So far, an attempt has been made to discuss the problem of resource mobilisation. In this chapter, the effects of public expenditure on economic development and income distribution are analysed. The expenditure programme of the government is an integral part of the fiscal policy since the government has to use "its expenditure and revenue programmes to produce desirable effects and avoid undesirable effects on the national income, production and employment" (1). A detailed discussion of the effects of public expenditure is, therefore, in order.

The influence of Keynes' General Theory on expenditure programme.

The importance of public expenditure as a 'balancing factor' in the determination and distribution of national income owes its origin to General Theory. For, Keynes with his 'smashing emphasis on fiscal policy as the new drama of mixed economic life,' broke with the classical and neo-classical tradition of atomistic economics and rendered laissez-faire capitalism obsolete. Keynes' General Theory provided the theoretical basis for recent developments in expenditure programmes, for there he indicated the possibility and desirability of influencing the behaviour of economic aggregates through the deliberate manipulation of government expenditures.

The classical economists did not give much importance to public expenditure. As Adams observes, 'the older English writers did not need a theory of expenditures, because the

The attitude of classical economists to public expenditure was characteristically reflected in J.B. Say's famous expression, 'The very best of all plans of finance is to spend little and the best of all taxes is that which is least in amount'. It was even thought that every particle of expenditure beyond what necessity absolutely requires for the preservation of social order and for protection against attack is waste and an unjust and oppressive imposition on the public (3).

The neo-classical economists did not improve the situation. Professor Pigou, the eminent neo-classical economist in his analysis assumed full employment in the economy and maintained that if any time there was not actually full employment, there was always a tendency towards full employment. The normal situation according to him was stable equilibrium at full employment. If disturbance did persist, it was attributed by him to interference by government or private monopoly with the free play of market forces. That means, the social policy which guarantees normal full employment is laissez-faire. This analysis was based on several factors. The important ones were:

(i) all income was spent, partly for consumption and partly for investment (saving is spending for producers goods i.e. investment) and so there was no reason to expect a break in the flow of the income stream,

(ii) the desired rate of saving and investment could be secured by manipulation of the rate of interest and

(iii) at any time, there was unemployment, this could be cured by flexible wage rate. Under perfectly free


(3) Sir H. Parnell, Quoted from Dalton, op. cit. p.139.
competition, among wage earners, wage rates fall under the pressure of unemployment until all who are willing to work can find employment. Only if the collective actions of the labour unions or governmental intervention created an imperfect labour market in which wage rates were not free to fall to their competitive levels, there was unemployment. Thus the responsibility for unemployment was placed at the door of labour itself (4).

The classical tradition was so strong in economics that even in 1930, the British Treasury cut the salaries of school teachers and retrenched on other expenditures in order to try to bring the budget into balance to meet the challenge of the Great Depression. President Hoover of the U.S.A. was so outraged by the ideas of Keynes that he referred to deficit spending and related recommendations as 'Operation Cuttlefish' and branded Keynes, along with Marx and Mussoline, as one of the three greatest enemies of modern civilisation (5).

However, within a few years, the Keynesian analysis successfully repudiated the stubbornly held classical and neo-classical tenets and changed the direction of economic policy of the government. Keynes' theoretical explanation of unemployment rested on the stickiness of interest rates taken in conjunction with the irrationality of business men's expectations about investment in durable capital assets. In Keynes' view, the peculiar characteristics of a developed monetary economy account for unemployment. Even if wage rates were perfectly flexible (which is not possible due to the fact that trade unions and

(4) A.C. Pigou: Theory of Unemployment, 1933. Prof. Pigou however in his 'Lapses from Full Employment', published in 1945 shifted his position in the sense that he favoured attacking the problem of unemployment not by manipulating wage rates but by manipulating demand. This is a significant development in his idea.

welfare legislations are now an integral part of modern
democratic economies) and commodity prices perfectly competitive,
unemployment could still exist(e). Keynes, therefore, sought a means
to prosperity through monetary expansion, public investment and
other forms of government action. This represented a complete
departure from the traditional policy of laisseg-faire. Due to
this analysis, public expenditure assumed tremendous importance
as a contra-cyclical or compensatory device to maintain stability
and promote increased employment opportunities. According to
Higgins, 'the General Theory raised public investment from the
rank of last line of defence to major offensive strategy'.

The importance of public expenditure in Keynesian
economics could be seen in three lines of thought, viz,
(i) prevention of periodic tendencies to depression in capitalistic
economy, (ii) regulation of the tendency towards secular
stagnation in mature economies and (iii) improvement in
distribution of income so as to increase aggregate consumption.
In the words of Fellner, they can be said as (i) cyclical
Keynesianism, (ii) stagnationist Keynesianism and (iii)
fundamental-theoretical Keynesianism.

(i) Let us first turn to 'cyclical Keynesianism'.

Keynes' analysis of periodic tendencies to depression
in capitalistic economies is based upon the assumption that when
national income rises, the volume of savings tends to grow and
probably more than in proportion to the increase in aggregate
income. In other words, the marginal propensity to consume
declines as incomes go up. Since total employment depends on

(7) Dudley Dillard : The Economics of J.M.Keynes,op.cit.,ch.2.
(7) William Fellner : Keynesian Economics After Twenty Years,
Fellner uses fundamental-theoretical Keynesianism to show the
theoretical position of Keynes that denies the Pigou-effect or
Patinkin's real balance effect, we have included distribution of
income as a part of the fundamental-theoretical Keynesianism.
total demand, the decrease in marginal propensity to consume 
due to increase in income creates deficiency in aggregate demand 
which leads to unemployment. Therefore, there is a need to increase 
real investment to fill up the gap between income and consumption 
demand out of that income. Here comes the role of public 
expenditure to increase demand and create more employment. This 
new expenditure will, according to Keynes, set out a chain of 
expenditures on the part of the successive income recipients 
and increase national income to a multiple (8).

This analysis is based upon the fact that the consumption 
is dependent on income and that there is a regular or normal 
relation between them. In recent years, this position has been 
attacked by a number of eminent economists. Williams, for example, 
has pointed out that consumption is not only dependent on income, 
it is also related to saving out of past income, liquid assets 
(Keynes' theory of liquidity affected only investment), capital 
gains, the last highest income reached in a boom, expectation of 
future income and other possible factors affecting the income 
consumption relation. That expectation should be brought in to 
explain consumption whereas, with Keynes it affected only 
investment, is a major departure. Williams also emphasises the 
interdependence between consumption and investment. 'The inter­
dependence of consumption and investment, each responding to the 
other-and both responding (spontaneously rather than systemati­
cally) to changing ideas, methods, resources,-seems to me the 
insence of economic progress' (9).

(8) Though the value of the multiplier within a period of time 
depends on many factors including (i) the size of initial outlay, 
(ii) the propensity of income recipients to spend new income, and 
(iii) the rate of turnover involved in the process, it is genera­
ally accepted that the multiplier has a positive value in 
increasing national income.
(9) J.H.Williams: Economic Stability in a Changing World, 
Professor Rolph on the other hand points out that the capital value of a person's assets is the dominant objective determinant of his expenditures for consumption. The rate of his consumption expenditures is the outcome of a choice between holding assets and consuming. In choosing among the kinds of assets including cash that he wishes to hold, he determines his demands, and to some extent others' demands, for new real assets. Professor Rolph, therefore, states, 'The amount of a person's consumption expenditures depends upon the value of his asset holding, including cash. The greater his asset holding, the more he spends on consumption but the smaller is the proportion of these expenditures to his asset holding' (10). This is his substitute for the 'psychological law' as proposed by Keynes.

It must be noted, however, that these criticisms do not indicate that income is not an objective determinant of personal expenditures. There may be other factors, but income easily outranks all other measures that influence consumption. Keynes himself pointed out, 'People's propensity to spend (as I call it), is influenced by many factors such as the distribution of income, their normal attitude to the future, and—though probably in a minor degree—by the rate of interest (11). But in the main, it depends mainly on the level of income. If it is admitted that income is the most important variable in the consumption function, Keynesian analysis remains valid. No one so far has denied this main point; namely, that income is the principal variable upon which consumption depends (12). Professor Rolph who violently

disagrees with Keynes regarding the determinants of consumption also admits that 'there is the minimum common ground that income is regarded as an important consideration affecting people's consumption expenditures' (13). If this is agreed, Keynesian consumption function remains valid.

A further characterization of the consumption-income relationship is the proposition that a small increment in income will be accompanied by a smaller increment in consumption. In technical Keynesian terms this states that marginal propensity to consume is less than unity. This idea is an important feature of 'cyclical Keynesianism'. What Keynes points out is that the amounts by which consumption rises and falls as income rises and falls will follow a fairly regular pattern. Only if this is true can the propensity to consume be stable, as Keynes assumes it to be. In the Keynes' psychological law, the amount of consumption is not stable because it depends on income, which in turn is not stable because the inducement to investment is not stable. But the propensity to consume is stable because it is determined by psychological characteristics of human nature and by the general social structure and practices of society, and these do not change readily except under unusual conditions such as social revolution, drastic inflation, or some other abnormal circumstance. It follows that in a given community over a short period of time, the subjective and objective factors determining the propensity to consume and to save are relatively fixed.

In recent years, the regular relation between income and consumption has been challenged by different writers. The rise of consumer durable goods has been the outstanding phenomenon of our times. Simon Kuznets' paper on 'Capital Formation 1879-1938' clearly demonstrated that while national

income rose greatly during this period, standards of living rose correspondingly and the great bulk of the increase in income went into consumption (not only consumer durables). Saving as measured by real investment, remained as a constant fraction of income with an apparent moderate tendency in the twenties for consumption to increase relatively to income. This secular upward drift of the consumption function is now a standard part of the consumption function. This, however, does not invalidate Keynesian stable condition. It can be said that this long-term consumption function is an important addition to Keynesian theory as a supplement to Keynes' short-term consumption function. But the short-term consumption function continues. Dillard points out that 'long term consumption function is important, not only as a piece of technical apparatus, but also because the idea embodied in it moderates the basic message of the General Theory. The size of the gap which must be filled by investment increases much less rapidly than is implied by Keynes, because of the upward movement of the short-term function. The range of instability and the threat of stagnation are thereby reduced, although by no means eliminated' (14).

Further, this long-run consumption function also proves that not only is consumption a function of income in the short run, but also in the long run. The secular upward shift in the consumption function is a result of the secular rise in income.

