestic adjustments of full encouragement of the export potentialities of the economy.

20. In the field of direct taxation, I have one other specific comment. It is as important to collect taxes as to levy them. It is possible that efficiency in collection has been improving. But the scope for further improvement is considerable, as that of evasion at most income levels is large. There is a thin line between evasion and avoidance and avoidance is sometimes claimed as a legal right to the point of holding that efforts on the part of the State to avoid the avoidance are unreasonable interference with the exercise of a legitimate right ! Here is a factor which has a considerable bearing on the efficiency and equity and productivity of the whole tax system. Uniform enforcement of tax obligations is of the very essence of the quality of the tax system. The knowledge of widespread tax evasion undermines morale, puts a heavy strain on tax compliance by the honest tax payer and impairs taxable capacity. While it is important, on the one hand, to avoid

harassment of the tax payer, we must be willing to confer on the administration necessary powers to defeat the artifices of persons who have developed evasion into a fine art, indeed. We have the example of other democratic countries where, on a random sample basis, tax returns are subjected to the most rigorous scrutiny and where the penalties of proved evasion are much more severe than we seem to have been willing to impose.

21. An inevitable question in the financing of development is the practicable and appropriate role of deficit-financing in the process. Different answers have been given by different persons for different countries in different situations. There is no one answer for all situations. And yet an approximate answer in the Indian context has to be given as a general guide to policy in the light of one's appraisal of the various elements in the situation. My own appreciation of the possible contribution of deficit-financing to the financing of development would be somewhat as follows. Deficit-financing—by which we briefly understand the net increase in Government's indebtedness to the Reserve Bank representing the excess of total public disbursement over public receipts from taxation loans (though these might contain somewhat inflationary elements) and other heads—would be only safe so long as it does not result in a significant degree of inflation, or large rise in prices. Significant inflation is liable to set up serious distortions in the economy and by directing resources to speculative and unproductive channels, to affect vitally the progress of development under the Plan. The best atmosphere for speedy real development would be found to lie in comparative stability of prices rather than in high and rising prices which hamper rather than promote the rational direction of resources. Moderate inflation may be unavoidable but significant inflation is the very anti-thesis of planning in finance : it is an acknowledgement of failure to find finance through a considered scheme. Significant inflation is certain to increase the degree of economic inequality

and is fundamentally inimical to greater economic equality and, therefore, basically inconsistent with the objective of a socialist pattern of society, of which greater economic equality forms such a crucial and integral part: it affects the poorest and most vulnerable sections of the community the worst. It is in view of considerations like these that I would favour raising resources through taxation even of essentials than through inflationary deficit-financing. Limitation of taxation affords no guarantee against a rise in prices occasioned by failure to finance development plans through normal means. Given the order of the development plans, if tax resources should fall seriously short and inflation should result, it may involve an even larger cut in current consumption standards of the weakest sections of the community than a systematic scheme of taxation of essentials, to the extent necessary. The useful practicable role of deficit-financing would vary appreciably with the general state of agricultural production; as the experience of 1953-54 and 1954-55 demonstrates, if the output is unusually good, a considerable increase in investment expenditure can be absorbed without serious pressures on prices. On the other hand, if supplies of basic essentials, principally foodgrains, are not so well assured, the risk is correspondingly larger.

22. The experience of the Great Depression in most agricultural countries brought out a peculiar trait of primary production especially small-scale and individualistic agricultural production viz., its inverse elasticity of supply in response to changes in prices. With falling prices and a narrowing margin between the proceeds of his surplus over subsistence and costs, the farmer tried to make up in volume what he lost in value. He produced more, not less, in contrast to the response of organised industrial production to a fall in prices. The phenomenon was world-wide. The obverse of this phenomenon—some flagging of effort and enterprise when prices cross a high water mark—has also been observed on a wide scale in under-developed countries in the early post-war

