VI

THE FIRST FIVE YEAR PLAN

THE PRE-PLAN PERIOD

The First Five Year Plan was preceded by two very important events in the economy of the country. We had devalued our currency along with other members of the Sterling block excepting Pakistan. This was called a defensive measure. India had to devalue the rupee in order to prevent the loss of foreign markets because of competitions from the countries which had devalued. Devaluation was also expected to correct our adverse balance payments, which had posed a serious problem before the country. The immediate effect of devaluation was an improvement in our balance of payments position. The gap between our exports and imports had considerably narrowed in the year after devaluation. Whereas in 1948-49, India had an overall adverse balance of payment on current account to the extent of Rs. 252.1 crores, the adverse balance in the succeeding year i.e., in 1949-50 there was a favourable balance of trade to the extent of Rs. 38.9 crores.

The change in our balance of payment position which was the second important event, was not solely on account of
the devaluation of the rupee, it was also a result of the out-break of the Korean war in 1950. With the involvement of the U.S.A. in the Korean war, there was a strong apprehension throughout the world that the war may become global and long drawn. On the economic front it meant stock piling of war materials and other essential consumption goods. All these circumstances had pushed up the export of Indian goods, particularly jute. "In 1949 - 50, however, exports increased to 514 crores owing to devaluation of the Rupee in September, 1949. In 1950 - 51, exports were influenced by the Korean war boom as a result of which they spurted to 647 crores".1

At the commencement of the First Five Year Plan, the economic condition of the country was not in a normal state. There was an acute shortage of food and raw materials. In the year 1950 - 51, the out turn of Kharif and Rabi crops suffered a great deal on account of a series of natural calamities. The loss of food grains was estimated to be about 5.5 million tons. The shortages of raw materials - an after effect of partition - continued in the year 1950 - 51. There was also a fall in industrial production in the year 1950. The general index of industrial production (Base 1946 = 100) for 1950 was at 105.2 as against 106.3 in 1949. The rehabilitation of refugees from Pakistan still posed a special problem.

The transport system was facing a serious bottleneck.
"Imports of food had reached the figure of 4.7 million tons in 1951, the highest ever recorded".

Whereas, the First Five Year Plan formally commenced from the 1st April, 1951, it was finalised in December, 1952. It may therefore be said that it was a four year plan, put into effect from December, 1952. The Indian economy changed its course at the end of 1951 - 52 and had taken a start towards a healthy growth. It was, therefore, possible (at the end of this year) to contemplate and undertake a large scale investment programme for economic development.

The strong inflationary pressure generated, due to Korean war slowed down in several countries including India from the second quarter of 1951. The anti-inflationary fiscal and monetary measures taken by several countries bore fruits. The Korean war boom was essentially a raw material boom. Stock piling of internationally traded strategic raw materials pushed up their prices. The Index of prices of industrial raw materials in India which was at 490 at the commencement of the Korean war spurted to 689 by the middle of 1951. The general index of wholesale prices moved from 393 in May, 1950 to 458 in April, 1951. The anti-inflationary measures taken by the Government in 1951 - about which

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we shall discuss shortly — and the economy returned back to near normalcy.

There was a higher agricultural and industrial production in India in 1951 - 52. The general index of prices at the end of 1951 - 52 was lower by 16 per cent as compared to that in 1950 - 51. The big gap in our export and import trade was rather beneficial to the country, as it had an anti-inflationary impact on the country's economy. The deficit in balance of payment was paid from the external assistance we received and out of the surplus we had earned during the previous year. On account of a general decline in prices, controls were removed from certain sectors.

The anti-inflationary measures taken in 1951 - 52 were mainly fiscal and monetary in character. The Government budgets for the year showed a substantial surplus on revenue account, which was to be utilised for meeting a part of the capital expenditure. Export duties were retained during the greater part of the year. The revenue surplus for the year amounted to Rs. 92.61 crores.

Two anti-inflationary monetary measures were undertaken — (a) a change in the bank rate from 3 to 3½ per cent from November, 15, 1951 and (b) the more strict lending policy of the Reserve Bank. The Reserve Bank announced at the end of 1951, that during the ensuing busy season, it would refrain from buying Government securities excepting
under extra-ordinary conditions. It was, however, stated that the Reserve Bank would lend money at Bank Rate against approved securities. "The new monetary policy undoubtedly helped to curb the inflationary tendencies during the First Five Year Plan". So we once again repeat that when the First Five Year Plan was finalised the economy had very few inflationary elements to cause any anxiety.

A group of people apprehended that a world wide recession was to start from this period due to an end of Stock piling in U.S.A. and a temporary recession in that country. But this did not prove to be correct. This happened to be just a temporary exhaustion of inflationary pressure created by the Korean War. It was wrong to interpret this as a starting point of a recession. The prediction proved to be as incorrect as the prediction of recession after the Second World War. It is said that, "The most outstanding — and for many the most unexpected — consequence of the Second World War has been the fact that there was no post war depression of the kind that beset so many countries in the years 1921 - 23". The prediction of a recession after World War having proved wrong — those expecting it perhaps thought that in any case the recession cannot be prevented now after the cessation of Korean War. Their expectation again belied them.


