CHAPTER - III

As indicated in the first chapter, there are two main alternative approaches - the Quantity Theory and the Keynesian Aggregative Demand analysis - to the study of the inflationary process. Both these approaches may have to be followed to explain the behaviour of prices in India during the period of the three Five Year Plans. A critical review of the experience of Japan and some Latin American countries in particular, undertaken in the second chapter, however, suggests that certain aspects of the economic structure and government policies have to be emphasized for a fuller understanding of the process of inflation in a developing economy. By this, however, it is not implied that those who have laid stress upon aggregate demand have ignored the structural aspects. An attempt has been made in this and the following chapters to study in some depth the bearing of the above-mentioned factors on the inter-relationship between the movement of prices, and economic growth in India during the period of our study.

An underdeveloped economy is characterized by the existence of a large non-monetised sector and the lack of a skilled organised labour force. Technological knowledge and capital equipment are also inadequate. Agriculture being the predominant occupation, inelasticity of supply in the short period and unstable demand tend to become the main contributive factors to the widespread fluctuations in the prices of primary products. The marginal propensity to consume is also higher and because of this, investment accounts for an insignificant proportion of the value of the aggregate output in the rural sector. In an effort to mobilize resources
for capital development, heavy reliance is placed on sources and methods of financing which have inflationary potential. With the important role assumed by the government in economic development, large budgetary deficits are often incurred and these are mainly financed by borrowing from the banking system. All this leads to an increase in the total money supply which is frequently the source of cumulative price increases. The lack of an organised capital market in the underdeveloped economy renders the private sector heavily dependent upon the banking system for short-term credit not only to finance current transactions but also for loans to undertake fixed investment. With an inadequate fiscal mechanism, the government finds it increasingly difficult to finance economic development through taxation and increasing reliance has thus to be placed on deficit financing.

But there are other factors in a developing economy which also strengthen inflationary potentials in the process of development, besides deficit financing. Apart from excessive aggregate demand, the increased velocity of circulation of money or a fall in the liquidity preference may also stimulate the monetary demand even when the variations in the quantity of money are not remarkable. So long as idle resources remain in an economy, deficit financing or an increase in aggregate monetary demand draws into use unemployed resources and thereby raises economic activity and real incomes. But in an underdeveloped economy, such a fiscal operation merely helps in a rise in the price level because of the structural rigidities which ultimately result in an imbalance between the sectoral demand and supply and cost factors, including rising import prices and the rate of expansion of money. These are the opposing forces which considerably limit the capacity of the economy to absorb deficit financing. Generally speaking, the inflationary effects of developmental expenditure based on deficit finance depend
on the time lag between investment expenditure and the consequent increase in output; the longer is this interval, the greater is the chance for inflationary price rise. Although it is difficult to distinguish the primary agent in the chain of causation in a cyclical change in a developing economy it should be, however, possible to locate the spot of friction. The problem of food supply has a widespread repercussion upon the price-structure of the economy, and the institutional setting by itself is a controlling element and a significant link in the inflationary process. Excess demand, on the other hand, at both the aggregate and sectoral levels along with rising import prices also constitutes a major cause in the inflation occurring in the primary producing countries, and the impact of expansion of money supply on this propensity is of great significance.

But this line of approach probably may not suitably explain the phenomenon of price rise in the Indian economy during the three plan periods since the causative factor is supposed to lie with monetary expansion alone. It has received some support from the reported stability of the income velocity of money since 1949. Nonetheless, there are some obvious limitations in emphasizing too much upon the quantity of money alone because some additional factors are also considered relevant for a practical explanation of the process of inflationary price rise. For instance, the structure of interest rates and of real income, the path of adjustment in the price level, and other variables are not considered here. The present controversy among the monetary economists, therefore, not so much about the adequacy of the quantity theory of money as an explanation of prices and money incomes but only as to whether or not the demand for money (money defined someway or other) is 'more stable than functions, such as the consumption, that are
offered as alternative key relations. The alternative approach for explaining the inflationary price rise in the Indian economy partially follows the lines of the Keynesian multiplier analysis. It is assumed that changes in aggregate demand are induced only by 'autonomous' changes in outlay and that domestic production and imports constitute the only sources of supply. Two other assumptions are made. It is assumed that the marginal propensity to consume in the economy has been stable. Another assumption is that changes in aggregate demand are induced only by 'autonomous' changes in outlay and that domestic production and imports constitute the only sources of supply. The general price level adjusts itself to the extent required to clear the market each year.