Robertson criticises consumption function from the point of view that current income cannot determine current consumption. According to him, current expenditures do not depend upon simultaneous income, because contemporaneous events cannot be mutually causal. The answers to this criticism are given in (14) The Influence of Keynesian Economics on Contemporary Thought, op. cit., p.78.
three ways:

(1) Income determines consumption provided a period of sufficient length is chosen (Lerner - Hansen)

(2) The consumption function holds continuously in the schedule sense (Samuelson-Klien)

(3) The consumption function holds under conditions of short-term perfect foresight (Fellner).

Each of these offers a possible defense for the theory that some part of expenditures depends upon the income generated by those expenditures. Lerner and Hansen point out that consumption may not be a function of simultaneous income in the present period. But they hold that if a sufficiently long period of time is allowed to elapse, consumption does depend upon simultaneous income. In contrast to Hansen-Lerner interpretation of the consumption function, Samuelson and Klien have proposed that the consumption function and the saving function should be viewed as schedules. They claim that investment and saving defined in the simultaneous sense are necessarily equal only as observables but they are not equal as schedules. In other words, there are hypothetical possibilities that the amounts that people are prepared to save are not equal to the amounts that other people are prepared to invest. This interpretation relies on the analogy to demand and supply schedules in the ordinary sense. At any actual price the quantities purchased equal the quantities sold. At unobserved prices these quantities are unequal. From the point of view of consumption function this means that consumption function holds good for any period; only in the equilibrium-period interpretation, one event can cause another when both are supposed to be contemporaneous. Fellner justifies consumption function on the assumption of perfect foresight for short periods.
If people are assumed to know their income in the present period, they can, as Fellner points out, make their consumption expenditures some fraction of this income.

Professor Rolph thinks that these interpretations do not succeed in overcoming the basic difficulty that expenditures cannot depend upon the income to which they give rise because such a theory involves the impossible condition that contemporaneous events can cause one another (15). Even though this is correct, this does not repudiate the consumption function. If Robertson's lagged definitions are inserted into the Keynesian functions, a dynamical system can be developed. To make the Keynesian system dynamical, one has to determine the time path of all variables of the system. That is to say, it is necessary to postulate that expenditure on consumption is made out of the income of the previous period. Robertson has supplied this idea, but he did not supply a theory of consumption function which gives a definite behaviour relation between consumption and income. For this, credit must go to Keynes (16).

Even Harry G. Johnson who makes a scathing criticism of Keynesian economics in his celebrated 'Invited Lecture' on the General Theory points out, 'But the propensity to consume survives as an integral part of modern business cycle and growth theory; it has also become a basic component of the theory of planning economic development' (17). The only criticism he makes on consumption function is 'More fundamentally, his (Keynes') stress on current income receipts as the prime determinant of current consumption expenditure, and particularly his deduction of the form of the income-consumption relationship from an a priori

'fundamental psychological law', reflects the general weakness of the Cambridge School in dealing with capital in its relation to economic behaviour' (18).

This brief account would indicate that the Keynesian consumption function is essentially correct and, therefore, 'cyclical Keynesianism' a valid proposition. Fellner in his appraisal of Keynesian economics on its twentieth anniversary points out, "I will add that in my opinion 'cyclical Keynesianism' has survived these twenty years and will continue to be influential doctrine in the predictable future". In that case, the role of expenditure as a compensatory fiscal policy will play an important part to avoid large-scale cyclical unemployment and excess capacity.

(ii) 'Stagnationist Keynesianism'.

The basic premises of stagnationist Keynesianism include those of cyclical Keynesianism and also a further premise. It is postulated that when at the capacity level of output planned investment begins to fall short of saving by a significant margin, conventional easy money policies are insufficient to restore balance, and that the wage-price flexibility mechanism either cannot or should not be relied upon to restore it. This is implied in cyclical Keynesianism. In addition, stagnationist Keynesianism implies that in advanced industrial economies the long-run prospects are for investment outlets to lag behind full employment savings. When the economy reaches a high state of development and thus 'matures', a point is eventually reached at which full employment cannot be maintained, in the absence of government action, because at the full employment level of

(18) Ibid, p.5.
national income, the volume of investment is inadequate to absorb the amounts of saving which are made at this income level. As a consequence, aggregate demand falls below the volume of output at current prices, and national income declines to the level at which savings and investment are equal, and thus below the full employment level. This tends to become the typical state of affairs of mature economies.

Stagnationist Keynesianism had a very great impact on the thinking of economists in the decade following the publication of the General Theory. In the U.S.A., Hansen, the leading Keynesian economist developed the stagnation thesis and applied it to the American economy. The stagnation in case of the U.S.A., a relatively mature economy, was attributed by him to a decrease in the rate of population growth, the passing of the geographical frontier (19), a slowing down in the rate of technological development, an increasing number of inventions being of the type which lessens the amount of capital necessary for a given volume of output and the increasing ability of business to finance itself by depreciation reserves and reinvested earnings (20). In addition


It should, however, be noted that the stagnation thesis is not the monopoly of Hansen. Schumpeter in his Capitalism, Socialism and Democracy also developed a theory which meant a gradual reduction in the pace of capital formation under capitalism. But his analysis was antagonistic to Hansen's and Keynesian theory. His view is a logical extension of his general theory about capital formation. For it turns neither on some autonomous change in the taste for saving, nor an independent decline in opportunities for investment, but on the metamorphosis through which the entrepreneurial function passes as capitalism develops. This leads to socialisation of economic activity.
there is tendency toward chronic unemployment in the Keynesian sense; that is toward a level of underutilisation where saving ceases to be greater than planned investment.

The stagnation thesis implies that government expenditure would have to be permanently expanded in order to eliminate the gap between investment and savings at full employment levels. Government expenditure in respect of welfare payments to low-income groups would also particularly be welcome to increase aggregate spending. If the gap between planned savings and planned investment is severe, public debt would have to be increased and a continuous unbalanced budget maintained in order to eliminate unemployment.

However, the stagnation thesis has received hard blows from economists and it is felt that there is no substantial degree of plausibility in the analysis. George Terborgh challenges the whole thesis and points out that a decline in the rate of population growth in the U.S.A. began a century ago and asks why it failed to produce stagnation long before the 1930s (21). Davies on the other hand argues that the experience of the 1940's has made the outlook for population growth far less gloomy than it appeared to Hansen in the late thirties and early forties. The same decade has belied predictions, atleast so far as the U.S. is concerned, that the population appears to be approaching stabilisation in geographical distribution (22).

Again, with regard to availability of territories, Terborgh points out that the geographical frontier in the U.S.


was closed by 1890, forty years before stagnation is said to have
developed. Others maintain that even though there is no possibility
of opening new territories, a large part of the existing
territories remains unsettled or partly settled.

With regard to innovations, there is no guarantee
that future innovations will be only of capital-saving type. If
there would be some capital-saving innovations, there might be a
large number of large and small additional capital-using
innovations. There is also a possibility that services would
become increasingly capitalised.

Hansen's stagnation thesis is also based on the
implicit assumption that capital yields diminishing returns in a
mature economy. According to him, at a given level of technical
knowledge, the yield of increments to capital stock tends to sink
as its quantity increases relatively to labour supply and resources.
Abramovitz does not reject this but asks: 'but are we at all
sure that, on balance, an increase in the scale of the market in
the U.S. does not still permit economies more sizeable than the
diseconomies it causes through pressure on resources and
otherwise? If it does, the inducement to invest', he further
points out, 'can feed on itself, atleast so far as secular trends
go, with capital formation limited by the supply of savings and
the size of capital goods industries' (23).

This shows that though stagnation is a possibility,
it need not necessarily be encountered (24). But the important

(23) Moses Abramovitz: 'Economics of Growth' in 'A Survey of
Contemporary Economics' Vol.II edited by M.J.Haley, Richard D.Irfwin,

(24) The actual experience of the U.S.A. since the war has rather
been secular inflation. That is why many economists who were once
concerned with the threat of chronic unemployment now look upon
inflation as the major long-run problem of the U.S.A. and suggest
ways and means to eradicate it.
contribution of stagnation thesis is that it calls for some adjustment in the economy which emphasises the role of public expenditure to increase economic activity, improve innovating activity (that raises output per unit of resource-inputs more than was the case in earlier phases) and create conditions for a lower propensity to save corresponding to the lower rate of acquisition of new resources.

(iii) Fundamental - theoretical Keynesianism.

The fundamental-theoretical Keynesianism of increased expenditure for improving distribution so as to increase aggregate consumption is based upon the theoretical position that denies the Pigou effect or Patinkin's "real balance effect". The point is whether in the event of threatening demand insufficiency at a given price level, a fall in money wage rates and prices would not raise effective demand to the size consistent with full utilisation. If there were perfect flexibility of money wage rates and of prices, this could have the beneficial consequence by raising the real value of the already existing money hoards and by thus encouraging the use of money for the purchase of goods. In our discussion of underemployment equilibrium, we have already seen that the real balance effect of money wages and price reductions is theoretically invalid and lacks practical significance. Johnson has pointed out that empirical research has confirmed that wage adjustment is slow in depressions and has also shown the "real balance effect" to be small (25).

It follows from this that the government should increase effective demand to increase income, production and employment in the economy. One way of doing this is to improve the distribution of income. Basing his analysis on the proposition that propensity to consume of the poor is greater than that of the rich, Keynes suggests that if there is less unequal distribution of income, total consumption will increase, which will, due to the multiplier effect, facilitate greater increase in national income and employment opportunities. This analysis is generally accepted by most of the economists.

The only criticism that is levelled against this is that if consumption patterns are governed by social influences, redistribution of income may not substantially increase aggregate consumption. Both Johnson and Duesenberry point out that if consumers' tastes and consumption behaviour patterns are independent of one another, redistribution of income from a richer to a poorer person will raise total consumption from a given aggregate income. But this is an assumption which very few if any economists have ever accepted as completely true, since the demand for at least some consumption goods is obviously strongly affected by social influences. If consumer preferences are interdependent, the primary effect of a redistribution from richer to poorer may be to lower rather than to raise aggregate consumption. The marginal propensity to consume of one in this case will depend on one's relation with other income groups. If one's income rises, one may learn higher (more expensive) consumption standards from others with whom one comes in contact.

Again, if account is taken of investment repercussions and the diversity of the conditions of production of different goods (i.e. neglecting the production of goods and services as a
homogeneous activity) and some of the possible features of the time process of adjustment (i.e. not confining our attention to static analysis), we cannot simply determine the primary effect of a redistribution of income in order to know the direction of its total effect (26).