2. Per Jacobsson: Some Monetary Problems International and National, Background, p. 41.
THE NEED FOR AN ECONOMIC PLAN IN INDIA

It is an accepted fact that the Indian economy is backward and that India is an underdeveloped country. Recently countries like ours who have embarked upon plans of economic development began to be termed as developing countries. When we started the First Five Year Plan, we had all the characteristics of underdevelopment in the country - they are still there excepting that we have created dynamism of growth in the country. The country had an excessive population and the most of it was not gainfully employed. There was a high infant and female mortality in the country and the expectation life in the country was very low. The economy of the country was predominantly agricultural with practically no signs of modernisation. The per capita income and the capital formation in the country was very low. The taxable capacity of the people being as low as 7 per cent of the total national income. All these things made the country's economy underdeveloped and the plan was to aimed at erasing out these signs of underdevelopment from the country.

There are some people in the country who still maintain that the free interplay of market forces, which balance the economy of any country should not be disturbed by economic planning and state interference. The champions of planning who are opposed to such ideas, feel that such free interplay of market forces may encourage investments most profitable to
the individuals and not those essential for the society. It may cause extreme inequality of distribution of wealth and finally imbalance in the economy of the country. The fate of the people in the country becomes dependent on the whim of pessimism and optimism of a handful of people in whose control the economy gradually passes.

In an underdeveloped economy like that of India where finance capital rather than industrial capital dominates the market, economic planning by the state is inevitable as otherwise there will be no industrial development, nor adoption of new techniques in agriculture and industries nor will there be any substantial investments in research. The country's economy in consequence would remain permanently stagnant.

The Governments in most of the underdeveloped countries, have, therefore, taken on themselves the responsibility of making economic planning and their execution. "The truth is that we are all planners now."¹ There are some Governments who cleverly avoid using the word plan in their economic programmes though they have definite economic plans for their countries. "A very interesting development in this connection (to remove economic backwardness) is the growing feeling of the need for some kind of economic planning by government,

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though some governments seem to be careful to avoid the word "plan" but have a word like 'program'.

Prior to the formulation of the First Five Year Plan in 1952, a number of developmental plans for the country were prepared. The two more important of them were - (i) the Bombay Plan and (ii) the post-war Reconstruction Plan. The Bombay Plan had amongst its framers Dr. John Mathai, Mr. J.R.D. Tata and Mr. A.D. Shroff. Sir Ardeshir Kulal, who was also associated with the Bombay Plan joined the Executive Council of the Viceroy as the Member for Planning and Development and prepared the post-war Reconstruction Plan. It was during Dr. John Mathai's, Finance Ministership that the Planning Commission was set up in India.

The Bombay Plan's object and strategy for development were described in the following words, "The future economic structure should provide for the free enterprise, but enterprise which is truly enterprising and not a mere cloak for sluggish acquisitiveness. It must ensure at the same time that the fruits of enterprise and labour are finally apportioned among all who contribute to them and not unjustly withheld by a few from the many". It was further stated in the

2. Quoted by Dr. G.D. Deshmukh: Economic Development in India 1946 - 1956, p. 70.
Bombay plan that there should be the least possible state interference. The ownership and control of industries should be kept outside state interference. The state should fix fair prices for all agricultural products. It may be pointed out here that the makers of Bombay plan could not foresee food shortages in the country. They rather acted against a background of depression in agricultural prices. The plan was made for a period of 15 years and the total outlay through state and private enterprises was to be Rs.20,000 crores. The per capita income in the country at the end of the plan was to go up from Rs.65 to Rs.135.

The post-war Development plan was primarily an anti-depression plan. The work for the preparation of the plan was started in 1944, when the Viceroy appointed a Planning Advisory Board. In May, 1944, all Provincial Governments were asked to prepare their development plans. The total outlay for Central and Provincial Plans was estimated to be Rs.1,295 crores. The first post-war Development plan was to cover a period of 5 years. It was to commence from 1947. The Central Government had to spend Rs.1,000 crores for its developmental work. Half of this expenditure was to be met from Revenue surplus and the remaining half from loans.

A brief resume of these two earlier plans has been given in order, "to give an idea of the scale and quality of planning in certain very different circumstances".¹

¹ Quoted by Dr. C.D. Deshmukh: Economic Development in India 1946 - 1957, p. 77.
Through the Five Year Plans in India a systematic and consistent effort has been made to eliminate the poverty of our people. It has been once and for all realised by the leaders of the country that the poverty of the people cannot be removed unless a consistent planned effort is made for its eradication. The Indian economy cannot be left to the free play of market forces. "The Central objective of planning in India at present said the Planning Commission, is to initiate a process of development which will raise the living standards and open out to the people new opportunities for richer and more varied life".¹ The aim of planning in India as stated by the Bernstein Mission was as follows: "The basic economic problem of India is the widespread poverty of its people. . . . The Five Year Plan occupies the central position as the means through which the Government of India proposes to deal with the basic economic problem".²

THE FIRST FIVE YEAR PLAN

The First Plan can be studied in three parts — (i) the targets of the Plan; (ii) the resources for the Plan and (iii) the fiscal and monetary policies during the Plan.