The sources of 'autonomous' outlay identified constitute the following: (i) changes in total investment expenditure incurred on capital goods produced within the economy, (ii) changes in total government expenditure (excluding investment expenditure already covered) and, (iii) changes in export earnings. Investment should include inventory accumulation, but a distinction has been made between 'active' and 'passive' accumulation since only the former can be regarded as a source of autonomous change. For this purpose, year-to-year changes in the total amount of

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loans and advances extended by banks are taken to reflect 'active' investment in inventories.

For estimating changes in aggregate demand on account of changes in 'autonomous outlay' two further assumptions are made: (a) that the price elasticity of total consumption expenditure is unity and that therefore changes in the price level from year to year do not make any difference to the assumed marginal propensity to consume and (b) that there are time-lags in the working of the multiplier, only three or four rounds of expenditure taking place in the course of a year. Lags in the multiplier are largely accounted for by the structural characteristics of the economy. In developed industrial economies, the time-lags in the working of the multiplier have been attributed in main to the length of time which lapses between effective economic earning of non-wage incomes and their passage into the control of consumers (this is more true of business profits which have to be first ascertained before being distributed). On the other hand, in the less developed economies, the case for introducing similar time-lags is mainly on account of the length of time which lapses between accrual of non-wage incomes in the agricultural sector (which is usually received in bulk in the harvesting season) and their spending. Aggregate supply available each year is thus initially taken to be equal to be market value of supply in the preceding year (i.e. the value of aggregate demand in that year plus the change in supply during the current year valued at prices of the preceding year when aggregate demand during the year exceeds (or falls short of) this aggregate supply. Prices are assumed to rise

(or fall) to the extent required to make the value of the latter equal to the former \( (x) \).

The statistical findings, based on these assumptions lend some analytical insights into the origin of inflation from a different point of view. However, these are not extended to prove that changes in money supply as such do not have any effect on price behaviour\(^3\). They carry only the implication that, since the factors causing 'autonomous' changes in outlay are to a large extent responsible for the observed changes in money supply, and since the effect of interest rates on investment is also incorporated in these 'autonomous' changes, it is not necessary to introduce money supply as an additional variable except for taking into account possible 'real balance' effects on aggregate demand (which has not been, however, adequately followed up here).

Based on these observations some other hypotheses can be drawn up with reference to the behaviour of price rise in the Indian economy during the three plan periods. First, given multiplicands of the magnitudes introduced into the system, a marginal propensity to consume of 0.75 can bring about sharp rises in the general price level unless the rate of growth of output and/or imports is considerably larger than it has been. The instantaneous multiplier in this case is found to have a value of four \( (4) \). It has, however, been earlier assumed that the marginal propensity to consume remains constant although. Secondly, given the

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\(^{\text{**}}\) For further reference, see P.50. The aggregate supply available each year is taken as given.
realized rate of growth of real national income in the economy, the rate of growth of foodgrains output has been inadequate to prevent a rise in the relative price of foodgrains above its 1949-50 level except in a few years; the effect of foodgrains imports in other years has been generally to depress the relative prices of foodgrains.

The aggregate demand approach thus has been used to yield an explanation of the behaviour of prices in India during the first three plans. However, the relevance of the structural factors cannot be dismissed and is implicitly recognized in the model. For one thing, the total change in aggregate demand induced by changes in "autonomous" outlays is not independent of the economic structure and the pattern of changes in the "autonomous" outlays. More importantly, the aggregate supply available each year is taken as given for estimating the excess demand (+). The behaviour of aggregate supply in a developing economy like India cannot be explained without demonstrating the links between the structural factors and policy parameters.

Our analysis of the experience of Japan and Latin American countries suggests that relatively high rates of growth are likely to be associated with relatively lower rates of inflation. This hypothesis appears to be valid on theoretical grounds too. Economic growth on a very abstract level of analysis can be represented as the resultant of the rate of investment, the capital-output ratio and population growth. The last factor can be treated as independent of the rate of inflation, so that one has only to