These criticisms do not, however, invalidate the Keynesian theory. In a developed economy where contact between different sections of the community is intimate, social emulation plays some part in determining the consumption pattern. But the fundamental determinant of consumption in each society is income and as such a less unequal distribution of income provides greater opportunity for increasing aggregate consumption.

The above analysis shows that the Keynesian economics has given a new trend to economic policy and increased the importance of public expenditure as a contra-cyclical policy.

ECONOMIC SIGNIFICANCE OF PUBLIC EXPENDITURE:

In the light of the Keynesian analysis and subsequent developments, we may now consider the significance of public expenditure in an economy. This will give a full picture of the role of public expenditure and show the influence of public expenditure in increasing national income and employment, in securing better distribution of income and in influencing allocation of resources. Of all the effects, these three are of primary importance.

(1) Effect of Public Expenditure on Income and Employment.

If the economy is underemployed, increased resource-using...
Public expenditure not accompanied by a decline in private spending will increase national income and total level of employment without any substantial increase in prices. The increase in national income may be several times the amount of the original expenditure. This is the familiar multiplier theorem as applied to government expenditure. The size of the multiplier will of course depend upon several factors. The major factor will be the rate of consumption and saving. Because, the multiplier is the reciprocal of the marginal propensity to save.

The effect of increased government spending may also go beyond the multiplier effect. The rise in national income will increase the profitability of investment, and once full utilisation of existing equipment is reached, further rise in consumption will cause a sharp rise in investment, under the operation of the acceleration principle. The increase in investment generated by the consumption increase will, in turn, be subject to the multiplier effect, and the combined influence of the multiplier and the acceleration principle, reinforcing each other, may bring about full employment more quickly as a result of continuing investment or consumption.

This shows that during a period of depression, an increased government expenditure will increase income, employment and general level of prices (without an inflationary tendency) and thus promote economic stability provided private consumption and investment do not show any declining tendency. On the other hand, if increase in public expenditure is continued beyond full employment level, prices may show upward tendency and thus real national income may decline due to inflationary pressures. Public expenditure has, therefore, the double role of increasing both the real level of national income and the general price level.
Another effect of public expenditure is to secure better distribution of income. This is generally derived from transfer expenditure. In all modern communities, better distribution of income is considered to be one of the most important goals of expenditure policy. The argument in favour of equitable distribution of income is based on (a) the law of diminishing marginal utility of money, (b) the famous Sidgwick assumption that persons with the same income possess the same capacity for enjoyment and (c) Keynesian propensity to consume. Pigou points out that since a 'man's economic welfare is made up of his utilities, transfers of money income from the rich to the poor of similar desire attitudes will increase economic welfare' (27).

Pigou's analysis is based upon three assumptions. In the first place, law of diminishing marginal utility of money is acceptable even in case of many-commodity world on the basis of 'broad grounds of experience, reflection and conversation'. Secondly, satisfactions of different individuals are comparable. 'Now, if we take', as Pigou points out, 'random groups of people of the same race and brought up in the same country, we find that in many features that are comparable by objective tests they are on the average pretty much alike; and, indeed, for fundamental characteristics we need not limit ourselves to people of the same race and country'. So he concludes that, 'on the basis of analogy, observation and intercourse, interpersonal comparisons can be made both in principle and practice' (28). Finally, he (27) Cf. A.C. Pigou: Some Aspects of Welfare Economics, American Economic Review June 1951 and also Economics of Welfare for a detailed treatment of the subject. (28) Some Aspects of Welfare Economics, op. cit.
accepts the Sidgwick assumption that persons with the same income possess the same capacity for enjoyment.

New Welfare economics of Hicks, Kaldor, Robbins and Hotelling do not agree with this. They segregate the conditions of optimum welfare into two groups and deal with them separately under the headings of efficiency and equity. With regard to equity they point out that nothing scientific can be said about it since it is based upon interpersonal comparison of utility and so they concentrate on efficient use of resources. New welfare economics is based on the idea that all ends other than maximisation of income are value judgments and accordingly unsuited for scientific purposes (29).

This analysis has driven welfare economics into curious channels. It is wrong to think that interpersonal comparison of utility is not based upon observation and introspection. Even Russel, the great mathematician argues that interpersonal comparison of utility is a scientific proposition (30). There is no doubt that there is difficulty in such comparisons. Comparisons of real income are also beset with many difficulties. But that does not mean that such comparisons are impossible or they are value judgments. Mr. Little is, therefore, right when he says that interpersonal comparisons of satisfactions are empirical judgments about the real world, and are not, in any normal context, value judgments. If one accepts behaviour as evidence for other minds, then one must admit that one can compare other minds on the basis of such evidence. Therefore,

those who deny interpersonal comparisons must deny the existence of other minds (31).

Again, even if it is assumed that interpersonal comparison of satisfaction is a value judgment, it is not desirable that economists should dismiss it as unnecessary. Some of the modern economists feel that economics should be a description of 'how things happen' or 'how to bring about certain objects which some one (not being an economist) desires to have brought about'. But there is and can be no such thing as an economics embodying only pure analysis and description. Economics must have a perfectly definite end, the material welfare of mankind. To dismiss such value judgments would be throwing the baby away with the bath water.

It is, of course, true that one cannot define optimum pattern of income distribution as one can define optimum pattern of production. An equal marginal utility of money is not a correct definition of economic equality and, therefore, the utilitarian argument that an equilibrarian distribution of real income will maximise satisfaction is not quite true. To remedy this difficulty, Lerner argued for equal distribution of income on a probability basis in the absence of knowledge of actual pattern of distribution which will maximise satisfaction. His argument is based upon the principle that capacities for satisfaction are distributed normally around the mode of a frequency distribution and that an equal distribution would involve only random error, whereas any other would involve a definite bias (32).

But this assumption is subject to question, particularly because actual satisfaction may depend to a large extent upon the

ability to be able to outdo other persons in consumption, or to keep up with them, in a society in which such 'keeping up' is not insured by equality of distribution. Moreover, an equal distribution of income may adversely affect the maintenance of a high level of national income due to its adverse effects on incentives to work and save.

So all that we can say is that the relative marginal utility of money is a good criterion of relative well-being and as such, an equitable distribution of real income would, in general, come near to maximising happiness. But to determine the actual pattern of distribution on a theoretical plane would be a difficult matter. However, there cannot be any controversy with regard to the expenditure policy of the government which aims at reducing inequality with better provisions of education, health, housing, nutritious food and social security measures for people who are now at low level of income. As Dalton has pointed out, 'that system of public finance is best which has the strongest tendency to reduce the inequality of income'. Pigou also reiterates that, 'from a long-run standpoint, after incomes in excess of a certain moderate level have been attained, further increases in it may well not be significant for economic welfare' (33).

Then comes the Keynesian argument for redistributing income so as to expand production via increased consumption. As already indicated, an important factor determining how much will be spent for consumption out of a given size of community income is the distribution of income. Since the marginal

(33) Some Aspects of Welfare Economics, op. cit.
propensity to consume of the rich is lower than that of the poor, a less unequal distribution of income and wealth would tend to increase aggregate consumption and facilitate greater investment for maintaining a high level of employment and income.

(3) Influencing Allocation of Resources.

Public expenditure has the effect of modifying the allocation of resources and thus influencing the composition of gross national product. For example, if there is no change in the total volume of public expenditures and there is only a variation in the specific purposes of these expenditures, this may depress or encourage particular industries or sectors of the economy with consequent repercussions on the volume of goods and services. An increase in public investment in high-way construction may stimulate automobile and allied industries, and this expansion in turn may retard railway expansion. In fact, the allocative effects of public expenditure depend upon the nature of goods produced by the government. Public expenditure to produce individual goods like water or electricity or social goods like defence or education changes the composition of the gross national product.

The effect of increased public expenditure on the production of private goods depends upon the state of employment. With unemployment, government activities will not decrease the production of private goods and services. The government can provide more education, high-ways, battle ships, etc. and yet these, instead of causing a reallocation of resources away from privately produced goods, may result (with proper financing methods) in the utilisation of otherwise idle resources to produce goods that constitute a net increase in the national product. On the other hand, if there is full employment, the output
of the private sector of the economy will be reduced as the output of the public sector is increased.

Finally, output of private producers is also directly affected by various subsidy programmes. Subsidies given for the assistance of particular industries may develop these industries at the expense of other industries. For example, if grants are made for building houses for middle or poor income groups, resources might flow to construction industries. But other kinds of transfer expenditures do not directly affect resource allocation, except in so far as resources are necessary to administer the programmes. But they produce secondary effects in the sense that there is a change in the distribution of income and consequent change in the pattern of consumption.

Role of Public Expenditure in Underdeveloped Countries:

On the basis of criteria laid down in the previous section, the role of public expenditure in underdeveloped countries may now be examined. Of the three criteria of public expenditure, the first two i.e. (a) increase of income and employment and (b) redistribution of income seem to be of over-riding importance in underdeveloped countries. As indicated earlier (Chapter II), allocation of resources is of minor significance in a country where the capital base of the economy is underdeveloped. In fact, increase of income and employment and improvement of allocation of resources are a part of the general problem of economic development in underdeveloped countries. The first and the third objectives of public expenditure need not, therefore, be separately treated. They may be subsumed under the broad heading of economic development. That means the role of public expenditure in underdeveloped countries has to be considered in terms of (a) economic development and (b) redistribution of income.
Public expenditure may also do another job. It may try to bring about regional development which is an integral part of the general problem of development. But since this is generally a special problem of underdeveloped countries, the last chapter has been devoted to a discussion of this topic. In this section, the role of public expenditure in economic development and redistribution of income has been analysed.

(a) Economic development.

As already stated, the major objective of fiscal policy is the attainment of a high rate of economic growth. It is the duty of public expenditure to fulfill this objective. In fact, the theory of public expenditure in an underdeveloped country should be a theory of public investment. Because, without increasing investment for productive purposes, the economy of underdeveloped countries cannot take a different turn. The investment criteria for underdeveloped countries have already been discussed in the second Chapter. All that we can say here is that investment expenditure programmes should be planned in such a manner that the long-term and short-term objectives of the Plan can be fulfilled. In other words, public expenditure should have the dual role of preparing the economy for structural change and at the same time, fulfilling the immediate needs by proper allocation of existing resources. The long-term and immediate problems may seem to be conflicting with each other and in fact, sometimes they are. But unless the two are correlated there cannot be smooth economic progress.