The target of the Plan was to increase the National

income of India from Rs. 900 crores at the inception of the plan to Rs. 10,000 crores at the end of it. The plan thus aimed at increasing the national income by 11 to 12 per cent. No estimate was made of the rise in per capita income during the First Plan years. It was rather estimated that "per capita income can be doubled by about 1977 i.e., in about twenty seven years and the level of consumption raised by a little over 70 per cent over that of 1950 - 51". ¹

At the inception of the First Plan, the rate of capital formation in the country was about 5 per cent of the national income. This rate of capital formation was barely sufficient to keep the economy in a static condition. It could hardly cause the economy to grow. Writing about the low percentage of capital formation to the national income in the country the Breunstein Mission said, "This (means this rate of capital formation) was apparently enough to provide the tools and equipment to enable a population growing at the rate of 1.27 per cent per annum to carry on production in much the same way and with approximately the same productive efficiency. It left little surplus for creating an expanding economy". ²

For every country there is a certain minimum proportion of national income, which must be reinvested for an increase in

². Economic Development with Stability, Bernstein Mission, p. 3.
production and per capita income. A country which fails to make that much of investment is sure to stagnate. The First Five Year Plan aimed at starting a rise in the rate of capital formation in the country to this level. The plan aimed at raising rate of saving - which was to be ultimately invested from the existing 5 per cent to 64 per cent of the national income at the end of the plan. It was estimated that the proportion of savings will go up to 11 per cent by 1960 - 61 and to 20 per cent by 1967 - 68. The increase in the rate of capital formation aimed at in the First Five Year plan was much lower than already existing in countries like U.S.A., U.S.S.R., Poland, Hungary, Japan and other developed countries. But when we look at the low standard of living of the people - who have one of the lowest standard of living in the world - we can say that only a very modest increase in capital formation could be possible in a period of five years. A much higher rate of forced savings and investment would have simply starved the people. No democratic country can afford to do this. Besides economic development, the plan aimed at developments in the field of Education, Health, Social Welfare and Public Administration. Though these are not directly connected with the economic development of any country, they widely influence the economy of any country.

The First Five Year Plan had therefore fixed the targets of achievements in the various sectors of the economy like Agriculture, Industries, Minerals, Transport, etc. etc.
The targets of achievements in the non-economic sectors were also fixed. Targets were fixed in terms of physical achievements and financial investments. As the country was suffering from chronic food shortages the plan gave the highest priority to agricultural programmes. 38.5 per cent of the total outlay was to be allocated for agriculture and community development, irrigation and multi-purpose irrigation and power projects.

The First Five Year Plan had to be a modest one for the following reasons — (i) a country which has no past experience of planning cannot suddenly venture a very big plan of economic development; (ii) the planning machinery being still incomplete it was not possible to make out a big plan; (iii) a country before it starts a bold plan must have a well developed administrative machinery to implement it, which we did not have and (iv) finally, it was not possible to make a grand scale bold plan, because we lacked adequate resources for it. Doubts were expressed in some quarters even about the achievement of these modest targets of the plan. The Bernstein Mission insisted that resources must be found for this modest plan. Mission's Report stated, "It would be tragic if this essential development programme designed to give momentum to the economy of India had to be pared down for lack of resources". 1

The First Five Year Plan made an estimate of developmental expenditure in both public and private sectors. Initially the plan expenditure in the public sector was estimated to be ₹2,069 crores. It was subsequently revised to ₹2,378 crores and again to ₹2,013 crores. However, the actual plan expenditure was only ₹1,960 crores.

There were short falls in expenditure under almost all the heads. The investment in the first two years of the plan was very low. Though in the remaining three years of the plan it had gained speed.

The resources for the plan investments were to come from: (1) The budgetary surplus during the five years; (ii) Contribution by the Railways; (iii) Additional taxes; (iv) Savings of the public obtained through loans and (v) Deficit Financing. Besides these internal resources, the Plan took into consideration the following external resources: (1) Sterling balances with Britain; (ii) Foreign aid from friendly foreign countries like U.S.A., West Germany, U.K., U.S.S.R., etc. and (iii) the loans from the International Organisations like I.M.F. and I.B.R.D.

Briefly the plan outlay of ₹1,960 crores in public sector was financed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs. crores</th>
<th>Percentage of the total</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Taxation and the surplus of railways</td>
<td>... ... 752</td>
<td>38</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(in crores)</th>
<th>Percentage of the total</th>
</tr>
</thead>
<tbody>
<tr>
<td>(b) Market borrowings ... ... 205 10</td>
<td></td>
</tr>
<tr>
<td>(c) Small savings and unfunded debt ... ... 304 16</td>
<td></td>
</tr>
<tr>
<td>(d) Other capital receipts ... ... 91 5</td>
<td></td>
</tr>
<tr>
<td>(e) External assistance ... ... 188 10</td>
<td></td>
</tr>
<tr>
<td>(f) Deficit financing ... ... 420 21</td>
<td></td>
</tr>
<tr>
<td><strong>1,960</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The Planning Commission was not very confident of raising sufficient internal loans. That was the time when people not only disliked to possess Government securities, but they did not like even to keep money in cash. According to the Commission, "The Korean war encouraged sections of the community to move away from holdings of money to holdings of commodity". 1

A country like India which cannot make all necessary investments from internal resources, even for a very modest plan, has to rely on foreign assistance. Foreign capital has helped in the economic development of many underdeveloped countries of the world. The developed countries have also taken on themselves the responsibility to help the underdeveloped countries with capital resources and technical

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knowledge. What made them to take such a responsibilities on themselves? It is because they feel as stated by the President of the World Bank, Mr. Eugene Black 'poverty at one place threatens prosperity everywhere'.

Writing about the importance of foreign capital in the economic development of an underdeveloped country, Prof. Nurkse said, "Past experience suggests that governmental investment financed by foreign loans can be suitable method of laying the foundations of a country's economic development". The best way to get foreign aid without interference in the political or economic life of a country is to get assistance from the International Institutions like I.M.F., I.B.R.D., I.P.O. and I....., etc. Of the expected total, foreign aid of Rs.156 crores, only Rs.9 crores was expected from the International Bank.

The plan estimated an amount of Rs.290 crores to be met through deficit financing. Even then there was a shortfall of Rs.365 crores, which was expected to be met either from external resources or by means of additional taxes, borrowings and deficit financing.