<table>
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<th>Country</th>
<th>Annual compound rate (growth)</th>
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<tr>
<td></td>
<td>(Inflation)</td>
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<tr>
<td>1) Chile (1946-52)</td>
<td>22.1</td>
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<tr>
<td>2) Paraguay (1950-54)</td>
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<td>3) Puerto Rico (1947-50)</td>
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<td>4) Mexico (1939-47)</td>
<td>19.6</td>
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Source: U. Tun Wai, "The Relation Between Inflation and Economic Development: [Cont]"
consider the effects of inflation on the first two variables to find out 
the impact of inflation on economic growth. It is usually claimed that 
inflation results in a shift in the distribution of income which leads 
to a higher savings-income ratio. This need not, however, always be 
the case. In our case study of the Latin American countries it has 
been found that in a period of rising prices, consumption rose to higher 
levels and inflation contributed to a further decline in saving 
(vide chapter II). Even if one concedes that in the process of inflation 
the distribution of income changes in favour of the group who can be assumed to have a higher marginal propensity to save, it is apparent that such a shift is neither a necessary nor a sufficient condition for stepping up the rate of investment. If, for instance, a developing economy happens to possess substantial accumulations of foreign exchange reserve and/or at the same time is a recipient of foreign assistance on a large scale, the excess of planned domestic investment over planned domestic savings will have a moderate effect upon the price level and the country concerned will find it easier to successfully implement the investment plans. If these conditions are not satisfied, the degree of inflation will be much higher and the rate of real investment and therefore, the rate of economic growth will be comparatively lower. On these grounds, then, one could expect higher rates of

5. Some economists like Prof. Lewis hold that savings increase because of rising prices followed by a rise in income of peasants and entrepreneurs who have a relatively higher marginal propensity to save in the community. See W. A. Lewis in Economics of Underdevelopment (Ed. Agarwalla).
inflation to be associated with relatively lower rates of economic growth and vice versa. Where on account of the foreign exchange situation the excess of planned domestic investment over planned domestic saving leads to a relatively higher degree of inflation, the rate of economic growth suffers because in most primary producing countries investment has a high import component. Since domestic revenues considerably depend upon the export earnings, any rise or fall in the prices of primary produce not only induces external influences upon the domestic economy but such movements equally produce more than proportionate changes in the domestic cost-price parity in these countries. Thus sharp fluctuations take place irrespective of and often against the desires of the governments in their foreign exchange rates that in turn severely hit their trading capacity. Exports fall and imports rise because most of the capital equipment and machinery are obtained through imports. All this ultimately leads to an acute imbalance in the trading pattern of the under-developed countries, exchange rates depreciate and successive devaluations cause serious dislocations in the production pattern and the monetary system alike. It could be therefore also expected that a relatively high rate of inflation would be usually associated with a persistent balance of payments problem. Put in a different way, the availability of external balances acts as a limit to deliberate deficit financing that may culminate into an inflationary process. If the safe limit of past savings in the form of external balances is crossed beyond mark, a significant rise takes place in the price level.6

The second hypothesis is that a shift in the distribution of income does not by itself tend to a higher saving-income ratio. Particularly in the Latin American countries, inflation had come to be regarded as the single most important factor impeding the growth of the economy. For in a society, that traditionally placed great emphasis on maintaining high consumption levels rather than saving and investment, inflation contributed to a cumulative decline in real saving and a mis-direction of investments into inflation proof real estate and speculative ventures. Thus the saving rate is extremely low not because of low income levels in general but because of a completely disproportionate propensity to consume of the upper income groups. Consumption habits of such groups are said to be entirely out of line with those of same-ranking income groups in relatively advanced countries. The need to bring about a regressive shift in income distribution in order to check inflation, even then with only a partial success, highlights even more fundamental difficulties, e.g. gross inequalities in income distribution and a pitifully low level of private investment as was found in some of the Latin American countries. In other words, it seems doubtful if the shift in income could be justified by its favourable impact on saving as was generally expected since the propensity to save of the upper income groups was very low. It may rather be explained by a lack of balance between the pattern of consumption demand resulting from a more equitable distribution of income and the unique structure of production which has arisen over the war and the post-war periods.

In our study of the Japanese economy, a contrast, however, is noted. Private capital formation in that country was rather aided by
wide inequalities in wealth and income as also by the resistance offered by traditional Japanese values to higher standards of material consumption. Savings mobilisation became all the more easier because the initiative was taken by Government as the prime mover of the fiscal and financial mechanism. For in the early stages of Japan's modernisation, government and banks first created money and credit on a grand scale which stimulated the growth of a number of enterprises and then the government and the banking system collected private savings in money form to augment institutional savings. Private saving was also growing apace, along with taxes, and was turning towards those forms which made it more readily available for investment in government and corporate securities, either directly or indirectly through the banks.