The need for a long-term perspective is necessary for changing the nature of the economy. The task of eliminating poverty and want cannot be completed in ten or twelve years and would require conscious and determined effort over several
decades. The pattern of investment which would give the maximum short-run increase in output is not the pattern of investment which can eliminate poverty or unemployment and give the maximum rate of growth. The objective of development is not to obtain maximum increase in output over a short period of five years but to obtain the maximum rate of growth of output over a period of, say, 30 years (34).

If this long-run perspective is taken into view, the pattern of investment expenditure will be of a different type. For example, a pattern of investment that concentrates on the development of an investment goods sector in the initial period may not result in a greater increase in production in the immediate future but would lead to a more rapid rate of growth of investment (and ultimately of output) over the long run. Thus, given the long-run perspective, it immediately follows that the rate of growth may be maximised by a relatively rapid development of basic and heavy capital goods industries in the initial periods.

But in these sectors there is a long time lag between the investment expenditure and the reaping of fruits. Again, these sectors generally tend to have a fairly high "capital output ratio". Does this mean that an underdeveloped country should refuse to undertake projects of this kind and concentrate on those where the capital-output ratio is low and the time lag (or "gestation period") is short? As Prof. Reddaway points out, it is seldom a case of deciding to have none of one type of investment and concentrate solely on some other one: the essence

of the operation is to secure a balance in the flow of products year by year, and this means that the decisions relate to how much of each type of investment to undertake (35). A compromise is, therefore, inevitable. An underdeveloped country in view of its immediate needs cannot neglect the disadvantages of schemes which have a long gestation period, or which give a relatively small amount of output for a given expenditure of scarce capital resources. But at the same time, it cannot drop projects which have long time lags or high capital output ratios when their eventual benefits are outstandingly great. As Prof. Reddaway has put it, 'One cannot, however, argue that as the hair-cutting industry requires very little capital for a given output and involves very little time lag, therefore capital expenditure should be concentrated on building and equipping barber shop' (36).

The second plank of the strategy of development is related to the problem of "self-sustained" growth. The objective of development in an underdeveloped country is to reach as soon as possible the stage from whereon the further progress of the economy can proceed essentially on the basis of internal resources. This requires a big push in the economy. Analysing the meaning of a 'self-generating' economy for India, I.G. Patel points out that the achievement of a self-generating economy requires (a) an increase in the rate of domestic savings from the present about 8 per cent of national income to some 15 per cent of national income; (b) a sufficient diversification of the Indian economy to permit a healthy balance of payments position by adding to our


(36) Ibid, p. 96.
potential for exports as well as import substitution; and 
(c) an adequate degree of initiative, enterprise and responsiveness 
to change among millions of our producers whether on farms or in 
factories, big or small, public or private (37).

This means, there is a need for structural change in 
the economy. Especially with regard to generation of savings, it 
is necessary that there should be emphasis on large scale 
industries which alone can impart a momentum for development and 
at the same time provide with adequate surplus for future 
development. The emphasis on capital goods industries may also 
enable the country to be self-sufficient in her production of 
capital equipments. The dependence of underdeveloped countries on 
foreign countries in these items is now considerably great. It 
follows from this that the importance of long-term development 
cannot be neglected in planning.

Finally, a perspective plan has the advantage that it 
seeks to maintain a certain modicum of continuity from one Plan 
period to another in the very process of change which it seeks 
to promote. The five year Plans give details as to what should 
be done on the basis of a long-term goal. That means one must 
not look only at results to be achieved within five years, 
because one could achieve the maximum increase in output by 
concentrating almost all investment expenditure on schemes which 
could be completed within the five year period leaving nothing in 
the way of half-finished schemes as 'legacy' for the future. 
Reddaway has pointed out that for a smooth and continuing process 
of the economy, Plans should not be arbitrarily divided into 
five year periods. On the other hand each Plan should leave a

(37) A Self-Generating Economy in 'Problems in the Third Plan, 
bigger legacy to the next in the form of construction-in-progress than it received from the previous one. He cites the example of India where in the first Plan industrial investments were concentrated on schemes which could be rapidly completed. By neglecting long-term projects which were essential for continuing development, the first Plan showed an apparently creditable record of achievement in relation to outlay. But it left a very poor legacy for the second, which had to bear all the burdens of constructing the three steel plants whilst reaping no benefits at all until the last year or so (38). This experience illustrates the inescapable need for combining long-term and short-term planning.

This does not mean that there should be any rigidity between the objectives of short-term and long-term planning. We start at a particular stage with a perspective and a five year Plan. But as we roll on to the end of one stage, we get another perspective and another five year picture for preparing the next stage on the basis of developments in the last stage. In fact, this is something like a 'rolling plan' and public expenditure should properly be guided to meet the needs of the 'rolling plan'.

While preparing the country for long-term development on the basis of perspective planning, the investment expenditure should not however neglect the immediate needs of the economy. Immediate needs are so urgent that any attempt to neglect them may have serious repercussions on the economy. The three basic factors necessary for the smooth working of the economy are: (a) improvement in the productivity of agriculture to meet the growing demand for food and raw materials; (b) increase in the supply of essential consumer goods to prevent an inflationary

(38) Importance of Time Lags in Economic Planning, op.cit.
tendency in the economy; and (c) provision of sufficient employment opportunities to absorb the surplus population in a productive manner so as to avoid unnecessary waste of human power.

The programmes included in this group are directly linked to long-run strategy of development. For a nation to lift itself from a state of poverty, low productivity and large-scale unemployment and enter upon the process of dynamic growth is a task that calls for a long and sustained effort. That is why we have emphasised the role of public expenditure for structural change. But in the short run, or during a period of five years, public expenditure should aim at meeting the immediate needs of the community by proper allocation of existing resources. The long period problem is one of setting a new economy; generating resources for a dynamic change in the economy. The short period problem is to prepare the country to reach that stage by efficient utilisation of the existing resources. That means given the resources, the main problem is 'how best to channel the mobilised savings into desirable development projects'. Thus, proper allocation of scarce resources assumes considerable importance in the scheme of investment expenditure.

The problem of allocation implies distribution of scarce means among different ends in the most economical way so as to ensure wise and full employment of resources as a whole. This implies two things. First, there is need to determine the order of priorities in the scheme of development. Since there are manifold ends, unless it is known which ends are more important and which are less for a country, there cannot be proper allocation of resources. Fixation of priorities is very often a political decision. However, if it is decided that greater priority should be given to the development of agriculture,
provision of essential consumer goods and the establishment of small scale industries which are ancillary to agriculture for providing employment opportunities in the first stage of development programme as we have emphasised in our analysis, resources should be directed to these sectors for fulfilling the objectives of the Plan.

The second problem refers to efficiency. As a general rule it is found that non-development expenditure figures prominently in most of the underdeveloped countries. They have a huge and expensive administrative structure which is not even equipped with sufficient ability to render normal economic functions with honesty and efficiency. Even with regard to development expenditure, the cost of establishment tends to be disproportionately high compared with real development expenditure. Unless such expenditures are drastically curtailed, resources available for real development may be inadequate, and what is worse, there might be an inflationary bias in the economy without any perceptible change in the rate of growth. Thus there is a great need for directing public expenditure for real development work. With regard to investment expenditure what is needed is that the methods of production selected must be those which will allow maximum output of particular goods, with available technical knowledge and factor supplies. That will ensure efficient utilisation of existing resources.

This does not, however, mean that the public sector should, like the private sector, try to equalise the value of the marginal product in different uses to maximise the size of the total product. Government goods are very often different from private goods. Public roads or public schools cannot be sold in the manner in which vegetables are sold. Moreover,
relative prices of different goods may not accurately indicate social benefits. A large proportion of government services may provide benefits to persons other than the immediate users. For example, if education is imparted to an individual, other members of the community are likely to be benefited, but the individual concerned is not likely to pay more than what he receives. As such, the equality of the values of the marginal product is not applicable in case of public sector (39). All that is emphasised here is that the public sector should not neglect efficiency in the conduct of its business.

(b) Removal of inequality.

The second important aspect of expenditure policy is the removal of inequality. Since taxation policy cannot realise this objective due to economic and political difficulties, expenditure policy should mainly be directed towards achieving this goal. However, this is the most controversial aspect of expenditure policy. Economists are sharply divided as to whether expenditure programmes of an underdeveloped country should aim at reduction of inequality. A detailed discussion is, therefore, in order. The following arguments may be cited in favour of reduction of inequality in underdeveloped countries through expenditure policy.

(i) Various studies indicate that internal inequality in underdeveloped countries is much greater than that of developed countries. The United Nation's primary data on world social situation (1952) for three underdeveloped countries and five developed countries show that usually rich are relatively richer, and the poor relatively poorer in underdeveloped areas compared with developed areas (Table VIII-1).

(39) See Allen and Brownlee: Economics of Public Finance, op. cit. Ch. IX.
### Distribution of income in developed and underdeveloped countries

<table>
<thead>
<tr>
<th></th>
<th>Percentage of total income received by wealthiest 1/10th before income</th>
<th>Percentage of total income received by poorest half before income</th>
<th>Percentage of total income received by wealthiest 1/10th after income</th>
<th>Percentage of total income received by poorest half after income</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Underdeveloped</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ceylon (1950)</td>
<td>33</td>
<td>21</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>El Salvador (1946)</td>
<td>44</td>
<td>26</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Puerto Rico (1946-47)</td>
<td>41</td>
<td>16</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Developed</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Denmark (1949)</td>
<td>-</td>
<td>29</td>
<td>-</td>
<td>23</td>
</tr>
<tr>
<td>U.K. (1947-48)</td>
<td>32</td>
<td>26</td>
<td>26</td>
<td>30</td>
</tr>
<tr>
<td>Sweden (1949)</td>
<td>29</td>
<td>-</td>
<td>27</td>
<td>-</td>
</tr>
<tr>
<td>Canada (1949)</td>
<td>28</td>
<td>26</td>
<td>26</td>
<td>27</td>
</tr>
<tr>
<td>U.S.A. (1949)</td>
<td>30</td>
<td>28</td>
<td>23</td>
<td>24</td>
</tr>
</tbody>
</table>

Prof. Kuznets includes India in a comparison of post-war income distribution in his Presidential address to the American Economic Association. According to his data, in underdeveloped countries the rich are richer and the poor are poorer than in developed countries. Table VIII - 2 presents his data (40).