DEVELOPMENT VS. STABILITY

The question whether there should or should not be

1. Prof. Ragnar Nurkse : Capital Formation in underdeveloped countries, p. 91.
price stability during the implementation of an economic development plan is a much debated question. The views on this vexed question are sharply divided. There are people like Dr. Madan who feel that development efforts should be coupled with price stability. In his words, "Economic policy in most countries now is based on acceptance of the fundamental objective of promotion of development with stability. In specific terms this means attainment of a steady growth of the national product and reasonably full employment with general financial including price and exchange stability."¹ The view expressed by the Planning Commission at the inception of the First Plan was that some price increase was inevitable during the plan period. But such rise in prices should be kept within control and should be related to the rise in production. There was another group of people who thought that development expenditure in a country should be increased in successive stages irrespective of price increase. In the post-war world, they thought, economic growth can be attained only through inflation. Mr. B.N. Simha pleads for an intermittent rise in prices during the period of economic development. He thinks that a rising prices should be followed by a period of price stability. He writes, "There is therefore, much to be said

¹ Dr. B.K. Madan : The Role of Monetary Policy in a Developing Economy, p. 21.
in favour of intermittent rises even if this would lead to some jerks in economic growth, though the trend should definitely be upward. In this way it may be possible to succeed to some extent in rendering inflation "self-liquidating". 1

The Bernstein Mission gave a very original definition of inflation. Its views about development with stability are likely to be guiding principles for the future planners of India. The Mission did not call all rise in prices as inflation. The Mission divided the price rises into — (i) Inflationary rise in prices and (ii) Functional rise in prices. According to the Mission the inflationary rise in prices is continuous and all pervading. The functional rise is temporary and confined to certain sectors. According to the Mission inflationary rise in prices should be kept under a check while the functional rise was inevitable. The Mission said, "In every country, a rise in the proportion of the national income going into investment sets up forces that induce an upward adjustment of prices in the sectors in which expansion is relatively large. This functional rise in prices should not be confused with an inflationary rise in prices. Even if the Government of India had all the resources needed for development, so that there could be

no problem of inadequacy of resources, some readjustment of prices would and should occur in conjunction with the implementa-
tion of the Five Year Plan.¹

The Mission had itself acknowledged the difficulty of distinguishing between inflationary and functional rise in prices during the working of any developmental plan. The practical experience of a planned effort for economic development has been that during the working of such plans in any underdeveloped country some mild inflationary rise in prices is inevitable. It rather makes the economy healthy, and encourages production.

DEFICIT FINANCING, PRICE STABILITY AND FOREIGN AID

While speaking about plan resources we referred to Deficit Financing. It is deficit financing which generally causes inflation during the period of development. Deficit Financing during the First Plan was described in the following words, "The Government of India is undertaking a considerable part of investment for development. It is clear that current revenues and the process of loans from the public, including commercial banks, will not provide sufficient funds to meet the requirements of the Government for its part of the financing of the Five Year Plan. The Government will, therefore, find it necessary to draw down its cash balances

and borrow from the Reserve Bank of India. The financing of the uncovered deficit in this way is called 'deficit financing' in India'.

Why deficit financing causes inflation? The answer is very simple. The developmental work that is undertaken with such created money gives employment and purchasing capacity to a large number of people. This causes an increase in demand for consumers' goods. The projects that are undertaken with the help of this created money start production only after some years—in some cases up to ten years. Thus whereas deficit financing increases the demand for consumers' and other goods, the supply of these cannot be quickly increased. With an increase in demand, the supply remaining practically constant, there is an increase in prices. The more the deficit financing, the more severe inflation there is likely to be in an underdeveloped country. But the case of developed countries is different. In a developed country the stock of goods is generally sufficient to meet any increase in their demand within a short time. Deficit financing under such circumstances, causes, a higher level of employment and a healthy growth of industries.

When a country like India takes recourse to deficit financing for the implementation of its economic plan, it

must take notice of the following:

1) It should invest money primarily for productive purposes.

2) The money should be preferably invested in such schemes, which yield production in a short period, and

3) Deficit financing should be the last resort and all possible precautions should be taken to see that the supply of money does not become excessive.

When the Plan commenced, there was control on the prices and distribution of a large number of essential goods, because of their short supply. It was, therefore, expected that with an improvement in the supply of essential goods in the later years the Government would remove such controls. In 1953, the controls were actually removed.

The aids received from foreign countries are also anti-inflationary in character. Unfortunately the proportion of foreign aid that India received during the First Plan was extremely meagre. Prof. Mohalanobis estimates the proportion of foreign aid to the total of our economic development expenditure to be 3 per cent. With the help of foreign aid we can import consumers' as well as capital goods. As such the increased supplies of foreign consumers' goods goes against the inflationary consequences of deficit financing.

THE SUPPLY OF MONEY DURING THE WORKING OF THE FIRST PLAN

We have already marked that the First Five Year Plan
was in fact a four year plan. During the first two years of the Plan, rate of investment was considerably low. It gained speed in the fourth and the last year of the Plan and caused considerable strain on the economy. The Plan outlay rose from a moderate figure of Rs. 259 crores in 1951 - 52 to Rs. 273 crores in 1952 - 53 and Rs. 340 crores in 1953 - 54. Thus during the first three years period the total outlay was Rs. 872 crores. In 1954 - 55 and 1955 - 56, the Plan outlay was Rs. 475 crores and Rs. 600 crores respectively. For the five year period, the total amount of deficit financing amounted to Rs. 420 crores - Rs. 241 crores in the first four years and the remaining Rs. 180.4 crores in the last year. As compared to the Plan outlay of Rs. 160 crores, deficit financing worked out to 21 per cent of the total outlay.