It has now to be observed whether the inflationary price movements in the Indian economy will have provided any incentive to the growth of real domestic saving in the economy considered essential for implementing the plans for her economic development.

The third hypothesis relates to the behaviour of intersectoral price movements in the economy and is largely a derivative of the second hypothesis. In pursuing an easy money policy, the government of an underdeveloped country have to decide a pattern of development of the different sectors of the economy, mainly the industry and the agriculture. The shift of emphasis from one sector to another will have its impact upon the intersectoral distribution of income through a change in the barter terms of

7. U. Tun Wai, op. cit.
times of inflation, as the prices of foodgrains and raw materials rise faster than those of goods sold by the non-agricultural sector, the latter has to spend a relatively large proportion of its income on agricultural products that is often characterised by a relatively inelastic demand. What happens in effect is that the sector which is the main saver in the society is obliged to save less while the sector that habitually does not save very much receives more income but cannot save proportionately.

Inflation will have distorted the relative prices of different sectors of the economy and the relative incomes of the different factors of production. It will also bring about major changes in the use of productive resources by different sectors of the economy. For the resultant distribution of national income, together with the price-wage spiral, which sooner or later is likely to be generated, will tend to transform the pattern of economic activity into one that makes less productive use of national resources and, perhaps, ultimately bring about a reluctance to invest in industry and a reversion to speculative transactions in land and inventories.

Much the same thing happened in the Latin American countries. Regulation of wages and salaries was resorted to for making the drive towards stabilization more effective in both public and private sectors. These were adjusted in such a way that earnings rose less than the rate of rise in prices thereby reducing the real income of the wage and salary earning sector. The distribution of income moved yet further way from the lower income groups and subsequently the demand for industrial goods declined. But of course the
Attempts to maintain the real income of the employee sector, at a time when total real income was falling, necessarily involved a shift in income distribution. But this was not possible without ensuring a substantial change in the structure of production to bring it more in line with the pattern of demand consequent upon a more equal distribution of income.

Although a mild contrast can be observed in the history of the Japanese economy, the factors accounting for a high degree of mobilization of domestic saving can be explained partly by the government's drive in tapping the saving potential although the economy and to a greater extent, by the important role that both industry and agriculture played in that country. For although the wholesale price level rose by 150 per cent in course of four years during the First world war, by far the largest rate of increase in prices in the history of that country, it is interesting to observe that even this was turned to her advantage. Despite a substantial rate of industrial growth, real wages in industry remained rather constant. Part of the increase in national output was absorbed by an increase in population which rose by about 6 per cent in the war years. But against all this, most of the enormous gains accrued to the already wealthy classes in the form of increased rents, interest, dividends and retained corporate profits. In turn, a substantial part of the rise in income was channelled into real capital formation.

Reviewing the lessons learnt from the examples cited above it may be held that inflation in underdeveloped countries is generally attributed to an imbalance in development which is again mainly due to an increased
stress on investment in preference to saving. But economic growth, understood in this sense, will tend to become largely illusory if major emphasis is placed upon developing heavy industries with a relatively greater neglect of agriculture. For, in doing so, the trend of consumers' demand is not taken into account and the remedial course of action will continue to alternate between "allowing the rate of agricultural development to determine the overall rate of growth or breaking this restriction by permitting inflation". Anti-inflationary measures, in such circumstance, can only work to the extent that these contain an integrated policy of promoting growth in agriculture. As has been amply demonstrated in the case of the Latin American countries, the attempts of the wage-earning sector to raise its share in the national produce and even to resist a fall in its absolute real income would not be successful in the absence of a structural change in production. Thus only through a structural change poised towards a balanced development of agriculture along with industry can economic growth become possible; otherwise it might be difficult for the government concerned to successfully tackle pressure for continuously forcing their money wages up. It is our broad guess that in the Indian economy, a change in the distribution pattern of inter-sectoral incomes, consequent upon the relative shift in priorities accorded to agriculture and industry may have caused an unfavourable impact upon the growth of saving in the economy. It will be our endeavour to verify

the Indian experience in this light with a view to discover the co-relation of inflation caused through a deliberate shift in emphasis upon one sector in preference to the other and the changes in barter terms of trade through a change in relative prices during the three Five Year Plans.