### TABLE VIII - 2

Distribution of income in developed and under-developed countries.

<table>
<thead>
<tr>
<th></th>
<th>Percentage of total income received by richest 20 per cent</th>
<th>Percentage of total income received by poorest 00 per cent</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Underdeveloped</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>55</td>
<td>28</td>
</tr>
<tr>
<td>Ceylon</td>
<td>50</td>
<td>30</td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>56</td>
<td>24</td>
</tr>
<tr>
<td><strong>Developed</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>U.S.A.</td>
<td>44</td>
<td>34</td>
</tr>
<tr>
<td>U.K.</td>
<td>45</td>
<td>35</td>
</tr>
</tbody>
</table>

This comparison is in respect of income before direct taxes and excludes free benefits from governments. A comparison in terms of income net of taxes and including government benefits would accentuate the wider inequality of distribution in the poor countries.

Prof. Kravis presents another set of figures to show the international differences in the distribution of income (41). His figures are presented in Table VIII - 3.

### TABLE VIII - 3

Index of Income Inequality, Early 1950's

( U.S. = 100 )

<table>
<thead>
<tr>
<th></th>
<th>Share of Lowest quintile</th>
<th>Share of Highest quintile</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Less inequality than U.S.</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Denmark</td>
<td>126</td>
<td>89</td>
</tr>
<tr>
<td>Netherlands</td>
<td>151</td>
<td>100</td>
</tr>
<tr>
<td>Israel (Jewish pop. only)</td>
<td>68</td>
<td>96</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Great Britain</th>
<th>Japan</th>
<th>Canada</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>B. About same inequality as U.S.</strong></td>
<td>102</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td></td>
<td>90</td>
<td>104</td>
<td></td>
</tr>
<tr>
<td></td>
<td>79</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Italy</th>
<th>Puerto Rico</th>
<th>Ceylon</th>
<th>El Salvador</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>C. More inequality than U.S.</strong></td>
<td>110</td>
<td>114</td>
<td>121</td>
<td>121</td>
</tr>
<tr>
<td></td>
<td>104</td>
<td></td>
<td>121</td>
<td></td>
</tr>
<tr>
<td></td>
<td>83</td>
<td></td>
<td>131</td>
<td></td>
</tr>
</tbody>
</table>

This table also indicates that underdeveloped countries like Italy, Puerto Rico, El Salvador and Ceylon have significantly greater inequality than that of the developed countries. Kravis’ study is also based on distribution of income before tax.

The above tables show that there is a discernible tendency for underdevelopment, low incomes, and inequality to go hand in hand and for development, high incomes, and relative equality to be associated with one another. The probable reason for this is that the distribution of income tends to be more equal the longer and the more thoroughly the country has been exposed to the processes of economic and social change associated with industrialisation (42). Such changes in social and economic conditions provide facility for integration of all segments of the population into the social and economic life. The most important social factors in this context are those which remove barriers to upward economic mobility. Myrdal has pointed that when a country reaches a higher average level of economic development the spread effects of expansionary momentum bring about social

(42) Ibid, p.409.
and economic integration and provide equality of opportunity for all groups to share the fruits of progress. On the other hand, the weak spread effects in underdeveloped countries place barriers to upward economic mobility in the paths of the less favoured groups in the population (43).

Economic development also improves educational facility which tends to become more wide-spread with growing economic maturity and generates forces that operate to make the income distribution more equal. For example, with the spread of educational opportunity and the consequent decline in skill differentials, the distribution of wage and salary incomes becomes more equal. On the other hand the limited supply of technical personnel in the underdeveloped countries tends to raise the relative remuneration of these people and hence to increase the dispersion of income.

The distribution of income between wages and profits is one way to compare the inequality between different income groups. Industrialisation and economic development have a tendency to increase the share of wages and decrease the share of profits in national income. This is evident from table VIII -4 which indicates that the ratio of wages to profits is lower in underdeveloped countries.

<table>
<thead>
<tr>
<th>Country</th>
<th>Wage-profit ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.A.</td>
<td>2.1</td>
</tr>
<tr>
<td>U.K.</td>
<td>2.3</td>
</tr>
<tr>
<td>Ireland</td>
<td>1.0</td>
</tr>
<tr>
<td>S.Rhodesia</td>
<td>1.5</td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>1.6</td>
</tr>
<tr>
<td>Columbia</td>
<td>1.5</td>
</tr>
<tr>
<td>Chile</td>
<td>1.0</td>
</tr>
<tr>
<td>Kenya</td>
<td>0.6</td>
</tr>
</tbody>
</table>


Another important change in the economic relation between different income groups is the tendency for the labour share in income to rise relative to the property share in developed countries. Kuznets' data as presented below, show that the share of property income in the U.S.A. has declined considerably due to rapid economic growth (44).

**TABLE VIII - 5**

Decline in the share of property income in U.S.A.

<table>
<thead>
<tr>
<th>Year range</th>
<th>1919-28</th>
<th>1929-38</th>
<th>1939-48</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest, rent and dividends as percentage of total income.</td>
<td>15.5</td>
<td>16.1</td>
<td>8.9</td>
</tr>
<tr>
<td>Share of top 5 percent in interest, rent and dividends.</td>
<td>57.1</td>
<td>24.8</td>
<td>19.4</td>
</tr>
</tbody>
</table>

The table shows that economic development produces a movement towards more equal distribution of income.

Simon Kuznets has pointed out that that the shape of income distribution is likely to pass through three stages. In the first stage of economic growth, it is likely to be widened, then stabilised for a time and in the final stage, narrowed down (45). As the diversity of industries and occupations increased with the beginning of industrialisation, degree of differentiation between different types of work and occupations increases and so also inter-industry and inter-occupational remunerations. With gradual improvement in supplies of different factors, such inequality is reduced and with the change in economic structure due to economic maturity, there starts a

(44) Simon Kuznets, Share of Upper Income Groups and Savings (N.Y. 1953) Tables 14 and 21, Quoted from I.B.Kravis,op.cit.

(45) Vide Economic Growth and Income Inequality, op.cit.
movement towards more equal distribution of income. Most of the underdeveloped countries are now in the first stage of development whereas highly developed countries like Great Britain and the U.S.A. have come to the final stage. This is one reason why inequality is greater in underdeveloped countries than in developed countries.

Growth of social expenditure also plays an important part in developed countries which tends to attenuate the inequality in personal incomes. In case of Great Britain for example, the growth of social expenditure has been particularly rapid during the last 40 years. The amount per capita increased from £2.8 s in 1913 to £38 in 1949. The amount for 1949 represents an increase in money terms of about 14 times the 1913 amount. The rate of increase has been much greater than that of the national income. In 1913, social expenditure was only 5.5 percent of the national income; by 1949, it had increased to 18.3 percent. One striking effect of the increase in British social expenditure is the shift in the importance of the social budget in relation to the total public budget. In 1913, 34.4 percent of the British public budget was devoted to the provision of social services; in 1938 the proportion had increased to 41.2 percent; by 1950 it had reached 50 percent.

Compared with Britain, the U.S.A. devotes a smaller proportion of its public budget and its national income to the provision of the social services. Yet the percapita amount of social expenditure in the U.S.A. has increased from about 6 dollars in 1913 to 60 dollars in 1948. As this represents a tenfold increase, there is no doubt about the rapid rate of development, even if allowance is made for changes in prices during the period.
Such increases in social expenditure have substantially augmented the income of the lower income groups and improved the total distribution of income in favour of the poor in leading capitalist countries. But unfortunately, there is no such redistributive mechanism in underdeveloped countries where the inequality of income is much greater. In most of them social services imply expenditure only on education and public health. There is either no social insurance scheme or where it exists, it has made very little progress. The redistributive effects of expenditure on education and health are of limited character. It is often said that these services provide benefits to the middle and upper classes rather than to the poorer classes. This is evident from the fact that in most of the underdeveloped countries, illiteracy is widespread and death rate is abnormally high. Again, owing to the high cost of administration, a given amount of public expenditure means less in terms of benefits than in advanced countries.

The above analysis shows that whereas there are strong forces in developed countries tending towards greater income equality, the underdeveloped countries are at a great disadvantage in this respect. A low level of economic development is not only accompanied by great economic inequalities, but is also associated with forces which weaken the movement towards equality of income. It follows, therefore, that there should be greater efforts in underdeveloped countries to create suitable conditions for the improvement of income distribution in favour of the poor and neglected groups of the society.

Distribution of income in favour of the poor and neglected groups is necessary not only from ethical and humanitarian point of view, but also from the economic point of
view. The classical and neo-classical economists approached the problem only from ethical point of view. They thought that any attempt at a large-scale or rapid change towards greater equality would injure the incentive for economic expansion and reduce the total volume of production out of which everybody's share was to come. It was thus easier to believe that the interests even of the poor were better served by abstaining from redistributional reforms as they would be holding back of production.

As Myrdal has rightly pointed out this view was entirely static (46). If we seek to learn from what has actually happened in the richer countries which during the last half century have proceeded far in the direction of greater equality of opportunities we reach instead a dynamic theory: that the realisation of more equal opportunities has been needed to spur and sustain economic progress as well as to make good the assumptions of social democracy.

The fact of the matter is that inequality of income gives rise to unequal opportunities and this leads to great economic waste. The waste is caused through (a) the loss of human capital and (b) inefficient management. Those who are made poor due to inequality of income do not get an opportunity to improve their professional skill or to invest on their children to make them efficient workers in future. Businessmen who have themselves acquired wealth may be efficient enterprisers, but their children who inherit their property and thus get higher income may not be at all as efficient as their fathers. Thus there starts a process of inefficient management and the rate of economic progress is lowered.

Prof. Galbraith has pointed out that economic development in the U.S.A. depends more on human skill than on physical capital. As he puts it, 'We now get the larger part of our industrial growth not from more capital investment but from investment in men and improvements brought about by improved men' (47). In case of underdeveloped countries, although both physical and human capital are essential for progress, human capital must be accorded some priority in the sense that a certain minimum of it is a pre-requisite to successful use of physical capital. Capital formation does not really consist of only additions to the stock of physical capital in the form of reproducible instruments of production, it also includes, as Adam Smith included in a country's stock of fixed capital 'the acquired and useful abilities of all the inhabitants'. If there is no improvement in human capital i.e. knowledge, skills, attitudes, aptitudes and other acquired traits that contribute to production, the most advanced physical plant and equipment would have virtually no economic significance if bequeathed to a truly primitive economy. The physical capital goods would rust and decay; some few items would be devoted to uses quite different from those for which they were intended. As Veblen said, technological knowledge and skills form the community's "immaterial equipment" or "intangible assets" without which physical capital cannot be productively employed. Without this immaterial equipment, or human capital, physical capital would not be a means of production but simply raw-materials, somewhat deranged and impaired through having been given the form which now makes them 'capital goods' (48).