The money supply in 1951 - 52 underwent significant changes. The outstanding feature during the year was the decline of about Rs. 174 crores in money supply as against an increase of Rs. 99 crores in 1950 - 51. Another notable feature of the year was the relatively small expansion of money supply during the busy season. As compared to an increase of Rs. 216 crores in money supply during the busy season of 1950 - 51, the increase in 1951 - 52 was only Rs. 9 crores. In contrast to 1950 - 51, when there was a sharp expansion of currency notes by Rs. 83.89 crores - in 1951 - 52, there was a net contraction of currency notes by Rs. 100.21 crores. The decline in money supply was due to - (1) a
decline in currency circulation and (ii) a considerable
deficit in our balance of payments.

In the year 1952 - 53, money supply with the public
further declined by about ₹39 crores. This contraction
in money supply during the year was mainly as a result of
the dis-inflationary policies the Government had prosecuted
since November, 1951. The two main reasons which accounted
for the fall in money supply during the year were — (a) the
contraction of scheduled bank credit by ₹51 crores as com-
pared with a contraction of ₹46 crores in 1951 - 52 and (b)
an increase of ₹27 crores in time deposits.

The reasons for a smaller contraction of money supply
during 1952 - 53 were — (i) whereas in 1951 - 52 there was a
considerable deficit in balance of payments, in 1952 - 53, the
payments were almost balanced, and (ii) in 1952 - 53, there
was a considerable deficit in Union budget, while in 1951 - 52
there was a small surplus. Circulation of the currency notes
at the end of March, 1953 was ₹1,135 crores compared to
₹1,141 crores in March, 1952.

In 1953 - 54, money supply with the public recorded a
sharp rise of ₹29.26 crores in contrast to a fall in the
past two years. It will be noticed that during the first
three years of the First Plan - money supply with the public
had recorded a net decline of ₹184.74 crores.
The rise in money supply with the public during 1953 - 54 resulted mainly from the balance of payments surplus which occurred during the year, from a position of near balance in 1952 - 53 and the deficit of Rs.17 crores in the Union budget. There was an increase in currency supply with the public to the extent of Rs.30.18 crores as compared to a fall of Rs.17.32 crores and Rs.110.8 crores in 1952 - 53 and 1951 - 52 respectively.

The money supply in 1954 - 55 increased by Rs.126.66 crores. This increase was higher than that in the previous year. The large increase in money supply in 1954 - 55 further reduced the figure of the decline in money supply with the public to about Rs.57 crores at the end of 1954 - 55. Of the total expansion of Rs.126.66 crores in money supply, Rs.82.34 crores was due to currency expansion and Rs.42.34 crores on account of an increase in deposit money.

The expansion in money supply in 1955 - 56 was considerably large. During the year, money supply with the public rose by Rs.264 crores (or 13.7 per cent) to Rs.2,184 crores as compared to the increase of about Rs.127 crores in 1954 - 55.

At the end of the First Five Year Plan, the amount of money supply with the public increased only by about Rs.206 crores, whereas the total of deficit financing during the plan was Rs.420 crores. So that the increase in money supply
during the First Plan was for less than the total amount of
deficit financing consequently the Indian economy had not to
suffer the full inflationary effect of deficit financing.

Table - 23

MONEY SUPPLY WITH THE PUBLIC

(Rupees crores)

<table>
<thead>
<tr>
<th>Last Friday</th>
<th>Currency with the public</th>
<th>Deposit money with the public</th>
<th>Money supply with the public</th>
<th>Variation in money supply with the public</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951 - 52</td>
<td>1,216.57</td>
<td>987.22</td>
<td>1,803.79</td>
<td>-174.92</td>
</tr>
<tr>
<td>1952 - 53</td>
<td>1,199.25</td>
<td>565.46</td>
<td>1,764.71</td>
<td>-39.08</td>
</tr>
<tr>
<td>1953 - 54</td>
<td>1,229.43</td>
<td>564.54</td>
<td>1,793.97</td>
<td>+29.26</td>
</tr>
<tr>
<td>1954 - 55</td>
<td>1,311.77</td>
<td>608.86</td>
<td>1,920.63</td>
<td>+126.65</td>
</tr>
<tr>
<td>1955 - 56</td>
<td>1,503.09</td>
<td>679.23</td>
<td>2,184.32</td>
<td>+263.69</td>
</tr>
</tbody>
</table>

* Reserve Bank of India : Annual Report on Currency and

The changes in price-level during the plan

The general index of wholesale prices in India with 1939 as base was 385.4 in March, 1950 and the cost of living index was 291. It was for this reason that the Bernstein Mission had to say the following about price policy during the plan period. *To super-impose a rise in prices (during
the 5 year period) on the large rise that took place between 1940 to 1950 would be to compound injury that has already been suffered by many whose income cannot respond to inflation". ¹

The price situation during the First Plan period was as follows:

**Index Number of wholesale prices in India**

*(1951 - 52 to 1955 - 56)*

*(1939 = 100)*

<table>
<thead>
<tr>
<th>Average of weeks</th>
<th>General Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>End of March, 1951</td>
<td>438.6</td>
</tr>
<tr>
<td>1951 - 52</td>
<td>434.6</td>
</tr>
<tr>
<td>1952 - 53</td>
<td>380.6</td>
</tr>
<tr>
<td>1953 - 54</td>
<td>397.5</td>
</tr>
<tr>
<td>1954 - 55</td>
<td>377.5</td>
</tr>
<tr>
<td>1955 - 56</td>
<td>360.4</td>
</tr>
</tbody>
</table>


In 1951 - 52, there was a fall in prices in India. This was due to — (i) the anti-inflationary measures of the Government; (ii) the end of the Korean war boom and (iii) rise in the industrial and agricultural production. The price level showed more or less a continuous downward trend.

some of the price and distribution control measures that were in vogue during the year, were relaxed by the end of the year. The year witnessed a price decline throughout the world. This was mainly due to a halt in the mounting defence expenditure and stock-piling of war materials in U.S.A. and other continental countries. Once again there was an apprehension of a slump throughout the world.