phase. Over and above technical factors related to production, there is also a certain inelasticity of effort determined by the peasant's standard of life, which accounts for the marginal acre remaining uncultivated because of the fact that, with inordinately high prices of produce, a little less production will do to maintain that standard. This seems to suggest that, contrary to popular belief, it is not high but stable prices which provide the best environment for improvement of the yield and efficiency of agricultural production. Common belief which associates high production with high prices derives, apart from experience in the non-agricultural sphere, from the undoubted correlation of movements in production and prices in respect of *individual* crops. The fallacy in it lies in translating the experience regarding individual products to the relationship of agricultural production and prices *as a whole*. This does not mean, however, that a fall in agricultural prices is good for the agriculturist. On the contrary, when prices fall, they usually fall to a greater degree in the case of agricultural commodities and this entails unusual hardship and sets up serious distortions in debtor-creditor relations and results in attendant problems of readjustment. It also leads to a worsening in the internal terms of trade for the agriculturist *vis-a-vis* the non-agriculturist or, what may be stated in simpler terms, a fall in the purchasing power of the agriculturist's rupee. The experience of depression and inflation alike in India underlines the conclusion that what agriculture requires is not high but stable prices, and especially broad parity of relationship with non-agricultural prices. A cynic may be tempted to remark: this is the hard way, and why should the medicine be prescribed for the agriculturist? The obvious answer is that the Plan does call for hard work and steady and strenuous endeavour on the part of all sections. The Plan itself is, therefore, a sufficient reason for being chary of a policy *viz.*, of high prices, which whatever its specious appeal for a certain section of the population can only confer short-lived benefits, as prices of agricultural products

would be the first to respond to the stimulus, and when they do, their general effect, beyond a point, will rather be to impair than to promote the maximum effort that the Plan calls for from one and all.

23. During the last five or six years, we have alternatively witnessed periods of serious shortage of foodgrains and soaring prices upto 1953-54, high production and sharp relapse in prices in 1954-55, and comparatively low output and steadily rising prices since ; prices of raw materials have moved more or less in line. The liability of agricultural prices to wide variations in prices in response to relatively small fluctuations in output has been strikingly and painfully demonstrated. This suggests the need for a policy of regulating the supplies to some extent with a view to eliminating the extreme oscillations of prices, which disturb and distort and are liable to disrupt the even course of development.

24. I have referred here to some of the fundamental elements of an environment conducive to development, as a policy for the financing of development has to have due regard to the creation and maintenance of the proper climate for economic growth over and above the stimulus of State-sponsored investment.

25. There is a somewhat pathetic faith in some quarters in the country in the efficacy of more money as a solvent of our economic ills. After all, it is asked, are not we suffering from an acute money famine, dearth of purchasing power for lifting stocks of this commodity or that, financial stringency of an unprecedented order ? Little do we appreciate,— considering developments in the last one or two years— that the increase in money-supply was never greater ; the expansion in bank credit never larger ; the imports never higher ; even the increase in bank deposits— which on the experience of last year's busy season (November 1955 to May 1956 ) are still referred to as lagging far behind



the currency expansion— was never more rapid and is in fact far greater than the increase in note circulation ; and that the expansion of investment both in public and private sectors has surpassed all records— the increase in investment in the private sector and imports on that account being appreciably larger in some ways than provided for in the Plan. There is a fairly widespread feeling which has often been voiced that there is not enough money to go round. It should be clear from the facts I have just quoted that this feeling persists not because there is not money enough going round, but because everybody wants more of it than there is. There are two ways in this situation to establish an equation : one is to increase the supply of money to meet the larger demand ; the other, to restrain the demand so as to keep the increase in money-supply and with it the rise in prices within bounds so as to safeguard the stability of the economy.

26. I must resist the temptation to dilate further on, and to represent in simplified terms, the difficult and complicated choices in fiscal and monetary policy, which form the many cross roads in the financing of development. There is a real limit to the pace of development set by the availability of real factors of production. The financing of development is relatively easy, so long as the additional expenditure can be matched by an increase in productive activity and real incomes of the community. It is when expenditure outruns the capacity of the economic system to produce a corresponding increase in production, incomes and welfare, when the quality of performance suffers as the tempo of effort rises and real targets recede as targets in financial terms are reached, and when distortions multiply that the process of development may be said to be touching one limit. The limit is not inflexible and may be more or less rigid. The problem is to push this limit as far and as fast as possible. But inasmuch as the limit is set by real factors, it is not the part of finance to outstep it.