The fourth and our next hypothesis is that inflation affects economic growth through a change in the capital-output ratio, in other words, through a shift in the pattern of investment that significantly affects the return on capital investment on a number of projects. In Argentina and Chile, the budget had been in large deficit for years together and tended to become unbalanced overtime. Although public investment rose to a lesser extent than the rate of growth of the gross national product, it, nevertheless, rose faster than public saving. More important yet, however, is the fact that inflation had gradually come to be regarded as the single most important factor impeding the growth of the economy. Thus in a society that had traditionally placed great emphasis on maintaining high consumption levels rather than on saving and investment, inflation contributed to a further decline in saving and to a misdirection of investments into unproductive channels. Private investment in fixed capital equipment was running at a very low level, at around a bare 5 per cent of the gross national product but this might not be due to lack of financial incentive or inability of the upper income groups to save. Chile, in particular, presents a very clear example of the distorting effects of rapid inflation on the distribution of investment. Resources tended to flow into speculation and "inflation proof" real estate and into the creation of luxury type

* Vide Chapter II.
residential building when the latter absorbed more than 45 per cent of fixed investment. This type of investment was of course of a low productivity nature. Thus capital formation did not benefit by as much as it might. On the other hand, "production began to reflect the consumption demand pattern associated with inequality, a development which was to add to inflationary pressures as time went on."11

Although the Japanese economy was in the grip of severe inflationary pressures, it was through a cautious policy of the State that resources were not allowed to be misdirected into unproductive channels. Since the government could easily channelise the domestic saving generated through easy money policy, the diversion of the income stream to the government gave the Japanese modernised industrial sector an essential infusion of capital until ploughback could take up over a good part of industrial financing. In the 1880's, a whole series of new industries took hold initially sparked by government initiative but later turned over to private enterprise and were mainly comprised of railways, ship building, cotton manufacture, silk cultivation and manufacture, coal industry and pig iron and then an entire gamut of engineering industries.12 All this was made possible because the whole process of capital formation was virtually influenced by the State at almost every point. In fact, private saving too, along with growing fiscal revenues, was turning towards those forms which made it readily available for

+ Vide ch.II.
investment in government and corporate securities, either directly or indirectly through the banks*. It is because of this highly controlled nature of the Japanese economy that investments were normally immune to the disruptive influence of inflation that is generally a characteristic in underdeveloped countries.

In an open economy, the excessive exchange depreciation induced by inflation and the protective import substitution policies which are likely to be adopted by the authorities, results frequently in a relatively high price rise in investment goods. The experience in nine Latin American countries suggests\(^{13}\) that one unit of consumption expenditure foregone in a stable country would permit the use of 15 per cent more investment in real terms than in the mild inflation countries, and almost 40 per cent more than the average for the strong inflation countries. This rise in relative prices of investment goods reduces the money rate of return on investment, and consequently, on saving with an adverse impact on the latter and a simultaneous rise in consumption. It may therefore be held that inflation gives rise to such forces as would both diminish the resources available for development and reduce the effectiveness of those funds that continue to flow into investment. Saving is likely to be lower than under stable monetary conditions and take forms less adaptable to the economy in the choice of final investment.\(^{14}\) The flow of foreign capital is likely to be

\(^{*}\) Vide ch. II.


reduced and the terms on which it comes to the country are likely to be more stringent.

It will be again wrong to suppose that all investment contribute in equal degree to the attainment of increased production and higher standards of living. This is because continuous inflation usually induces the wrong kind of investment. When the investment is of a type that increases the demand for labour and increases the supply of goods for consumption by the lower income groups, its use benefits are high. Such investment tends to raise wages relative to other incomes and to hold down the cost of living relative to other prices. Investment in industry and agriculture is notably of this type. On the other hand, when the investment is of a type that offers large profits, including capital goods, its ownership benefits are high. Investment in holding wealth rather than using it is likely to involve a high degree of ownership benefits and a low degree of use benefits. Thus the pattern of investment during inflation does not conform to a stable order on the one hand and tends to be characterised as mostly volatile in nature while, on the other hand, the development plans relate to those types of investment which are capital-intensive in nature and have long gestation lags. One can, therefore, in all probability anticipate that inflation does not always facilitate the transfer of real resources to profit earners and even if it does so, there is no certainty that such a process will lead to real investment in worthwhile undertakings. Though the Indian experience

in this regard is unlikely to parallel that of the Latin American countries in all respects, the adverse impact on investment from this source can none-theless be expected.