Mr. Trygve Lie, Secretary General of the U.N., therefore called a meeting of five experts to find out ways and means to ward off the expected world wide slump. "The experts have shaken off the bondage of the economic theories, that has so far held the field in regard to the origin and cause of a slump". The experts' opinion was that a slump is not caused in the modern world due to overproduction and lack of demand within the same country. The experts held the view that so long as there are a large number of under-developed areas in the world, who are in perpetual need of capital goods and industrial raw materials, there can be no wide scale long period slump in the world. An international economic co-operation, between the developed and under-developed countries of the world will permanently solve the problem of economic slump.

In 1952 – 53, there was again a fall in prices. The Economic Adviser’s index showed a decline of 54 points.

In the year 1953 – 54, Economic Adviser’s General Index of wholesale prices (base : year ended August, 1939) recorded a rise of 17 points. The improvement in supply position resulted in a further progressive relaxation of controls, particularly on food grains and cotton textiles. This was not followed by any price increase. "It (rather) resulted in all-round increase in production".¹

We have already stated that the amount of money supply in 1953 – 54 increased by Rs.29.26 crores as compared to a fall of Rs.39.08 crores in the previous year. Price and distribution controls over a large number of consumers’ goods were either removed or relaxed. But even then there was no sharp rise in prices. This was on account of a record agricultural production in that year and in the previous year. "Agricultural production touched a record level in 1953 – 54 and was 11 per cent higher than that in the previous year".² Industrial production had been rising continuously since 1950.

Against the background of increased money supply of Rs.126.6 crores in 1954 – 55, there was a sharp decline in

commodity prices. Over the year the general index of wholesale prices (base: year ended August, 1959 = 100) showed a sharp fall of 20 points. The main factor contributing to the downward movement in prices was the increased pressure of supplies resulting not only from bumper crops and growing industrial output but also due to a large volume of imports and dehoarding of accumulated stock due to the removal of controls.

In the last year, i.e., 1955-56, the price level further came down inspite of an increase of Rs. 264 crores. However, the prices had begun to rise towards closing months of the year. The rise, that had started in fact was in first instance regarded as a corrective of the fall that had already taken place. The Government even went to the extent of giving support to falling prices. The continuous upward movement of prices during the later half of the year was on account of a fall in agricultural production, floods and increase in the demand owing to the peoples' increased capacity to purchase.

If we review the Plan period as a whole we find that price level at the end of the Plan was 78 points lower than that at the commencement of the Plan, though money supply during the same period increased from Rs. 1,979 crores to Rs. 2,184 crores i.e., by a little over 10 per cent. This could happen only because the output during most of the Plan period recorded a marked increase. "On the whole, the implementation of
the development programmes in the Plan did not cause any significant strain on the economy mainly because of the increases in output.¹ Favourable natural conditions which caused an increase in agricultural production could neither be created nor forecasted. Good harvests which brought about a fall in prices were primarily due to this. This favourable condition during the First Plan period has been stated as something, "dependent to a great extent on conditions which could not be planned or even forecast with confidence".² Sir B. Rama Rau very correctly stated that the price stability during the Plan period was more due to increased production rather than the anti-inflationary monetary policies that were started from November, 1951. In his words, "The new monetary policy undoubtedly helped to curb the inflationary tendencies during the First Five Year Plan, but, in my opinion, the principal factor that brought about a remarkably steady price level during the First Plan period was the striking increase in production".³

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1. Planning Commission: Review of the First Five Year Plan, p. 11.


FOREIGN AID, BALANCE OF PAYMENTS AND THE PLAN

At the inception of the Plan, it was expected that a total of ₹156 crores would be received from foreign countries as loans and grants. The actual receipts were, however, unexpectedly more at ₹298 crores. Of this about ₹94 crores worth of foreign aid was carried over to the Second Plan.¹ Most of the total loans and grants came from U.S.A. The figure came to ₹232 crores. Loans from the I.B.R.D. were a little over ₹12 crores. The contribution to our Development Plan by the I.B.R.D. was therefore very meagre. This has been due to businessman like behaviour of the Bank. It was stated by the World Bank President in his farewell address, when he was relinquishing his post, that the Bank makes investments on sound business principles. That is it would not only make investment on humanitarian ground, but with due consideration to the return on and the safety of the invested capital. "India could therefore say that although the treatment it has received from the Bank is not bad it is certainly not too generous".² Contributions from Colombo Plan countries totalled about ₹45.5 crores, and the Canadian Government gave ₹32 crores. These were some other important contributions to our Plan.