Many underdeveloped countries now do not have the capacity to absorb large amounts of physical capital even when it can be obtained from abroad on favourable terms. The lack of absorptive capacity is often due to inadequate supplies of suitable labour, which reflect past deficiencies of investment in human capital. Goode, therefore, points out that a properly balanced development programme should make large investments in both physical capital and human capital (49). Public expenditure can play an important part in providing opportunities for the development of human capital.

Again, it is not correct to say that unequal distribution of income necessarily increases saving in underdeveloped countries. In many cases, it is rather a hindrance to saving and investment because people of the higher income group generally spend on extravagant consumption rather than investing their resources for productive purposes. Prof. Baran, therefore, points out that income inequality thwarts economic growth rather than stimulating it. As he puts it, 'Many of them (persons in the higher income group) are landowners maintaining a feudal style of life. Their "requirements for consumption" are so high that there is only little room for savings. Only insignificant amounts are left to be spent on improvements of agriculture estates' (50). The other high income receiving classes are equally incapable of making investments which may speed economic growth. Prof. Baran further states, 'other members of the "Upper-Crust" receiving incomes markedly surpassing reasonable levels of consumption are wealthy

(49) Adding to the Stock of Physical and Human Capital, p.150.
businessmen. Their consumption too is much larger than it would have been were they brought up in the puritan tradition of a bourgeois civilisation. Their drive to accumulate and to expand their enterprises is continuously counteracted by the urgent desire to imitate in their living habits the social dominant 'old families', to prove by their conspicuous outlays on the amenities of rich life that they are socially (and therefore also politically) not inferior to their aristocratic partners in the ruling coalition' (51).

What Prof. Baran's analysis implies that inequality of income increases consumption due to the so called 'demonstration effect'; that is the stimulation of desires as a result of contact with higher standards of living. Even businessmen are not exception to this. In fact, this 'demonstration effect' in underdeveloped countries operates internally, as rural people come in contact with the cities and the amenities enjoyed there, and on the international plane, as knowledge of conditions in more advanced countries spreads. The 'demonstration effect' may not be as strong as in developed countries due to lack of intimate contact between different groups, but certainly it works in underdeveloped countries and reduces voluntary saving to some extent. This suggests that an underdeveloped country need not be so apprehensive about the supposed incompatibility of greater income equality with economic progress'.

That means, income inequality will increase the volume of saving only when the higher income goes to a class which is 'thrifty, abstemious and enterprising'. The whole basis of the analysis of the classical and neo-classical approach was that capital accumulation depended upon the 'abstinence of the rich'.

(51) Ibid, p.81.
When that does not operate in underdeveloped countries and income inequality instead of increasing saving and investment leads to an increase in consumption (52), there is no justification for perpetuating inequality on economic grounds.

In fact, there are alternative ways of increasing saving. The classical economists committed a mistake in thinking that the only way of getting more saving is to increase the inequality of income in a country. But if the government becomes an entrepreneur and appropriates a part of the income of the people by taxes and forces them to reduce consumption or for that matter, if the government produces goods and charges a price above cost, there would be no necessity of continuing inequality of income. Moreover, the classical economists were emphasising only personal saving, but in the course of development, institutional saving may assume greater importance than personal saving. If it is recognised that magnitude of saving is the strategic variable in economic growth and not the inequality of income and the latter is just one way and probably the least efficient way of increasing saving 'the classical argument about the "abstinence of the rich" based on income inequality is', as Kurihara puts it, 'as inconclusive as it is misleading' (53).

(3) Apart from theoretical considerations, it is also practically impossible to maintain inequality in underdeveloped countries to increase the rate of saving. This is so both

(52) This is evident from the fact that in spite of greater income inequality, the volume of saving is low in underdeveloped countries.
because of much greater poverty in these countries and also because of the democratic form of government through which the plans of development have to operate. Mr. Aneurin Bevan once said, 'It is not easy in some parts of the world where life is exceedingly primitive to entrust to all the people the power of democratic selection, and then to ask them to forego some immediate delights. It is not easy'. Many of the underdeveloped countries have gone all the way to full democracy with universal suffrage. In such an environment to expect to follow the pattern of earlier capitalistic development in which 'the levels of real income and consumption of the working masses were kept exceedingly low to allow for sustained rapid capital formation' is simply impossible. This will not be tolerated in a society where the masses have power to change the government.

Moreover, in a democratic planning, popular enthusiasm is an important factor for the success of planning. As Prof. Lewis has said, popular enthusiasm is both the petrol and the lubricating oil of economic development - a dynamic force which makes almost all things possible (54). But enthusiasm can be generated only if people have faith in the ultimate objectives of the Plans. If they believe that the fruits of economic development will be shared by all, they will be willing to make the necessary sacrifices which the exigencies of planning require them to make. If on the other hand they find that they have to make disproportionately large sacrifices than the wealthy, there will be all kinds of resistances including strikes, go slow policy, etc. which may hamper economic growth. Prof. Laski rightly observed that political democracy has a tendency to

convert itself into economic democracy. The government cannot, therefore, mobilise popular enthusiasm without an equitable distribution of income.

The above discussion leads us to the conclusion that income inequality is not essential for economic development. Simon Kuznets has pointed that 'there is a danger in simple analogies; in arguing that because an unequal income distribution in Western Europe in the past led to accumulation of savings and financing of basic capital formation, the preservation or accumulation of present income inequalities in the underdeveloped countries is necessary to secure the same result' (55). This clearly indicates that one of the important objectives of public expenditure is to make an attempt to reduce inequality of income and wealth in underdeveloped countries.

**An Analysis of Public Expenditure in India.**

Having seen the role of public expenditure in underdeveloped countries, we may apply it to India and examine the extent to which public expenditure has brought about changes in economic development and distribution of income in recent years.

(a) Public expenditure and economic development in India.

Though figures of different periods upto 1950-51 are not strictly comparable, it can generally be said that non-development expenditure in the Central budget was much more important than the development expenditure during the period 1921-22 to 1950-51. Of the total expenditure of about Rs.110 crores (excluding the main grants to Provinces) on revenue account of the Central government, expenditures on economic development and social services were only Rs.3.59 crores and (55) Vide Economic Growth and Income Inequality, op.cit.
Rs.2.31 crores respectively in 1921-22. In 1938-39, the total expenditure came to about Rs.82 crores of which expenditure on economic development was Rs.4.39 crores and on social services Rs.1.62 crores. This shows that public expenditure did not emphasise economic development or social services prior to the war. After the second world war, there was some improvement in the development expenditure and of the total expenditure of about Rs.336 crores in 1950-51, expenditures on economic development and social services amounted to Rs.26.23 crores and Rs.14.62 crores respectively (56). This cannot, however, be considered as significant changes in the relative components of Central expenditure.

The expenditures of the Provinces / States were of different character. There was greater emphasis on development expenditure as compared with the Centre. The development expenditure including expenditure on social services was about 40 percent of the total expenditure in 1921-22 and there was almost no change in the proportion of development and non-development expenditure from 1921-22 to 1938-39. By 1950-51, the proportion of development expenditure had increased and become almost half of the total expenditure (57).

An integrated picture of Indian finances is, however, possible only since 1950-51. The trend of expenditure since 1950-51 shows that there has been a definite improvement in the development expenditure of the Government of India. Though the overall increase in the expenditure on revenue account between 1950-51 to 1960-61, the first decade of planning, has been of the order of about 140 percent, the expenditure on social and

(57) Ibid, p.36.
Development services have recorded a phenomenal increase of about 500 percent. From a mere Rs.39.50 crores in 1950-51 which was about one-fourth of the expenditure then incurred on Defence Services, the expenditure on Social and Developmental Services increased to Rs.336.40 crores in 1950-51 which is very close to the Defence expenditure of Rs.247.55 crores.

During the first two years of the third Plan, there has been a slight decline in the expenditure on social and developmental services on account of the increase in expenditure on debt services and contribution to the States for developmental purposes. This cannot, therefore, be taken as a reversion of the recent trends in expenditure policy of the Government of India.

With regard to capital outlay of the Central government, it is observed that over the period of 1950-51 to 1961-62, the developmental outlay has increased nearly sevenfold and non-developmental outlay by sixfold. Of the developmental outlay, the largest relative increase has taken place on Industrial Development. The increase has been elevenfold since 1950-51. Most of this increase has taken place almost entirely in the second Plan period. Provision for Railways and Industrial Development together account for three-fourths of total provision of Rs.367 crores in 1961-62 for developmental outlay. Lagging behind but next in magnitude is the outlay on State Trading (58).

Similarly in the States, development expenditure has registered sizeable increase. In the year 1951-52, the total expenditure on social and developmental services has amounted to Rs.230.20 crores as compared to Rs.69.40 crores in 1950-51, an increase of more than 230 percent. The increase in expenditure on Social and Developmental Services for the States during the first two years of the third Plan has been to the extent of Rs.127.10 crores.

Development expenditure was Rs.196.21 crores as compared to Rs.190.42 crores of non-development expenditure (59). In 1962-63 (Budget), development and non-development expenditures account for Rs.738.38 and Rs.524.59 crores respectively. This shows that whereas development expenditure on revenue account has increased by about 276 percent, non-development expenditure has increased by about 167 percent.

In capital outlay of the States, the expenditure on development has been much greater. From about Rs.100 crores in 1951-52, the development expenditure has increased to about Rs.382 crores in 1962-63 (Budget). On the other hand, non-development expenditure has registered a decrease, from about Rs.27 crores to about Rs.22 crores during the same period.