Our last hypothesis relates to the behaviour of wage-price spiral in a period of inflationary price rise. Although for the large part it may go untested, it has, nonetheless, some use as a general observation. It is sometimes held that inflation may not have an adverse effect on the total savings of the non-profits receiving group and hence, savings in the form of additions to cash balances in real terms may rise during the process of an inflationary price rise. This is almost certainly, however, to be offset by a reduction in other forms of savings of the non-profits receiving group. Furthermore, the liquidation of some types of previous savings by this group provides profits receivers with a means of using their savings without undertaking new investment. The net effect of inflation on saving and investment may thus be quite small. Once the price-wage spiral has begun, it may be difficult to break. The tendency for wage adjustment to keep pace with price increases is much more marked as the continuous rise in prices makes the workers more alert to protect their interests. In fact, wage increases may exceed and begin to anticipate expected price increases. In countries where prices have been rising steadily for many years, it is common to find that profits in real terms are not reasonably high. This in itself would indicate that investment is not much more than it might have been with reasonably stable prices since the level of real profits under continuous inflation is closely related to the volume of investment.

During an inflationary process there may be some increase in profits and a consequent shift in real income to the recipients of profits because of a lag in wage-price adjustment, particularly in the consumer goods industries. It is out of these increased profits that additional saving will take place, which is equivalent to the increase in investment that businessmen have undertaken on the basis of an expansion of bank credit. But there is hardly any reason to assume that the shift in real income to profits will be precisely equal to the increase in investment. For some of the increase in profits will be paid in taxes, some will be used to finance increased consumption, some will be used to transfer funds abroad and some will be used to acquire other assets at home; only the remainder will provide the net addition to savings that is the necessary concomitant of the increase in investment.

It has been found in the Latin American countries that inflation became more striking largely due to a deliberate shift in income distribution. But the attempt to maintain the real income of the employee sector at a time when real income as a whole was falling was not successful in the absence of a commensurate change in the structure of production in line with the change in the pattern of demand. But in countries where private capital formation received some degree of stimulus from inequalities in wealth and income as in Japan, wage-price adjustment did not bear any relationship with the inflationary price rise. Another factor was the growing resistance

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offered by the traditional Japanese values to higher standards of material consumption*. Again, since the unions were few and far between and free of any outside intervention, the pressure for a rise in wages was less, the productivity of labour always moved ahead of wage increases and thus helped to maintain the competitiveness of Japanese production. The wholesale price index remained fairly stable during the end of the fifties and end of the sixties because of the advance of labour productivity in line with, if not ahead of, wage increases**. Thus it is apparent that the price-wage relationship did not become as strong as it usually happens in the under-developed countries under the stimulus of inflation.

In a disarrayed inflationary process it is difficult to locate as to what extent the price-wage spiral is specifically caused by government expenditure, excessive investment or excessive expectations of labour regarding real wages. In practice, in a number of countries the use of wage-price links is a sequence of labour's reaction to a probable erosion of real income that happens in the process of inflation. On the other hand, there is also a temptation for monetary authorities to lay blame to the pressure for higher wages for causing inflation that has its real origin in excessive investment and government expenditure. With pressures developing for increases in wages to outstrip the increases in productivity, the consequent wage behaviour is to a large extent dependent on an environment of excessive investment financed by bank credit. As a matter of fact,

* Vide ch. II on Japan.

** A rough estimate is that while during 1959 to 1968 wages increased from 100 to 295, labour productivity rose from 100 to 291 points.
the wage-price spiral is itself conducive to excessive investment by creating expectations of rising prices and costs. Business also support the scheme under such conditions in order to avoid the extreme and haphazard wage demands that might develop later on. But it should be noted that the degree of flexibility in the economy is reduced by the linking of wages and prices.

There may be a slight modification in this regard. The method of linking industrial wages with industrial productivity may not be always correct since industries cannot be treated in isolation once their impact upon the rest of the economy is taken into consideration. Price and wage levels in one industry or one sector must ultimately affect the price-and-wage level in other industries and also other sectors of the economy. If in a country the manufacturing sector is a small one compared to the size of the national economy which in its turn is dominated by agriculture as in the Indian case, it may be presumed in all probability that money wages in industry may not move very much ahead of the average income in the overall economy. If it does, it will exert a demand pull on agricultural prices, push the general price level upwards and depress real wages. In other words, although industrial labour may feel aggrieved since their incomes do not always reflect productivity gains they must admit, however, that their purchasing power is ultimately decided by the efficiency of their fellow workers on the farms.

19. E.M.Bernstein, "Wage-price links in a prolonged inflation"
I.M.F. Staff papers, 1957-58, pp. 325-343.