Foreign loans and grants sanctioned during the first two years of the Plan amounted to ₹110.4 crores. In the next two years foreign assistance available was for a further amount of ₹35 crores. The whole of the foreign assistance available during the five years could not be entirely utilised within this period, because the rate of utilisation of such assistance in the first three years was very low as compared to the amount of assistance available. And the slow rate of utilisation of foreign assistance in the earlier years of the Plan was due primarily to the delays in the formulation of various programmes, the shortages of requisite equipment and personnel and the difficult position regarding steel and shipping.¹

**Balance of Trade and Payments**

We have already stated in the previous chapter that India's balance of trade and payment which was adverse during the post-war years, suddenly changed into surplus in 1950 - 51. This change was due to the Korean War boom, the devaluation of the Indian Rupee and the restrictions imposed on imports. The balance of trade and payments position during the First Plan period was influenced by certain external as well as internal factors. Among the external factors, the Korean War boom and the temporary recession in the U.S.A. in 1953

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¹ Planning Commission : Review of the First Five Year Plan, p. 31.
were some of the important ones. The internal factors which influenced our foreign trade were record agricultural production due to good monsoons and increasing industrial production.

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<th>Table - 24</th>
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<tr>
<td><strong>INDIA'S OVERALL BALANCE OF TRADE: 1951-52 TO 1955-56</strong></td>
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<tr>
<td>(Rupees crores)</td>
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<tr>
<td>Imports</td>
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<td>Exports f.o.b.</td>
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<td>Trade Balance</td>
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In the year 1951-52, our foreign trade, particularly exports, were influenced by the Korean war boom. Exports reached an all-time peak of 730 crores. The prices of export commodities had also gone up. The imports were equally high, being the highest in the whole Plan period. The imports amounted to 963 crores. This big jump in imports was due to the policy of import liberalisation followed by the Government. The adverse balance was more marked in the case of our trade with the countries outside the sterling area. "If Pakistan were to be left out of
account, India's trade surplus with the Sterling Area amounted to ₹112 crores in 1951 as against ₹61.5 crores in 1950.¹

There was a steep fall both in exports and imports during the next two years i.e., during 1952 - 53 and 1953 - 54. Exports in the two years came down to ₹692 crores and ₹540 crores respectively. Similarly, imports declined to ₹633 crores and ₹592 crores respectively. Owing to a fall in imports, trade deficit which was ₹233 crores in 1951 - 52, dropped down to ₹31 crores and ₹52 crores during the two respective years. The balance of payments on current account which included official donations and other invisible items showed a surplus of ₹60 crores in 1952 - 53 and ₹47 crores in the next year. The impact of economic development on our balance of trade and payments was clearly visible during the last two years of the Plan. There was once again an increase in imports and exports. Imports increased on account of a rise in domestic investments. In 1954 - 55, the imports amounted to ₹690 crores and in 1955 - 56 to ₹773 crores. Our exports had increased on account of a rising economic activities and the policy of import liberalisation adopted by a number of important countries. But the rise in exports was far less than the increase in imports. This resulted

¹ Indian Finance: June 7, 1952, Balance of Payments in 1951.
in increasing trade deficit, which amounted to ₹52 crores in 1953 - 54, ₹93 crores in 1954 - 55 and ultimately to ₹133 crores in 1955 - 56. But even with this continuous adverse balance of trade during the five years, practically all through the Plan period, we had a favourable balance of payments. This could be possible, because of the foreign assistance, official donations and other invisible earnings of the country.

Table - 25

**INDIA'S OVERALL BALANCE OF PAYMENTS : 1951-52 TO 1955-56**

(Rupees crores)

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<tbody>
<tr>
<td>Imports</td>
<td>962.9</td>
<td>633.0</td>
<td>591.8</td>
<td>689.7</td>
<td>733.1</td>
</tr>
<tr>
<td>Exports</td>
<td>730.1</td>
<td>601.9</td>
<td>559.7</td>
<td>596.6</td>
<td>640.3</td>
</tr>
<tr>
<td>Trade Balance</td>
<td>-232.8</td>
<td>-31.1</td>
<td>-52.1</td>
<td>-93.1</td>
<td>-132.8</td>
</tr>
<tr>
<td>Non-monetary Gold</td>
<td>1.0</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Official Donations</td>
<td>+ 5.3</td>
<td>+10.8</td>
<td>+19.0</td>
<td>+21.7</td>
<td>+51.9</td>
</tr>
<tr>
<td>Other Invisibles</td>
<td>+ 65.9</td>
<td>+80.5</td>
<td>+80.5</td>
<td>+77.4</td>
<td>+87.6</td>
</tr>
<tr>
<td>Current Account Net</td>
<td>-162.6</td>
<td>+60.2</td>
<td>+47.4</td>
<td>+6.0</td>
<td>+6.7</td>
</tr>
</tbody>
</table>

Excepting for the year 1951 - 52, there was an overall balance of payments surplus on current account during the whole of the Plan period. This was reflected in the net accretion to the foreign exchange reserve of the country from 1952 - 53, except in 1954 - 55 when there was a draft of ₹18 crores on the Reserve.

The Plan had estimated a balance of payment deficit (on current account) between ₹667 and ₹727 crores. But the actual deficit on current account, excluding official donations, was about ₹151 crores. There was a net surplus of ₹109 crores on official donations and the net inflow of capital was ₹13 crores. The draft on our foreign exchange reserves during the Plan was only ₹127 crores against an estimated amount of ₹290 crores.