27. I have not referred directly to the question of external assistance, despite its vast significance to the financing of development and the great contribution it has already made. To deal adequately with its role would require another lecture. On the other hand, the issues that arise in this field are different, and can be conveniently considered separately. For the present, I have little to say on the subject. In so far as external finance is made available by the contribution of exports of goods and services by the economy—and this must remain the principal source—the issues that arise are integrally related to those of internal financing.

28. The Second Plan forms another mile-stone on the long and hard road of planning from poverty to prosperity on which we have set out : the goal is a socialist pattern of society which implies a decisive improvement in the general level of living and a distinct narrowing of economic disparities. Vision in formulation of targets and wisdom in implementation are primary prerequisites of successful advance in the direction. Boldness and caution, vigour and restraint, speed and stability, must be combined in due measure if steady progress along the path is to be assured ; withal, austerity and discipline must remain the watchwords.

**GOKHALE INSTITUTE OF POLITICS AND ECONOMICS, POONA 4.**  
**List of Publications.**

*Note*—(\*) Suffixed to Serial No. or K. M. L. YEAR indicates "Out of Print" publication.

- No. 1\*—The Salaries of Public Officials in India. By D. R. Gadgil. 1931.  
 No. 2\*—Imperial Preference for India. (The Ottawa Agreement Examined).  
 By D. R. Gadgil. 1932.  
 No. 3\*—A Survey of the Marketing of Fruit in Poona. By D. R. Gadgil and V. R.  
 Gadgil. 1933.

No. 4\*—A Survey of Six Districts of the Bombay  
 Presidency. DK

No. 5\*—Urban M. Joshi. 1936.

No. 6\*—Debtors in India

By Gadgil and V. R.

No. 7\*—N. V. Sovani. 1942.

No. 8\*—Labour in India.

No. 9\*—N. V. Sovani. 1944.

No. 10\*—By G. S. Ghurye,  
 of Bombay. 1943.

No. 11\*—By D. R. Gadgil.  
 Price Rs. 15 or 30s.

**SERVANTS OF INDIA SOCIETY'S LIBRARY**  
**POONA 4.**

No. 12\*—es in Sholapur.

No. 13\*—1. Books drawn from the library may not be  
 retained for longer than a fortnight. 8vo. Pp. 203, 1947.

No. 14\*—2. Borrowers will be held strictly responsible  
 for any damage done to books while they 8vo. Pp. 220, 1947.

No. 15\*—are in their possession. Direct and Indirect.  
 Gadgil. Demi 8vo.

No. 16\*—a  
ion and Fertility;  
 8vo. Pp. 86, 1948.

No. 19.—Some Observations on the Draft Constitution. By D. R. Gadgil. Demi 8vo.  
 Pp. 112, 1948. Price Rs. 3 or 4s 6d.

No. 20.—Reports of the Commodity Prices Board. Edited By N. V. Sovani. 1948.  
 Royal 8vo. Pp. 236. 1948. Price Rs 10 or 15s.

No. 21.—Post-War Inflation in India—A Survey. By N. V. Sovani, Royal 8vo.  
 Pp. 100. 1949. Price Rs. 5 or 7s. 6d.

No. 22.—Planning of Post-War Economic Development in India. By N. V. Sovani,  
 Demi 8vo. Pp. 102. 1951. Price Rs. 3.50 or 5s.

No. 23.—Social Survey of Kolhapur City. Vol. II—Industry, Trade and Labour.  
 By N. V. Sovani. Demi 8vo. Pp. 346. 1951. Price Rs. 12 or 18s.