This shows that public expenditure in India has registered great changes during recent years. The increase in development expenditure has been substantial and as a result, there has been considerable development in the economy. The total investment in the economy during the first two Plans has been Rs.10,110 crores. Outlay in the public sector has amounted to Rs.6,560 crores. Over the ten years, 1951-61, national income at 1960-61 prices has increased by about 40 percent. Increase in agricultural production is about 41 percent between the same period. All major agricultural commodities have registered increase. In more particular terms, our basic industries are taking definite shape. The increase in the production of iron and steel, machine tools, machinery, essential industrial materials like cement, coal, aluminium, etc. and important

(59) Cf. Reserve Bank of India Bulletin, October 1962. If expenditure on civil works is excluded, development expenditure comes to Rs.155.28 crores.
consumer goods have created the necessary base for further development. If the over-all average is taken, industrial production as a whole has recorded an increase of about 94 percent between 1950-51 and 1960-61. Along with large and medium-sized industries, there has been considerable development in the field of village and small industries, power supply and transport and communications (60). The same trend is continuing in the third Plan.

The data and discussion presented above indicate that quite a few things have been achieved in India during the last decade. There is little doubt that the Indian economy is moving away from stagnation. This is not a mean achievement considering the economic stupor the economy had been in for years before planning started. Yet, by modern standards, the achievements cannot be regarded spectacular. Though public expenditure has substantially increased in recent years, it still continues as a small proportion of the total income compared with other developed countries. The combined expenditure (on Revenue and Capital Accounts) of the Central governments, States and local authorities amounted to Rs. 1,170 crore in 1953-54 and formed only 11 percent of the probable level of national income of the Indian Union (61). In the year 1962-63 (Budget), total expenditure of the Centre and the States on Revenue and Capital accounts comes to about Rs. 3,556 crore and forms less than 20 percent of the national income. Yet it is much less than the U.S.A. where public expenditure was 34 percent in 1957. The average investment-income ratio is about 10 to 11 percent in

(60) Vide Table 4 Selected Indicator of Growth in Ch.III and Annexure I to Chapter V in Third Plan for the progress of the economy in the first decade of planning.

India whereas it is more than 20 percent in many of the developed countries. Again, non-development expenditure still forms a large part of the total expenditure. In 1953-54, about 60 percent of the total expenditure of all governments on revenue account was incurred on defence, administrative items, debt services and collection charges or what may be termed non-development functions, less than 20 percent on social services and 21 percent on economic development and analogous functions (c2). Though there has been some improvement in recent years, there is no significant change in relative components of government expenditure. It is, therefore, obvious that unless there are radical changes in the size and nature of public expenditure, no perceptible change can be expected in the economic development of India.

The income targets look particularly uninspiring when compared with the achievements of other countries where special efforts at economic development have been made in the post-war period. The average growth rate over the period 1952-58 in China, for example, has been 7.6 percent, in Japan 10.4 percent and in Yugoslavia about 17 percent. But in India national income has risen at the rate of 3.5 to 4 percent per annum from 1951 to 1961. But what is worse is that due to increase in population, the annual increase in per capita income in India has been negligible. The U.N. Year Book of National Accounts Statistics 1958 (Second Edition) presents some data in regard to average annual rate of growth of gross national product (at constant prices) and per capita product during the period of 1951-57. These figures are presented in table VIII - 6.

(c2) Ibid, p.40.
TABLE VIII - 6

Annual average rate of growth of gross national product (at constant prices) during the period 1951-57 of some selected countries.

<table>
<thead>
<tr>
<th></th>
<th>Aggregate %</th>
<th>Per capita %</th>
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<tbody>
<tr>
<td>Austria</td>
<td>6.1</td>
<td>5.9</td>
</tr>
<tr>
<td>West Germany</td>
<td>7.5</td>
<td>6.5</td>
</tr>
<tr>
<td>Sweden</td>
<td>4.6</td>
<td>3.9</td>
</tr>
<tr>
<td>Switzerland</td>
<td>4.6</td>
<td>3.5</td>
</tr>
<tr>
<td>U. K.</td>
<td>2.4</td>
<td>2.3</td>
</tr>
<tr>
<td>India (1951-56)</td>
<td>3.9</td>
<td>2.5</td>
</tr>
</tbody>
</table>

These figures show that not only is the rate of increase in average annual rate of growth in India much less, but also the per capita increase in income is proportionately much less compared with the rate of increase in developed countries. The U.K. is the only country where the growth rate is less than that of India. But here also, while there is an increase in the rate of growth to the extent of 2.4 percent, per capita increase is 2.3 percent whereas in India, where the rate of growth is 3.9 percent, higher than that of the U.K., the per capita increase in income is almost the same. Recent figures put the average increase in per capita income at the rate of 2 percent per year and annual improvement in consumption per head (due to some saving out of newly created incomes) at about 1.25 to 1.5 percent per annum. This cannot be considered to be a creditable achievement.

But when it comes to employment, the situation is alarming. In case of India the minimum that the 'take-off' must accomplish is the elimination of accumulated backlog of unemployment, besides absorbing in productive employment the
additional labour force that emerges as a result of the yearly growth of population (c3). Judged by the employment criterion, despite all the investment that has taken place over the last decade, our economy seems to be receding. The first Plan being primarily designed to correct imbalances in the economy could not give sufficient prominence to the problem of unemployment. However, it created additional employment opportunities for about 5.5 million. The second Plan started with a backlog of unemployed estimated at 5.3 million and with the prospect of adding roughly 10 million new entrants to the labour force. It is estimated that the second Plan has provided employment to the extent of about 8 million.

This shows that as against the backlog at the end of the first Plan of 5.3 million unemployed, there was a backlog of about 7.5 to 8 millions to contend with at the end of the second Plan. Estimates for new entrants to the labour force between 1961-66 work out at about 15 millions. But the third Plan makes a provision to provide about 14 million employment opportunities.

This shows that the Indian Plans aim at absorbing all or most of the new entrants to the labour force arising from growth of population, leaving the existing number of unemployed and under-employed unchanged or increasing. This is a sad commentary on the development of the economy.

Take another question: the utilisation of existing facilities in the Indian economy. For example, the failure to utilise fully the old and newly created irrigation facilities

has been widely commented. At the end of the first five year Plan, the irrigation potential created by major irrigation works was 559,000 acres in Bihar and 465,000 acres in West Bengal, of which only 265,000 and 223,000 acres respectively were actually irrigated, thus leaving about half the potential unutilised (64). In many of the irrigated areas water is available for more than one crop per year. Yet a recent survey showed that only about 12 percent of the land under irrigation has more than one irrigated crop grown per year (65). This failure is by no means solitary. Many others can easily be met with in India today.

Take the programme of Community Development projects that was launched in 1952 with the express purpose 'to set free the creative energies of the people so that they may build through their own effort and through their own institutions a richer and improving social life'. The recent appraisals, both official and non-official, of the achievements of this programme have indicated that the productive aspects of the programme have not been achieved.

All this indicates that whereas productive capacity has been augmented in various fields and the overall rate of economic performance has been quickened due to increase in investment expenditure, they do not reflect themselves in structural changes in the economy. The organisational failure is so widespread that in many cases development expenditure fails to bring about an efficient use of the existing potential. On the otherhand the complaint is that development expenditure very often settles down to a dead administrative routine. The

national income statistics also show that there is no structural change; the proportion of national income originating in agriculture does not show any material change. Nor is there any improvement in the composition of total agricultural production. Foodgrains continue to constitute the dominant component in total agricultural production. Change in the occupational structure is another indication of structural change. Here also the performance of the economy is negligible. Agriculture continues to absorb about 70 percent of the total working force in India. Another test of economic change is improvement in labour productivity. There is no indication that economic development in India has brought about any significant change in labour productivity. These are all crucial factors bearing on economic development. The analysis shows that considerable effort is necessary to change the direction of the economy so as to bring about a structural change in the Indian economy.

(b) Public Expenditure and Redistribution of Income in India:

From the beginning, it has been stressed that the objective of planned development in India is not only to increase production and attain higher levels of living, but also to secure a social and economic order based on the values of freedom and democracy in which "justice, social, economic and political, shall inform all the institutions of the national life". Where the bulk of the people live so close to the margin of poverty, the primary aim of the Plan is to provide for basic necessities to all persons within the community and at the same time to emphasise the place of human values in economic and social development. Long before independence these purposes were expressed through the movement for national freedom and guided the thinking of those who urged the need for planned development.
In December 1954, Parliament declared that the broad objective of economic policy should be to achieve the 'Socialist Pattern of Society'. Progress towards socialism lies along a number of directions. According to the Planners in India, a socialist economy must be efficient, progressive in its approach to science and technology, and capable of growing steadily to a level at which the well-being of the mass of the population can be secured. In an underdeveloped country like India, a high rate of economic progress and the development of a large public sector and a co-operative sector are among the principal means for affecting the transition towards socialism. In the second place, a socialist economy should ensure equality of opportunity to every citizen i.e. as a first step, it should provide for the basic necessities, in particular for food, work, opportunity for education, reasonable conditions of health and sanitation, improvement in conditions of housing and a minimum level of income which, in the given circumstances, will ensure tolerable living standards. In the third place, through the public policies it pursues, a socialist economy must not only reduce economic and social disparities which already exist, but must also ensure that rapid expansion of the economy is achieved without concentration of economic power and growth of monopoly. Finally, a society developing on the basis of democracy and socialism is bound to place the greatest stress on social values and incentives and on developing a sense of common interest and obligations among all sections of the community (66).

In the previous section, an assessment has been made regarding the fulfillment of the first objective. The importance of 'social values' or 'a sense of shared citizenship' will take a long time to have a firm root on account of social and economic (66) Third Five Year Plan, pp. 9-10.
rigidities in India. In this section, an attempt will, therefore, be made to examine the progress of the economy towards the realisation of the second and the third objectives.

In the first as well as the second five year Plans considerable importance was attached to the development of human resources of the country through the provision of facilities of education, health and social welfare. In the first five year Plan, total outlay on social services was placed at Rs. 459 crores which was 23 percent of the total outlay. In the second Plan, it was increased to Rs. 830 crores. Of the total outlay, it was 18 percent. Taking the decade as a whole, expenditure on social services, therefore, amounted to Rs. 1289 crores. In the third five year Plan, there is a provision of Rs. 1300 crores for social services which comes to 17 percent of the total outlay. This shows that considerable effort is being made to develop the human resources of the country and break through the deep rooted poverty and economic stagnation of decades.

Yet, there are many weaknesses in the economic and social structure that still persist. The country's potential for development is far from being realised. Of all the weaknesses, the problem of inequality is the most important. The expenditure on social services has hardly touched the problem. Though there are no comprehensive data on income distribution in India and the report of Mahalanobis Committee, which was appointed in 1960 to inquire into the changes in the pattern of distribution of income and wealth and the levels of living during the first and second
Plan periods, is yet to be published (67), the few facts that are available show that there is a great deal of inequality in India.