"The relatively comfortable position of the balance of payments during the First Plan period had certain important implications. Firstly, the actual developmental effort fell considerably short of what was planned. This was evident from a fall in the proportion of investment to national income in 1952 - 53 and a virtual stationary level of investment in the following year. Since the expected impact on the balance of payments was linked up with the volume and pattern of investment, the reduction of the investment led to a lower order of imports, mainly of capital goods. In a sense the slowing down of the pace of investment
and the consequent easing of the payments position led to a much greater pressure on the balance of payments in subsequent years. Secondly, there was an unexpected rise in domestic output of food grains and as a result, the quantum of food imports declined considerably.¹

THE REVALUATION CONTROVERSY

In early 1951, Dr. John Matthai, after having relinquished Finance Minister's post, expressed the view that, the exchange value of the rupee should have been fixed at a higher level. His view was supported by the Eastern Economist, Indian Finance and a number of influential individuals. In the July, 1951 issue of the Tata Quarterly, Dr. Matthai wrote an article in support of this view. He pleaded for the revaluation of the rupee to 1 s. 8 d. from its existing rate of 1 s. 6 d. It was during Dr. Matthai's Finance Ministership, that the Rupee was devalued along with the pound. He pleaded that, during the 23 months that had elapsed since devaluation, conditions had changed so much that it had become necessary that the Indian Rupee be appreciated.

Dr. Matthai argued that devaluation had served its purpose in as much as it had helped us in overcoming the

problem of adverse balance of payments. But devaluation had also caused inflation in the country. Dr. Matthai wrote, "while our economic position externally has shown improvement, our position has internally deteriorated in consequence of the increase in the general level of prices. Unless the inflationary pressure is not merely checked but reduced it will react adversely on economic development partly through a disturbance of industrial relations of which signs are already beginning to appear and partly through an increase in the cost of materials and of plant and machinery required for Government as well as private development projects".¹

Dr. Matthai and others in favour of the appreciation of the Rupee put forth the following arguments:

1) That the Indian Rupee was unduly undervalued.
2) That we had a favourable balance of payments from 1949 and 1950.
3) That there was a fall in our imports because the prices of imported goods had been unduly high due to the undervaluation of the Rupee.
4) That inflation in the country was a sure sign of the undervaluation of the Rupee. It was stated, that on account of undervaluation, the prices of imported materials had gone

up and this ultimately caused a rise in prices of the products manufactured out of such materials.

The champions of the cause of appreciation further recounted what they regarded to be of definite advantage to the country.

1) Appreciation would reduce the cost of our imports. After appreciation for the same volume of imports, we shall be required to pay less than what we were paying until then. As India had to make large scale purchase of capital goods from abroad, it would help India to economise her foreign exchange resources. It was particularly felt that as India had to purchase huge quantities of food grains from the U.S.A., appreciation of the Rupee would reduce the amount of dollars required for this purpose.

2) It was expected that the appreciation of the Rupee would check inflation and bring down the price level. The import price of raw materials would become cheaper and this in turn would reduce the cost of the goods manufactured out of them.

3) Pakistan had not devalued her currency and as such the exchange rate of the Indian Rupee to Pak Rupee under the Indio-Pak trade agreement in February, 1951 was settled at 121 Indian Rupees = 100 Pak Rupees. It was therefore argued that revaluation would put India in an advantageous position vis-a-vis Pakistan.
Appreciation of the Indian Rupee (at 1 l. 8 d.) was opposed as it was feared that this would result in the country's balance of trade remaining adverse for a long time to come. With her slender foreign exchange reserve it was not possible for the country to take such a risk. It was pointed out by Dr. C.R. Deshmukh that according to Reserve Bank of India experts an appreciation of the Rupee by 15 per cent would have caused a balance of payments deficit of Rs. 50 crores and a 30 per cent appreciation might have resulted in a deficit of Rs. 135 crores. "If we do not revalue, we should hold things square," said Dr. Deshmukh. The opponents of appreciation therefore said, "In these circumstances an appreciation of the rupee will further deteriorate the balance of trade and will exert a deflationary influence on the economy. But since the country is characterized by severely inadequate foreign reserves it would not be prudent to jeopardise these reserves. If, in order to protect reserves the country takes measures to restrict imports or to increase exports, appreciation cannot be deflationary and loses its raison d'être".

The I.M.F. was also opposed to any appreciation of currency in order to combat internal inflationary forces. The I.M.F. thought that in a competitive world market there

2. Ibid., p. 109.
was no scope for isolated appreciation by any one country. It would 'touch off a chain reaction'.

The I.M.F. thought that appreciation of currency was no cure for the inflationary conditions in any country. The I.M.F. maintained, "In the present world situation member countries' anti-inflationary policies should primarily rely on measures which will combat the inflationary pressure within their own economies, rather than an attempts to transfer these pressures elsewhere. . . . . . Wide-spread appreciation would be as ineffective in solving this problem as wide-spread depreciation was in solving the problem of deflation in the thirties".  

So we see that inflation in India was a result of internal factors, like war-time deficit financing, a fall in agricultural production, war-time cheap money policy, etc. The solution of the problem had to be found within the country. Inflation in the country was also due to the peoples' preference for tangible goods and the increased hoarding capacity of the farmers. Appreciation of the rupee could not cure the causes of inflation.

The boom in our export trade was a temporary phenomenon on account of Korean war. The favourable balance of trade in 1950 was due to increased exports and restricted imports.

1. I.M.F. Annual Report, 1951, p. 36.
It would also not have been appropriate for India to raise the exchange value of the Rupee in order to derive benefit out of Indo-Pakistan trade agreement of 1951. Although Pakistan's refusal to depreciate, temporarily increased the official value of the Pak Rupee in terms of the Indian Rupee, ultimately Pakistan had also to take a decision to devaluate its Rupee after a vain effort for six years to stick to the original value of exchange in terms of dollars.

It may therefore be concluded that no useful purpose would have been served by the appreciation of the Rupee to over 1 1/4 6 d. on the contrary such a measure could have harmful effects on our economy.