- No. 24:—Social Survey of Kolhapur City. Vol. III—Family Living and Social Life. By N. V. Sovani. Demi 8vo. Pp. 330. 1952. Price Rs. 12 or 13s.
- No. 25:—Poona—A Socio-Economic Survey. Part II. By D. R. Gadgil. Royal 8vo. Pp. 330. 1952. Price Rs. 15 or 30s.
- No. 26:—Report on the Poona Schedules of the National Sample Survey. By V. M. Dandekar. Royal 8vo. Pp. viii + 223. 1953. Price Rs. 6 or 9s.
- No. 27:—Survey of Fertility and mortality in Poona District. By V. M. Dandekar and Kumudini Dandekar. Royal 8vo. Pp. 191. 1953. Price Rs. 5 or 7s. 6d.
- No. 28:—Structure and Working of Village Panchayats: A Survey based on case studies in Bombay and Madras. By A. V. Raman Rao. Royal 8vo. Pp. 218. 1954. Price Rs. 7 or 11s. or \$ 1.50.
- No. 29:—Second Report on the Poona Schedules of the National Sample Survey (1950-51). By V. M. Dandekar. Royal 8vo. Pp. viii + 176. 1954. Price Rs. 6 or 9s. or \$ 1.25.
- No. 30:—Economic Policy & Development (A Collection of writings). By D. R. Gadgil. Royal 8vo. Pp. 248. 1955. Price Rs. 8 or 12s. or \$ 2.
- No. 31:—Fertility Survey of Nasik, Kolaba and North Satara Districts. By N. V. Sovani and Kumudini Dandekar. Royal 8vo. Pp. xvi + 167. 1955. Price Rs. 6 or 9s. or \$ 1.25.
- No. 32:—Primary Education in Satara District: Reports of Two Investigations By D. R. Gadgil and V. M. Dandekar. Royal 8vo. Pp. 174. 1955. Price Rs. 6 or 9s. or \$ 1.25.
- No. 33:—Use of Food Surpluses for Economic Development. By V. M. Dandekar. Royal 8vo. Pp. 153. 1956. Price Rs. 5 or 7s. 6d. or \$ 1.10.
- No. 34:—Poona: A Re-Survey (The Changing Pattern of Employment and Earnings) By N. V. Sovani, D. P. Apte, R. G. Pendse, 1956, Royal 8vo. Pp. 550. Price Rs. 13 or 25s. or \$ 3.50.
- No. 35:—Working of the Bombay Tenancy Act, 1948: Report of Investigation By V. M. Dandekar and G. J. Khundanpur. Royal 8vo. Pp. 194. 1957. Price Rs. 7-50

### R. R. Kale Memorial Lectures

- 1938\*—The Social Process. By Dr. G. S. Ghurye, Bombay University.
- 1939—Federation versus Freedom. By B. R. Ambedkar, M.A., Ph.D. Price Re. 1.
- 1941\*—The Problem of the Aborigines in India. By A. V. Thakkar, L.C.E.
- 1942\*—A Plea for Planning in Co-operation. By Vaikunth L. Mehta.
- 1943—The Formation of Federations. By S. G. Vaze. Price Rs. 1-50.
- 1948—Central Banking in India: A Retrospect. By Chintaman D. Deshmukh. Price Rs. 1.50 or 2s. 3d.
- 1949\*—Public Administration in Democracy. By D. G. Karve.
- 1950—Policy of Protection in India. By Dr. H. L. Dey. Price Rs. 1 or 1s. 6d.
- 1951—Competitive and Co-operative Trends in Federalism. By Prof. M. Venkatrangaiya. Price Rs. 1.50 or 2s. 3d. or \$ 0.30.
- 1952\*—The Role of the Administrator: Past, Present and Future. By A. D. Gorwala.
- 1954—Public Administration and Economic Development. By W. R. Natu. Price Re. 1 or 1s. 6d. or \$ 0.20.
- 1955—Reflections on Economic Growth and Progress. By Dr. E. K. Muranjan. Price Re. 1 or 1s. 6d. or \$ 0.20.