For example, the N.S.S. report on land holdings in 1954-55 showed that 61 per-cent of the households owning land accounted for only 6 percent of the total area, while the at the other end 3 percent of households owned as much as 35 percent of the total area. There has been no improvement in the situation due to land reform measures. On the other hand, the allegation is that land reform measures have resulted in a large number of evictions of tenants, bogus partitioning of land, etc. The N.S.S. data on distribution of households in rural areas in 1951 by size of monthly expenditure showed that 51.6 per-cent of the households reported a monthly expenditure of less than Rs.100. Figures collected by the Rural Credit Survey in 1954 showed that 39.1 percent of the families accounted for only 5.8 percent of the value of agricultural produce, while the percentage of families reporting the value of agricultural produce at less than Rs.1000 for the year was as much as 77.7.

The surveys conducted by the two Agricultural Labour Inquiry Committees showed an even more depressing state of affairs in regard to the income of the 43 million people

(67) Press reports indicate that the findings of the Mahalanobis Committee show that the ownership of stock and shares, which form one of the important sectors of private wealth and confer on their owners great economic power, are highly concentrated in India. The Committee's conclusion shows that one percent of the country's households own as much as 75 percent of privately held stocks. Again, within this small minority the further distribution of ownership is highly concentrated. More than half of the privately owned share capital in India, the Committee underlines, is owned by only 14,000 houses. In other words, it is only one percent of India's privileged class which in turn is one percent of the total population - that really owns and controls the bulk of the nation's wealth. Vide The Statesman, Calcutta, October 25, 1962.
belonging to the category of agricultural labourers and their families, who accounted for no less than 12 percent of the entire population of the country. Their per capita annual income was Rs.104 and Rs.99.4 respectively during the years 1950-51 and 1956-57, the corresponding figure for the entire population being Rs.265.2 and Rs.291.5.

The distribution of income in urban areas is equally unsatisfactory. The income tax figures provide a definite picture in this respect. The number of assessees paying income tax in India, including Hindu joint families and unregistered partnerships, was less than 6.5 lakhs in 1951-52 and their taxable incomes amounted to Rs.582 crores. The total national income in the same year was estimated at Rs.9,550 crores earned by 14 crores of the working population. Thus 6 percent of the income was earned by 0.45 percent of the earners. The average earning of this group was 13 times the national average. The number of super-tax payers in the same year was 38 thousands; they were assessed on an income of Rs.202 crores, which means that only 0.027 percent of the people had 2.1 percent of the national income. On an average, the earners in this group obtained 78 times the average income.

The study of the Planning Commission also indicates that poverty and inequality of income and wealth in India are staggering in their starkness. The gravity of the situation can be realised from the fact that even after 12 to 13 years of planning, nearly two-thirds of the country's population now subsists at starvation level. The extent of inequality can be seen from the fact that more than a third of the entire national income at present goes to the top 10 percent of the total population of the country. This 10 percent also accounts for a
fourth of the country's aggregate consumption. At the other end of the social scale, the poorest 10 percent of the people earn less than 2½ percent of the national income, and consume less than 3 percent of the worldly goods available to the nation. In absolute terms, the average monthly income of the 10 percent people at the bottom rung of the ladder is less than Rs.7 per head. The 10 percent in the next 'upper bracket' earn less than Rs.10 per month, and the 10 percent in 'still higher bracket' less than Rs.12 per month. On the whole it is found that 60 percent of the population earn much less than the overall national average of per capita monthly income of Rs.25, while the experts point out that a man must eat food worth about Rs.35 per month to attain the minimum standards of health and nutrition (68). This is really a depressing state of affairs.

Further, there is evidence that income inequality has increased in India during the last decade due to planned economic development. Economic development has improved opportunities in respect of road, railways, irrigation, cheap and adequate power, finance at a reasonable rate of interest, etc. Large and medium producers rather than poor producers are likely to derive more benefit from these services. It is pointed out that the benefits of planned investment, as also increases in government administrative expenditure, increasingly flow to the U-Sector (the Upper Class Sector). Dr. Krishna Murti points out, 'At each stage, the expansionist process implies increasing accruals of profits and salaried (and other) incomes to the U-Sector: and new entrants seek admission to the U-Sector' (69).

(69) See B.V.Krishna Murti: The Plan and the U-Sector in Economic Weekly September 24, 1960 and subsequent discussion on the topic by different writers in Nos. 41, 42 and 43, and 44 of the Weekly.
This is corroborated by the recent study of the Reserve Bank of India regarding income distribution in the Indian economy which shows that income inequality has increased due to planned development (70). The object of the study was to estimate income distribution in the household sector comprising individuals, non-corporate business (including agricultural sector) and private collectives like temples, educational institutions and charitable foundations of the Indian economy during the period 1953-54 to 1956-57 and to indicate the changes in income distribution between the two sub-periods 1953-54 to 1954-55 and 1955-56 to 1956-57 as a result of the acceleration of the economic activity. The income receiving unit for the purpose of the study is the household and not the individual. The most important conclusion of the study is that the degree of inequality in income distribution increased somewhat during period II covering the years 1955-56 and 1956-57, as compared with period I covering the years 1953-54 and 1954-55. This was more or less entirely due to a substantial increase in the per household income of the high income, non-salary earner group. This was also the reason for the differential rates of increase in the per house-hold personal of the high-income rural and urban group and the high income farm and non-farm household groups.

But this increase in income inequality and the growth of the U-Sector have not helped in capital formation. The U-Sector is strongly motivated by the demonstration effect.

(70) Vide Distribution of Income in the Indian Economy: 1953-54 to 1956-57, Reserve Bank of India Bulletin, September 1962. The study is prepared in the Division of Planning and Special Studies, Economic Department, by P.D. Ojha and V.V. Bhatt.
Consequently, there is no lag in income and expenditure within the participants of the U-Sector. What is worse is that with its aristocratic way of life, the U-Sector diverts scarce resources for the benefit of a few. 'In aggregate terms', says Dr. Krishna Murty, 'these resources (eg. steel, cement, electricity, foreign exchange, technical skills, and wage goods for industrial labour) are in scarce supply for the nation. Therefore, increased U-Sector consumption results in the diversion of these resources from other areas of economic activity, especially the planned priority projects'.

This situation is intolerable if the objective of planning is to massbase the advantages that flow from this expenditure (71).

Again, the rise in per capita income which has been achieved due to planned investment in India has not substantially improved the economic condition of the poor man. The development of the economy has been accompanied by such a rise in prices that real income has not increased for significant numbers of low income workers in the country. On the other hand there is evidence that during the Plan period there has been a large shift of income from the poor to the rich due to rise in prices. For example, between 1952-53 and 1959-60, the annual price increase, judged both by the wholesale and the consumer price index numbers, has been of the orders of about 3 percent per annum. This rate has been much higher since 1954-55. Compared to this, the perhead earnings of factory workers drawing less than Rs. 200/- per month increased only 2.3 percent per annum.

(71) Kersi Doodha has shown how the U-Sector consumption in case of housing, automobiles, refrigerators, one room air-conditioners and furniture has increased during the last decade. Vide Capital Formation in the U-Sector, Economic Weekly, October 29, 1960.
during 1952 and 1957. Earnings through interest as judged by the yield of government bonds went up by only 1.5 percent per annum. On the other hand, profit index between 1952-53 and 1959-60 works out on an average to be about 7 percent per annum. This shows that due to rise in prices, merchants, manufacturers, large farmers with surpluses have improved their position much better than the wage earners and interest-earners (72).

In fact, the industrial and economic policy of the Government of India since independence gives little scope for a diminution of concentration of wealth and economic power in the country. There are two basic reasons for this. First is the rigorous import restrictions which make the Indian market the most protected in the world, and in which almost anything can be sold at almost any price. The notable feature of existing policy of the Government is, as Prof. Gadgil points out in his Convocation address to the Nagpur University, its declared reliance on capital formation in the private sector. The government policy is, therefore, directed towards eliminating risks from the appropriate fields and towards enabling private capitalists to procure the needed resources, material and financial (73). All growth of modern industry in India since the early twenties has been brought about under a protective regime, major cost of which has been borne by the Indian consumer. In planned industrialisation, protection is continued in a variety of ways, and the Plan is articulated through

(72) Dr. A.M. Khusro, Income Redistribution in India, Yojana, Republic Day Number, 1961.
selecting particular capitalists for particular fields and enabling them to acquire highly scarce resources of every type. Further, almost all government operation is based on the offer of incentives to private capitalists. That means, whatever the ability and skill of the capitalist, his success and progress are mainly due to conditions created by State policy and maintained at public cost. Prof. Gadgil, therefore, concludes, 'Thus not only are the selected capitalists enabled by government policy to establish themselves in particular sheltered fields but also are their conditions of operation so regulated that they command, over and above a normal profit margin, a large savings potential. The result is that the existing group of capitalists is assured of a monopoly of large expansion-opportunities in the future and a continued and an increasingly concentrated hold on the industrial economy' (74).

The second reason which stands in the way of reducing the concentration of wealth is the constitutional provision for compulsory payment of adequate compensation for private property acquired by the State. It might be said that the Article 31 of 'The Constitution of India' which guarantees that "No property shall be compulsorily acquired or requisitioned save for a public purpose and save by authority of law which provides for compensation for the property so acquired or requisitioned ...." is a fundamental right of the citizen which no democratic government should violate at any cost. But in peculiar conditions of India where the inequality of distribution of income is among the largest of the world, and the level of national income is among the lowest, such a provision is likely to perpetuate

inequality and maintain economic supremacy of princes, land lords and the priestly class in the country.

It may be noted here that if the economic power is concentrated in the hands of small groups in a society with a view to increasing production, it cannot easily be rectified in future. The dominant groups will neither surrender their interests nor will there be any sincere attempt on the part of the government, dominated as they were by such forces, to reverse such a policy. If it is the objective of economic development to secure social and economic justice, the growth process should be oriented from the very beginning on that line.

The above analysis shows that though public expenditure in India has improved the economy and provided better facilities for education, health, etc., it has not yet firmly secured a strong economic base for self-sustained economic growth or established a 'Socialist Pattern of Society' which the Parliament accepted as the basic goal of economic development. We have a long way to go towards realising these objectives.